

In Practice

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Cash confirmations: treating conditionality with caution

This article will explore the legal and practical concerns relevant to a financial adviser and its legal counsel when giving a cash confirmation in the context of a debt funded bid. In most cases the relevant considerations apply equally whether the bid is being implemented by way of an offer (recommended, hostile or mandatory) or a scheme of arrangement. Issues particular to a bid which is funded by an equity raise by the Bidder fall outside the scope of this article.

THE CONTEXT

Under Rule 2.7(a) of the Takeover Code (Code), a Bidder may only announce a firm intention to make an offer for a target when it has every reason to believe that it can and will continue to be able to implement the offer (Rule 2.7 Requirement). Under Rules 2.7(d) and 24.8 of the Code, if an offer is made in cash (or includes an element of cash) the offer document is required to include confirmation by an appropriate third party, usually the Bidder's financial adviser, that resources are available to the Bidder sufficient to satisfy full acceptance of the offer (a Cash Confirmation).

IDENTIFYING THE "OUTS"

In order to satisfy the Rule 2.7 Requirement in the case of a debt funded offer, prior to the offer announcement being made, the Bidder should have executed finance documents in place under which it is entitled to draw sufficient funds (when combined with any other sources being used, such as cash) to settle the maximum amount of consideration payable under the terms of its offer or scheme. The Code does not expressly require the Cash Confirmation to cover any refinancing of existing target indebtedness or any fees payable under the finance documents for the period from signing to completion. However, given that any inability to fund these items will result in immediate defaults under the relevant financing documents upon the acquisition completing, it is prudent for a Bidder and its financial adviser to regard these items, together with the offer/scheme consideration, as forming the aggregate amount which must be available to the Bidder (together, the Transaction Consideration). Subject to strictly limited conditionality, at least this amount should be available for drawdown by the Bidder for an availability period mirroring the relevant scheme or offer timetable (usually including any contemplated subsequent acquisitions of minority shares via a squeeze-out procedure) (the Certain Funds Period).

Similar to other contexts in which "certain funds" financing is required, the primary preoccupations when diligencing the financing arrangements of the Bidder are identifying the circumstances in which the lender(s) may decline to fund and satisfying oneself that these are limited, as far as possible, to matters which are reasonably within the

Bidder's control to avoid. In the context of a public to private process, the available "outs" for the lenders will typically be limited to:

- (i) a failure to satisfy the conditions precedent to drawdown;
- (ii) mandatory prepayments triggered upon illegality (and sometimes also an exit); and
- (iii) the occurrence of a "Major Default" (including within its terms breaches of "Major Undertakings" and misrepresentations in respect of "Major Representations").

In line with market practice, a financial adviser can expect a letter of advice from its lawyers (a Comfort Letter) detailing the exact nature of the "outs" under the relevant financing documentation and in which their legal adviser should state that it is reasonable for the financial adviser to conclude that the Rule 2.7 Requirement has been met by the Bidder.

MITIGATING THE "OUTS"

In addition to establishing that the customary "outs" identified in (i) to (iii) above are appropriately limited, the financial adviser should also seek specific comfort that each one is not reasonably likely to occur. In relation to (i) above, the adviser should require clarity on the exact requirements and status of each condition precedent to funding via sight of a detailed condition precedent satisfaction letter (CP Satisfaction Letter) provided by the facility agent to the Bidder. The CP Satisfaction Letter delivered at signing should confirm that all conditions precedent are either satisfied or are demonstrably within the Bidder's control to satisfy, on or prior to completion of the acquisition. A financial adviser can also expect to benefit from direct representations from the Bidder given in a letter addressed to the financial adviser (a Representation Letter) confirming that the Bidder is not aware of any circumstance which would (or could reasonably be expected to) cause any of the remaining conditions precedent to utilisation to be incapable of satisfaction.

The illegality and exit mandatory prepayment events should be confirmed in the Comfort Letter as being customarily narrow. The Bidder will also likely state in its Representation Letter that (to the extent within its control), it will not take (or omit to take) any action so as to render it unlawful for the finance parties to perform their obligations under the finance documents. Similarly, the Comfort Letter will detail the scope of the Major Defaults, Major Representations and Major Undertakings to the financial adviser and the Bidder should confirm in its Representation Letter that they are not aware of the occurrence of any Major Default, or any circumstance which could reasonably be expected to cause one to occur during the Certain Funds Period.

Key concerns when reviewing the scope of the Major Defaults are that they expressly apply to the Bidder group only (and not target entities) and that they are limited to serious breaches such as non-payment, breach of a Major Undertaking, misrepresentation in respect

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of a Major Representation, insolvency-related events of default and unlawfulness and repudiation. Major Representations should in turn be narrowed to basic legal representations (covering matters such as corporate status and validity and admissibility in evidence) and Major Undertakings limited to serious and essentially deliberate breaches of prohibitions on the incurrence of indebtedness, granting security, merger, declaring dividends, changing the nature of the Bidder group's business or failing to comply with specific undertakings relating to its conduct of the offer or scheme.

NEW OR EXISTING DEBT?

Achieving a robust certain funds regime as described above will be much easier for a Bidder where it is negotiating new acquisition financing arrangements which are being put in place specifically for the purposes of the bid. Where the intention is to tap the Bidder's existing debt facilities to fund all or part of the Transaction Consideration, these will likely require relatively significant amendments for them to be made available on an appropriate certain funds basis. Consideration should also be given to whether the existing financing documents provide for funding in the required currency and that they expressly permit all aspects of the contemplated acquisition, including an appropriate clean-up period in relation to the target group to avoid breaches being triggered immediately upon the acquisition completing. If hedging is to be employed by the Bidder group to obtain the Transaction Consideration in the required currency, care should also be taken to ensure that the terms of such hedging agreements do not cut across the narrow Major Defaults regime negotiated as part of the certain funds package in the main financing documents.

THE NATURE OF THE BIDDER

A financial adviser's ability to conclude that no Major Default is reasonably likely to occur during the Certain Funds Period will also be heavily impacted by the nature of the bidding entity and the scope of the security and guarantee package required from the Bidder group at signing. If set up as a newly incorporated SPV with the sole purpose of acquiring the target, concerns regarding the Bidder incurring liabilities or conducting its business within the confines of the financing documents during the Certain Funds Period will obviously be much more limited. Conversely, where existing and operating members of the Bidder group are obligors under the relevant financing documents from the signing date, careful consideration should be given to whether their existing operations and liabilities carry with them a significantly heightened risk of triggering a Major Default such as, for example, insolvency-related cross-defaults.

THE NATURE OF THE BID

Bids are often dynamic processes, particularly in a competitive scenario. Bidders may seek to build flexibilities into their financing documents to allow them to increase their offer and available borrowings (typically via an accordion or potential drawings of working capital facilities), or to have the ability to switch from an offer to a scheme (or vice versa). When scoping their original Cash

Confirmation, financial advisers should be alive to any additional conditions attached to utilising accordion or revolving capital lines or to the ability of the Bidder to switch the structure of its bid between a scheme of arrangement and an offer. Where additional conditionality is included, supplementary cash confirmation documentation with suitable additional representations from the Bidder may be appropriate. To the extent arrangers of the financing have been afforded flex rights in connection with syndication during the Certain Funds Period, advisers should also be comfortable that any scope to make changes to the terms of the financing will not impact the Bidder's ability to utilise the facilities or comply with their terms.

THE NATURE OF THE FUNDER

In the current debt market where credit funds are as likely as banks to be financing a bid, additional due diligence may need to be undertaken in respect of their fund structure. Such diligence should focus on matters such as the undrawn commitments of the fund(s), their capacity to enter into the financing documents and the process for them funding their commitments, whether via a capital call or use of their own bridge facility.

CONCLUSION

The Panel on Takeovers and Mergers has not issued detailed guidance on the level of diligence to be undertaken by financial advisers in order to conclude that the Rule 2.7 Requirement has been met. However, when issuing a Cash Confirmation an adviser must be reasonably satisfied that its contents are true, accurate and not misleading and have acted responsibly in taking all reasonable steps to assure itself the cash was available. A failure to meet this standard constitutes a breach of the Code and may leave the adviser open to a misrepresentation claim from shareholders or potentially an obligation to itself cover any shortfall. A detailed understanding of the sources of funding for a bid should always be undertaken alongside careful diligence of any express or indirect conditionality attached to related debt financing. ■

Biog box

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