TAKEOVER FINANCING

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The most important regulatory and statutory provisions with which practitioners in this field grapple, in terms of their effect on the financing of takeovers, are contained in the City Code on Takeovers, the Fair Trading Act of 1973 and of course the Companies Act of 1985. The Code sets out a series of general principles and specific rules which are designed to ensure "fair and equal treatment of all shareholders in relation to takeovers". It is a very broad and admirable concept. It represents the collective opinion of those professionally involved in takeovers. It does not however have any legal force, although persons involved in a takeover are expected to comply. If they do not comply, according to the Code "they may find that by way of sanction the facilities of the securities market are withheld from them and that the Securities and Investment Board" and the self-regulatory organisations under the Financial Services Act 1986 may require persons subject to their jurisdiction eg. the merchant bank advising an offending offeror not to act in relation to the takeover.

In practice the Code is substantially complied with and it should not be assumed that a breach of the Code can escape effective remedy.

The Fair Trading Act contains in ss.57-75 provisions enabling the Secretary of State for Industry to refer a takeover to the Monopolies and Mergers Commission in certain circumstances. Again, I do not imagine this is great news to you, but it is important in the context of what we are talking about. This has an obvious impact on the financing of the bid in that it affects the timing, a delay of up to 9 months being possible to enable the MMC to consider the reference. Nine months of course is fatal. In other words, a bid will almost inevitably fail if there is a reference to the MMC.

But it can also affect the basis on which the banks making the financing available agree to do so. This is due to the fact that when it reports the MMC is able to recommend that the bid may proceed but only on certain terms. For example, that the offeror agrees to divest itself of certain assets if it is successful.

If the banks took these assets into account in making their initial credit analysis by reference to the funding that they were prepared to make available for the takeover finance arrangement, they could be prejudiced by such a result.

Finally, the Companies Act 1985 contains provisions which I think are very similar to yours. Section 85 permits an offeror who acquires 90 per cent of the shares to acquire the compulsorily the remaining 10 per cent. That is one aspect which is important. The other one is that it also contains provision - ss.151 to 154, preventing the offeree company from providing financial assistance to the offeror in connection with the acquisition of the offeree's shares. Care must be taken to ensure that the loan agreement does not require the offeror to procure the doing of anything which could breach these provisions, eg. the disposal of assets by the offeree to repay the loan.

I should mention two other aspects in the context of takeover financing coupled with regulatory/statutory collision. One of them is EEC merger control, now a growing factor in the horizon of takeovers, particularly cross-border takeovers; the EEC merger division has pronounced on a couple of UK takeovers quite recently and there is certainly a merger directive which is likely to be adopted before 1992. Although this will not replace the Fair Trading Act, it will have an ancillary and important effect on cross-border mergers within the EEC.

Finally, we are learning to cope with takeover litigation. We find for example that the Minorco Consgold bid has currently reached a point where Minorco has over 54 per cent of acceptances, which on any basis would mean that Minorco had won, and yet in the United States an injunction is still outstanding prohibiting Minorco from purchasing further Consgold shares. It was not stated where or where not these shares might be purchased, but by virtue of our own laws relating to extraterritoriality, we would not regard that injunction as binding in England. In other words it would not be a contempt of court in England for Minorco to purchase Consgold shares in England. But apparently such action would amount to contempt in the USA, and given the substantial Minorco's assets in the USA, Minorco may not be prepared to risk the consequences of such contempt.

Therefore, US litigation is a factor which any major UK corporate involved in making a takeover has to take into account if it and the offeree both have US presences so that the courts can claim jurisdiction; in turn, banks financing takeovers of that sort will have to take into account what happens if the takeover bid sparks off legal action in the United States.

The most common form of takeover financings are bank facilities, and these are usually syndicated. In our experience syndicated loan agreements of this sort are in most respects similar to ordinary syndicated loans for general working capital purposes. In other words there is nothing magical about the format of the actual loan agreement. The structure of the document and the provisions will be very similar. For example, there will be all the usual representations, covenants, events of default, yield protection, agency and other standard provisions that one would normally expect to see in the standard syndicated loan. Generally one would expect these provisions to be based on previous provisions accepted by the relevant borrower in previous syndicated loan transactions.

However, the special nature of takeover financing will inevitably mean that the banks and the borrower will attempt to tailor some of the provisions. This is obviously a matter of commercial negotiation but broadly the concerns which arise can be discussed under the following headings:

- Control of the bid.
- The conditionality and availability of funds.
- Events of default.
- Timing and duration of commitments.
- Indemnities.
- Repayments.
- Suitability of financing for its purpose.

Taking each one of those in turn. First of all control. The banks will, at an early stage, normally at or just prior to the announcement of the bid, commit to make funds available to the bidder to enable the acquisition to be completed. At the outset the bid will be made at a certain price per share and may include a share or loan note alternative or mixture. A question which has to be considered is whether the bidder should be permitted to increase the price per share offered without the consent of the banks. Whilst the banks may have been prepared to make available, for example, $100,000,000 to finance an acquisition of the whole of the share capital of the target, they may not be as happy to see their facility being used to acquire 50 per cent at $200 per share. Clearly those figures are entirely arbitrary. The bid may also be subject to other conditions that is to say a lapse of waiting periods under the US Hart Scott Rodino Act, the antitrust legislation, no referral to the UK Monopolies and Mergers Commission etc. As I mentioned earlier, because of the length of time if there is a referral in ordinary UK takeover practice, takeovers lapse, and a finance agreement would correspondingly want to contain a provision that it lapses if there is a referral to the MMC. The banks may attempt to provide in the loan agreement that the bidder shall not alter the terms of the bid or waive any conditions without their consent. The banks are trying to control the bidder not just purely from the point of view of their own financial commitment, but also because they want to get the best possible deal for their money or rather in terms of repayment of their money. This has raised problems in negotiations with bidders. But they have to be thought through at an early stage because nothing is worse than if the bid is announced and the banks begin to question what is happening.

A bidding company will obviously attempt to resist this sort of control on the basis that it may respond quickly to developments and any possible delay in having to seek bank's consent might be unacceptable to it.

I am now busily trying to cut down what I was going to say in order to appease my Chairman. There was a point I wanted to make in connection with the availability of finance for the bid because Phillip remarked that the position in England and here was markedly different in his opinion. Our own view is that the Code requires that the announcement of the bid should include confirmation by the offeror's financial adviser that resources are available to the offeror sufficient to satisfy full acceptance of the offer. I think that so far we are more or less _ad idem_.

If the financial adviser does not act responsibly in giving that confirmation, rule 25C of the Code provides that it would be expected that it, the financial adviser, would be expected to make the finance available itself. Rule 24(7) requires in addition that the offer document must contain a confirmation to that effect. This is important to those involved in the financing of the bid. In order to satisfy the requirement it is essential that a firm commitment to provide the finance is obtained from the banks. This would ideally take the form of a signed loan agreement - and please note the word "ideally" because I think that this is where Phillip and I slightly part company. He is I believe of the impression that a signed loan agreement is virtually a _sine qua non_ to a bid going ahead, whereas our experience has been that it is not necessary to provide a signed loan agreement. However, if we cannot produce a signed loan agreement we are required to produce more than an assurance, namely a firm commitment letter, with the banks, in which the main areas of contention that is to say the conditions precedent, the warranties, the covenants, events of default and of course the conditionality clauses have to be contained. It is not necessary however that the obligation to lend should be unconditional. Conditions are permitted but they must be spelt out.

One other very sensitive conditionality aspect which I must talk about is the question as to whether the bank facility can be used to build up a stake through market purchases, for example a dawn raid, or whether the funds can only be drawn down when the public offer itself has gone unconditional and the bidder has received unconditional acceptances, in respect of the agreed percentage which could be 50, 75 or even 90 per cent.

From the banks' point of view, they may regard their security and credit position as being less than satisfactory if their funds can be used to build up a stake that might result in the bidder, if the bid does not go ahead or if the bid is unsuccessful, being locked into a less valuable minority interest, financed by the banks.

On the other side, of course, the bidder will require maximum flexibility.

I see that I must stop here; thank you.