

UK Pensions Briefing

The Takeover Code

January 2020

Executive summary

Since 2013, it has been necessary under the City Code on Takeovers and Mergers (the Code) to:

- Include a statement in the offer document of the bid company's intentions relating to:
 - Employer contributions (including deficit reduction)
 - Benefit accrual
 - Admission of new members
- Afford trustees the same rights as employee representatives to:
 - Receive bid information
 - Have the opportunity for their views to be published with the target company's board's circular

The Code does not apply to defined contribution schemes. While defined contribution schemes may be included in offer letters to trustees, this may be simply as a result of custom and practice. A pension scheme to which the Code applies is defined as *"a funded scheme sponsored by an employer, or any of its subsidiaries, which provides benefits, some or all of which are on a defined benefit basis, and which has trustees (or, in the case of a non UK scheme, managers.)"*

The Code is designed principally to ensure that shareholders in a target company are treated fairly and are not denied an opportunity to decide on the merits of a takeover. It also ensures that shareholders in the target company of the same class are afforded equivalent treatment by an offeror. It provides an orderly framework within which takeovers are conducted.

The Code generally applies to all offers for companies which have their registered offices in, and where their shares are traded in, the United Kingdom, the Channel Islands or the Isle of Man. The Code also applies to all offers for public and private companies which have their registered offices in the United Kingdom, the Channel Islands or the Isle of Man and which are considered by the Panel to have their place of central management and control there too (but see the Code for exceptions).

Requirements of the Takeover Code

Within 28 days of the announcement of a firm intention to make an offer, the bidder must send offer documentation to shareholders in the target company and to persons with information rights (that is, a person in respect of whom a nomination under the Companies Act 2006 has been made by a registered shareholder). The bidder must state in the offer document its intentions with regard to the company's pension scheme, but it does not need to include an assessment of the likely repercussions of its strategic plans on the scheme.

Any statements made commit the bidder to that course of action for a period of 12 months from the date on which the offer period ends, or for such other period as specified in the statement. Following the publication of the initial offer documentation, material changes in any information disclosed in connection with the offer must be promptly announced, as must any material new information which would have been required to be disclosed, had it been known at the time. Examples of such changes to information previously disclosed include that in relation to the bidder's intentions with regard to the future of the business, continued employment of employees, strategic plans for the company and employer contributions to the pension scheme.

The Code also requires the bidder, or the target company, to make available to the trustees of the target company's pension scheme all the documents that they are currently required to make available to the target company's representatives. These documents include:

- The announcement under which the offer period commences
- The announcement of a firm intention to make an offer
- The offer document
- The target company board circular response to the offer document
- The revised offer document
- The target company board circular in response to any revised offer document
- Any document required to be sent to shareholders of the target company and persons with information rights

In addition, if new information is disclosed in any interviews or discussions with the media, the Takeover Panel may require an additional document to be sent to the trustees of the target's pension scheme setting out the new information.

Additional requirements apply to post offer undertakings by a party. Where a post offer undertaking is made, details of that offer must be set out by the bidder in the next such document it publishes. The Panel may also require the offer to be sent direct to the trustees. The bidder must comply with the terms of the undertaking unless a qualification or condition applies. Failure to meet the terms of the undertaking for any other reason must be the subject of a public announcement unless the Panel decides otherwise.

The board of the target company must append to its circular a separate opinion from the trustees of the target company's pension scheme on the effects of the offer on the pension scheme if it is received in sufficient time.

Under the Code, when the target company provides a copy of an announcement from the bidder which either commences an offer period or is an announcement of a firm intention to make an offer to the trustees of the target company's pension scheme, it must at the same time inform the trustees of the right to have their opinion noted when the target company's subsequent circular is published. This will also apply to revised offers.

The cost of providing this opinion will be met by the target company's pension scheme. As defined benefit schemes are funded by the sponsoring employers, ultimately the cost will be borne by these employers.

Impact of the Code in practice

The Code results in trustees receiving information, and an indication of the bidder's intentions towards the target company's pension scheme. In addition, unless there is a material change in circumstances, the bidder's statement of intention with regard to the target company's pension scheme is binding for a period of one year from the offer date, which will give comfort to scheme members.

The publication of the pension scheme trustees' view of the offer will provide them with a platform to air their views, but the impact it will have on shareholders will obviously depend on the circumstances of each bid.

Detailed due diligence in relation to the target's pension scheme may be required at an earlier stage in order to formulate a firm intention. Whilst early dialogue with the trustees would provide this, it is likely that, in practice, the bidder's statement as to its intentions in relation to the target's pension scheme will not be very detailed and may result in no more than the current status quo being maintained for a year.

Position of the Pensions Regulator

There are no requirements to refer a takeover to the Pensions Regulator. However, the Regulator will involve itself in a takeover if it considers it appropriate, as was the case in the takeover of GKN PLC (GKN) by Melrose Industries PLC (Melrose) in March 2018.

The combined deficit of the GKN schemes was £1.4bn. On March 29, 2018, the shareholders voted in favour of the Melrose bid. Ahead of the final GKN vote on the proposed takeover, Melrose agreed a package of support for the two UK-based defined benefit schemes, including cash contributions of up to £1bn to fully fund them on a revised funding basis, including one-off contributions to be paid when businesses within the group were sold.

In a response to a Freedom of Information request, the Regulator revealed that, since 2016, it had conducted:

- three meetings with GKN
- nine meetings with GKN Pension Fund Trustees (or their representatives)
- two meetings with Melrose in respect of GKN and the pension schemes

The subsequent Section 89 report from the Regulator highlights the positive impact on the funding of the two UK GKN schemes that regulatory intervention has had.

Regulatory intervention also occurred in relation to the Telent Pension Scheme in 2007, when the Regulator's Determinations Panel appointed three independent trustees following an approach from the Scheme trustees, who were concerned about the implications for the Scheme of the takeover of Telent by Pension Corporation.

Although the Regulator has only occasionally intervened in takeovers in the past, this may change following future changes in pensions law. One of the most significant pensions developments following the General Election of December 2019 was the reintroduction to Parliament of the Pension Schemes Bill 2019. This follows consultations by the Department for Work and Pensions on a set of proposals under which the Regulator would secure greater and earlier insight into corporate transactions which could have an adverse effect on covenant strength and scheme funding. Detail is still awaited in the form of draft regulations governing the new notifiable events regime. This regime sets out the statutory duty that employers and trustees have to notify the Regulator of certain events occurring in relation to defined benefit schemes. One of the triggering events is expected to relate to the sale of a material proportion of the business or assets of a scheme employer which has funding responsibility for at least 20 per cent of a scheme's liabilities. Consultations are now expected to take place on the revised legal framework in 2020, although the new law strengthening the Regulator's powers is unlikely to be implemented before 2021.

The Regulator's 2019 defined benefit funding statement highlights its approach regarding a scheme's equitable treatment in comparison with other stakeholders. It has ongoing concerns over the disparity between dividend growth contributions, and other forms of what the Regulator terms "covenant leakage" by which it means value leaving the sponsoring employer. The statement also sets out an explicit warning that the Regulator will commence formal investigations where necessary and appropriate, which is a clear reminder of its intention to be a "clearer, quicker, tougher" regulator.

Comment

Whilst the provisions of the Code are relatively benign, parties should be aware of potential interference from the Regulator in leveraged situations. The purpose of the Code is to protect shareholders and it is debatable whether it gives trustees any more real power than before. However, what the Code does achieve is a higher profile for pension issues in affected transactions, with more involvement for trustees than previously. The clearer role for trustees in terms of greater access to transaction information, together with a chance to provide their opinion on the proposals of the deal, may be beneficial to scheme members.

Considerations for trustees will include a decision on whether they should, in fact, submit an opinion, with the requirement that they should bear their own costs being a possible deterrent. Trustees are likely to prepare an informal opinion in most transactions, even if this is not officially submitted. Framing that opinion will require trustees to be aware of the strength and impact of the employer's covenant to the scheme and to have a clear understanding of the implications for pensions benefits of the proposed transaction.

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EMEA21205 – 01/20