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Adam Gray
Long-term Focus Consultation
Corporate Law and Governance
Department for Business, Innovation and Skills
1 Victoria Street
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Dear Sir,

A Long-term Focus for Corporate Britain: a call for evidence

We write in response to the Department for Business, Innovation and Skills's call for evidence entitled "A Long Term Focus for Corporate Britain" (the "Consultation Paper").

Deutsche Bank is a leading financial adviser on public takeovers in the UK market, and has been involved in many high profile transactions in recent years on both sides of the table. This includes advising the offeree on the offers for Scottish & Newcastle, Rio Tinto and Arriva, and acting for the offeror on the bids for BOC, Hanson and Corus (our responses to the Consultation Paper are, necessarily, limited by the requirements of client confidentiality). We firmly agree with the statement in Section 6.2 of the Consultation Paper that "takeovers are a vital part of a vibrant market economy", and think they are a necessary component of maximizing the value and productivity of UK plc. In addition, our Corporate Broking franchise has more than 50 retained clients, primarily constituents of the FTSE 100 and FTSE 250, including Standard Life, Tesco and Unilever. In these capacities, we have regular contact with both boards of, and investors in, UK listed companies.

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Management Board: Josef Ackermann (Chairman),
Hugo Bänziger, Michael Cohrs, Jürgen Fitschen, Anshuman Jain,
Stefan Krause, Hermann-Josef Lamberti, Rainer Neske

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It is our view that Boards are fully aware of their duties: they focus intently on these, especially during takeover situations, and their decision as to whether or not to recommend a takeover bid is driven by these considerations. Shareholders are more sophisticated than ever in focusing on the value of any potential offer in relation to the long term stand alone value of the business, and are more able to act on such views than ever before. We believe the current environment in which UK corporates operate is largely effective in promoting the long term prospects of UK plc, although (as outlined below) we would be supportive of certain alterations to the regulatory framework to allow Boards to communicate their long-term view of their businesses to the market more fully during takeover situations, and allow shareholders to take even more informed decisions in these crucial moments when deciding the future of a company.

Boards' awareness of responsibilities during takeovers

For the vast majority of Boards in the UK, acquiring, or being acquired by, another company is one of the most significant challenges they have to face, and they will, almost without exception, seek extensive assistance to guide them through the process. They are fully aware of their responsibilities in these situations, and take them very seriously. Current regulations require offeree boards to seek financial advice and be briefed by their financial advisers and lawyers on The Takeover Code and their broader fiduciary duties as directors, including on the long-term implications of any takeover offer. Our experience suggests that offeree Boards will not recommend an offer unless they feel that doing so is in the clear interests of shareholders.

Short-termism

There has been considerable discussion of short-termism in equity markets in recent months. Market participants are now able to buy and sell stock more quickly, at tighter spreads, based on more up-to-date information, than ever before. This strong pool of liquidity facilitates capital raising for businesses, and allows shareholders to act on their views as to the current value of stocks. It is our strong view that such liquidity provides a net benefit for shareholders, businesses and UK plc, and that any attempt to restrict it would be impractical, necessarily clumsy, very likely a damper on capital raising, and ultimately be detrimental to the UK's long term prospects.

It would, however, be wrong to view the market as being populated only by short-term investors out to 'make a quick buck'. For example, the largest 25 shareholders in the UK (excluding market makers), who combined hold c. 27% of the value of the market as a whole, are all large, long-only institutional investors who take a long-term approach to investing.

Requirements for offeror companies' shareholders to vote on acquisitions

The current UK Listing Rules require an offeror company seeking to acquire a company that is material in relation to its own size to vote on such an acquisition when it is above a certain threshold. In our experience, these rules are sufficient, and extending the right of offeror shareholders to vote on every takeover bid, regardless of materiality, would be unworkable. Making the UK an international outlier on these rules may also run counter to shareholders' and companies'

interests, by introducing an ability for offerors to withdraw an offer more easily than they can at present in the event of an adverse change of circumstances.

Boards' ability to access information on beneficial share ownership

In terms of Boards' ability to access up-to-date and full information as to who the beneficial owners of the shares are, we believe the UK has greater transparency than virtually any other jurisdiction. When a company goes into an offer period, the disclosure requirements in The Takeover Code and Disclosure and Transparency Rules provide for very detailed information. We feel this framework adequately meets the (sometimes conflicting) demands of Boards to know who the shareholders are, and of shareholders to avoid too much bureaucracy in announcing every share sale or purchase (or their intention in respect of such shares).

Communication with shareholders during an offer period

Vital to any decision to recommend an offer is the Board's view of the long term prospects of the business on a standalone basis. Currently, various elements of regulation in the UK, including The Takeover Code, constrain Boards' abilities to communicate their views of such prospects to their shareholders. For example, Rule 28 of The Takeover Code requires that *"forecasts must be examined and reported on..."*

We believe that the current UK takeover rules take an overly protective attitude to shareholders in this respect: whilst there are clearly retail investors who are less sophisticated, the majority of market participants and institutional investors are more analytical than ever. In most cases, they are sufficiently sophisticated to decide for themselves the merits of any forecasts produced by a company's management during an offer period. Shareholders have shared with us their frustration in certain circumstances at the constraints preventing management from providing information about their expectations in relation to the future performance of the business.

The current regulations in this area seek to avoid a situation where a party to an offer (an offeree, or an offeror offering share consideration) produces an overly flattering set of forecasts to entice shareholders to take its side in the bid situation, and these shareholders then suffer a loss in value if the forecasts subsequently fail to materialise. To prevent such a scenario, the Panel requires any forecasts to be reported on by both accountants and financial advisers.

In theory, there is nothing to prevent a company making any profit forecast as far into the future as it wishes, provided that the directors and external advisors stand behind it. However, the practical implication of the rules is very different. No firm of accountants would be prepared to put its name to a set of forecasts beyond a very limited time horizon (typically no more than the end of the current reporting period), creating a very real imbalance between offerors and offerees. Offerors may attack an offeree's historic track record as they wish, casting doubt on management's ability to extract value from the business in the future, whilst offerees are restricted from holding an open debate about their plans to deliver such value.

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In our view, these requirements put offeree boards at a disadvantage compared to potential offerors in their communication with shareholders during an offer period. Perhaps it is time to revisit these requirements. It is more common than it used to be for companies to publish forward looking information: shareholders have become familiar with such information in the ordinary course of business, and indeed it is often expected. They are then deprived of it during an offer period, which is the most critical time of all as they are deciding on the future of the company they own.

We fully support the notion that less sophisticated investors deserve protection, and would suggest that, were the profit forecast restrictions to be lifted or amended, sufficient safeguards will remain in place to prevent willful abuse of forecasting. Companies have clear legal and regulatory obligations not to mislead markets or shareholders, and any statements made during an offer period are subject to prospectus standards of verification. It is also a requirement under The Takeover Code that, amongst other things, all documents are *"prepared with the highest standard of care and accuracy"*, and that directors take responsibility for information contained within such documents. Directors also face the threat of being removed by disgruntled shareholders if they make commitments, on the basis of which an offer is rebuffed, and management then fail to deliver. It would, of course, also be entirely open to offerors to critique the forecasts and question their credibility, an opportunity which in a hostile offer they would undoubtedly take up. These factors would continue to ensure a very sober appraisal before forecasts are published.

We hope that you find our views helpful for the purposes of your review and we would, of course, welcome the opportunity to discuss anything raised in this response with you in person if you feel that would be useful.

Yours faithfully

Nick Bowers
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James Arculus
Managing Director, UK Mergers and Acquisitions