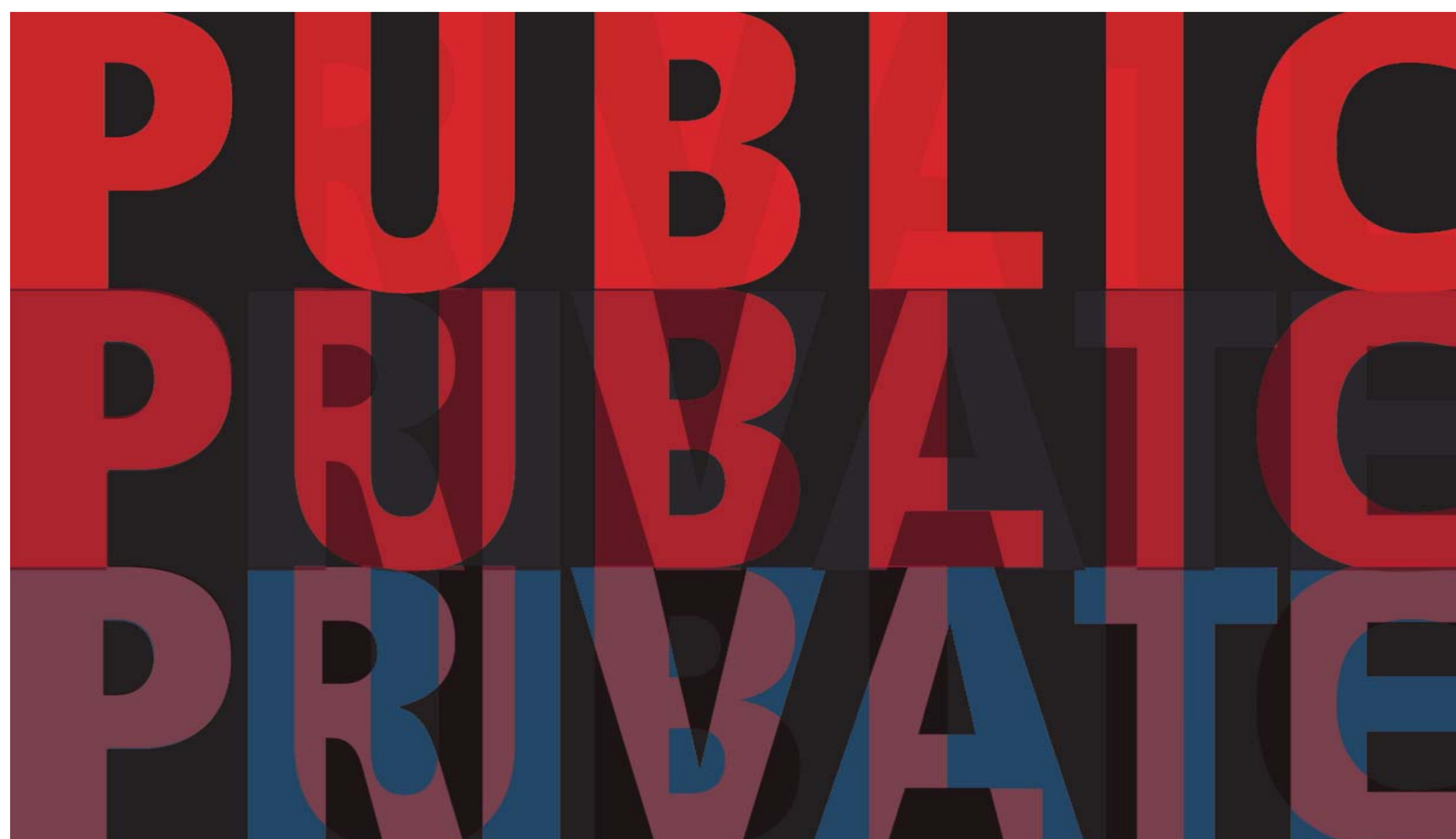

PUBLIC TO PRIVATE
THE RETURN OF THE PRIVATE EQUITY BIDDER

Gavin Davies, Robert Moore and Antonia Kirkby of Herbert Smith Freehills LLP examine the recent rise in the number of private equity bidders on public M&A transactions.

2019 has seen a significant rise in the number of private equity (PE) and other financial buyers on public mergers and acquisitions (M&A). When a PE house undertakes a public M&A transaction, it should be aware from the outset that there are some key differences to private M&A, and that there are specific issues for PE bidders that do not commonly arise on other public M&A deals, particularly if they are forming a consortium to make the offer.

There have been 26 public to private offers announced to date in 2019, compared to 14 in 2018 and 12 in 2017. The return to public M&A activity by PE houses follows increased competitiveness for private assets, in particular from trade buyers that can achieve synergies more easily. This has made listed company targets more attractive. A weakened pound also makes UK target companies, particularly those with an international footprint, more attractive to overseas buyers.

This article looks at how PE houses have adapted to the 2011 changes to the Takeover Code (the Code) and some of the particular issues that they encounter in practice in public M&A.

INCREASE IN PE ACTIVITY

When the Code was substantially amended in 2011, the changes were seen as creating obstacles to PE houses on public M&A transactions, more so than for other potential bidders. Particular concerns were raised about the tightened "put up or shut up" (PUSU) regime, the requirement to disclose financing arrangements and the prohibition on break fees and other offer-related arrangements that used to afford bidders some level of deal protection (*see Focus "Takeover Code changes: impact on private equity bidders", www.practicallaw.com/2-507-9308*). However, the attractiveness of UK-listed targets has meant that PE houses have largely overcome those concerns.

On the target company side, there has been a reduction in investment research on smaller listed companies, as a result of the enhanced requirements under the recast Markets in Financial Instruments Directive (*2014/65/EU*), which has contributed to a decrease in liquidity in a number of those companies. Coupled with that, listed companies are under increasing scrutiny as governance issues move up the public agenda.

These factors could well have caused some of those companies and their stakeholders to become more receptive to being taken private. PE houses are also increasingly willing to acquire much larger listed company targets than in the past, with seven PE-backed deals in 2019 valuing the target at over £1 billion.

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THE IMPORTANCE OF SECRECY

A number of provisions in the Code seek to ensure that information in relation to a bid is not shared more widely than is absolutely necessary before the announcement of an offer or possible offer, to minimise the risk of a leak; and a leak will have certain consequences under the Code. These provisions present some specific issues for PE houses seeking a target for acquisition.

PUSU regime

If, after a bidder has approached a target about a possible offer, the bidder's interest in the target leaks to the market, then, unless a dispensation applies, the potential bidder will have to be named publicly (*Rule 2.4(a), the Code*). It will then have 28 days to "put up or shut up", that is, it must announce a firm intention to make an offer under Rule 2.7 of the Code (Rule 2.7) or announce that it does not intend to make an offer, in which case it will be subject to the restrictions in Rule 2.8 of the Code, including on making another bid for the same company for a period of six months (*Rule 2.6(a), the Code*).

The imposition of the PUSU deadline is automatic. Any leak will trigger a PUSU deadline and a bidder would then potentially only have 28 days in which to put together a fully financed offer. The deadline will only be extended by the Takeover Panel (the Panel) at the request of the target, not the bidder. Maintaining secrecy before the announcement of an offer or possible offer is therefore of the utmost importance and this is emphasised in Rule 2.1 of the Code.

Even before an approach is made to a target, the Panel may require an announcement to be made if a bidder is actively considering an offer and there is a leak, or rumour and speculation in the market about its interest (*Rule 2.2(d), the Code*). This announcement would also trigger a 28-day PUSU deadline. The Panel will determine if a potential bidder is actively considering an offer in order to determine whether an announcement is required.

The Panel does not operate a hair trigger on these judgments and recognises that bidders will regularly consider potential acquisition targets without "actively considering" them. It will, however, take into account factors such as the level of consideration from the bidder, whether third-party finance providers or management teams have been approached and whether advisers have been appointed for the deal (*Panel Practice Statement 20, www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/ps20.pdf*).

The rule of six

Rule 2.2(e) of the Code limits the number of parties that a bidder can speak to before an announcement of a possible offer. The Panel will generally permit a bidder to speak to six parties before requiring an announcement (*Panel Practice Statement 20*). Finance providers (whether equity or debt), pension fund trustees, potential management team candidates (other than existing target employees) and target shareholders will count towards the rule of six, although the parties and their advisers will not. Where a bid is being put together particularly by a consortium the limit can be met very quickly.

In considering whether to consent to more than six parties being approached without an announcement being made, the Panel will need to be satisfied that secrecy will be maintained.

> **Recent deals involving stub equity**
>
> The following are some recent transactions that involved a share alternative being offered as part of the consideration:
>
> - NorthEdge Capital LLP's bid for Catalis plc (2019).
> - Raglan House Holdings Limited's offer for Freshwater UK plc (2018).
> - Qinvest LLC/Atlas Merchant Capital LLC's bid for Panmure Gordon & Co plc (2017).
> - Continental Investment Partners SA and Harwood Capital LLP's bid for Source BioScience plc (2016).

FORM OF CONSIDERATION

A PE-backed bid is typically wholly or largely in cash. While a bidder is generally free to set its offer price, if it has bought target shares in the three months before the start of the offer period, this may set a minimum floor for the consideration it must offer (*Rule 6, the Code*). Any decision around whether to stakebuild, where permitted by the fund in question, should factor this in, although given that most bids are typically at a premium to the three-month average share price, it is unlikely to have a practical impact.

Cash confirmation

Where a bidder is offering cash, the bid will have to be fully financed at the time that a firm intention to make an offer is announced under Rule 2.7. The bidder's financial adviser, or another appropriate third party, is required by the Code to confirm in the offer announcement and offer document that the bidder has sufficient cash resources available to it to satisfy the cash consideration payable under the offer in full (*Rule 2.7(d) and Rule 24.8, the Code*). The financial adviser and its legal advisers will want to undertake a due diligence exercise before giving that confirmation, as the Panel may require the financial adviser to make up any shortfall if the bidder fails to pay the full amount. The financial adviser will therefore want to ensure that the cash is available and, depending on the circumstances and funding structure, may require it to be ring-fenced or placed in escrow.

If the bid is to be debt financed, the financial adviser will analyse any conditionality in the financing arrangements in order to identify the circumstances in which the banks can refuse to allow the bidder to draw down the funds. Any outstanding conditions should only reflect any conditionality in the offer or issues that are within the control of the bidder. This is known as "certain funds financing", as the usual drawdown conditions on a conventional financing will not be acceptable on a facility to fund a bid.

Where a bidder is a consortium or a PE house and the cash is to be financed through equity investment in the bid vehicle, the due diligence exercise is likely to be more complicated and may involve more detailed analysis of the funding arrangements or require binding equity commitment letters from the limited partners in the fund.

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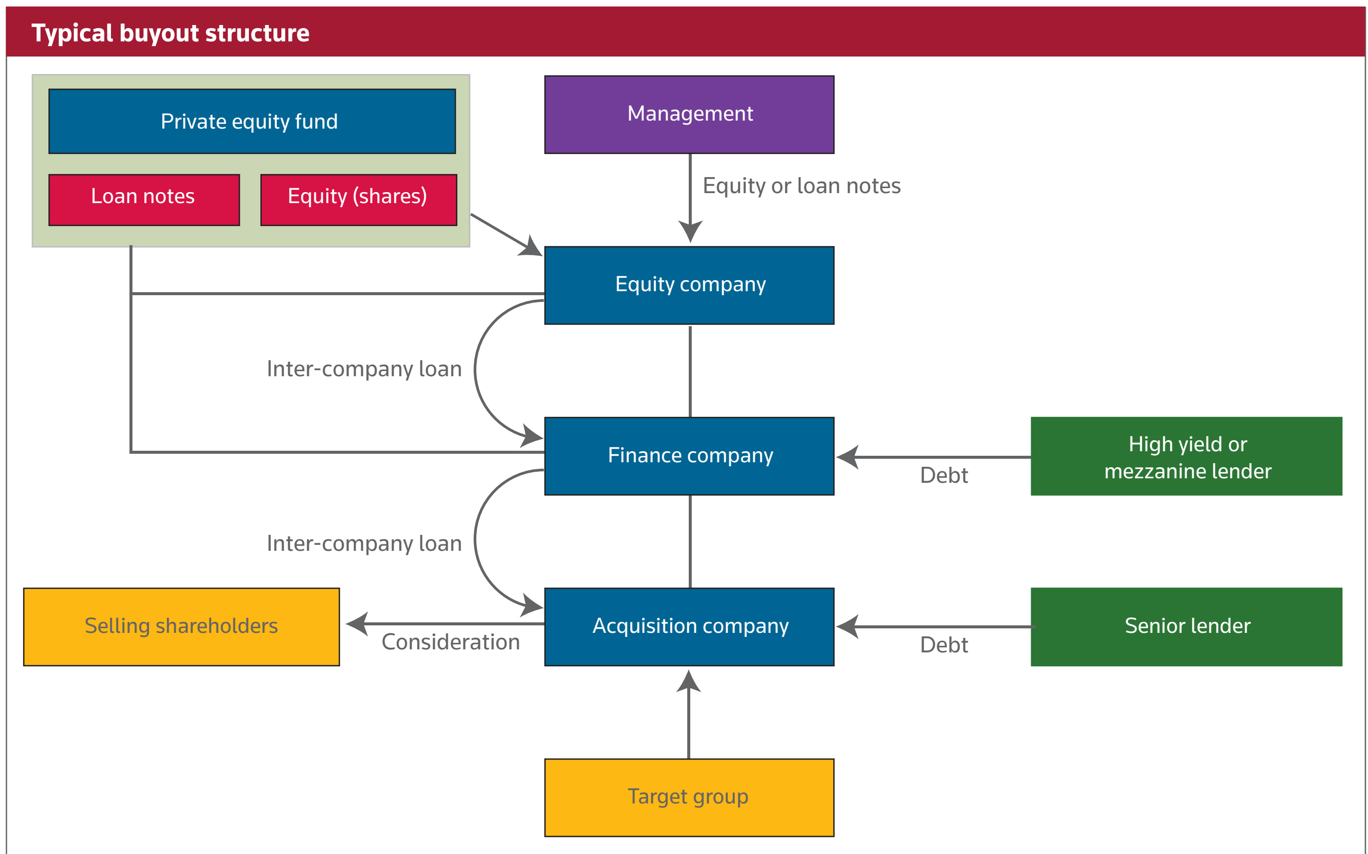

Stub equity

Bidders may wish to offer target shareholders the ability to participate in the target business in future, especially if there are significant target shareholders whose acceptance of the offer is key to the transaction completing. As PE bidders typically cannot offer a conventional share alternative, they may consider offering stub equity; that is, a partial share alternative where the shares issued under the alternative are unlisted equity in the bid vehicle. The partial share alternative will form only a small part of the consideration and will not offer full equity participation in the bid vehicle.

General Principle 1 in the Code (General Principle 1) requires all target shareholders to be treated equally and Rule 16 of the Code (Rule 16) does not allow a bidder to offer special arrangements to one target shareholder if they are not being extended to all shareholders, although there is an exception for management incentivisation (*see "Management participation and incentivisation" below*). For that reason, any stub equity offer must be made available to all shareholders, although it will likely be targeted at key target shareholders (*see box "Recent deals involving stub equity"*).

Stub equity is considered as a possible option far more often than it is actually offered, but it can provide a useful tool to win the support of key target shareholders for the bid.

FINANCING A BID

There are a number of issues for a PE house to consider in respect of the financing of a bid and what needs to be disclosed.

Disclosure of financing arrangements

An offer document must set out how a bid is to be financed (*Rule 24.3(f), the Code*). This does not require details of how a PE fund's financing works but will require disclosure of how the bid vehicle will be funded; for example, debt, equity subscription, bridge facility or a combination of these. The financing documents, such as facility agreements or equity commitment letters from limited partners, will also have to be put on display on a website under Rule 26.2 of the Code from the time of the Rule 2.7 announcement. Other documents that will have to go on display include any bid conduct or co-operation agreement, management rollover agreement and shareholders' agreement.

Redaction is generally not permitted but if the financing arrangements have headroom to increase the offer built into them, that can be dealt with in a side letter which will not have to be disclosed. Market flex provisions, which allow the arrangers of debt to vary certain terms of the financing after the agreements have been entered into, in order to facilitate the syndication of the debt, may also carry some sensitivity. It is normally possible to get a Panel waiver from the requirement to disclose specific figures in any market flex arrangements during the period between the firm offer announcement and the publication of the offer document or completion of the syndication.

Debt syndication

If the debt financing needs to be syndicated, and another department in a member of the syndicate holds target shares, the syndication exercise could result in a breach of the provisions in Rule 20.1 of the Code on equality of information to shareholders, as the information given to arrangers of the debt would generally be more detailed than that provided to target shareholders on an offer. It could also breach the prohibition on entering into special deals with target shareholders in Rule 16, as it would be possible to offer more favourable debt terms on the syndication as a means of providing additional value to a member of the syndicate in its capacity as a target shareholder.

Panel Practice Statement 25 sets out the Panel's approach in this situation (*www.*

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thetakeoverpanel.org.uk/wp-content/uploads/2008/11/ps25.pdf). In particular, it says that it will view Rule 20.1 of the Code as not having been breached if effective information barriers are put in place between the department involved in debt syndication and any department responsible for trading, or making investment decisions in relation to, equity investments. Likewise, it will not view Rule 16.1 as having been breached in that situation, as the equity department will not know if favourable debt terms are offered to the debt department as part of the syndication.

Bidders should also bear in mind the rule of six: debt providers will count towards the six parties that may be approached, although where a debt provider which has been approached declines to participate, the Panel may be prepared to treat that party as no longer counting towards the six parties (*see "The rule of six" above*). As the bid will almost certainly involve inside information, the provisions in the Market Abuse Regulation (*596/2014/EU*) (MAR) on selective disclosure of inside information will also have to be considered. If the debt financing needs to be syndicated, this will not happen until after an announcement of an offer or possible offer, given the rule of six and the need for secrecy.

Definition of acting in concert

The definition of "acting in concert" in the Takeover Code states that:

"Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), co-operate to obtain or consolidate control... of a company or to frustrate the successful outcome of an offer for a company. A person and each of its affiliated persons will be deemed to be acting in concert all with each other.

Without prejudice to the general application of this definition, the following persons will be presumed to be persons acting in concert with other persons in the same category unless the contrary is established:

(1) a company, its parent, subsidiaries and fellow subsidiaries, and their associated companies, and companies of which such companies are associated companies, all with each other (for this purpose ownership or control of 20% or more of the equity share capital of a company is regarded as the test of associated company status)..."

Impact of debt financing on offer structure and conditions

If a bid is to be debt financed, that may affect whether a contractual takeover offer or scheme of arrangement is the more suitable offer structure. Finance providers are likely to prefer the bidder to use a scheme of arrangement rather than a contractual takeover offer if the debt is to be pushed down to the target after closing. By using a scheme, the bidder is assured of getting 100% control of the target. That will enable the target to be reregistered as a private company after completion. The debt can then be restructured and secured over the target assets.

A contractual takeover offer runs the risk of not securing 90% acceptances, which is the level that is required to squeeze out any remaining minority shareholders. If a bidder does not reach 90% acceptances, minority shareholders holding 5% of the company's share capital could challenge re-registration of the public limited company as a private company under section 98 of the Companies Act 2006 (2006 Act). If that were to succeed and the company remains a public limited company, it will be unable to take on the debt or grant security over its assets in connection with the debt as that would constitute financial assistance under the 2006 Act.

If it is decided that a contractual takeover offer is more suitable, the finance providers are likely to want to have some control over whether the acceptance condition is waived down below 90%, for the same reason. Of the 26 take private bids to date in 2019, 20 were implemented by way of a scheme.

Equity finance

It is not uncommon for a PE bidder to make a bid in conjunction with others. That may be because they want to: co-invest together in the target; bring in parties with different expertise to work together as partners in the target; or break up the target between them.

If a bid is to be wholly or partly equity financed (that is, the proceeds to pay the cash consideration will come through equity investment in the bid vehicle), the issues discussed above in relation to the cash confirmation will have to be considered. Similar issues to those discussed above in the context of debt syndication in relation to the rule of six and MAR provisions on selective disclosure of inside information are also likely to arise in the context of equity syndication.

Details of the investment in the bid vehicle will also have to be disclosed (*see box "Typical buyout structure"*).

As discussed above, Rule 16 does not allow a bidder to offer a special deal to individual target shareholders. If a participant in the bid vehicle is also a target shareholder, any arrangements with that person which are not offered to other target shareholders may contravene Rule 16, unless the person is treated as a joint offeror. The test that the Panel applies when determining whether a party is a joint offeror, rather than just a member of the bidder's concert party, is set out in Panel Statement PS 2003/25, which considered the position on a consortium offer for Canary Wharf Group (*www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/2003-25.pdf*). Factors that the Panel will look at when determining whether a party is a joint offeror include the equity participation that the person will have in the bid vehicle and whether the person is expected to:

- Exert significant influence over the bid vehicle.
- Participate in the profits.
- Bear the risk of poor performance.

If a person does not meet the threshold for joint offerors, the arrangements will have to be offered to all target shareholders, unless they form part of management incentivisation arrangements (*see "Management participation and incentivisation" below*).

INFORMATION SHARING

A PE bidder will need to be mindful of the restrictions on information-sharing when working on a bid for a public target.

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Bidder sharing information with target shareholders

In the context of putting a bid together, and approaching potential management teams, participants in a consortium or debt providers, the rule of six must be borne in mind.

General Principle 1 is underpinned by Rule 20.1 of the Code, which requires that information and opinions relating to an offer or a party to an offer must be made equally available to all target shareholders. This includes documents and presentations given to shareholders, so bidders must take care when preparing these. Where the documents are provided before the announcement of a firm offer, they need only be published once the offer is announced.

Rule 20.2 of the Code requires (in the absence of a dispensation) meetings or telephone calls with target shareholders to be chaperoned by the bidder's financial adviser or broker, who will have to confirm to the Panel that no material new information or significant new opinion was provided to the shareholder. Where the meeting takes place before the start of an offer period or a firm offer announcement, the chaperone must confirm that material new information and any significant new opinion will be published when the offer is announced.

A bidder will also have to bear in mind the restrictions under MAR on selectively disclosing inside information. Where a bidder is speaking to target shareholders, it should consider whether it wants to fall within the market soundings safe harbour in Article 11 of MAR, in which case it will have to follow the procedures prescribed by Article 11 of MAR and Commission Delegated Regulation EU/2016/960.

Target sharing information with the bidder

The due diligence on a public M&A transaction will typically be more limited than on a private M&A transaction. One of the reasons for this is that any information given to one bidder will have to be given to any other bona fide potential competing bidder under Rule 21.3 of the Code (Rule 21.3).

On a PE-backed management buyout, the Code rules on equality of information to competing offerors are adapted so that they apply to information generated by the target, including by the management of the target acting in their capacity as managers, which is passed to external providers or potential providers of finance (whether equity or debt) to the bidder (*Note 3 on Rule 21.3*). The directors of the target who are involved in making the offer will have to co-operate with the independent target directors in assembling this information.

Post-offer intention statements

Rule 19.6 of the Takeover Code requires that a post-offer intention statement must be both:

- An accurate statement of that party's intention at the time the statement is made.
- Made on reasonable grounds.

The Takeover Panel also requires a bidder to confirm whether it has complied with its intention statements and to announce that to the market 12 months after the end of the offer period, or to make an earlier announcement if it takes a different course of action.

MANAGEMENT PARTICIPATION AND INCENTIVISATION

A PE bidder is likely to want to retain at least some of the target's senior management team and therefore management participation will need to be considered carefully. Directors' statutory duties and their contractual obligations under their service agreements are owed to the company. Therefore, any substantive negotiation with, or disclosure of information to, a would-be bidder requires the consent of the target board. In addition, protocols have to be put in place regarding information flow, with the members of management excluded from the target's discussion of the bid. The target will also need to deal with conflicts of interest.

A PE bidder may want to incentivise management to stay on in the target following completion. Any discussions regarding management incentivisation will have to be disclosed under Rule 16.2.

The Code recognises that a bidder may want to offer incentivisation arrangements (such as roll over of target shares into equity in the bidder) to retained management, and that those arrangements could breach the Code requirements on equal treatment of target shareholders if the members of the management team are shareholders in the target. Rule 16.2 sets out the requirements in that situation, which depend on the nature of the arrangements and the stage of discussions. If discussions are advanced, the target's financial adviser will have to confirm that the arrangements are fair and reasonable. If the value of the arrangements is significant or the nature of them is unusual, independent target shareholder approval may also be required by the Panel; for example, this was the case in the NorthEdge bid for Catalis.

CONCERT PARTIES

While all potential bidders need to identify who will be treated as acting in concert with them, the structures of PE houses mean that this needs to be a particular focus for a PE bidder. There are a number of implications of the Code's concert party rules for a takeover:

- The offer or scheme document must disclose the identity of each concert party member and their interests and dealings in the target shares.
- The bidder must ensure that concert parties do not deal in target securities if they have inside information in relation to the target (*Rule 4, the Code and MAR*).
- The bidder must ensure that its concert party members do not acquire shares that take the aggregate interests of the concert party members through 30% of the voting rights in the target, as that could trigger the requirement to make a mandatory offer under Rule 9 of the Code.
- Any acquisition of shares by a concert party member could set the floor price or type of consideration required to be offered by the bidder under Rule 6 or Rule 11 of the Code (*see "Form of consideration" above*).
- The restrictions in the Code that apply to a bidder will also apply to other concert party members.

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The definition of acting in concert under the Code means that the PE fund will be treated as acting in concert with the bid vehicle.

The presumption in the first limb of the definition of acting in concert extends to associates of concert parties; that is, persons in whom the concert party has a 20% interest, or which has a 20% interest in the concert party (*see box "Definition of acting in concert"*). Limited partner investors in the PE fund will not generally be treated as acting in concert unless they have a significant investment in the bid vehicle or will have some control over it, or technically in or over the fund itself, although that would be unusual.

A limited partner that co-invests to a significant extent with the PE fund, or has the right to do so, may also be treated as a member of the concert party. Other entities in which the PE fund is invested will also be caught, although in certain circumstances it may be possible to get a waiver from the Panel for large PE houses with multiple portfolio investments that would otherwise be caught.

Where a sovereign wealth fund or state-owned entity is involved in a bid, the analysis will be more complicated due to the potential for a huge number of entities to be caught by the Code definition of acting in concert.

Recent high-profile offers

The following are some recent offers announced by private equity bidders for UK-listed companies:

- Offer for Sophos Group plc by Thoma Bravo LLC.
- Offer for Cobham plc by Advent International Corporation.
- Offer for Merlin Entertainments plc by a consortium comprising KIRKBI A/S, the Blackstone Group LP and Canada Pension Plan Investment Board.
- Offer for Inmarsat plc by Apax Partners LLP, Warburg Pincus International LLC, Canada Pension Plan Investment Board and Ontario Teachers' Pension Plan Board.
- Offer for BCA Marketplace plc by TDR Capital LLP.
- Offer for Flybe Group plc by Stobart Group Limited, Virgin Atlantic Limited and Cyrus Capital Partners LP.
- Offer for esure Group plc by Bain Capital Private Equity, LP.

DISCLOSURE OF INTENTIONS REGARDING TARGET

The firm offer announcement and the offer document will have to disclose the bidder's intentions for the target, in particular as regards target employees and any research and development function that it has, as well as any material change in the conditions of employment or in the balance of the skills and functions of employees and management (*Rule 2.7(c)(iv) and Rule 24.2(a), the Code*).

As these disclosures have to be made in the announcement of a firm intention to make an offer, as well as the offer document, part of the bidder's bid preparations must relate to its future intentions for the target business.

Any statements about, for example, any job losses will have to be consistent with the PE house's private business modelling for the target. While it will not have to publicly disclose its modelling for the business, when a party to an offer makes any statement of intention, it must comply with the Code requirements for intention statements (*see box "Post-offer intention statements"*).

Therefore, if a bidder says in the offer document that there will be no job losses but then cuts the workforce within 12 months, it will be required to announce the change of intention to the market. As well as requiring an announcement, the Panel is likely to want to understand whether the intention statement when made was an honestly held view and made on a reasonable basis.

A statement by a bidder that it intends to undertake a review of the target business following completion of the offer, or that it will support the target's existing strategy, will not, of itself, satisfy the requirements of Rule 24.2 or Rule 2.7 of the Code. Where the bidder intends to undertake a review following completion of the offer, the Panel has said that the bidder should disclose what the review is likely to cover and its expectations in relation to the review (*Response Statement 2017/2, www.thetakeoverpanel.org.uk/wp-content/uploads/2017/12/FinalRS2017-2.pdf*).

Responsibility for documents

While a newly incorporated special purpose vehicle (SPV) is likely to be the bidding entity, the Panel will look through that and require key individuals in the fund, including the members of the investment committee, to take responsibility for information in the offer document alongside the directors of the bid vehicle.

DEAL PROTECTION

One of the significant changes made to the Code in 2011, which was designed to afford greater protection to targets, was the prohibition on offer-related arrangements; that is, any commitment by the target to the bidder in relation to the offer. The area where this had the greatest impact was to ban targets from agreeing to pay bidders a break fee if the bid failed, which had become almost routine on bids before 2011.

Bidders and targets may still, and often do, enter into co-operation agreements in relation to a bid, but they cannot include commitments by the target to the bidder, except those permitted by Rule 21.2(b). Further commentary on what the Panel will permit these agreements to contain can be found in Panel Practice Statement 29 (*www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PS-29-New.pdf*).

A PE bidder cannot therefore receive a break fee from a target other than in very narrow circumstances, but it can still use other means to try to secure the success of a bid, the most common of which is obtaining irrevocable undertakings from target shareholders. The Panel will, however, want to be certain that there are no commitments that may breach

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Rule 21.2, particularly in any irrevocable undertakings given by directors. A director is not permitted to give commitments in an irrevocable undertaking that go beyond what the director intends to do with their shares under the offer. For example, a director's irrevocable undertaking cannot contain a commitment not to solicit or recommend a competing offer. Panel Practice Statement 29 contains further commentary on this.

It may also be possible to get a break fee from a target shareholder, subject to both commercial considerations and the Panel's consent. For example, in Hanover's offer for Kalibrate Technologies in 2017, Eurovestech plc (a shareholder in Kalibrate) agreed that it would compensate Hanover for its abortive costs if Eurovestech or Invesco Asset Management Ltd did not accept Hanover's offer.

POLITICAL INTERVENTION

While PE-backed bids do not usually raise competition issues, unless they already have investments in the relevant sector, there is a trend, not just in the UK but around the world, for increased intervention by governments in acquisitions of assets or companies that may raise national security issues.

Traditionally, PE-backed bids were seen as less susceptible to intervention but that is no longer the case and, in the UK in 2019, public interest intervention notices were issued on Advent International Corporation's bid for Cobham plc and a consortium bid (comprising Apax Partners LLP, Warburg Pincus International LLC, Canada Pension Plan Investment Board and Ontario Teachers' Pension Plan Board) for Inmarsat plc (*see box "Recent high-profile offers"*). Where the target operates in a sector that may raise public interest issues, particularly national security concerns, a PE bidder will have to be prepared for the risk of intervention and any resulting impact on the timetable.

It may be possible, where there is a risk of intervention, to give undertakings to assuage any concerns. However, it is worth noting that the bidder for Inmarsat agreed voluntary undertakings with the Secretary of State for Digital, Culture, Media and Sport but a public interest intervention notice was still issued. Ultimately, the Secretary of State accepted undertakings from the bidder, avoiding an in-depth Phase 2 investigation. However, it is notable that the undertakings which the Secretary of State ultimately accepted were far more onerous and detailed than the voluntary undertakings that were first offered by the parties and accepted by the government shortly after notification of the proposed transaction to the Competition and Markets Authority.

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