# The Acquisition and Leveraged Finance Review

Fourth Edition

**Editor**
Christopher Kandel

The Law Reviews

# THE ACQUISITION AND LEVERAGED FINANCE REVIEW

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# The Acquisition and Leveraged Finance Review

Fourth Edition

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# PREFACE

Acquisition and leveraged finance is a fascinating area for lawyers, both inherently and because of its potential for complexity arising out of the requirements of the acquisition process, cross-border issues, regulation and the like. It can also cut across legal disciplines, at times requiring the specialised expertise of merger and acquisition lawyers, bank finance lawyers, securities lawyers, tax lawyers, property lawyers, pension lawyers, intellectual property lawyers and environmental lawyers, among others. An additional area of complexity and interest at the moment comes out of market forces that are driving convergence in the large cap leveraged financings between loan and high-yield bond products generally, as well as between different markets (particularly pressure on markets outside the United States to conform to terms available in the US market but sometimes also vice versa), and increasingly the market is debating whether to adjust for differences in bankruptcy, guarantee or security regimes, and frequently deciding not to.

*The Acquisition and Leveraged Finance Review* is intended to serve as a starting point in considering structuring and other issues in acquisition and leveraged finance, both generally but also particularly in cases where more than just an understanding of the reader's own jurisdiction is necessary. The philosophy behind the sub-topics it covers has been to try to answer those questions that come up most commonly at the start of a finance transaction and, having read the contributions, I can say that I wish that I had had this book available to me at many times during my practice in the past, and that I will turn to it regularly in the future.

Many thanks go to the expert contributors who have given so much of their time and expertise to make this book a success: to Nick Barette, Gideon Roberton and Gavin Jordan at Law Business Research for their efficiency and good humour, and for making this book a reality; and to the partners, associates and staff at Latham & Watkins, present and past, with whom it is a privilege to work. I should also single out Sindhoo Vinod, Aymen Mahmoud, Angela Pierre and Oliver Browne for particular thanks – their reviews of my own draft chapters have been both merciless and useful.

**Christopher Kandel**
Latham & Watkins LLP
London
August 2017

**Chapter 8**

# ENGLAND & WALES

*Christopher Kandel and Karl Mah*[1]

## I OVERVIEW

The United Kingdom has a relatively 'open market' approach to acquisitions and a long tradition of merger and acquisition activity, including leveraged buyout activity that dates back at least to the 1980s. While there is some debate regarding open trade and acquisition policies in the current political environment, both in the United Kingdom and elsewhere, and the United Kingdom's decision to trigger the process leading to its exit from the European Union (Brexit) has increased unpredictability in the area, at the time of writing this remains unchanged in the United Kingdom. Typical sources of finance for acquisitions have included commercial and investment banks, both lending directly or – for larger transactions – where they underwrite the debt initially but then syndicate it widely to investors such as other banks and institutional lenders including collateralised loan obligations (CLOs) and collateralised debt obligations (often incorporated in tax-haven jurisdictions such as the Cayman Islands) and hedge and other funds. The high-yield bond (notes) market started slowly in the 1990s in the United Kingdom and Europe, largely tapping the US market in its early days and becoming increasingly European in the first decade of the 21st century, but since 2010 it is commonly looked to particularly for larger acquisitions and refinancings. Given the usual need for certainty in the financing of an acquisition, a notes issue in connection with an acquisition is normally preceded by the underwriting banks providing a bridge loan or bridge loan commitment that is subsequently refinanced by the notes.

As a result of the credit crisis, new lenders have stepped into the market and we increasingly see funds making directly arranged loans in certain mid-market financings (in effect, cutting out the arranging banks), including through the introduction of debt products such as unitranche loans. The market in this area continues to expand, and it may be that the European Central Bank's May 2017 'Final Guidance on Leveraged Transactions' will accelerate this trend as it potentially restricts involvement in some financings of the European banks subject to the guidance. Notably, the United Kingdom banks (with the Bank of England Prudential Regulatory Authority as primary regulatory supervisor) is not following this path. We have also seen the development of a buoyant market in which European borrowers and acquisitions are financed with loans placed in the deeper US markets, particularly the US term loan B, covenant-lite and second-lien markets. Competition from the US loan and bond markets has resulted in a trend for European loan financings for top-tier financial sponsor-backed borrowers to have much increased convergence with the terms in the US market; the market in Europe continues to grapple with some of the structural implications

1 Christopher Kandel and Karl Mah are partners at Latham & Watkins LLP..

of the US market terms such as the typical flexibility to incur unsecured debt at any guarantor (usually subject to compliance with one or sometimes two ratio tests at the time of incurrence) – this flexibility has different and adverse consequences for the more senior lenders in a European restructuring or insolvency than would be the case in a restructuring or insolvency under the US bankruptcy system.

## II REGULATORY AND TAX MATTERS

England and Wales has comprehensive regulations that apply to banking and related businesses conducted in the United Kingdom. The Bank of England Prudential Regulatory Authority regulates and supervises banks, insurers and certain investment firms. Separately, authorisation is required by the Financial Conduct Authority for firms and individuals that carry out any regulated financial service market activity in the United Kingdom.

While a survey of that regulation is outside the scope of this chapter, it should be noted that simply making a secured or unsecured loan, subscribing for a secured or unsecured debt security of a borrower or issuer that is incorporated or tax-resident in England and Wales[2] (or the purchase of either from someone who has already funded such a loan or investment) does not in itself require any kind of banking or similar licence.

In common with a number of other European jurisdictions, the United Kingdom imposes withholding tax on payments of interest (and on certain other payments). Withholding tax is imposed on payments of interest that have a UK source, and the applicable withholding tax rate is currently 20 per cent. However, withholding tax can be reduced or eliminated pursuant to a number of exemptions.

First, withholding tax is typically eliminated where the beneficial owner of the interest is a UK bank, or a UK corporate lender that brings the interest into account for UK corporation tax purposes.

Second, non-UK lenders can often reduce or eliminate withholding tax pursuant to a network of bilateral tax treaties[3] that is relatively comprehensive, but that notably does not include entities that are tax-resident in the main tax-haven jurisdictions.

Third, withholding tax can be eliminated under the 'private placement' exemption, which came into effect on 1 January 2016 (though can apply to unlisted debt securities issued prior to that date). Although the effect of the relevant rules is, in practical terms, relatively untested and use of this exemption is not currently widespread on deals, HMRC has confirmed that it is capable of applying to syndicated loans where the necessary conditions are met. Accordingly, it is possible that greater use of this exemption may be made going forward (though it is worth noting that it will be difficult to obtain the benefit of this exemption when lending entities are tax-resident in the main tax-haven jurisdictions).

Finally, there is also a 'quoted eurobond' exemption from withholding tax for interest bearing debt that is publicly listed on a recognised stock exchange regardless of the identity

2 Consumer finance lies outside the scope of this chapter; as such, regulation in that area is not addressed here.

3 Note that these tax treaties are not a creature of European Union law, so any exit from the European Union would not in itself affect the availability of any exemptions from or reductions in the applicable rate of UK withholding tax.

of the beneficial owner of the interest. This allows UK corporates to issue high-yield notes without a withholding tax concern; however, note that of the English categories of 'legal persons', only a public limited company may issue publicly listed securities.

These exemptions are often sufficient to enable acquisition financings to be placed; in some cases where syndication of loans (whether definitive or bridge) is necessary to investors in tax-haven or other jurisdictions without a suitable tax treaty, it can be necessary to use (or add) a foreign loan borrower. Cross-border intra-group proceeds loans into the UK (in the form of notes) are occasionally listed where (for example) there is either no tax treaty between the interest paying and receiving countries or there is concern that the interest receiving entity does not have sufficient substance to qualify under the relevant tax treaty.

The UK currently has rules that allow a form of tax consolidation within a corporate group (essentially by enabling group members to surrender losses and reallocate gains between each other on a current year basis). Therefore (subject to the principles mentioned below) a UK bidco borrowing to make an acquisition of a UK operating group can, in principle, achieve deductibility of the related interest expense against operating profits in the United Kingdom. A UK group of companies for this purpose can include both companies incorporated in the UK and companies incorporated outside the United Kingdom that are UK tax-resident by virtue of being centrally managed and controlled in the United Kingdom.

UK tax law has a number of principles that can limit deductibility of interest. These include limitations in respect of interest that is not considered to be 'arm's length' under thin-cap and transfer-pricing principles, interest that has equity-like characteristics and interest that is considered to have been incurred for a tax avoidance purpose. In addition, new corporate interest deductibility rules are expected to be introduced in a 2017 Finance Bill (with effect from 1 April 2017) in line with the OECD's recommendations published as part of its Base Erosion and Profit Shifting (BEPS) project. The key aspect of these new rules is likely to be the 'fixed ratio' limit, which provides that a UK group's tax deductible interest expense for a period of account should be limited to 30 per cent of its EBITDA (calculated after taking into account certain tax-related adjustments) for that period (the rules also include a number of other aspects that impact the deductibility of interest, though a detailed discussion of these is beyond the scope of this chapter). Inevitably, deductibility of interest will be looked at and modelled by accountants in the context of an acquisition financing.

While interest in payment-in-kind (PIK) instruments fluctuates, and is currently less seen partly as a result of spillover effects of US leveraged lending guidelines, it is also worth noting that PIK interest is, in principle and in common with cash paid interest, deductible on an accruals basis for UK corporation tax purposes. Notably, UK withholding tax only applies where interest is paid (in cash, or through the issue of PIK securities representing the interest due) – the rolling-up of PIK interest with no corresponding payment should, in principle, not trigger UK withholding tax.

The provision of acquisition finance and subsequent transfers of debt in the secondary market are typically exempt from UK stamp duty. In this context, there is a general stamp duty exemption for debt (assuming that the debt is not considered to have equity-like characteristics), known as the 'loan capital' exemption.

## III SECURITY AND GUARANTEES

Upstream, cross-stream and downstream guarantee and security packages are widely used in leveraged and acquisition financings involving England and Wales.

As an initial matter, guarantees are readily available from companies incorporated in England and Wales (for ease of reference, referred to in this chapter as English companies), subject to a number of caveats that as a practical matter are usually able to be dealt with in the typical finance transaction. These include the following:

*a* the guarantor must have the capacity to give the guarantee under its constitutional documents, and in addition each director of an English company must act in the manner that he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders as a whole[4] (i.e., there normally must be a corporate benefit). English case law does, however, support the premise that a shareholders' resolution may ratify transactions that are outside the scope of the directors' authority, so it is common to require such a resolution in the case of upstream or cross-stream guarantees given by an English company where the benefit to that company may be unclear;

*b* English law guarantees are unenforceable unless evidenced in writing and signed by or on behalf of the guarantor;[5] in addition, a guarantee under English law is a contract, so there must either be consideration or the guarantee must be signed as a deed (the enforceability of a deed does not require consideration, unlike an ordinary contract);

*c* generally speaking, no English public limited company or English incorporated subsidiary of the public limited company may give financial assistance directly or indirectly for the purpose of the acquisition of shares in the public limited company or, in the case of a public limited company, the acquisition of shares in its private limited company holding company; otherwise, the financial assistance restriction on English private companies with its 'whitewash' exception was eliminated in 2008 and is no longer a concern;[6] and

*d* if the giving of a guarantee requires the making of a provision by the guarantor at the time of the giving of the guarantee, it could be deemed a distribution that would need to be limited to distributable reserves of the guarantor. It is not often the case that a provision is required at the time an acquisition financing is made.

English law also distinguishes between guarantees and indemnities. A guarantee is a secondary obligation that cannot be more robust than the primary obligation guaranteed, so the guarantor may rely on any defence available to the person or entity whose obligations are guaranteed, while indemnities are primary obligations and can be enforceable even when the obligation guaranteed is not; a well-drafted 'guarantee' agreement will include both, and that distinction can be ignored as a practical matter.

---

4 Section 172 of the Companies Act 2006. The Act also sets out factors that a director must consider in fulfilling that duty, including 'the likely consequences of the decision in the long term [...] the interests of employees [...] the need to foster [...] business relationships with suppliers, customers and others [...] the impact of the company's operations on the community and the environment [...] the desirability of the company maintaining a reputation for high standards of business conduct [and] the need to act fairly among' shareholders. These additional factors are relatively new under English company law. Directors may also owe a duty to creditors if the company is nearing insolvency, and the Section 172 duties of directors are expressly subject to those other duties in that circumstance.

5 Section 4 of the Statute of Frauds 1677.

6 As a matter of practice, a leveraged acquisition of a public limited company will typically be followed by a reregistration of the company as a private limited company, after which any required financial assistance would be given.

In terms of security, England and Wales is a creditor-friendly jurisdiction that allows creditors to obtain meaningful and comprehensive security, usually at a reasonable cost.[7] However, the details are complex, because security in this jurisdiction is a creature of common law with a degree of statutory support, and takes multiple forms. The forms relevant to modern leveraged finance are a mortgage through transfer of title; a pledge through transfer of possession; a charge (an equitable appropriation – without any transfer of possession – of an asset to meet a debt); and a possessory 'lien', which enables the secured party to retain possession until paid, but not to sell the asset in question unless the lien is a banker's lien – and this category of security also causes endless confusion in conversations between solicitors, on the one hand, and US lawyers and the high-yield market, on the other, which understand 'lien' to mean 'security interest' generally.

Further complicating matters, which of these different kinds of security is appropriate for a given asset depends on the nature of the asset – for instance, a pledge or lien can only be given over an asset over which possession may be taken (i.e., physical assets; security over intangible assets that can only be taken through a mortgage or charge, etc). Notably, and by way of contrast to certain other jurisdictions, English law does allow grants of security over future property so the security automatically attaches when the debtor acquires an interest in the asset in question.

A mortgage or charge can be legal or equitable; the principal practical difference between legal and equitable is whether a *bona fide* purchaser for value without notice takes precedence and, in the case of a legal dispute in relation to a contract right mortgaged or charged, whether the secured party may need to join the pledgor in the legal dispute.

Third-party security – a grant of security by an entity that is not otherwise a guarantor or borrower – is also a workable and common construct under English law, particularly for security granted by a holding company in shares of or loans to a subsidiary where the holding company is not otherwise part of the financing.[8]

Where security is to be granted to a class of creditors that changes over time – for example, lenders under a syndicated loan agreement – it is well-established practice in England to grant the security in favour of a security trustee, who holds the security on trust for that changing group of creditors, eliminating the need to deal with transfers of security when interests in the loan are transferred.

Finally, if an English company grants certain kinds of security, whether over assets in the United Kingdom or abroad and whether under an English law security document or under a foreign law security document, as a general rule a certified copy of the instrument granting the charge (security) together with a duly completed 'statement of particulars' must be presented for registration with the Registrar of Companies within 21 days of creation, otherwise the charge will be void against any liquidator, administrator or other creditor of the security grantor.[9] While certain exceptions apply,[10] this requirement applies to most security granted by an English company in a typical acquisition or leveraged financing.

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7 Security granted by partnerships presents particular issues that are not further addressed here.

8 But cf. discussion below regarding the power of certain floating charge holders to appoint an administrator, which will not be available in the case of third-party security in the absence of such a floating charge.

9 Section 859H(2) of the Companies Act 2006.

10 A notable exemption is where the security is over financial collateral and qualifies as a 'security financial collateral arrangement' under the Financial Collateral Arrangements (No. 2) Regulations 2003 (as amended), in which case the Regulations confer a number of benefits on the collateral taker, including an exemption from registering the security. The collateral taker also benefits from the right to 'appropriate'

Notwithstanding all this apparent complexity, commercial lawyers in England and Wales have developed the 'all singing, all dancing' debenture, which grants appropriate forms of fixed and floating security over virtually all assets of a security grantor; as such, obtaining the right security in practice can usually be done through the execution of one agreement, and at reasonable cost, absent unusual circumstances.

English law provides that security, and in some cases guarantees, may be avoided if they represent transactions at an undervalue[11] or a preference.[12] The incidence of challenge on the basis of a transaction at an undervalue is significantly less than the US fraudulent conveyance or transfer principles that have a superficial similarity, largely because safe harbours apply in the United Kingdom where the transaction is entered into by the company in good faith and for the purpose of carrying on its business, and at the time it did so there were reasonable grounds to believe that the transaction would benefit the company (and in any event is not being entered into for the purpose of putting assets beyond the reach of a creditor or prejudicing creditors). In addition, preference claims in the United Kingdom require a degree of desire to prefer (i.e., intent) on the part of the guarantor or security grantor that has made this area of attack of almost no market concern to the structuring of a typical acquisition or leveraged financing.

A floating charge may also be set aside, except to the extent of any value to the company given at the same time or after the grant of the floating charge, if it is granted within 12 months of insolvency unless the company was not unable to pay its debts[13] at the time of the grant or as a consequence of the transaction. This period is extended to two years (and without the benefit of that solvency exception) if granted to a connected person.[14]

While the distinction between a fixed and floating charge has consequences under applicable statutes, there is no statutory definition of a fixed or floating charge, and the distinction has been drawn in case law. The leading decision in the area[15] stands for the principle that it is possible a purported fixed charge may be recharacterised as a floating charge if the chargor retains too much ability to deal in the asset charged. The distinction is not always easy to draw but, absent unusual circumstances, security in assets that are changing over time (such as inventory) will be floating.

A floating charge which, together with any fixed charges in favour of the holder of the floating charge, relates to the whole or substantially the whole of the chargor's property and is either designated expressly as a qualifying floating charge by reference to paragraph 14 of Schedule B1 of the Insolvency Act 1986 or purports to give the holder the power to appoint an administrator or administrative receiver, will enable the holder to appoint the administrator in the event of an administration. This is considered a useful power by

the financial collateral in an enforcement scenario. Moreover, in an insolvency situation, benefits to the collateral taker under the Regulations include removing some of the restrictions on enforcing security, disapplying insolvency provisions relating to the order of payment of creditors and prohibiting avoidance by a liquidator or administrator of the financial collateral arrangement in certain situations.

11 Sections 238 and 423 of the Insolvency Act 1986.

12 Section 239 of the Insolvency Act 1986.

13 Within the meaning of Section 123 of the Insolvency Act 1986.

14 Section 245 of the Insolvency Act 1986. Note that under Section 426 of the Insolvency Act 1986, a court with insolvency jurisdiction in another jurisdiction may seek assistance from a court that has insolvency jurisdiction in the United Kingdom, and this may give the UK court discretion to apply either English or the applicable foreign law in certain circumstances, which could add other grounds for challenge.

15 *National Westminster Bank plc v. Spectrum Plus Limited and others* [2005] UKHL 41.

secured parties and features in most debentures, although the market's increasing acceptance of exclusions to the scope of the floating charge in some cases may result in uncertainty as to whether this power can be exercised at the time, based on what are then the assets of the charger within the exclusion.

## IV PRIORITY OF CLAIMS

Floating charges, when compared to a fixed charge, are relatively vulnerable to other claims. A subsequent fixed charge taken without notice is prior to a floating charge, and there are certain categories of claims that are prior to floating but not fixed charges.[16] The main categories are as follows:

*a* expenses of winding up or the administration of the chargor (including the remuneration of the liquidator or administrator but excluding certain litigation costs), to the extent the assets of the chargor are insufficient to pay general creditors;

*b* a 'prescribed part' of the floating charge assets, which varies but is currently capped at £600,000, is made available for unsecured creditors;

*c* certain pension claims (usually relatively small in amount – certain employee contributions deducted but not yet paid; 12 months of employer contributions to a contracted-out scheme, subject to various limitations); and

*d* certain unpaid wage and accrued holiday entitlements of employees and similar amounts.

When the above are being considered in relation to a corporate group, they are determined on a company-by-company basis, although there are limited categories of liabilities such as pensions and tax that can cut across corporate entities (i.e., pierce the corporate veil).

Unfunded pension liabilities in the United Kingdom are normally not priority claims and are not prior to valid fixed or floating charges. However, change of control transactions can trigger significant rights to require payments by the trustees of the pension liabilities, so it is not uncommon (where the credit quality of the unsecured undertaking to pay is reduced in the transaction) for a negotiation to ensue with the pension trustees that may result in a consensual granting of security for those liabilities, rather than immediate payment, as negotiated.

In the context of a corporate group, entities other than the employer itself may also have liability under the Pensions Regulator's ability to give financial support directions or contribution notices under the Pensions Act 2004.[17] A 2013 Supreme Court case[18] is of relief to holders of floating charges, because it overruled a recent line of precedents that had held such directions or notices, if given after the initiation of an insolvency proceeding, to be a priority claim.

English law also has a concept of 'perfecting' a security interest that is different from the US equivalent, in that a lack of perfection does not mean the security is invalid in a

16 Certain exceptions also apply for charges that constitute a 'security financial collateral arrangement' under the Financial Collateral Arrangements (No. 2) Regulations 2003 (as amended), also discussed in footnote 10.

17 This power to impose liabilities on other group companies is not limited to other English companies, and accordingly can extend to legal persons in other jurisdictions.

18 *Re Nortel Companies and Re Lehman Companies* [2013] UK SC 52.

bankruptcy. Instead, English perfection relates to priority over certain potential competing interests – for instance, an assignment of a receivable or a bank account (which analytically is similar under English law) is perfected by giving notice of the assignment to the account debtor, and until this takes place a *bona fide* purchaser for value (which may include a subsequent security taker) may achieve priority, and rights of set off in favour of the account debtor may continue to accrue.

Contractual subordination is much used in English law finance documentation, particularly intercreditor agreements, and there is general agreement that – as a matter of English law – it should be enforceable as between the contracting parties. Surprisingly, the case law support for this is not as developed as one might expect; while recent case law is clearly supportive,[19] the waters were initially muddied by the 1975 *British Eagle* case,[20] in which the rights of creditors who had not agreed were sought to be affected by a clearing agency netting arrangement (and accordingly the case was distinguishable on its facts). In addition, language is normally included in well-drafted intercreditor agreements to require turn over in the event of mandatory insolvency set off (which can apply in some circumstances)[21] or another mandatory distribution of assets contrary to the agreement that results in a recovery to a subordinated creditor.

## V JURISDICTION

Expressly selecting English law to govern a commercial contract such as a loan or credit agreement is currently straightforward – the EU Rome I Regulation[22] applies to give effect to the parties' choice (without any requirements for, e.g., connection to England), but there are certain important exceptions and, where these are applicable, further thought must be given. The main ones relate to:

*a* the existence, due authorisation, capacity, execution of agreements by and winding-up of legal entities;

*b* whether an agent can bind a principal;

*c* formation of trusts and the relationship between the parties to the trust (this includes indenture trusts);

*d* obligations from dealings prior to the conclusion of an agreement; and

*e* choice of forum and arbitration agreements.[23]

In addition, Rome I does not override mandatory provisions of public policy of individual countries.

The subsequent Rome II Regulation[24] has extended a similar regime to allow parties to choose the law applicable to non-contractual obligations. This choice may be made either

19 See, e.g., *Squires & Ors (Liquidators of SSSL Realisations (2002) Limited) v. AIG Europe (UK) Ltd and Anor* [2006] EWCA Civ 7; *Re Maxwell Communications Corporation* [1993] 1 WLR 1402.

20 *British Eagle International Air Lines v. Compagnie Nationale Air France* [1975] 1 WLR 758.

21 See, e.g., *National Westminster Bank Ltd v. Halesowen Presswork & Assemblies Ltd* [1972] AC 785.

22 Regulation (EC) 593/2008 on the Law Applicable to Contractual Obligations.

23 Arbitration clauses are normally only entered into in acquisition financings where the borrower or target is organised in a jurisdiction that enforces arbitral awards but not, for example, English court judgments. Examples of such countries include Russia and a number of the other countries that were formerly part of the Soviet Union.

24 Regulation (EC) 864/2007 on the Law Applicable to Non-Contractual Obligations.

in an agreement after the event giving rise to the damage occurred, or also 'where all the parties are pursuing a commercial activity […] by an agreement freely negotiated before the event giving rise to the damage occurred'. This regime is subject to exceptions that are largely (but not entirely) similar to those in Rome I. Generally and broadly speaking, a contractual submission to the jurisdiction of an English court of competent jurisdiction in connection with financing documentation will be valid, subject to a variety of exceptions that are not seen as problematic by the markets but that can be in particular circumstances. The precise nature of the exceptions is dependent, *inter alia*, on the domicile of the person submitting to that jurisdiction[25] and whether another forum is more appropriate, and whether other proceedings are already pending or the issue has been determined in other proceedings.

English courts do not automatically give leave to serve process on parties located outside the United Kingdom even where there is a contractual consent by that party to jurisdiction, so it is considered good practice to require foreign contractual counterparties to appoint an agent for service of process in England and Wales where appropriate.

Brexit, if it occurs (and there is no sign currently that it will not), may have an effect on whether the EU regulations described above continue to apply indefinitely. EU Regulations naturally have direct force of law in Member States (subject to certain exceptions not relevant here) without any domestic legislation being required, in contrast with EU Directives, which must be implemented domestically. This means that, theoretically, if the UK ceases to be a Member State of the European Union and does no legislative planning, the then-existing European laws under the Regulations will cease to apply in the UK but the then-existing European laws following Directives will continue to apply because they have been given effect by locally enacted domestic laws.

It seems unlikely that no planning will occur. There are, however, some preliminary observations that can be made about Brexit without any legislative changes:

*a* recognition and enforcement of foreign judgments in commercial cases will still 'work' under English law more or less as before, just the legal framework and detail will change in relation to judgments from EU/European Free Trade Association countries.[26] It may

25 This in part arises from the complex web of law in this area, the primary bodies of law in the UK being Regulation (EC) No. 44/2001 of 22 December 2000 on the Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters and the Civil Jurisdiction and Judgments Act 1982 applying the 1968 Brussels Convention and the 1988 Lugano Convention.

There is currently some market debate as to the extent to which a French Court of Cassation case (Decision 11-26.022 (26 September 2012)), which held invalid – on the basis of certain principles of French or Luxembourg contract law (which is not clear in the case) – a consent to jurisdiction clause in which one party agreed to exclusive jurisdiction but the other party could bring suit in that or other jurisdictions (i.e., it was asymmetrical in application), raises an issue in the United Kingdom for the normal asymmetrical consents to jurisdiction used in European leveraged finance (exclusive for the borrower and non-exclusive for the lenders), because the Court of Cassation purported to make its decision under the Regulation, which also has the force of law in the United Kingdom. It is the view of the authors of this chapter that the laws of England as currently in effect do not follow that French case (and there is now case law in another jurisdiction refusing to follow that case), but it should be recognised when dealing with French parties that if a dispute is first brought in France, the French court may disregard any consent to jurisdiction clause that is asymmetrical.

26 Givers of legal opinions will have the unenviable task of determining which apply of (1) the Brussels Convention 1968 (enacted into English law under the Civil Jurisdictions and Judgments Act 1982), and applying to a variety of current and past European Union/European Free Trade Association countries, (2) the Administration of Justice Act 1920, applying roughly to the Commonwealth countries but notably

be helpful in that respect that many of the main EU countries are party to the Brussels Convention 1968, to the extent that it would remain in effect in relation to the United Kingdom (opinions differ on this matter). In addition, it is inconceivable to us that the European Union (or its various Member States) would pass legislation so that English judgements would be less recognised or enforced than New York judgements, for instance; and

*b* English common law is well developed in relation to recognition of a contractual choice of law for a contract involving loans, bonds and other commercial matters, so from an English law viewpoint the differences between the choice of law regime under the regulations and the common law should have little or no practical effect on finance documents.

## VI ACQUISITIONS OF PUBLIC COMPANIES

The financing of acquisitions of public companies in the United Kingdom presents additional issues for financiers beyond those issues usual for an acquisition financing. Most of these arise from the fact that, if the target is a UK, Jersey, Guernsey or Isle of Man-incorporated public limited company, the acquisition will be subject to the City Code on Takeovers and Mergers (Code), which is administered by the Panel on Takeovers and Mergers (the Panel). The Panel was established in 1968 without a statutory underpinning, and yet functioned effectively for many years that way; it now has various regulatory underpinnings from the Companies Act 2006 and the European Directive on Takeover Bids.

The main Panel-related issues for such a financing are:

*a* the requirement that the bidder have 'certain funds', from the time of announcement of a firm intention to make an offer, which affects the form and permitted conditionality of the financing;

*b* Panel requirements that the terms of the offer financing be publicly disclosed – including commercially sensitive fee and flex terms;[27] and

*c* the Panel imposes a strict confidentiality and equality of information regime that narrowly limits the number of persons (including potential financing banks) who may be told of an offer before its announcement, but also affects how syndication can be carried out after announcement and, depending on the circumstances, the scope of diligence that can be done (including in preparation for a high-yield bond offering).

In addition, for offers that are effected by means of a tender offer,[28] lenders must get comfortable with an interplay between the availability of the statutory minority shareholder

excluding countries such as Australia, Bangladesh, Canada, Gibraltar, Hong Kong, India and South Africa, (3) the Foreign Judgments (Reciprocal Enforcement) Act 1933, which applies to a variety of countries including India, Pakistan, Australia, the Australian Capital Territory, the Federal Courts of Canada and the Canadian Provinces (except Quebec) and (4) the common law regime.

27 The Panel has (on application) allowed a delay in disclosing flex terms until the offer document is posted to shareholders (at the latest 28 days after the announcement of the firm intention to make an offer), and also that the terms may be omitted from the offer document if they can no longer be exercised at that time. Given the difficulty of syndicating an undrawn financing in 28 days, this limited window does not often eliminate the issue for the borrower or its financiers.

28 An offer effected through a scheme of arrangement under Part 26 of the Companies Act 2006 does not present these issues because, once the requirements for it are met (which include a vote of a majority in

squeeze-out regime (at 90 per cent acceptances measured across the shares for which the offer is made rather than measured across the issued share capital)[29] and the practical need to allow the bid to become unconditional as to acceptances at a level lower than this.[30] Lenders usually get comfortable with the risk profile for closing at a 75 per cent or above level of acceptances (measured in this case at 75 per cent of the fully diluted issued voting share capital – the level at which control of a special resolution of shareholders is guaranteed), for a number of corporate governance reasons under the Companies Act 2006 and because a 75 per cent shareholder can take the target private at this level of shareholder control both in terms of delisting it and reregistering it as a private limited company so as to enable the target to give financial assistance for the financing. There are additional risks in closing below this level.[31]

The certain funds requirement arises from a Panel requirement that an offer, when announced (and also the subsequent offer document), must include a confirmation by the bidder's financial adviser – or by another appropriate third party – regarding the bidder's available resources. Because the financial adviser might be required to fund the offer if the resources prove to be unavailable, fundable commitment[32] or long-form finance documentation is required at this stage that include only conditions to funding during the

number and 75 per cent in value of the shareholders (or class of shareholders, depending on the specifics) present and voting either in person or by proxy (see Section 899 of the Companies Act 2006), and a court hearing as to fairness and certain other matters), no further approvals are required to squeeze out any dissenting shareholders, to delist the target and to reregister it as a private limited company (so as to enable it to give financial assistance). A scheme also has certain stamp tax and other advantages (including in some cases exemptions from registration under Section 3(a)(10) of the US Securities Act of 1933 for shares issued in the scheme) that usually make this the preferred method unless the target is hostile, there is a significant risk of competing offers or there are other reasons for the speed of execution being important (the scheme timetable can be longer than an offer timetable).

29 Section 979 of the Companies Act 2006.

30 It is rare for an offer to achieve 90 per cent acceptances without first being declared or otherwise becoming unconditional as to acceptances at a lower level – e.g., some institutional investors are not permitted to (or as a matter of practice do not) accept offers until the offer has become unconditional in this way. There are also circumstances in which a bidder can trigger an affirmative obligation to make an offer – known as a 'Rule 9 Mandatory Offer' after the Code provision requiring it – but such an offer presents additional risks for a financier, is rarely debt financed and is not otherwise discussed here.

31 There are also a variety of minority challenge rights that, although they are rarely encountered in the typical take-private financing for an offer, they nonetheless do exist; for example, a holder of 5 per cent or more of the target shares (among certain others) can apply to court to challenge the reregistration of the target as a private company. In addition, any shareholder may generally challenge corporate actions on the basis that the target's affairs are being conducted in a manner that is unfairly prejudicial to the interests of shareholders generally or to a class of them.

There is little case law, which is comforting because it means challenges are rare, but it also means there are few guidelines from which to assess the likelihood of success in a given circumstance. It is widely observed that the greater the majority of shareholders accepting an offer, the less the likelihood that a court would intervene. Optimally, an offer would achieve a level of acceptances that permits squeeze-out so that relevant corporate actions can be taken without this concern (although theoretically the squeeze-out too could be challenged on these bases, there is something of a consensus that this kind of challenge for a cash bid could only succeed in unusual circumstances).

32 In some cases financiers are comfortable with a commitment letter and a fundable interim loan agreement to bridge the period until long-form documents can be negotiated and agreed.

offer period that are completely within the bidder's control. The sole exception to this is that financial advisers will normally also permit a condition for illegality or invalidity of the financing documents.

The financiers are able to obtain some indirect comfort from the detailed terms of the offer itself – which will include conditions such as the absence of material adverse change – but the Code provides that the bidder (and so, indirectly, also the lenders) may rely on an unsatisfied condition only if the Panel consents to the bidder withdrawing the offer on this basis. However, the Panel's history in this area is not encouraging to bidders or lenders seeking comfort from those conditions. In practice, even if a condition has not been satisfied by its terms, the Panel will only give such consent where the circumstances underlying the failure of the condition are of material significance to the bidder in the context of the offer.

This feature is softened by two exceptions – the bidder may always rely on:

*a* the condition as to level of acceptances (and, as noted, in practice the 90 per cent threshold most offers start with is rarely achieved without it being waived, so the bidder can always consider the other conditions in deciding whether to waive); and

*b* the condition regarding absence of referral for UK or European competition authority review.

The Panel interprets its confidentiality rules and 'equality of information' rules broadly and, prior to announcement of a bid, a bidder normally must consult the Panel before disclosing the possibility of the offer beyond a very limited number of parties, which is usually no more than six entities outside of the bidder's advisers – as such, this limit of six entities applies to sources of debt and equity finance (where they are not also acting in an advisory capacity), target shareholders, bidder shareholders, etc. This can sometimes make the formation prior to announcement of a (small) club of financing banks challenging.

Following announcement, the rules on confidential information are applied such that special steps must be taken to ensure potential lenders who will have access to non-public information (e.g., projections) either do not hold equity in the target – which can be difficult for entities with trading desks – or have appropriate information barriers.[33] Finally, the equality of information rules can adversely affect the willingness of a target to allow due diligence, given that a competing bidder will often have a right to the same information.

## VII OUTLOOK

Europe's economic performance and outlook have improved over the past 12 months, notwithstanding uncertainty arising from a number of elections over that period including in the United States. The United Kingdom's economy shows signs of being affected by market reaction to Brexit, but this is disputed by commentators. A view has also developed that

33 This requirement is embodied in confidentiality language agreed between the Loan Market Association (LMA) and the Panel, and is published in the LMA form Confidentiality and Front Running Letter for Primary Syndication. However, there is an additional due diligence requirement on the bidder's financial adviser that can cause issues for any kind of wide syndication – particularly exacerbated where 'click through' web-based confidentiality agreements are sought to be used, as would be the norm in some cases outside the UK offer financing context (e.g., in a US term loan syndication). See Panel Practice Statement 25, Debt Syndication During Offer Periods.

Europe (and the United Kingdom) are relatively valuable from an investment viewpoint. Available liquidity remains buoyant. Fundamentals for leveraged finance therefore remain encouraging.

Second-lien, covenant-lite and unitranche financings are giving borrowers and investors on both sides of the Atlantic more borrowing and investment choices and opportunities. The impact of financial regulations (e.g., the European Central Bank's Final Leveraged Lending Guidelines come into effect on 16 November 2017, Dodd-Frank, Basel III) on leveraged lenders and lending activities more generally is something that continues to affect the market in a variety of ways,[34] as will the effect of expected further rises in interest rates in the United States.

Any of these factors seem certain to affect the current trends we are seeing, although in ways that are difficult to predict. The sanctions landscape must also be monitored carefully in the current geopolitical climate.

34 Notably, the US leveraged lending guidelines are having a clear effect in Europe, albeit of uneven application due to its uneven coverage of players and kinds of financings.