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Five factors for lenders to consider in connection with a P2P

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Authors: Shane McDonald, Jeremy Duffy, Philip Broke, Samantha Richardson

Although acquisition activity in the European leveraged finance market has been on an upward trajectory since 2012, 2018 saw a substantial increase in buyout activity, which reached €57.6 billion in total, marking a return to issuance levels not seen since before the financial crisis. This dominance of M&A has continued into this year and has been particularly noteworthy because of a marked change in the type of activity being undertaken by sponsors. Instead of the all-too-familiar secondary and tertiary buyouts, PE houses have been turning their attention to finding new targets, resulting in a significant increase in corporate carve-outs and public-to-privates ("**P2Ps**") in 1Q19.

Whereas until a few years ago sponsors, were reluctant to pursue P2Ps because they were viewed as overly complicated and highly regulated, the success of recent big ticket take-private deals has eased concerns and led to increased interest. In 1Q19, public-to-private deals accounted for approximately 11 per cent. of all M&A activity in Europe, up from six per cent. in 2018, and, with several such deals already featuring in the forward calendar, many market participants are optimistic that this trend will continue.

Added to this more optimistic attitude towards take-private deals, some believe that UK plcs could increasingly find themselves the target of takeover offers as sponsors take advantage of some of the side effects of Brexit uncertainty, such as a fall in the value of sterling and depressed share prices.

In view of the expected uptick in take-private deals, this article examines some of the issues that face lenders providing financing on public-to-private deals, with a particular focus on compliance with the UK Takeover Code (the "**Code**").

1. Cash Confirmation and Certain Funds

The UK Takeover Panel (the "**Panel**") requires a bidder to announce a bid only after ensuring that it has sufficient resources to complete an offer. Where cash consideration is tendered, the Panel requires a financial adviser to provide a "cash confirmation", setting out that sufficient cash is available to satisfy full acceptance of the offer for the offer period. In connection with such cash confirmation, the financial adviser will require that any debt financing needed for the acquisition is made available on a "certain funds" basis, meaning that it must not be subject to any financing condition outside of the bidder's control, other than regulatory clearances.

In addition, because of the obligation to have "cash certainty" during an offer period, the certain funds regime requires that many of the drawstops under a debt financing, which, if triggered, would mean the lenders could refuse to fund, are disapplied. The effect of this is that arranging banks will have limited ability to cancel or terminate the facility during the "certain funds period". Many of the lenders' other rights, remedies and entitlements, such as the right to accelerate any drawn loans following an event of default, are also suspended during the certain funds period. These rights, remedies and entitlements are not waived, but will only become exercisable upon the expiry of the "certain funds period".

Typically, arranging banks will be required to fund under a certain funds regime, *provided that* the financing conditions are met, no "change of control" has occurred, it is not unlawful for the arranging

banks to fund, the "major representations" are accurate in all material respects and no "major default" is continuing. Generally speaking, "change of control", "major representations" and "major defaults" concern matters which are either within the control of the bidder or its parent or relate to matters, such as insolvency of the bidder, where the financial adviser providing the cash confirmation has performed sufficient due diligence on the bidder to be comfortable that such an event will not occur. These "major representations" and "major defaults" are typically limited to the bidder and do not apply to the target group, reflecting the commercial reality that the bidder is not yet in control of the target group.

The length of the "certain funds period" varies between transactions but should always contain a longstop date and end upon the earliest to occur of certain milestone events, which are generally determined by the requirements prescribed in the Code. In the UK, we would typically expect a certain funds longstop of approximately six months.

2. **Limited Due Diligence**

In public M&A transactions, the amount of due diligence information available on the target company will be dependent upon whether the bid is recommended or hostile. Where the bid is hostile, diligence information will typically be limited to information which is public. In a recommended deal, additional information on the target may be made available; however, it is unlikely to be as fulsome as that usually made available in a private M&A transaction. The rationale behind this is that the Code requires equality of information to all *bona fide* potential bidders, no matter how unwelcome.

This means that arranging banks will need to get comfortable with limited target due diligence if they wish to participate in P2P transactions.

3. **Highly Regulated – Potentially Longer Timetable and Syndication Restrictions**

Syndication of P2P transactions often happens later than in private acquisitions and a number of factors contribute to the delay: (i) limited due diligence makes it difficult for arrangers to prepare an information memorandum or provide sufficient quality information on the target group to potential lenders prior to the bidder gaining control of the target: (ii) until the bid is declared unconditional, the target board is unlikely to co-operate in giving customary presentations to potential lenders required in connection with syndication; and (iii) the bidder will want to keep the number of people who know about the offer to a minimum. In the UK, there are tight restrictions on the number of parties who may be approached prior to an initial announcement. The "rule of six" requires that the Panel be consulted prior to more than six parties in total being approached in relation to a potential offer.

Additional issues can also arise if potential syndicate members hold shares in the listed target. In the UK, the Panel requires that information and opinions relating to an offer or a party to an offer must be made equally available to all of the target's shareholders. In the context of a recommended bid, this could result in a potential syndicate member receiving information not available to the other target shareholders (or the public at large).

Restrictions may also arise around special deals with favourable conditions. The Code restricts a bidder from making any arrangements with a target shareholder if there are favourable conditions attached which are not being offered to all shareholders. Issues arise if lender-friendly debt terms provide additional value to a potential syndicate member via its shareholding in the target.

Generally, issues relating to a potential syndicate member with a shareholding in the target can be addressed by either (i) obtaining an undertaking from the potential syndicate member that it, any member of its worldwide group will not hold any target shares during the offer period, or (ii) ensuring that required information barriers are in place between its debt and equity departments.

4. **Disclosure Requirements**

Careful consideration also needs to be given to the disclosure requirements pertaining to the offer. In the UK, all financing documents must be published on a website no later than 12 noon on the business day after a bidder announces a firm intention to make an offer. This includes the primary financing documents and any supplemental financing documents, including syndication and fee letters, which contain details of financing fees and flex terms. No redaction of the primary financing documents is permitted. The implication of such disclosure is that loan market participants and bond

investors will have full knowledge of a lender's economics and backstop positions when they are approached during syndication or bookbuilding. As a result of the sensitivities around the disclosure of flex terms for the purposes of syndication, the Panel has granted several dispensations to allow flex terms to be disclosed and displayed at the time of offer or lodgement of the scheme document rather than at the announcement stage.

Given the restrictions around the "rule of six" and its impact on syndication prior to an initial announcement, if the arranging banks do not want flex terms to be disclosed prior to syndication, they will need to obtain a dispensation from the Panel. In practice, many arranging banks elect to forego flex altogether on P2P transactions in light of higher initial pricing of the margin.

5. **Security Timing Issues – Financial Assistance**

P2P transactions can potentially give rise to financial assistance issues. In the UK, public companies are generally prohibited from giving direct or indirect financial assistance for the acquisition of their shares or for reducing or discharging any liability incurred in connection with such P2P acquisitions. Public companies may re-register as private companies in order to facilitate the provision of financial assistance; however, the financial assistance cannot be provided until re-registration has occurred.

Generally speaking, lenders supporting a UK P2P will prefer the acquisition to be implemented by way of a court-approved Scheme of Arrangement (a "**Scheme**"). A Scheme is favourable because a public company can be re-registered as a private company on the same day that the transaction is sanctioned pursuant to a Scheme and, in theory, target level security can be granted at closing.

In contrast, with an offer scenario, there will be a delay before full security over the target can be granted. Whilst arranging banks will typically be able to obtain security over the bidco assets on day one and shortly thereafter obtain limited target level security in respect of non-acquisition debt, full security over target assets cannot be granted until the target has been re-registered as a private company. This is dependent upon a number of circumstances and in certain instances may take as long as six months before target security is granted.

It remains to be seen whether the anticipated wave of P2Ps will actually materialise in 2019, but if it does, it is clear that having an adviser expert in the Takeover Code is a must for all arranging banks involved. In a takeover scenario, the regulatory requirements demanded of the bidder will often be the main focus of attention, but it is essential that arranging banks are equally prepared for the additional intricacies this type of deal presents.

EMEA leveraged finance partners

Jill Concannon ●
Partner, London
T +44 20 7532 1534
E jconcannon@whitecase.com

Lee Cullinane ■
Partner, London
T +44 20 7532 1409
E lcullinane@whitecase.com

Christopher Czarnocki ■
Partner, London
T +44 20 7532 1201
E cczarnocki@whitecase.com

Jeremy Duffy ■
Partner, London
T +44 20 7532 1237
E jduffy@whitecase.com

Gareth Eagles ■ ●
Partner, London
T +44 20 7532 1251
E geagles@whitecase.com

Jacqueline Evans ■
Partner, London
T +44 20 7532 1404
E jevans@whitecase.com

Martin Forbes ■
Partner, London
T +44 20 7532 1229
E martin.forbes@whitecase.com

Emma Foster ■
Partner, London
T +44 20 7532 1299
E efoster@whitecase.com

James Greene ■ ●
Partner, London
T +44 20 7532 1439
E jgreene@whitecase.com

James Hardy ■
Partner, London
T +44 20 7532 2728
E james.hardy@whitecase.com

Colin Harley ■
Partner, London
T +44 20 7532 1200
E colin.harley@whitecase.com

Richard Lloyd ■
Partner, London
T +44 20 7532 1247
E richard.lloyd@whitecase.com

Shane McDonald ■
Partner, London
T +44 20 7532 2698
E shane.mcdonald@whitecase.com

Jeffrey Rubinoff ■
Partner, London
T +44 20 7532 2514
E jeffrey.rubinoff@whitecase.com

Shameer Shah ■
Partner, London
T +44 20 7532 1215
E shameer.shah@whitecase.com

Justin Wagstaff ●
Partner, New York
T +1 212 819 2694
E jwagstaff@whitecase.com

Ben Wilkinson ■
Partner, London
T +44 20 7532 1276
E ben.wilkinson@whitecase.com

Thierry Bosly
Partner, Brussels
T +32 2 239 25 09
E tbosly @whitecase.com

Hadrien Servais ●
Local Partner, Brussels
T +32 2 239 2544
E hadrien.servais@whitecase.com

Claire Matheson Kirton ■
Partner, Dubai
T +971 4 381 6218
E cmathesonkirton@whitecase.com

Rebecca Emory ●
Partner, Frankfurt
T +49 69 29994 1432
E rebecca.emory@whitecase.com

Thomas Flatten
Partner, Frankfurt
T +49 69 29994 1233
E tflatten@whitecase.com

Gilles Teerlinck ■ ●
Partner, London
T +44 20 7532 2232
E gilles.teerlinck@whitecase.com

Florian Degenhardt
Partner, Hamburg
T +49 40 35005 298
E fdegenhardt@whitecase.com

Vanessa Schuermann ■
Partner, Frankfurt
T +49 69 29994 1431
E vanessa.schuermann@whitecase.com

Gernot W. Wagner ●
Partner, Frankfurt
T +49 69 29994 1430
E gernot.wagner@whitecase.com

Florian Ziegler
Partner, Frankfurt
T +49 69 29994 1575
E florian.ziegler@whitecase.com

Tanja Törnkvist
Partner, Helsinki
T +358 9 228 64 351
E ttornkvist@whitecase.com

Güniz Gökçe
Partner, Istanbul
T +90 212 355 1311
E guniz.gokce@gkcpartners.com

Yoko Takagi
Partner, Madrid
T +34 91 7876 320
E yoko.takagi@whitecase.com

Iacopo Canino
Partner, Milan
T +39 020 068 8340
E iacopo.canino@whitecase.com

Gianluca Fanti
Partner, Milan
T +39 02 00688 390
E gianluca.fanti@whitecase.com

Michael Immordino ●
Partner, London
T +44 20 7532 1399
E michael,immordino@whitecase.com

Alessandro Nolet ■
Partner, Milan
T +39 020 068 8420
E alessandro.nolet@whitecase.com

Natalia Nikitina
Partner, Moscow
T +7 495 787 3027
E nnikitina@whitecase.com

Samir Berlat
Partner, Paris
T +33 1 5504 1551
E samir.berlat@whitecase.com

Colin Chang ●
Partner, Paris
T +33 1 5504 5815
E cchang@whitecase.com

Denise Diallo ●
Partner, Paris
T +33 1 5504 1518
E ddiallo@whitecase.com

Tomáš Jíně ■
Partner, Prague
T +420 255 771 233
E tomas.jine@whitecase.com

Jan Linda
Partner, Prague
T +420 255 771 271
E jlinda@whitecase.com

David Plch
Partner, Prague
T +420 255 771 298
E dplch@whitecase.com

Jonathan Weinberg ■
Partner, Prague
T +420 255 771 262
E jweinberg@whitecase.com

Oscar Liljeson
Partner, Stockholm
T +46 8 506 32 379
E oscar.liljeson@whitecase.com

Carl Hugo Parment
Partner, Stockholm
T +46 8 506 32 341
E carlhugo.parment@whitecase.com

Magnus Wennerhorn
Partner, Stockholm
T +46 8 506 32 370
E magnus.wennerhorn@whitecase.com

Nicholas Coddington ■
Local Partner, Warsaw
T +48 22 50 50 160
E ncoddington@whitecase.com

Tomasz Ostrowski ■
Partner, Warsaw
T +48 22 50 50 123
E tostrowski@whitecase.com

Monica Holden ●
Partner, London
T +44 20 7532 1483
E mholden@whitecase.com

■ English Qualified ● US Qualified

White & Case LLP
5 Old Broad Street
London EC2N 1DW
United Kingdom

T +44 20 7532 1000

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