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Corporate M&A 2022

UK: Law & Practice
and
UK: Trends & Developments

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UK

Law and Practice

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1. TRENDS

1.1 M&A Market

The M&A market in 2021 has been surprisingly buoyant. The year started off at pace notwithstanding the residual impact of the Delta variant and it remained consistently busy throughout despite some uncertainty. This was in sharp contrast with 2020 when uncertainty lead to inactivity.

1.2 Key Trends

The trends in 2021 followed very closely to 2020 in terms of IT and digital businesses capitalising upon increased demands highlighted by the pandemic. The UK also continues to be a key player on the global M&A stage.

1.3 Key Industries

The IT and digital sectors have continued a surge in transactional activity as the lockdown restrictions placed the spotlight on the skills, resource and technological gaps businesses faced.

2. OVERVIEW OF REGULATORY FIELD

2.1 Acquiring a Company

Private

The acquisition of a private company is dependent on identifying a willing seller. Once you have a willing seller you can acquire a private company in the UK either by way of a share purchase or an asset purchase. Whilst either way will achieve broadly the same commercial objective there are important legal and tax differences between the two structures.

Asset Purchase

This is the purchase of specific assets (and sometimes) liabilities which comprise the business. The parties will negotiate and agree which assets are being acquired and those which will remain in the selling company. In this way the buyer does not acquire the limited company itself, but instead it buys certain elements which make up the business (eg, business records, equipment, stock, goodwill, the business contracts, intellectual property). This has the advantage for the buyer in that it can be selective with what is included within the purchase and the buyer can exclude any assets/liabilities which it considers problematic. Various consents and approvals may need to be sought in order to transfer the agreed assets. With an asset sale the funds will be paid directly to the limited company with limited involvement from the company's shareholders as opposed to a share sale which involves direct payment to the shareholders.

The transfer of assets involves tax considerations such as VAT, transfers of going concern, Stamp Duty Land Tax, deductions of acquisitions cost and corporation tax. Asset purchases are also likely to fall under the scope of Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246) (TUPE), which provides for certain employee protections as part of the transfer of assets.

An asset purchase is usually effected by entering into a business purchase agreement which will cover:

- provisions identifying which assets are included and excluded from the sale;
- limited warranties;
- apportionment of liabilities and obligations between the buyer and seller in relation to the assets being transferred; and
- restrictive covenants.

Tangible assets are delivered to the buyer and intangible assets are formally assigned in a deed.

Share Purchase

This is where the shares in the limited company are purchased such that ownership of the assets and business will remain within the limited company but the overall ownership of that company is transferred. As the trading entity does not change business continuity is preserved. The transfer is "warts and all" meaning that the buyer as the new shareholder of the company will take over all assets and liabilities. This presents a significant risk to any buyer making the due diligence process all the more important.

A share purchase is effected by entering into a share purchase agreement with the following provisions:

- warranties;
- indemnities;
- tax covenant; and
- restrictive covenants.

On completion of the share purchase agreement a stock transfer form will be executed by the seller and new share certificates issued to the buyer.

Public

Public companies are acquired through the purchase of all or a substantial part of the shareholding. This can happen in two ways, namely recommended (ie, with approval of the target board) or hostile where the management team has publicly advised the shareholders to reject the offer to prevent the takeover.

A takeover can be effected in two ways.

- A contractual takeover offer whereby the bidder makes an offer to the target shareholders which is subsequently accepted by over 50% of the voting shares. If 90% of the voting shares accept the offer the buyer may be able to acquire the remaining shares from the minority. This method is more flexible than a scheme (see below) and can be implemented in a shorter period of time.
- A scheme of arrangement whereby 75% of the voting shares agree to the take over which is also approved by the High Court. In these circumstances all of the shareholders will be bound. This method will generally be used to implement recommended bids and is a more efficient way of acquiring 100% control of the target company.

2.2 Primary Regulators

UK City Code on Takeovers and Mergers

The EU Takeover directive was implemented in the UK under the terms of part 28 of the Companies Act 2006 and within the City Code on Takeovers and Mergers (the "Code"). The Code provides the framework for public company takeovers in the UK and its objectives include ensuring that target shareholders are treated fairly and not denied the opportunity to consider the merits of a bid, and that they are afforded equivalent treatment by a bidder.

The Code is administered by the Panel on Takeovers and Mergers (the "Panel") which has full jurisdiction to enforce the Code and place sanctions for non-compliance. The Panel regulates takeover bids and other merger transactions for companies with registered offices in the United Kingdom, the Channel Islands or the Isle of Man if any of their securities are admitted to trading on a regulated market or multilateral trading facility in the United Kingdom or on any stock exchange in the Channel Islands or the Isle of Man. The Panel comprises of 36 members, 12 of whom are appointed by large financial and business organisations.

Other Statutory Restrictions for Takeovers

- Companies Act 2006 – merger relief which prohibits unlawful financial assistance and provisions concerning a public company's

right to investigate who has an interest in its shares;
- Criminal Justice Act 1993 – prohibits insider dealing;
- Financial Services and Markets Act 2000;
- Financial Services Act 2012;
- Market Abuse Regulation (see **4.3 Hurdles to Stakebuilding**);
- Enterprise Act 2002; and
- National Security and Investment Act 2022.

Other Relevant Regulatory Bodies

- Financial Conduct Authority;
- Competition and Markets Authority (CMA);
- the European Commission – has exclusive jurisdiction where transactions concern the EU Merger Regulation (EUMR) which regulates M&A at EU level – see **3.2 Significant Changes to Takeover Law**;
- ministerial departments – may be involved when a transaction is of national interest; and
- specific industries (such as banks) may have their own regulatory body.

2.3 Restrictions on Foreign Investments

Foreign companies are subject only to the same regulations which apply to UK based companies such as the UK merger control regime. Whilst the controls apply equally, intervention may be more likely in the case of foreign investors due to public or national interest.

The National Security and investment Act 2022 (NSI) came into force on 4 January 2022 and introduced a new foreign direct investments regime which replace the EA02 in relation to transactions involving national security concerns. There are 17 sectors which will require mandatory notification and clearance prior to completion of a transaction involving a company carrying out activities in those sectors, which comprise of defence, energy, transport, technology and artificial intelligence (refer to Notifiable Acquisitions Regulations 2021). The trigger events for mandatory notification are:

- the acquisition of more than 25%, more than 50%, or 75% or more of the votes or shares in a qualifying entity; and/or
- the acquisition of voting rights enabling or preventing the passage of any class of resolution governing the affairs of the qualifying entity.

The government has retroactive powers to call for review any qualifying transaction completed between 12 November 2020 and 4 January 2022. It is important to consider the new regime for all transactions completed from 12 November 2020. Notifications should be made to the new Investment Security Unit (ISU). The secretary of state must reach an initial decision within 30 working days.

In respect of non-mandatory notifications (for these entities not in the 17 sectors), consideration would need to be given for a voluntary notification the trigger for which would be the acquisition of “material influence” in a company and the UK Government has the power to call for review transactions 5 years after completion.

See **2.6 National Security Review**.

Competition Law

The UK government can intervene from a competition law perspective for public interest under the UK merger control regime as stipulated in the Enterprise Act 2002 (EA02). The UK government lowered the legislative thresholds (from GBP70 million to GBP1 million) for intervention to protect public interest for targets involved in activities connected with three areas of the economy namely; goods and services with military or dual use, computer hardware technologies and quantum technologies.

In June 2020 the UK government expanded its powers under the Enterprise Act 2002 such that it can intervene in the interest of the public on transactions which could impact the UK Pandemic response. This is not just confined to health response but could include food supply and internet services.

Section 13 of the UK Industry Act 1975 allows the Department for Business, Energy and Industrial Strategy to prohibit an acquisition by a foreign entity of an "important manufacturing undertaking" if there is a perceived risk that change of control would be contrary to the interests of the UK as a whole. These powers were used to consider the acquisition by Gardner Aerospace (a subsidiary of a Chinese aerospace and mining company) of Northern Aerospace in June 2018.

The Economic Crime Bill is also currently being considered by the UK government in relation to transparency with regards to ownership of land in the UK by overseas entities.

2.4 Antitrust Regulations

The Competition and Markets Authority (CMA) undertakes merger control and investigations of mergers based primarily on thresholds including turnover, asset values and market shares. It derives most of its powers from the Enterprise Act 2002 and Competition Act 1998.

Transactions which qualify may be investigated by the CMA in an initial Phase 1 investigation. Where this initial phase determines that the merger could result in the substantial lessening of competition in a market in the UK, the CMA will refer the matter to a Phase 2 investigation.

The Phase 2 investigation may result in a prohibition decision or a decision that the transaction should be allowed to proceed subject to commitments or clearance.

There is no requirement to notify the CMA of a merger prior to implementation, however, a company may want to apply for clearance prior to completion in order to manage any risks.

The secretary of state also has limited powers of intervention if a merger raises a "public interest consideration". These powers relate to specific sectors such as newspaper and media outlets as with the investigation into the Sky-Fox merger.

In July 2021 the UK government launched a consultation (a new pro-competition regime for digital markets) which will increase merger scrutiny especially in relation to large digital companies operating in the UK and also grant the CMA jurisdiction to investigate mergers even if target and acquirer are not competitors where the acquirer has over GBP100 million UK revenue and one party has over 25% share of supply. The UK has also established a dedicated digital markets unit within the CMA to regulate competition and innovation in digital markets.

2.5 Labour Law Regulations

With an asset purchase of a private limited company a buyer must have regard to its obligations under Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). Where a relevant transfer is deemed to have taken place, anyone employed will be transferred to the buyer under their existing terms of employment.

Prior to completion of the purchase various steps must be taken in order to inform and consult with the employees in order to avoid any liability such as:

- under TUPE, any changes in the employees' terms of employment are void if the sole or principal reason for the change is the transfer itself, unless the reason for the variation is permitted under the contract or for an economic, technical or organisational reason; and

- dismissals will be automatically unfair if the sole or principal reason for the dismissal is the transfer, unless that reason is an economic, technical or organisational reason.

In respect of public takeovers, the Code sets out a number of obligations relating to employees. This includes providing the employees the following information:

- any possible offer announcement that commences an offer period;
- the offer announcement;
- the offer document;
- any circular sent to the shareholders containing the board's opinion on the offer;
- any post-offer undertaking made by a party to an offer; and
- any announcement (or document which includes the contents of the announcement) which the Panel determines.

The employees must also be notified of the offeror's intentions with regards to:

- the future business and safeguarding of the jobs of employees and management;
- any material changes in the conditions of employment; and
- strategic plans for the two companies and the likely impact on:
  (a) employment; and
  (b) places of business.

2.6 National Security Review

The National Security and Investment Act 2022 (NSI) came into force on 4 January 2022 and introduced a new foreign direct investments regime which replace the EA02 in relation to transactions involving national security concerns.

There is a significant increase in the types of transactions covered by such that it is not confined to M&A but includes minority investments, acquisitions of assets including property and IP. There are 17 sectors which will require mandatory notification and clearance prior to completion of a transaction involving a company carrying out activities in those sectors, which comprise of defence, energy, transport, technology and artificial intelligence (see the Notifiable Acquisitions Regulations 2021). The trigger events for mandatory notification are:

- the acquisition of more than 25%, more than 50%, or 75% or more of the votes or shares in a qualifying entity; and/or
- the acquisition of voting rights enabling or preventing the passage of any class of resolution governing the affairs of the qualifying entity.

The Government has retroactive powers to call for review any qualifying transaction completed between 12 November 2020 and 4 January 2022. It is therefore important to consider the new regime for all transactions completed from 12 November 2020. Notifications should be made to the new Investment Security Unit (ISU). The secretary of state must reach an initial decision within 30 working days.

Failure to comply may result in significant sanctions including turnover-based fines, criminal liability and transactions being void.

3. RECENT LEGAL DEVELOPMENTS

3.1 Significant Court Decisions or Legal Developments

Rock Advertising v MWB Business Exchange Centres Ltd [2018] UKSC 24

The Supreme Court decided that a variation clause in a contract which required any subsequent variation to be in writing meant that an oral agreement to vary was void.

Chudley and others v Clydesdale Bank Plc [2019] EWCA Civ 344
The Court of Appeal confirmed the rebuttable presumption that there is a third-party right where a contractual term confers a benefit on a third party pursuant to the UK Contracts (Rights of Third Parties) Act 1999.

Guest Services Worldwide v Shelmerdine [2020] EWCA Civ 85
The Court of Appeal decided a non-competition clause 12 months in duration imposed on employee/shareholders under a Shareholders Agreement was valid and enforceable.

Re System Building Services Group Lt (In Liquidation) [2020] EWHC 54 (Ch)
The Insolvency and Companies Court considered the nature of a director's duties to a company and whether those duties survive the company's entry into an insolvency process. ICCJ Barber held that the "duties owed by a director to the company and its creditors survive the company's entry into administration and voluntary liquidation." The judgment demonstrates the continuing responsibility of directors to protect the interests of the company's creditors even after an office holder has assumed control, the director's duties remain in force and a director should consider the risks associated with subsequent transactions.

Okpabi and Others v Royal Dutch Shell Plc and Another [2021] UKSC 3 – The Supreme Court overturned the Court of Appael judgment and found that there was the question of whether a UK holding company had breached a duty of care to third parties over activities of its subquery in Nigeria, was an arguable case for trial. The judgment reinforces that a parent should ensure regulatory policies are implemented by its subsidiary's operations.

Quantum Actuarial LLP v Quantum Advisory Limited [2021] EWCA Civ 227
The Court of Appeal upheld a High Court decision that the restraint of trade doctrine did not apply to covenants in a service agreement where that agreement formed part of a wider restructuring and joint venture. The decision highlights that the courts are more likely to enforce restrictive covenants in commercial agreement as compared to employment contracts.

Re Euro Accessories limited [2021] EWHC 47 (Ch)
The High Court decided that a "fair value" buyout provision in a private company's article of association meant that a majority shareholder could apply a discount when valuing a minority shareholder's interest. The judgment reinforces that the starting point to valuing a minority shareholder's shares is to apply a discount.

Dodika Ltd and Others v United Luck Group Holdings Ltd [2021] EWCA Civ 638
The court of Appeal considered whether a buyer's notice of tax covenant claim under a Shera Purchase Agreement ("SPA") was valid and compliant. In dadding in the buyer's favour the Court of Appeal stated that where a contract prescribes that certain information must be include in a notice of a claim which fails to do so then the notice will be invalid. Whereas if the SPA imply required "reasonable details" this would vary with the circumstances. The case is a reminder that the SPA should include prescriptive wording.

MDW Holdings Limited v Norvill and Others [2021] EWHC 1135 (Ch)
This High Court case followed previous decided case to conclude that clear language is needed to exclude liability under a Share Purchase

Agreement for misrepresentations and also a reminder that a seller must provide full and accurate details of any known issues in the disclosure letter to be protected.

3.2 Significant Changes to Takeover Law

Changes to the UK's Takeover Code (the Code) came into effect in July 2021 and are the most key changes to the Code in many years. The changes relate to the conditions for regulation and merger control clearance and offer timetable, including:

- a single date for satisfaction of all conditions;
- acceptance condition can only be satisfied once all other conditions satisfied or waived;
- a bidder is required to set a long stop date for the offer. The Code now states that all conditions to an offer must be satisfied by no later than Day 60 from publication;
- acceleration statement – bidder can bring forward the unconditional date of an offer from Day 60;
- acceptance condition invocation notices – bidder must give shareholders at least 14 days' notice to invoke the acceptance condition to lapse its offer;
- an offer must remain open for 21 days. If a bidder wants to lapse an offer on or after Day 21 before the unconditional date it must give 14 days' notice to do this;
- acceptance Levels – must be announced on Day 21 and every seven days after that; and
- withdrawal rights – shareholder who have accepted an offer can now withdraw their acceptance of an offer any time prior to the unconditional date.

The Code was also updated to reflect that EU law will no longer apply to the UK. The Takeovers (Amendment) (EU Exit) Regulations 2019 (SI 2019/217) made the changes required to Part 28 of the Companies Act 2006 to enable the UK takeovers regime to operate outside the EU framework of the Takeovers Directive.

The UK will be outside the EU Merger Regulation (EMUR) and merging parties may need to seek clearance from the UK authorities. Mergers, whether UK or foreign businesses that meet the UK and EU thresholds, will face a parallel review under both systems. UK turnover will no longer apply when assessing a merger which would fall under EUMR. As there are a large number of international businesses for whom a large part of their EU turnover is created in the UK, this will result in fewer mergers meeting the EMUR thresholds and instead of being reviewed by the European Commission being reliant on the relevant EU member states jurisdiction

4. STAKEBUILDING

4.1 Principal Stakebuilding Strategies

In the UK, it is not usual for a bidder to build a stake in the target prior to an offer however it does happen. There are pros and cons associated with stake building, by way of example, stake building could be positive as it could offset shares which might be voted against. On the whole, stake building is regarded as a hard-hitting approach and not therefore favoured in the UK.

4.2 Material Shareholding Disclosure Threshold

There is an ongoing disclosure requirement under Chapter 5 of the Financial Conduct Authority's (FCA) Disclosure Guidance and Transparency Rules (DTR) which governs UK companies traded on either a regulated or prescribed market. This obligation is triggered by the percentages of voting rights held, whether directly or indirectly or whether through a financial instrument.

A disclosure must be made when a holding's voting rights exceeds 3% of the total and then every time such voting rights increases or decreases by a whole 1% over 3%. The target must notify a Regulatory Information Service (RIS) as soon as possible and in any event by the end of the trading day following notification from the shareholder. The FCA can impose penalties for breach of the disclosure requirements which can result in penalties including the suspension of voting rights of the shares.

4.3 Hurdles to Stakebuilding

The Code imposes certain restrictions on a bidder acquiring a stake holding which must be adhered to. There are also controls with regards to market abuse prohibited by the Market Abuse Regulations (MAR) which include insider dealing, where a bidder has information which could place the bidder at an unfair advantage. Insider dealing can give rise to civil and criminal sanctions (Criminal Justice Act 1993).

The FCA has the power to impose unlimited sanctions on any contravention of the MAR including Article 14 (prohibits insider dealing) and Article 15 (prohibits market manipulation). The market abuse regime cannot be diluted by any rules introduced by the company.

Following the UK's withdrawal from the EU on 31 December 2020 it has introduced a new regime for all issuers with securities listed or traded on the UK markets namely the UK MAR, which is broadly along the same lines as the previous regime (aimed at discouraging insider trading, market manipulation and unlawful disclosure) with a few changes businesses will need to be aware of.

The SME Growth Markets Regulation ((EU) 2019/2115) made some amendments to to EU MAR with effect from 1 January 2021. As these amendments took effect after the end of the Brexit transition period, they do not automatically apply to the UK. The UK only adopted some of these amendments to UK MAR hence there is divergence in practice.

The changes below were made to UK MAR from 29 June 2021:

- insider lists – issuers as well as any person acting on their behalf must maintain an insider list; and
- PDMR transactions – issuers must make public any PDMR transactions within two working days of receiving notification of a transaction from the PDMR or PCA.

4.4 Dealings in Derivatives

The trading of derivatives is not fully prohibited however following the 2007/2008 financial crisis; dealing in derivatives is highly regulated. The Financial Services and Markets Act 2000 restricts the carrying on of a regulated activity and making financial promotions unless authorised by the FCA.

4.5 Filing/Reporting Obligations

The European Market Infrastructure Regulation (EMIR) imposed reporting requirements to ensure transparency amongst derivatives markets, namely:

- information on each derivative contract must be reported to trade repositories and sent to supervisory authorities; and
- trade repositories are required to publish aggregate positions based on class of derivatives, for OTC and listed derivatives.

The European Union (Withdrawal) Act 2018 ensured that EU EMIR formed part of UK law so effectively post-Brexit the original EU EMIR continued to apply to EU derivatives transactions and the UK version for UK EMIR. The FCA has released guidance to explain the changes.

EMIR legislation has not changed after the UK left the EU.

When the transition period ended on 31 December 2020, the European Securities & Markets authority (ESMA) switched off the FCA's access to its Markets In Financial Instruments (MiFID) systems. The FCA has built equivalent FCA systems in the UK.

4.6 Transparency

There is no requirement for a bidder to make known the purpose of its acquisition and its intention regarding control of the company.

5. NEGOTIATION PHASE

5.1 Requirement to Disclose a Deal

An announcement must be made where:

- there is a firm intention to make an offer notified to the target board, the Code governs the requirements for a firm offer announcement (Rule 2.7); or
- there is an acquisition of shares which results in an obligation to make a mandatory offer.

An announcement may have to be made subject to Panel consultation where:

- the target is subject to rumour and speculation; or
- the is unusual movement in the targets share price.

Once a takeover period has commenced the disclosure requirement under Rule 8 of the Code applies. Rule 8 sets out the circumstances in which Dealing Disclosures and/or Opening Position Disclosures are required to be made. There must then be a disclosure of dealings by parties to the takeover in writing on a daily basis to a RIS.

After the opening position disclosure if a person is interested (directly or indirectly) in 1% or more of any class of relevant securities of an offeror or the target, then a dealing disclosure must be made.

5.2 Market Practice on Timing

Market practice on timing for disclosure strictly follows the requirements of the Code. As non-compliance is considered seriously by the Panel.

5.3 Scope of Due Diligence

Generally, the due diligence (DD) conducted will fall into three main areas for a private limited company:

- business – considering the boarder market issues such as competitors, business strengths and weaknesses, sales and marketing;
- financial – identifying the financial risks and opportunities of the business; and
- general/legal – identifying any areas of risk to the buyer as well as providing the buyer with a more comprehensive view of the company in its entirety.

In contrast on a public acquisition, all persons with confidential information on an offer must keep the information confidential until the offer is announced publicly, therefore, due diligence, in the first instance, is limited compared to private sales. The offeror is under a duty to only announce an offer when it knows it will implement the offer (Rule 2.7 of the Code).

It is now standard practice for due diligence on acquisitions to be undertaken remotely with the use of data rooms hence the impact of the pandemic on DD was confined to circumstances where it was necessary to engage in face-to-face meetings (in particular in relation to cross border transactions) and the restrictions prohibited that.

5.4 Standstills or Exclusivity

To protect target shareholder value, the Code generally prohibits the bidder and target from entering into exclusivity agreements. However, the target can seek safeguards from the bidder which are not prohibited by the Code; see **6.7 Types of Deal Security Measures**.

5.5 Definitive Agreements

Tender offer terms and conditions are, generally, set out in the bidder's formal offer or in the Scheme document.

6. STRUCTURING

6.1 Length of Process for Acquisition/Sale

The below is subject to **3.2 Significant Changes to Takeover Law**. The timeline for completing a public takeover depends on whether by it is by way of an offer or scheme.

Takeover Offer

- Within 28 days (and no earlier than 14 days without the target board's consent), of an announcement of a firm offer, the offer documents must be sent the shareholders (offer date);
- the offer can be closed 21 days from the offer date;
- the offeror must announce the level of acceptances and will usually announce the next closing date 22 days after the offer date;
- an offer will become unconditional as to acceptance 60 days after the offer;
- on the basis the offer becomes unconditional as to acceptances on day 60, 81 days from the offer date is then last day for fulfilment of the other conditions. Thereafter 95 days after the offer date is the last date for consideration to be posted to the shareholders; and
- the offeror can complete compulsory acquisition procedure 100 days after the offer date.

Scheme of Arrangement

- Within 28 days bidder and target announce scheme;
- within 21 days of the scheme document a meeting of the shareholders to approve special resolution;
- within 40 days court sanction hearing;
- on day 41, the court sanction is submitted to Companies House and the scheme takes effect; and
- day 55 is the last day for payment of consideration.

The pandemic's impact on timetabling of deals has rested primarily with regards to regulatory requirements given the challenges faced by regulators including the court system, Companies House and Financial Conduct Authority.

6.2 Mandatory Offer Threshold

Rule 9 of the Code provides if a person acquires an interest in shares in the target which results in the person holding 30% or more of the voting shares of that company or person who already holds between 30% to 50% of the voting rights acquires an interest in any other voting shares, that person will be obliged to make an offer to acquire all of the equity and voting share capital of the target on the terms set out within Rule 9.

The offer is to be made in cash (or cash alternative) which is level with the highest price paid by the offeror for any interest in shares in the previous 12 months. The offeror is not entitled to attach any condition to the offer save that where it is refused on the grounds of competition.

6.3 Consideration

Cash remains more commonly used in the UK. We expect to see more earn out or deferred consideration-based deals focussed on adjustments to account for the current valuation uncertainties. How a deal is structured and tax too can help reduce the gap between buyers and sellers and address risks caused by the uncertainty of whether a business can meet its financial projections in light of the pandemic.

6.4 Common Conditions for a Takeover Offer

The Code permits an offeror to include conditions or indeed pre-conditions to an offer, however, there are constraints, primarily that such conditions must not be dependent on the subjective judgment of the offeror. Common conditions include:

- where consideration shares are going to be issued and such class of shares are already listed as consideration then a condition will be included such that the offer becomes unconditional only once the consideration shares are admitted to listing and to trading;
- that there will be no reference made to the Competition and Markets Authority or, where the takeover falls within the scope of EU Merger control, the European Commission;
- that all relevant authorisations/approvals for conducting the business are in full force and effect at completion;
- there being no material ligation or other disputes ongoing or pending against the target; and
- there being no material adverse changes in the target's financial or trading position other than those which have been made known to the offeror; however, a change in economic, industrial or political circumstances will not normally justify the withdrawal of an offer according to the Panel.

6.5 Minimum Acceptance Conditions

Amendment to the Code in July 2021 means that the acceptance condition can only be satisfied once all other conditions satisfied or waived.

Under Rule 10 of the Code, an offeror must have agreed to acquire 50% of the voting rights in the target for it to be able to declare the offer unconditional as to acceptance. An offeror will often include a conditional threshold so that 90% of the shares to which the offer relates must accept. This allows the offeror to rely on Section 976 of the Companies Act 2006 to acquire the remaining 10% of the shares. Without the 90% condition the offeror will be left to contend with minority shareholders remaining in the company who it will have no right to buyout.

6.6 Requirement to Obtain Financing

Generally, an offer cannot be made conditional on obtaining finance; this is reflected within General Principle 5 and Rule 2.7 of the Code. Only in limited circumstances may the Panel permit obtaining finance as a pre-condition to the offer under Rule 13, for example, where it will take a substantial length of time to gain regulatory clearance or authorisation. A bidder must, therefore, ensure it has the funds to satisfy the consideration due in its offer.

Rule 24.3 (f) of the Code requires that offer documents set out how the offer is being financed including terms of finance and interest rates.

6.7 Types of Deal Security Measures

There is a general prohibition on "offer-related arrangements", between a bidder and target company on takeovers of UK companies to which the Code applies. Pursuant to Rule 21.2 of the Code, the target company may not enter into any "offer-related arrangement" with the bidder during an offer period or when an offer is reasonably in contemplation without the prior consent of the Panel.

This prohibition covers any agreement, arrangement or commitment in connection with an offer, including any inducement fee arrangement or break fees. Some break fees are permitted, however, where they do not exceed 1% of the offer value and the target's financial adviser has confirmed it is in the best interest of the shareholders.

The following are examples of safeguards permitted under the Code:

- confidentiality constraints;
- non-solicitation of employees, customers or suppliers;
- requirement for assistance for the purposes of obtaining any official authorisation or regulatory clearance;
- employee incentive arrangements; and
- agreement in relation to the future funding of any pension scheme.

6.8 Additional Governance Rights

If a bidder does not seek 100% ownership of a target, there is no real scope for the bidder to seek additional governance rights from the target.

6.9 Voting by Proxy

Section 324(1) Companies Act 2006 sets out a statutory right of the members to appoint proxies to exercise all or any of the member's rights to attend, speak and vote at general meetings. This will override any conflicting provision in the company's articles, though the articles will usually prescribe how a proxy is to be appointed.

6.10 Squeeze-Out Mechanisms

An offeror can rely on Section 979 of the Companies Act 2006 in order to force minority shareholders into the transaction. This provision is subject to there being a "takeover offer" for the purchase of all of the shares in the target company (less the shares already held by the offeree). The offeror must also have acquired or agreed to acquire 90% of the shares which are not currently held by the offeror.

If the above conditions are met, the offeror can give a squeeze out notice under Section 981 (Companies Act 2006) within three months of the expiry of the original offer to the shareholder who did not accept the original offer ("minority shareholders"). The notice will obligate the offeror to acquire the shares from the minority shareholders on the same terms of the main takeover offer. The minority shareholders can apply to court to contest the compulsory acquisition, however, the court is likely to find that the offer the majority shareholder have accepted is fair and reasonable.

Six weeks after serving the squeeze out notice the offeror must provide to the target company a copy of the entire squeeze out notices, a stock transfer form executed by a person nominated by the target in respect of the minority shareholder and the consideration for the shares.

6.11 Irrevocable Commitments

Irrevocable commitments are widely used to improve the chances of success of a takeover offer. In advance of the announcement of an offer and with the consent of the Panel, shareholders will give an undertaking that they will accept the offer and will vote in favour of any resolutions in order to progress the offer.

There are two types of irrevocable commitments, hard irrevocables which are binding even if a higher offer is made or soft irrevocables which will fall away if a higher offer is made. Usually, the higher offer must be at least 10% higher.

If an offeror obtains an irrevocable commitment during the offer period, this must be disclosed in writing to a Regulatory Information Service (RIS) (Rule 2.10(a) of the Code).

7. DISCLOSURE

7.1 Making a Bid Public

Rule 2.7 of the Code sets out what needs to be included within an announcement, namely (not limited to) offer terms, identity of the offeror, details of any existing holding of shares, any conditions, details of any dealing arrangements, a list of documents which must be published on a website and, where there is a cash element involved in the offer, confirmation from the offerors financial adviser that there are sufficient resources to make the offer. Since January 2018, it is at this stage that an offeror must confirm its intentions with regards to the business, employees and pension scheme of target.

The announcement must be published via a Regulatory Information Service. If the announcement is submitted outside normal business hours, it must also be distributed to at least two national newspapers and two newswire services in the UK.

If a leak occurs, the announcement is governed by Rule 2.4 of the Code.

7.2 Type of Disclosure Required

It is unlawful for a public offer of transferable securities (including listed shares) to be made in the UK unless a prospectus approved by the FCA (or the competent authority of another EU state) has been issued beforehand, or an exemption applies. The prospectus regime was policed by the Prospectus Regulation (EU) 2017/1129, which sets out a number of exemptions from the requirements to produce a prospectus. However following UK's exit from the EU, it will have its own distinct prospectus regime. This new UK prospectus regime largely follows the structure set by the EU Prospectus Regulation, but with some important differences to reflect the UK's withdrawal from the EU.

7.3 Producing Financial Statements

A bidder is required to produce audited accounts/financial statements for the previous two years of trading.

7.4 Transaction Documents

Alongside the main bid documents, a bidder must disclose to the public other material documents including irrevocable commitments, letters of intent, any offer related arrangements, funding details and any other material contracts related to the offer.

8. DUTIES OF DIRECTORS

8.1 Principal Directors' Duties

Directors owe statutory duties enshrined in the Companies Act 2006.

Duty to Act within Powers (Section 171)

If a director is allotting shares with the intention of preventing a takeover bid this is deemed to be acting outside of the confines of the powers and was successfully challenged in Hogg v Cramphorn Ltd [1967] Ch 254.

Duty to Promote the Success of the Company (Section 172)

When considering whether to recommend an offer or in the case of competing bids, the directors will need to consider whether a bid is in the best interest of the company. This involves taking a long-term view of the interests of the company. The court is unlikely to disturb a decision unless no reasonable director could possibly have concluded that such action would promote the success of the company.

Duty to Exercise Reasonable Care, Skill and Diligence (Section 174)

Generally a committee will be nominated to oversee the day-to-day responsibility of a takeover; the board are still under a duty to monitor the activities of the committee.

Duty to Avoid Conflicts of Interest and Conflicts of Duty (Section 175)

In a takeover, conflicts may arise where a director of the target also holds a position in the bidder company or vice versa or if a target director will have a continued role in the group following the transaction. Where a director does have an interest in an arrangement the director will be under a duty to disclose such interest (Section 177).

Directors owe their duties primarily to the company itself and, therefore, any action is taken by the company usually after a majority of shareholders have voted for action to be taken. Shareholders are unable to take action unless they can prove unfair prejudice or by bringing a derivative claim seeking relief on behalf of the company where the company has a cause of action against a director.

8.2 Special or Ad Hoc Committees

Usually, it is common for a committee to be appointed from the outset to deal with urgent issues relating to the takeover.

Where a company is subject to a management buyout or another connected party transaction which could result in a conflict, a special committee consisting of non-conflicting directors should be appointed in order to deal with the transaction.

Independent advisors should be consulted rather than using the company's existing advisors, it is not sufficient to simply establish information barriers.

8.3 Business Judgement Rule

Directors' judgment is rarely challenged in the UK Courts and a Court is unlikely to disturb directors' decisions unless no reasonable board could have reached that decision.

8.4 Independent Outside Advice

Rule 3 of the Code provides that the target must have an independent financial adviser. The target board must obtain competent independent advice as to whether the financial terms of any offer (including any alternative offers) are fair and reasonable.

The board will usually put together a team of advisors including investment banks (who will act as the financial advisors), brokers, lawyers, accountants and public relation advisors. This is to enable the board to deal with the offer, the substance of the board's advice to the shareholders and how to deal with the offer process.

8.5 Conflicts of Interest

See **8.1 Principal Directors' Duties**.

9. DEFENSIVE MEASURES

9.1 Hostile Tender Offers

Hostile tender offers are permitted in the UK and account for around 12% to 18% of bids, annually.

9.2 Directors' Use of Defensive Measures

The use of defensive measures is restricted by the Code. The Code will only apply once an approach has either been made or the board have reason to believe that a bona fide offer might be imminent.

In such circumstances, under Rule 21.1(a) of the Code, the board cannot, without shareholder approval, take any action which may result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits. This includes:

- issuing shares;
- granting share options;
- disposing of any material assets; and
- entering into agreements outside the ordinary course of business.

The directors are also prevented from taking any action in so far as it puts them in breach of their director's duties owing to the target.

9.3 Common Defensive Measures

Urging shareholders to reject an offer is a commonly used defensive measure.

The Board will seek to persuade the shareholders that the price being offered is an undervaluation of the company and that by not engaging in the sale the shareholders will see a greater benefit in the long run. The Board will make this judgment based on financial information with regards to the performance of the company.

A board may also release new information such as business plans and forecasts to reinforce the idea that the long-term gain will outweigh the shareholders cashing out on the offer.

Where shares are being offered as consideration, the board may scrutinise the value of the offeror and will look to discredit its worth.

The board should ensure that where this tactic is employed any information given must be adequately and fairly presented (Rule 19.1). There has been noticeable reporting of a change in the use of defensive measures due to the pandemic.

9.4 Directors' Duties

There are two main duties which are key when employing defensive measures. The first is the duty to act in a way the director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole (Section 172 Companies Act 2006). Success is determined based on the directors' judgment, however, the act does provide several factors which must be considered including but not limited to:

- the likely consequences of any decision in the long term; and
- the interests of the company's employees.

The second is that the directors must act within their powers (Section 171 of the Companies Act 2006) which requires the director to act within the confines of the company's constitution.

9.5 Directors' Ability to "Just Say No"

As detailed, in order for directors to comply with their statutory duties they cannot "just say no". They must make a reasonable assessment based on requisite independent advice in order to determine what is in the company's best interests long term. The Code generally allows for target shareholders to decide the outcome of an offer and, provided directors comply with their duties, they are allowed to express their opposition to a bid.

10. LITIGATION

10.1 Frequency of Litigation

Litigation is not common in connection with M&A deals in the UK. Generally, commerciality plays a much larger role resulting in most issues being resolved on commercial terms rather than resorting to litigation. The Panel whilst not strictly of judicial standing does play a key role in determination of issues arising during the course of the bid process.

10.2 Stage of Deal

If litigation is brought (which is rare), there is no usual stage which is more likely to result in litigation.

10.3 "Broken-Deal" Disputes

The Pandemic has seen a surge in disputes between buyers and sellers including between exchange and completion. Buyers seeking to get out of a deal or stall the deal whilst the industry improves or force renegotiation on price. Sellers on the other hand seeking to get the deal over the line even if structured in a different way (such as earn outs or deferred consideration). Deals may look completely different in a post-pandemic world compared to when heads of terms were negotiated hence why the gulf between the buyer and seller has lead to disputes. Sectors seeing the most disputes are travel, tourism, transport and retail.

Given the novelty of the current pandemic situation and the absence of decided cases the outcome of these disputes remains uncertain. However, if the global financial crash of 2008 is anything to go by then we can expect more litigation and strongly contested cases in the next 12 months as we adjust to a post-pandemic world.

11. ACTIVISM

11.1 Shareholder Activism

Mergers and acquisitions activity remains a key focus for activists.

11.2 Aims of Activists

Increasingly, activists make their demands public by way of open letters, white paper reports, shareholder proposals and proxy contests. The general aim being to focus on issues relating to corporate governance, such as replacing the management team, level of dividend pay-outs, new director appointment of directors and executive compensation. Activist shareholders have been fairly quiet during the uncertain times of COVID-19 and volatile trading conditions hence there is an expectation activists will make up for lost time in the year ahead.

11.3 Interference with Completion

Activists have developed a number of M&A-related strategies to interfere with completion. These strategies include pressuring companies into a merger or acquisition, or ruining deals that would otherwise have proceeded.

A further popular strategy involves campaigning for improved deal terms, commonly referred to as "bumpitrage". This involves the activist acquiring shares in a company that is subject to a takeover bid, and then persuading the other shareholders that the current bid is insufficient and should be renegotiated.

Often, the threat that shareholder approval may not be forthcoming is sufficient to encourage a target board to renegotiate the terms of the deal.

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Trends and Developments

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Introduction

Most UK businesses are still in a state of shock from the pandemic, whether that is due to an unexpected increase in turnover and opportunity or decline in revenue. Despite this, 2021 proved to be another record year for M&A activity, with Carter Black Winter LLP reporting that the number of completed deals topped 3,791 across all sectors. This was a 33.5% increase over 2020, with total value of deals amounting to just shy of GBP176 billion, a 75% increase over 2020.

According to a report by Thomson Reuter's Practical Law Company the number of offers made for UK listed companies rose to 55 in 2021 compared to 40 in 2020. In this context the energy sector will be ripe for consolidation between companies seeking to achieve efficiencies in order to drive down overall costs. Those listed companies that have invested in new technologies for lower carbon energy or renewables will be attractive to potential buyers.

The year 2022 also started with optimism in the air and the expectation most businesses would bounce back to pre-pandemic levels, but this has quickly been dampened due to record levels of inflation in the UK combined with supply issues and now the outbreak of war in Ukraine, which will have wide reaching global economic ramifications.

Those UK companies who reacted quickly to stabilise their businesses during the pandemic by transforming operations to fully remote digital environments will reap the rewards as they will be perfectly positioned to enhance future productivity. The pandemic has accelerated recognition that digitalisation is one of the key future risks to most businesses regardless of industry sector hence the focus placed on investment in digital solutions to develop new products, customer experiences and capabilities. This need for change is what will be the driving force of M&A during the next 12 months with businesses seeking acquisitions to increase or improve operational capabilities.

M&A in the TMT space

White & Case reported a significant increase in M&A activity in the Technology, Media and Telecommunications space with transactions such as the bids for Blue Prism, Avast, Playtech, Gamesys and Sumo. This trend will continue due to the emphasis on digital capability, fintech, data analytics and connectivity that has been sparked by the pandemic. The consensus view is artificial intelligence will also rise in 2022.

Technology is evolving faster and faster, through mediums such as AI and 3D printing. Therefore, there needs to be more innovation and investment within many sectors including the manufacturing sector if businesses are to keep up with their ever-changing competitors. Productivity is the most important factor that will translate to the bottom line, being the profit made by a company. There has always been a different approach between, for example, the UK and Germany, as the UK favours labour to create productivity whilst the Germans focus on investing in new technology, equipment and software to create their productivity.

The UK's focus on employees has led to full employment and even the redundancies expected from COVID-19 never transpired meaning that most businesses are well positioned for M&A

activity. The UK now has to focus on increasing its capability and quality of output. Robots can be made to work faster or slower where needed, without incurring significantly higher costs other than the initial cost of purchase and installation. This investment should carry through into the services industry as well.

Capital Investment

Post-Brexit and COVID-19, most sectors have a chance to re-focus on capital investment in order to upskill the existing UK workforce to use new technology. The UK immigration policy will not provide the additional workers for the UK economy to help increase productivity. There is also then the issue of where the money is going to come from for capital investment, as some of the foreign investment into the UK may already have been diverted away as a result of Brexit. These challenges will provide scope for consolidation of businesses.

BDO UK also reported an increase in deal activity in the worldwide technology sector and a corresponding increase in demand for underlying infrastructure (fibre, data centres, etc). It also reported that cybersecurity remains an active space. Interestingly BDO UK noted the re-emergence of corporate buyers in tech M&A in 2021 whereas as private equity has previously dominated this market.

UK companies also continued to maintain a strong role in cross boarder deals with EY UK reporting that almost 65% of UK respondents to a survey were focusing on cross border acquisitions and UK ranked in the top three deal destinations amongst global respondents. Brexit was a catalyst for UK companies acquiring businesses in Europe to secure supply chains. This trend was expected to continue into 2022 but the conflict in Ukraine will now inevitably influence this.

The increased focus on sustainability will also shape the world of M&A in 2022. According to the Mergers & Acquisitions Research Centre at Bayes Business School, environmental, social and governance (ESG) will continue to drive deal activity for the long term.

Rise in Cost of Living

As the cost of living continues to rise and the UK faces inflationary pressure (heightened by the conflict in Ukraine) interest rates will inevitably rise, hence the expectation is that there will be a real surge of M&A activity in the first and second quarter of 2022 where deals are being pushed through before the cost of borrowing increases. That said, the lull in M&A activity during the pandemic has resulted in a lot of cash and liquidity in the market with some corporates and private equity investors sitting on large pots of cash seeking out the right opportunities whether that is a distressed sale or otherwise. This is especially relevant to the leisure and hospitality sector which has been under enormous pressure due to closures during the pandemic. Whilst this sector has recovered well it is expected that there will be records level of M&A activity as investors cease to take advantages of depressed asset prices.

There are many reasons that contribute to the current rate of inflation, including a contracting market in energy suppliers or the cost of "big-ticket" items increasing because of supply chain issues.

All the things mentioned for the current rate of inflation are very similar to those of the 70s when there was a weak pound, a fuel crisis and the government injecting money into the economy through high wage settlements for public sector employees. In the same way during the last 24 months the government has borrowed record sums to deal with COVID and prevent a free fall in the economy. The real difference now, however, is that interest rates have not yet increased to counter-act inflation.

It is only with improvement to productivity that progress can be made, which is why businesses should take the opportunity in this new hybrid working environment to maximise productivity by working smarter and keeping that big beast of inflation at bay.

Outlook

Whilst the pandemic has been the key factor adding uncertainty to the M&A sector for the last two years, this will now be replaced with the conflict in Ukraine, the fallout from which could see an economic tidal wave not witnessed in half a century. In addition, the risk factors for M&A in 2022 include increased interests rates due to high inflation, increased energy costs and global instability.

The UK's increased scrutiny of direct foreign investment in the form of new emerging legislation will impact certain industries including tech and hinder deal activity. The additional regulatory requirements under the National Security and Investments Act 2021 will mean deals take longer to get over the line. The Economics Crime Bill when legislated may also impact on asset-based deals too.

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