HERBERT SMITH FREEHILLS

PUBLIC M&A TRENDS IN THE UK

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Legal Briefings

We have seen a number of common themes arise on public Mergers and Acquisitions transactions in the UK in the past 12 months and we believe that these trends are likely to continue in to 2016.

- **Redomiciliations and inversions** – We have continued to see companies migrating to a different jurisdiction in search of a more favourable tax or regulatory environment, often as part of a wider M&A transaction. Although the US Treasury sought to deter US companies from moving overseas in Autumn 2014, and announced further measures in November 2015, it has not, as yet, stopped these transactions entirely. We expect companies will continue to examine the most suitable legal and regulatory environment when undertaking a large or transformative transaction.

  On an inversion transaction, the interaction between the UK and US requirements raises a number of issues, in particular the conflicting requirements of the US reporting regime and of the Takeover Code regime for profit forecasts and quantified financial benefit statements, which require careful management.

- **Bids involving controlling shareholders** – A number of listed companies with major shareholders have been acquired in recent months, whether taken private by the major shareholder or acquired by a third party with the support of that shareholder. In addition to governance, conflict of interests and confidentiality concerns, this may raise issues under Rule 20.1 where the shareholder has a nominee director on the board and a protocol on information-sharing may be required. The recommendation by the target directors may also present particular challenges, for example if the directors think that the offer price is not recommendable but recognise that delisting of the target is very likely.

- **Anti-trust conditions** – The conditions to an offer, in particular anti-trust and regulatory conditions, have continued to be a key issue in the light of the growing global trend for increased regulatory jurisdiction and intervention. Whilst the invocation of a condition

relating to clearance by the UK's Competition and Markets Authority (CMA) or under the EU Merger Regulation is not subject to any materiality threshold under the UK Takeover Code, regulatory and anti-trust conditions in other jurisdictions, including those relating to national authorities in other EU Member States, can only be invoked if they are of "material significance" to the bidder. The competition issues on a bid will therefore have to be analysed carefully and, if significant, discussed with the Panel.

- **Bid Conduct Agreements and reverse break fees** – Bid Conduct Agreements (or Co-operation Agreements) are now very common on larger bids in the UK, with the balance of power tipping back in favour of the target due to the prohibition in the Takeover Code on offer-related arrangements. The parties can use the agreement to address issues such as co-operating to obtain regulatory clearance. The Takeover Panel has issued a Practice Statement setting out what is and is not acceptable in a co-operation agreement and the Panel will review the terms of the agreement once it has been published (as required by Rule 26 of the Code) to ensure it does not breach the Code.

  In recent public M&A activity, requirements for bidder shareholder approval and/or regulatory clearances have contributed to a significant increase in the number of bidders agreeing to pay a reverse break fee, that is a break fee payable by the bidder to the target if the deal fails in certain circumstances. The Panel will be concerned to ensure that the conditions for the payment of the reverse break fee, and the circumstances in which it is not payable, do not fetter the target or deter a potential competing offeror.

- **Transfer schemes** - The prohibition on the use of cancellation schemes to effect a takeover, which was introduced in March 2015, has not resulted in a reduction of the use of schemes on a bid. The prohibition was introduced to close what the Government perceived to be a stamp duty loophole. Whilst the fact that stamp duty was not payable on a cancellation scheme was one advantage of using a scheme instead of an offer, schemes still carry other advantages, for example the bidder has certainty that it will obtain 100% of the shares in the target if the scheme is duly approved.

  Bidders have used "transfer schemes", in preference to a contractual offer, on approximately 75% of offers over £50 million since the prohibition was introduced. A transfer scheme is simpler than a cancellation scheme and recent HMRC guidance means that the transfer scheme timetable can be up to two weeks shorter.

AREAS FOR CHANGE IN 2016

Looking forward to the coming year, we anticipate, or at least would like to see, reform in the following areas of public M&A in the UK.

- **Conditions to an offer –** We anticipate that the UK Takeover Panel will consider

reviewing its approach to regulatory conditions on an offer in the light of the growing global trend for increased regulatory jurisdiction, review and intervention on offers. The Panel's current approach, namely treating conditions relating to the UK's CMA and EU clearance in a different way to conditions relating to anti-trust clearance by other authorities, is imbalanced. In relation to the latter, the bidder must show the condition is of material significance before it can be invoked, whereas no materiality threshold applies to CMA or EU conditions. We also consider that the Code timetable for contractual offers should be reviewed to allow for more flexibility to obtain overseas regulatory clearances (without being forced to use a pre-conditional offer).

- **Squeeze out of minority shareholders –** Where a company has a controlling shareholder which owns more than 50% of the shares in the company, smaller shareholders are not explicitly protected by the Code, as the rules relating to mandatory offers only apply where a shareholder holds between 30% and 50% of the company's voting rights. This issue has been highlighted by the trend in recent years for companies with controlling shareholders to be taken private by those shareholders. We note that the UKLA has taken steps in this regard and would welcome the introduction of specific provisions in the Code to further protect minority shareholders where a controlling shareholder seeks to squeeze them out.

- **EU Market Abuse Regulation -** The new EU Market Abuse Regulation, which comes into force in July 2016, may have an impact on the ability of bidders to take action in advance of a bid, such as stake building, and of target directors to give irrevocable undertakings to accept an offer.

- **"Fence Sitter" protection –** We would welcome provisions in the Takeover Code that require a bidder to give notice to target shareholders before it can close an offer. Targets can seek a provision to this effect in a Bid Conduct Agreement but we believe it would be advantageous to all target shareholders if it were a requirement of the Code itself.

- **Communications relating to bids –** Methods of communication have changed dramatically in recent years with the wide spread use of social media and, while it is clear that the Principles of the Code apply to all forms of communication, we would welcome an update to reflect the change in the nature of communications. Target companies often find themselves disadvantaged in comparison to shareholder and investor commentary through social media.

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