

EQUITY DERIVATIVES: RECENT UK DEVELOPMENTS AND CONSIDERATIONS FOR THE PROPOSED CHANGES IN AUSTRALIA

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Legal Briefings - By **Mike Flockhart, Andrew Rich and Ken Ooi**

In this article, we explore disclosure requirements of long economic exposures in the UK takeovers context and compare these with the Australian Takeovers Panel's proposed updates to its Guidance Note on equity derivatives. The article also examines the care that needs to be taken in articulating to the market the nature and level of support from persons who only hold an economic interest in target securities.

IN BRIEF

- In the UK, the extensive nature of the disclosure regime is designed to capture almost any conceivable form of long economic exposure.
- In Australia, proposed changes to the Takeovers Panel's Guidance Note on equity derivatives contemplate a more rigorous approach that will bring the Australian disclosure regime closer to the position in the UK.
- Disclosures made by Takeaway.com in relation to its recent UK takeover bid for Just Eat plc provide a reminder that when relying on disclosures of interests to form a view on the level of support for a takeover, a long economic exposure does not necessarily translate to voting rights or approval rights in a takeover.
- In a takeover context, bidders (and targets) should take care to ensure that they do not mislead the market by overstating the nature of the commitment of someone holding an economic interest, and similarly equity derivative holders expressing support for an offer should be careful not to over-promise their ability to vote on a scheme or to deliver shares into a takeover.

BACKGROUND TO THE UK DISCLOSURE REGIME

In the UK it has long been a policy objective of regulators to ensure that holders of significant interests in securities are required to disclose those interests, regardless of the form in which those interests are held. Substantial amendments have been made to the UK disclosure regime to that end, and regulators continue to consult on amendments to broaden the scope of the disclosure regime in response to market developments.

The UK disclosure regime is contained in the *City Code on Takeovers and Mergers* (the **UK Takeover Code**) and the Disclosure Guidance and Transparency Rules (for companies on the Official List or (in some cases) on the London Stock Exchange's AIM market). The cohorts to which these rules apply overlap imprecisely, and care is required to ensure the correct rules are applied in each case. The position is further complicated by:

- the Disclosure Guidance and Transparency Rules' application of lower thresholds for disclosure of interests in UK headquartered companies (starting at 3%) than for international companies with UK listings (starting at 5%); and
- sector specific disclosure and approval regimes, such as that applicable to companies in the financial services sector, irrespective of whether they are publicly traded.

For the purposes of this article we have set out the rules that apply to the disclosure of interests in UK headquartered companies which are listed on the Official List (as most large listed UK companies are), without regard to sectoral disclosure regimes.

For holders of interests in such companies the disclosure regime in the Disclosure Guidance and Transparency Rules (**DGTR**) is of general application and the disclosure regime in the UK Takeover Code is applicable only once an offer period has started.

Subject to certain exceptions, the DGTRs require disclosure by any person holding an interest in securities representing 3% or more of the voting rights in the company. For these purposes "interests" is broadly defined and includes not just physical interests in shares, but also any interest having a similar economic effect.

This formulation, which was introduced in 2009, had the effect of bringing within the scope of the rules cash-settled derivatives and other instruments that did not necessarily permit the holder to demand physical delivery of the underlying shares. The UK's Financial Services Authority (as it then was) was prompted to introduce this change by examples of companies effectively stakebuilding through cash-settled derivatives, in the knowledge that their counterparty would hold the underlying shares to hedge its exposure, and thus provide a ready source of shares at the point at which the derivative was settled or unwound.

UK TREATMENT OF LONG ECONOMIC EXPOSURES

Once an “offer period” for a takeover or a scheme has commenced for the purposes of the UK Takeover Code (broadly speaking, when a potential bidder has announced a firm intention to make an offer or the possibility of doing so, or when a potential target has announced it has been approached) a much lower disclosure threshold applies.

All holders of interests representing 1% of the target’s securities have an obligation to make an opening position disclosure before the end of the tenth day after the announcement initiating the offer period. If any such person acquires or disposes of shares they have an obligation to announce such acquisition or disposal before noon on the business day after the trade is made and, if relevant, before the deadline for disclosure of its opening position. The UK Takeover Code definition of “interest in securities” has similarly been extended to capture interests giving the holder a long economic exposure to the target shares, regardless of the form in which that interest is held. There are few exemptions from disclosure.

The UK Takeover Code also requires potential bidders and their concert parties to declare their opening position and any relevant trades, without any threshold. Special rules apply to exempt principal traders and exempt fund managers associated with the relevant potential bidder.

A combination of the DGTR and the UK Takeover Code mean that there is significant visibility of those holding long economic exposures in relevant companies, particularly during offer periods. This helps the regulators to ensure a fair and orderly market and to avoid information asymmetries.

TAKEOVER TACTICS AND CONSIDERATIONS

This transparency may also inform the parties’ tactics in takeover situations, particularly those which are hostile or contested. A sharp increase in hedge funds on a target’s register is often thought to signal a likely victory for a hostile bidder and the ready identification of parties with influence or control over shares can assist parties to engage in proxy solicitation efforts.

Some caution is required, however, in relying on disclosures of interests to form a view on the level of support for a bid. The extensive nature of the disclosure regime is designed to capture almost any conceivable form of long economic exposure, and whilst some disclosure exemptions exist to mitigate this, it is possible for more than one person to have a disclosable interest in relation to the same shares (thus resulting in double counting).

This is particularly the case if derivative positions are imperfectly hedged. Moreover, it is possible that a party with a long economic interest does not – legally or practically – have the right to direct voting or obtain physical delivery of the underlying shares. In hostile or competitive situations it is actual votes (or acceptances) of the physical shares that matter, not the views of a holder of an economic interest.

To that end a holder of an economic interest expressing support for an offer must be careful not to over-promise, for example by irrevocably undertaking to deliver shares which it cannot be certain of delivering. In the same vein, bidders must take care to ensure that they do not overstate the commitment of the interest holder in making announcements about the level of support for their offer.

A recent example of appropriate disclosure in this regard appeared on Takeaway.com's bid for Just Eat plc, where Takeaway.com disclosed that a hedge fund had made a commitment to accept (or procure the acceptance of) the takeover offer on a "best efforts basis", as the hedge fund held its exposure in Just Eat via cash-settled derivatives.

DRAFT REVISED GUIDANCE NOTE ON EQUITY DERIVATIVES IN AUSTRALIA

In April 2019, the Australian Takeovers Panel released a consultation paper on a draft revised Guidance Note on equity derivatives (**GN 20**), which proposed a number of changes to the public disclosure of equity derivative positions.

The key proposed changes in GN 20 include:

- that all long positions (whether capable of physical or cash settlement) over 5% should be publicly disclosed, importantly, irrespective of whether there is a control transaction that has commenced;
- confirmation that the accumulation of an aggregate long position (whether capable of physical or cash settlement) in excess of 20% would constitute unacceptable circumstances; and
- guidance on the Panel's considerations when determining what orders should be made if the Panel finds that non-disclosure is unacceptable.

We have written further on this consultation paper and the proposed changes [here](#).

Notwithstanding the differences in thresholds between the Australian and UK regimes, if GN 20 is implemented as proposed, the Australian position would be brought closer in line with the regulatory position in the UK, through broadening the disclosure requirements to holders of all long positions irrespective of whether the position relates to a control transaction, which was previously the case.

It is important to note that, similarly to the hedge fund's irrevocable undertaking in support of Takeaway.com's takeover bid, although these disclosures might be seen to imply some level of control over the underlying shares, this disclosure does not reveal the full picture (for the reasons discussed earlier) since an economic interest does not necessarily equate to equivalent voting rights for the physical shares. Accordingly, Australian market participants should similarly take this into consideration when publicly commenting on the level of support for a takeover, or when expressing support for a scheme, so as not to mislead the market.

Submissions to the Takeovers Panel on GN 20 were due 31 May 2019, and we will provide further updates on this when the final updated GN 20 is published.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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