HERBERT SMITH FREEHILLS

WARRANTY PROTECTION IN PUBLIC M&A DEALS

31 October 2017 | Australia
Legal Briefings – By **Tony Damian and Lauren Wright**

The structural flexibility of schemes of arrangement can allow for the type of warranties that are generally given in a private M&A transaction to be provided in favour of the purchaser in a public M&A context, as evidenced by the recent UK scheme for the acquisition of Hargreave Hale Limited. That deal also demonstrated how W&I insurance can be used in public M&A deals, in that case, alongside a holdback structure.

IN BRIEF

- The Hargreave Hale Limited scheme of arrangement provided private M&A style warranties and indemnities to the purchaser in a public M&A deal. It utilised a combination of a holdback structure and W&I insurance to do so.
- Holdback structures to facilitate warranties in a public M&A deal have precedent in Australia that traces back to the Cashcard Australia scheme of arrangement and which has been followed in subsequent deals..
- A number of Australian public M&A deals have also used W&I insurance to achieve warranty coverage for purchasers in a public M&A context.
- Other ways of dealing with unknown matters in public M&A deals include the use of contingent consideration notes.

BACKGROUND

Incorporating warranties in a public M&A context requires a degree of novelty since, unlike in a private treaty M&A transaction, there is generally no natural and continuing vendor to pay claims, to defend warranty claims or to pay for the costs in contesting those claims.

However, the structural flexibility of a scheme of arrangement provides scope to do so, as evidenced by the recent UK acquisition by Canaccord Genuity Wealth Group Holdings (Jersey) Ltd (**Canaccord**) of Hargreave Hale Limited (**Hargreave Hale**).

WARRANTIES GIVEN IN HARGREAVE HALE

In the Hargreave Hale scheme, there was W&I insurance, but that insurance was coupled with liability of certain directors of Hargreave Hale (the **Warrantors**) for the deductible for claims under the W&I insurance and holdbacks under the scheme so that an amount of additional liability was to be met by funds otherwise payable to the Warrantors in their capacity as shareholders of Hargreave Hale. Collectively, the Warrantors were to receive up to approximately £23,837,646 of the £77,806,693 total cash consideration potentially payable to all Hargreave Hale shareholders on a pro rata and fully diluted basis for the entire issued and to be issued share capital of the company.

A warranty deed was entered into between the Warrantors and Canaccord (**Warranty Deed**). The Warranty Deed provided what was described in the explanatory statement as a market standard suite of warranties and certain indemnities (including a tax indemnity) in favour of Canaccord. By operation of the scheme, the directors of Hargreave Hale were empowered to execute a deed of accession on behalf of any Hargreave Hale shareholder that was not a party to the Warranty Deed as attorney or agent or otherwise to ensure that each Hargreave Hale shareholder was bound by the terms of the Warranty Deed.

In the event of any claim under the warranties, the scheme provided that the first £250,000 was to be met by the Warrantors. This amount represented the deductible on a warranty and indemnity policy with a maximum limit of £30,000,000 that was taken out by Canaccord (and the cost of which was borne by the Hargreave Hale shareholders) (**W&I Policy**).

Where the value of a claim exceeded £250,000, Canaccord would be required to seek cover under the W&I Policy in the first instance and failing that would retain the right to pursue the Warrantors, up to the aggregate maximum liability of the Warrantors, which was capped at £10,000,000 for all claims and breaches of the warranties and indemnities. The Warrantors' liability would be offset against any staged consideration payable by Canaccord to the Warrantors.

AUSTRALIAN PRECEDENT SET IN CASHCARD

The acquisition of Cashcard by First Data for cash consideration some years ago was a novel transaction that incorporated several structural elements routinely found in private treaty M&A transactions, despite the fact that Cashcard was an unlisted public company.

The warranties and indemnities were given effect by having consideration payable in many parts, as follows:

- *Floor Payment:* AU$228 million, which was payable in all circumstances to shareholders (unless a shareholder had defective title to the relevant shares);
- *First Adjustment Amount:* AU$15 million, which was paid into an escrow account at implementation and payable to shareholders 6 months after implementation, subject to (among other things) reductions from any warranty-style claims;
- *Second Adjustment Amount:* AU$11 million, which was also paid into an escrow account at implementation and subject to (among other things) reductions from any warranty-style claims;
- *Costs Amount:* AU$1 million, which was paid into an account controlled by the "Specified Persons" and set aside to assist the Specified Persons to consider and challenge proposed downward adjustments from First Data; and
- *Specified Persons Amount:* AU$4 million, paid into an escrow account at implementation and payable to 4 executives of Cashcard subject to (among other things) reductions from any warranty-style claims.

In terms of the order of priority, amounts from claims for, among other things, reductions from any warranty-style claims would first be taken from the Specified Persons Amount, then the First Adjustment Amount and finally the Second Adjustment Amount.

Structures similar to that in Cashcard were adopted in the subsequent acquisition of RuleBurst Holdings Ltd by Oracle Corporation and the acquisition of Ebooks Corporation Limited by ProQuest LLC.

These two deals did not utilise W&I insurance.

THE RISE OF WARRANTY AND INDEMNITY INSURANCE IN PUBLIC M&A

The adoption of warranty and indemnity insurance has occured in a number of recent Australian public M&A takeovers and schemes, including:

- the acquisition of Sinclair Knight Merz Group by Jacobs Engineering Group;

- ARC and Dakang’s joint takeover bid for S. Kidman and Co in 2016;
- the scheme of arrangement in relation to RV Parks in 2016;
- the scheme of arrangement in relation to Staging Connections Group in 2015; and
- WorleyParson’s takeover bid for Evans & Peck in 2009.

As evidenced in Hargreave Hale, warranty and indemnity insurance can work in conjunction with a bespoke deal structure to provide private M&A style warranties in a public M&A context.

OTHER STRUCTURES

Contingent consideration can also have a role to play in public M&A deals in relation to an unknown issue for which the value outcome is unknown at the time of announcement. By way of example, in the Sportingbet / Centrebet scheme, target shareholders received AU$2.00 cash per share as well as a “Litigation Claim Right” and a “Litigation Claim Unit” that conferred economic upside in the event a AU$90 million dispute with the ATO over GST provided a positive outcome for Centrebet (which, in a postscript that shows that sometimes structuring complex instruments is worth the effort, it did).

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

TONY DAMIAN
PARTNER, SYDNEY

+61 2 9225 5784
Tony.Damian@hsf.com

LEGAL NOTICE