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Panel approach on flex disclosure

Of all of the provisions in syndicated lending commitment documents, the right of the arrangers to "flex" the terms of a committed financing in order to meet their minimum hold – by, for instance, increasing its pricing – is one of the most important. It is also one of the most sensitive. Publicly-disclosed flex arrangements would distort the primary trading market in favour of debt purchasers. Consequently, flex provisions are not disclosed to potential syndicate members. In the context of UK public takeovers, however, that approach is no longer possible.

By and large, prospective purchasers of UK-listed public companies must comply with the City Code on Takeovers and Mergers, which was revised with effect from 19 September, 2011 (the "**Code**", administered by the "**Panel**"). Prior to the September revisions, the Code required financing arrangements to be summarised in the offer document and financing documents put on display only in some circumstances. In contrast, the Code now requires that the offer document contains such information as is necessary to allow the reader to effect an analysis of the balance sheet and debt of the combined group following the takeover and that all documents relating to financing arrangements are put on display on a website without redaction. Specifically relevant to the disclosure of flex terms, new rules in the Code require that:

- 'details of interest rates including any '"step up" or other variation provided for' are set out in the description of how the offer is to be financed in the offer document (*Rule 24.3(f)*); and
- 'any documents relating to the financing of the offer' are published on a website (*Rule 26.1(b)*).

The terms of any flex arrangements would appear to sit within these new rules, and the Panel has taken the view that it does. It is noteworthy, however, that the Panel did accept that "headroom" – where financing was obtained in a maximum amount exceeding the offer price – need not be disclosed.

Several reasons could be offered for the changes to the Code, which could be explained, for example, in terms of protecting a broader range of stakeholders in target companies, many of whom, such as employees, may have an ongoing interest in the potential financing costs of the business. In addition, recent high-profile takeovers of British companies by overseas purchasers have done little to generate appetite within the UK for easier takeovers; perhaps, at present, there is little motivation to facilitate the process? In any event, the revised Code appears clear, and, in the current environment, one should not expect concessions to be available.

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One way or another, the new rules may lead to the pricing and flex arrangements applicable to UK public acquisitions being different to the arrangements in non-public UK deals and, indeed, in non-UK transactions. In all likelihood the disclosure of flex will lead to an increased cost of funding, as potential lenders will be on notice of the maximum amount of interest that the purchaser is willing - potentially obliged - to pay, which will unsettle the typical market forces that determine pricing of syndicated loans. It may become difficult to avoid flexing the terms of a transaction right up to the agreed maximum. Alternatively, banks may agree to forego a flex right altogether, in exchange for higher initial pricing. That initial pricing may need to be much higher – potentially as high as the "flexed" price would otherwise have been – and sponsors may expect a robust "reverse flex" right to be in place. A further alternative may be for buyers to finance their acquisitions with 100% equity and subsequently refinance with debt; that solution, however, may well need discussing with the Panel in each relevant situation – and especially where the refinancing is contemplated, let alone documented, at the time of the acquisition.

Since the credit crisis, there have not been a large number of UK public bids financed by syndicated debt facilities (one such transaction is Colfax Corporation's bid for Charter International plc, in relation to which White & Case LLP acted for Deutsche Bank AG New York Branch, Deutsche Bank Securities Inc. and HSBC Securities (USA) Inc). In the future, if revived credit markets give rise to a renewed desire to finance public offers in the syndicated debt market, market participants may find that the new rules necessitate a new approach to flex disclosure and possibly, therefore, to pricing and structuring.