SEEKING CLOSURE: HOW TO MINIMISE DEAL DISRUPTION

08 November 2019 | London
Legal Briefings – By **Antonia Kirkby, Caroline Rae and Gavin Davies**

Mergers and acquisitions are increasingly taking longer to close. This is due in large part to the rapid rise in the number of antitrust regimes around the world and the increased willingness of antitrust regulators to intervene in transactions. Protracted deal timetables also mean that a transaction is at greater risk of intervention by an interloper.

Mergers and acquisitions (M&A) are increasingly taking longer to close. This is due in large part to the rapid rise in the number of antitrust regimes around the world and the increased willingness of antitrust regulators to intervene in transactions. Add to that the global trend for political intervention in transactions that do, or have the potential to, raise national interest concerns, and more willingness on the part of shareholders to take a stance that is at odds with their company's board recommendation, and the result is a significant increase in obstacles to deals closing. Protracted deal timetables also mean that a transaction is at greater risk of intervention by an interloper.

However, companies and their advisers can take steps to minimise the risk of a deal collapsing. The first and most important aspect of a successful transaction is preparation. Parties need to anticipate where obstacles may arise and plan early on how to prevent, or at least minimise the risk of, those obstacles causing the transaction to fail. Traditionally, the focus was on getting to the point of signing; now it is just as important to plan for the period between signing and closing.

ANTITRUST CONCERNS

The preparatory steps on any transaction should start with identifying the jurisdictions in which antitrust filings may be required and, of those, where competition concerns could arise. The next stage is to establish the process and timeframe for getting clearance in the relevant jurisdictions. This is likely to be the key driver for the transaction timetable; for example, the takeover of Lonmin plc by Sibanye Stillwater was first announced in December 2017 but the antitrust process in South Africa and challenges to the initial ruling caused significant delay to the deal timetable, meaning that the transaction did not close until June 2019.

Early dialogue with regulators is critical and collating relevant information early on will help engagement and preparation with the filings. Most competition authorities now routinely request internal documents covering the transaction rationale and process, so it is vital that these are drafted with care from the outset. It is also important to bear in mind that regulators liaise with each other, so all submissions and filings should be consistent.

Where there are likely to be antitrust issues, parties and their advisers should consider and identify what remedies they are prepared to offer in order to smooth the path to clearance. Sellers in a competitive process should take into account any regulatory risk associated with each potential buyer when choosing their preferred bidder. They may also seek a “hell or high water” requirement in the share purchase documents that obliges the buyer to undertake any steps, including divestitures, required to obtain antitrust or other regulatory approval. However, these remain relatively unusual.

POLITICAL INTERVENTION

Around the world there is increased powers for governments to intervene, most notably with the Committee for Foreign Investments in the US, whose powers were expanded in 2018. Governments are also taking a broad interpretation of national security, which often includes critical infrastructure, communications assets and advanced technology (*see News brief “Mergers and national security: a sea change in scrutiny”*) (*see box “UK national security interventions”*).

Assessing the risk of government intervention is likely to be harder than assessing anti-trust risk as the regimes tend to be less transparent. However, parties should analyse whether there is a risk of intervention and how to minimise the chance of a deal being blocked. In the UK, for example, on a public M&A transaction the bidder could consider offering post-offer undertakings (POUs) under the Takeover Code (the Code) or direct undertakings to the Secretary of State, both of which were given on the Melrose bid for GKN in 2018. It is important to note that agreeing a POU may take longer than parties anticipate and ensuring that undertakings are precise, specific and measurable will assist in getting the POUs agreed.

CONDITIONS TO CLOSING

Parties should consider which jurisdictions are key when getting clearance for a transaction and whether it is possible to close a transaction before clearance is given, or any waiting period has elapsed, in any relevant jurisdiction. The conditions to any M&A transaction must then reflect those key jurisdictions and restrictions. It may be possible to minimise the impact on a transaction by, for example, delaying completion in jurisdictions where clearance is not key but completion cannot take place without clearance having been given.

On a public M&A transaction in the UK, while it is market standard to include conditions relating to clearance in multiple jurisdictions, such as China, Brazil, and the US, the Takeover Panel (the Panel) only permits those conditions to be invoked if they are of material significance to the bidder in the context of the offer (Panel Practice Statement No 5). Only conditions relating to clearance in the UK by the Competition and Markets Authority (CMA) or under the EU Merger Regulation (109/2004/EC) do not have to meet that higher threshold before they can be invoked.

BREAK FEES

On a private M&A transaction, a party could consider asking for a break fee that becomes payable if, for example, the directors decide not to recommend the transaction to shareholders. A break fee encourages directors to ensure that the transaction proceeds, although their directors' duties must be able to override any agreement to recommend, and also acts as a deterrent to other interlopers. Break fees are not, however, particularly common in private M&A.

In public M&A, break fees are generally prohibited by Rule 21.2 of the Code (offer-related arrangements) except in limited circumstances, such as on a formal sale process. However, more reverse break fees are now being agreed, where the bidder agrees to pay the target an agreed sum if the deal fails to proceed in specified situations, such as the board changing its recommendation. Examples include the offer for Greene King by CK Asset Holdings in 2019 and the offer for Shire by Abbvie in 2014, where Abbvie paid Shire $1.635 billion following the withdrawal of Abbvie board's recommendation of the acquisition.

Whether parties agree a break fee or reverse break fee will, in large part, come down to the relative strength of each party and any competitive tension, as well as any regulatory restrictions. Even if agreed in principle, the quantum and circumstances in which it becomes payable will require careful negotiation. In some instances the quantum may effectively be capped in any event; for example, the rules on break fees in Listing Rule 10 and Panel Practice Statement No 29 may require the break fee to be capped at 1% of the transaction value.

SHAREHOLDERS

Boards have historically been used to shareholders generally following their recommendations. With the rise of shareholder activism, however, there has been an increase in shareholders willing to take a divergent view. Where a transaction requires shareholder approval, it is important to sound out shareholders to ensure that they will support the transaction. When doing so, if the company is subject to the Market Abuse Regulation (596/2014/EU) (MAR) and the transaction is price-sensitive, the company must bear in mind its obligations under MAR not to unlawfully disclose inside information.

The sounding out of shareholders in those circumstances will likely be "in the normal exercise of an employment, profession or duties" and so permissible but companies should ensure that the shareholder is aware that it is in possession of price-sensitive information and should not deal in the company's securities (Article 10(1), MAR). Shareholders must also owe a duty of confidentiality to the company. The market sounding regime under Article 11 of MAR provides a safe harbour from the offence of unlawful disclosure of inside information on a takeover or equity issue, provided that the detailed requirements for a market sounding are followed. However, it is a voluntary regime and subject to the obligation under Article 11(3) of MAR, which must be complied with in all cases; that is, the disclosing market participant must consider in advance whether the sounding will involve the disclosure of inside information and make a written record of its conclusions and the reasons for those conclusions.

As well as sounding out shareholders, parties should consider obtaining irrevocable undertakings from shareholders to vote in favour of a transaction or accept a takeover offer. The duration of the undertaking and any carve-out to it should be considered carefully. It is also important to ensure that the entity giving the undertaking is actually in a position to secure the necessary vote in favour, either because it is the legal registered shareholder or because the custodian arrangements in respect of the shares allow the giver of the irrevocable undertaking to give directions as to how the shares should be voted. If a shareholder is unwilling to give an irrevocable undertaking, it may be worth considering a letter of intent as an alternative. While not legally binding, this may help to signal to the market that the deal terms are acceptable to the shareholder.

Where a party is required to obtain shareholder approval for a transaction, such as for a class one transaction under Chapter 10 of the Listing Rules, the counterparty should consider what protection it can build in to a share purchase agreement to minimise the risk of shareholder approval not being obtained. This could include ensuring that, as much preparation of the circular is done as soon as possible, imposing a reasonable endeavours obligation on the listed company to obtain shareholder approval and requiring the company to seek shareholder approval as early as possible in the transaction timetable, even if there is likely to be a protracted antitrust process. It is also important to bear in mind that the directors must not fetter their discretion, so any agreement to recommend the deal to shareholders should have a carve-out to allow them to change their mind if they believe the transaction will no longer promote the success of the company.

BUSINESS CONDUCT PROVISIONS

Whenever there is a gap between signing and completion, a buyer should ensure that the share purchase agreement sets out the parameters within which the business should be run during that period. These business conduct provisions may, for example, limit the amount of capital expenditure during that period or prevent the sellers from entering into material contracts without the buyer's consent. It is important to ensure that these provisions do not give rise to any competition law concerns such as "gun-jumping". Competition authorities have recently shown themselves more willing to impose fines for overstepping the mark in this interim period. In September 2019, Paypal was fined £250,000 by the CMA in the context of its acquisition of iZettle for breaching an interim enforcement order designed to prevent further integration pending the outcome of the CMA's investigation (see News brief "Gun-jumping fine: PayPal pays the price for botched marketing campaign", this issue).

On public M&A, it is standard to include conditions relating to the target business but it is unlikely that the Panel would allow these to be invoked (see "Conditions to closing" above). Where the bidder is offering shares as consideration under the offer, it is not unusual to see offeree protection conditions that give the target and its shareholders some comfort that the bidder's business will not change dramatically pending completion of the offer. For example, the bid for Just Eat by Takeaway.com included conditions relating to the state of the bidder's business and finances.

UK NATIONAL SECURITY INTERVENTIONS

In the UK, there have been four intervention notices on national security grounds in the past three years:

- The 2019 bids for Cobham and Inmarsat, where the decisions are still pending.
- The 2018 acquisition of Northern Aerospace by Gardner Aerospace, which was cleared unconditionally.
- The 2017 takeover of Sepura by Hytera, which proceeded with undertakings to address the national security concerns.

This article was first published on 24 October 2019 in PLC Magazine (uk.practicallaw.thomsonreuters.com)

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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