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IN THIS ISSUE >

Flirting before the offer: The Intricacies of Approaching Shareholders

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Flirting before the offer: The Intricacies of Approaching Shareholders

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Do you remember your first school dance? The awkwardness in trying to connect with someone you liked in circumstances where you know what you want but not quite understanding the rules of how to get there. With everyone watching. You can think of an offeror looking to implement an M&A transaction as being in the same situation. The offeror knows what it wants and why it wants to do it, but there is something of the gawky teenager in the way it goes about it, because once you have committed yourself, a rebuff is potentially public and awkward.

One of the primary strategies for potential offerors to manage this, is to approach some of the material shareholders of the target company before the offer becomes public to get a feel for whether an offer will be acceptable (the "ask her friends first" tactic of the corporate world).

However, it is here (in our increasingly tortured metaphor) that the chaperones step in: one of the strongest underlying philosophies behind the regulation of transactions and the trading of securities is the concept of equality of information. In an ideal world, all shareholders (and potential offerors) would have access to the same information, and information made available to some shareholders and not all violates this basic principle. Of course, this is not how reality works, and regulations struggle to deal with the gap.

This article seeks to explore the extent to which a potential offeror contemplating the making of an offer to give effect to an affected transaction under the Companies Act, 2008 may engage with shareholders of the target.

The Companies Regulations

The Companies Regulations, 2011 regulate the manner in which the approach to the target and subsequent negotiations and offers must be conducted. As a starting point, regulation 99 specifically requires that: *"An approach with a view to an offer being made, or an offer, must be made only to the board of the [target]"*.

The regulations require that confidentiality must be observed in respect of *"price sensitive information"* before a cautionary announcement or a firm intention announcement is made and regulation 95(6), which is the sole provision within the regulations which touches on approaches to shareholders, provides that: *"Price sensitive information may be provided to select persons on a confidential basis."*

As an aside, the always fraught concept of *"price sensitive information"* can be a debate (and an article) all of its own, but for our purposes let us assume that information that an offer is to be made does constitute price sensitive information and, for the purposes of the discussion of the Financial Markets Act, 2012 below, it would have a material effect on the price of the securities issued by the target.

Accordingly, although the Companies Act and the Companies Regulations go into intricate depth on the way in which offerors and targets must comport themselves in the lead up to making an offer and the offer itself, they avoid dealing directly with whether and how shareholders may be engaged with.

Flirting before the offer: The Intricacies of Approaching Shareholders *...continued*

The TRP approach recognises the need for, and likelihood that, shareholders will be approached but still leaves something of a regulatory no-mans' land in dealing with the issue.

The Takeover Regulation Panel's Guidelines

The regulatory authority tasked with managing compliance with the takeover provisions of the Companies Act and the Companies Regulations, is the Takeover Regulation Panel (TRP). Notwithstanding the gap in the regulatory regime, the TRP has explicitly recognised the issue and sought to manage it through its Guideline 1/2013. The Guideline specifically recognises the commercial reality that it may be necessary for an offeror to approach a number of minority shareholders in order to obtain their views on a proposed offer, after issuing a cautionary announcement but prior to establishing and making an offer. The provisos to the above are the following:

(i) the approach to shareholders may only be made to a maximum of 5 shareholders each holding at least 5% or more of the aggregate securities subject to the offer;

(ii) prior to being provided with any information relating to a proposed offer, the relevant shareholders must acknowledge that they will not disclose said information or use it for their own, or any other person's benefit; and

(iii) the Financial Markets Act, 2012 and regulation 95 of the Companies Regulations (confidentiality) must be adhered to.

Notably, the Guideline provides that approaches to shareholders should only be made after a cautionary announcement is made. In practice, this poses a real difficulty as a target and a potential offeror would be highly reluctant to issue what would amount to a very bland cautionary announcement at such an early stage.

As regards enforceability, the TRP Guideline is not legally binding, but merely constitutes recommended practice. In this regard, it should always be kept in mind that if the proposed offer is launched one of the disclosures which will have to be made in the offer circular is which shareholders support the offer (so called *"irrevocable undertakings"*): effectively a list of the shareholders formally approached by the offeror and/or the target before announcement of the offer.

Accordingly, the TRP approach recognises the need for, and likelihood that, shareholders will be approached but still leaves something of a regulatory no-mans' land in dealing with the issue.

The Financial Markets Act, 2012

The Financial Markets Act regulates "*inside information*". The definition of inside information and the applicable part of the definition of an insider in s77 of the Act are as follows:

*"**inside information**" means specific or precise information, which has not been made public and which:*

(a) is obtained or learned as an insider; and

(b) if it were made public, would be likely to have a material effect on the price or value of any security listed on a regulated market.

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Flirting before the offer: The Intricacies of Approaching Shareholders *...continued*

Representatives of the target might approach the shareholders, perhaps together with the offeror, if the board is amenable to the potential offer and, as insiders themselves, would have to rely on the defence in s78(4) in order to avoid breaching the disclosure prohibition.

*"**insider**" means a person who has inside information:*

(a) through:

(i) being a director, employee or shareholder of an issuer of securities listed on a regulated market to which the inside information relates; ....."

The Act places various prohibitions on dealing whilst in the possession of inside information and, in s78(4), also prohibits the mere disclosure of inside information (subject to the defence contained in s78(4)(b) whereby an insider is not guilty if, on a balance of probabilities, he or she can show that the disclosure was *"necessary to do so for the purpose of the proper performance of the functions of his or her employment, office or profession in circumstances unrelated to dealing"*).

An analysis of the above definitions will show that an offeror's knowledge of an impending offer for shares in the target is not necessarily in and of itself inside information (it will not have been obtained or learned as an insider, although perhaps some caution will have to be exercised in the analysis if the offeror is already a shareholder in the target). The offeror can therefore disclose the information regarding the offer to a shareholder of the target without breaching s78. However, once that information is disclosed, the shareholder to whom it is disclosed is an insider, and of course shareholders are very reluctant to be made insiders for any appreciable length of time as it restricts their ability to deal in the securities of the target.

Representatives of the target might approach the shareholders, perhaps together with the offeror, if the board is amenable to the potential offer and, as insiders themselves, would have to rely on the defence in s78(4) in order to avoid breaching the disclosure prohibition.

Generally, it will make sense for shareholders to be approached only when an offer is imminent as they will wish to avoid a situation where they become insiders for any material period. Earlier more exploratory approaches would thus need to be tailored to ensure that no specific or precise information is included regarding any potential offer, and on the basis that a potential offer is only being considered but has not yet reached the decision point where there is a reasonable prospect that it will be made, to avoid falling within the definitions.

The Listing Requirements

If the target's securities are listed on an exchange, the listings requirements of that exchange are also likely to have something to say on the matter. Listings requirements are primarily applicable to the target rather than to an outside offeror, but will naturally affect the approach to negotiations between them. Exchanges require that price sensitive information be announced in accordance with their rules.

The JSE Listings Requirements require information to be disclosed equally to all shareholders at the same time and that price sensitive information should not be released until such time that it has been published. Accordingly, the target should not divulge price sensitive information

Flirting before the offer: The Intricacies of Approaching Shareholders *...continued*

The aim for the offeror will be to quietly gather information as to whether its potential offer is going to be acceptable to the shareholders so as to assist it with the decision to commit to the offer.

to one shareholder without disclosing the same information to all the other shareholders. Notwithstanding this, the disclosure of price sensitive information is permissible on materially the same basis as s78(4)(b) of the Financial Markets Act.

Section 3.9 of the JSE Listings Requirements requires that if an issuer is aware of price sensitive information and *"the necessary degree of confidentiality of such information cannot be contained or if the issuer suspects that confidentiality has or may have been breached"* then the issuer must publish a cautionary announcement and update such announcement.

As already noted, the parties will be reluctant to trigger the issue of a cautionary announcement before the potential offer has coalesced into a position where it is likely to go ahead. The likelihood is that a bland cautionary (one without any details of the potential transaction which merely advises shareholders to exercise caution in trading their shares) will lead to speculation potentially moving the share price of the target such that the potential offer is prejudiced. The JSE has specifically enjoined issuers to avoid the issuing of bland cautionaries and requires that details of the issue which has given rise to the cautionary be published as soon as possible.

Conclusion

If for no other reason than commercial realities, it makes sense for potential offerors to be able to engage with material shareholders in a target before an offer is formally launched. The shareholders need to be carefully chosen, the manner in which the chosen shareholders are approached needs to be cautiously scripted and at all costs confidentiality needs to be jealously guarded, to avoid the various regulatory pitfalls. One of the primary tactical considerations for an offeror is at what stage, and in what order, to approach the target and its shareholders.

The aim for the offeror will be to quietly gather information as to whether its potential offer is going to be acceptable to the shareholders so as to assist it with the decision to commit to the offer. The aim of the shareholders will be to ensure that they are not rendered insiders for an unacceptable period, but also to allow for an environment where an acceptable offer can be triggered to the ultimate benefit of all shareholders.

If all goes well, the actual dancing can begin.

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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