

UK Pensions Briefing

The UK Takeover Code: Overview of key aspects relevant to pension schemes

August 2021

Introduction

This briefing considers the key aspects of the UK Takeover Code (Code) relating to defined benefit (DB) pension schemes (including schemes which have some DB benefits). Pensions are important on takeovers because the Pensions Regulator's new "clearer, quicker and tougher" approach makes it more likely to intervene to protect a pension scheme.

As well as considering how the Pensions Regulator could potentially intervene in a takeover, we also discuss specific Code requirements regarding:

- Provision of information to trustees of the target company's pension schemes.
- The right of trustees to have their opinion provided to target company shareholders.
- The application of the frustrating action rules to proposals affecting the target company's pension schemes.

When does the Code apply?

The Code primarily applies to companies that are incorporated and publicly traded in a Code jurisdiction (being the UK, Channel Islands or Isle of Man).

Most commonly Code takeovers are of companies admitted to the Main Market of the London Stock Exchange or to AIM. However it is important to be aware that the Code will not apply simply because a company is publicly traded in the UK - it must also be incorporated in a Code jurisdiction.

Key Code requirements

Disclosure of bidder's intentions in relation to pension schemes

The Code requires bidders to include statements of their intentions in relation to various aspects of the target company's business both in the announcement of their firm intention to make an offer (commonly referred to as a "firm offer announcement" or "Rule 2.7 announcement") and in the offer document that is subsequently sent to target company shareholders.

In the context of the target group's pension schemes, the bidder must disclose its intentions in relation to the following areas:

- Employer contributions (including current arrangements for the funding of any scheme deficit).
- Benefit accrual for existing members.
- Admission of new members.

If the bidder does not intend to make any changes in relation to these matters it must make a negative statement to that effect. The bidder does not need to comment on the likely impact of its wider strategic plans on the pension schemes or the employer covenant.

Bidders will want to ensure that they have the necessary information at a sufficiently early stage in the process to be able to formulate their intentions and the wording of the required statements. Where there is a pension deficit which is material in the context of the bidder's funding or the acquisition (including where it is considered material amounts may need to be contributed to the schemes) the bidder will likely request that the target facilitates discussions with the trustees before a firm offer is announced. Before an offer is publicly announced, the Code restricts a bidder from discussing it with more than a very limited number of people unless the Takeover Panel (Panel) consents otherwise. As a result, depending on the circumstances, a bidder may need to get clearance from the Panel before it approaches the trustees.

Any statements made by a bidder about its intentions regarding the target group's pension schemes will be treated as "post-offer intention statements" under the Code. Although, strictly speaking, post-offer intention statements are not binding, they are taken very seriously by the Panel and the market, and the Code requires that they are both:

- An accurate statement of the bidder's intentions at the time they are made.
- Made on reasonable grounds.

The Code also requires the bidder to confirm to the Panel, and announce to the market, that it has complied with its post offer intention statements. This confirmation/announcement must be made 12 months after the end of the offer period (or, if different, at the end of the period of time specified in the intention statement). If a bidder intends to depart from any of its intention statements prior to this, it must consult the Panel in advance and will be required to make appropriate disclosure to the market.

If the Panel determines that a bidder has made an intention statement which did not comply with the high standards required by the Code, disciplinary action is likely to be taken.

Provision of information to pension scheme trustees

The Code requires certain offer documentation to be provided to the trustees of the target company's pension schemes. These documents include:

- The firm offer announcement and any possible offer announcement that commences the offer period.
- The offer document and any separate response document from the target company.
- Any revised offer/response documents.
- Any other documents required to be sent to target company shareholders.

Opinion of pension scheme trustees

Under the Code, the trustees of the target group's pension schemes have the right to have their opinion on the effects of the offer (and any revised offer) on the schemes provided to target company shareholders.

Where it is received in good time before publication, this must be appended by the target company to its response document (or, in the case of a recommended offer, the combined offer and response document). Where the opinion is not received in good time before publication, the target company must instead promptly publish the opinion on a website and announce this to the market.

Although the Code requires the target company to pay for the costs of publication of any opinion received from the trustees it does not (unlike in the case of employee representatives' opinions) require the target company to pay for the costs incurred by trustees in obtaining advice required for the verification of the information contained in the opinion. As a result, the cost of providing the opinion (as opposed to its publication) will be met by the pension scheme.

In practice, it is relatively unusual for trustees to provide an opinion – this has been a feature of only approximately 15 per cent of offers made for target companies with DB schemes since the right was introduced in May 2013¹.

The trustees' decision as to whether or not to provide an opinion is likely to be influenced by their views of the likely impact of the takeover on employer covenant, their strategy for dealing with this and, potentially, by the wishes of the employer company and its group. Whilst the publication of an opinion provides a platform for the trustees to air their views, in practical terms the impact it will have on shareholders will obviously depend on the circumstances of each bid.

Restrictions on “frustrating action”

Under the Code, the target company is prohibited from taking any action which may result in an offer or bona fide potential offer being frustrated or in shareholders being denied the opportunity to decide on its merits. The restriction on frustrating action applies during the course of an offer but will also apply before the date of the offer if the target board has reason to believe a bona fide offer might be imminent – in essence, the restriction is likely to be engaged as soon as a potential bidder has made an approach. Frustrating action can only be taken if it is approved by target company shareholders or if the Panel agrees to provide a dispensation.

The Code specifically notes that the restriction on frustrating action may apply to proposals affecting the target company's pension schemes (such as proposals involving the application of a scheme surplus, a material increase in the financial commitment of the target company in respect of its pension schemes or a change to the constitution of the pension schemes) and that the Panel must be consulted in advance in these circumstances.

As a result, where an approach has been received it will be important for target company directors to ensure that any proposed action in respect of the pension schemes is discussed with the company's advisers in advance (notwithstanding that it may be unconnected to the potential offer) in order to determine whether the frustrating action rules apply and whether the Panel should be consulted.

¹ Based on information from Thomson Reuters Practical Law “What's Market?” as at July 31, 2021 and excluding deals where the firm offer announcement had been made but the offer/scheme document had not been published at that date.

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. If the Regulator is concerned that the takeover could materially weaken the employer covenant it will expect the pension scheme trustees to have robust discussions with the employer (and in practice the bidder) to explore whether some form of mitigation would be appropriate. It could decide to become involved in those negotiations.

The Regulator has only occasionally intervened in takeovers in the past. For example, in the 2018 takeover of GKN PLC by Melrose Industries PLC it oversaw negotiations between the GKN schemes' trustees and the management of bidder and target. These resulted in Melrose agreeing 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 and one-off contributions to be paid when businesses within the group were sold. In April 2021, a contribution of £100m was reportedly paid into the GKN schemes following the sale of Nortek Air Management, a Melrose business.

In cases where the Regulator is not satisfied with the arrangements agreed for the scheme, it may investigate whether to use its powers to require support to be put in place. In recent years, the Regulator has had the stated aim of being “clearer, quicker and tougher” and from October 2021 it will have significantly enhanced powers to punish behaviour in relation to DB schemes, including new powers to bring criminal prosecutions.

Notifiable Events

The Regulator's so-called “notifiable events” regime requires employers to formally notify the Regulator of certain key corporate events that could affect the pension scheme. The list currently includes a decision by a controlling company to relinquish control of the employer company.

While it may be possible to conclude that a particular takeover will not trigger this notification requirement, advice should be sought and companies may decide to err on the side of caution in cases of doubt. This is particularly important since penalties for non-compliance are expected to increase significantly from October 2021, including new fines of up to £1 million.

New employer-related events that trigger a notification requirement are also expected to be added to the existing list in the near future and these could potentially be relevant to takeovers, depending on how the new rules are framed. 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.

These changes are unlikely to be implemented before 2022 and as at the date of this briefing we await regulations from the Department for Work and Pensions to provide the detail.

Comment

Although it is debatable how much real power the Code gives trustees, it does provide a higher profile for pension issues in affected transactions. The requirement to provide trustees with certain information about the transaction, together with the opportunity for them to provide their opinion on the impact on the schemes, gives them a formal role and arguably some leverage.

Trustees will need to be aware of the Regulator's expectations of them where a takeover could adversely affect the level of support provided to their scheme by the employer company or other group companies. They will need to take appropriate advice at an early stage to understand the implications of the transaction for the scheme and their legal obligations.

Parties should also be aware of the potential for the Pensions Regulator to become involved, particularly in leveraged situations, and take advice as needed.

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