

BREXIT: MERGERS & ACQUISITIONS

What does it mean for M&A transactions?



The legal and business impact of the Brexit vote is still some way from becoming clear. If, however, you are in the middle of an M&A transaction right now, there are extra questions to consider:

Due diligence

The Brexit vote requires a different lens to be applied during due diligence on targets. Buyers will need to understand how Brexit may impact the target business in the medium/long term. Some of the issues to consider include:

- ▶ **Employees/workers** - what is the immigration status of the workers based both in this country and the EU, and do any workers undertake travel to and from the EU? We have seen concerns regarding an increase in harassment and fair treatment of migrant workers within UK businesses, which should be considered where the target employs a significant number of migrants.
- ▶ **Exchange rates** – do key long-term contracts require cross-border amounts to be paid or received in sterling or in euro/US dollars/other? A structural impact of profitability may be required to understand the impact of weaker sterling (and of course some such contracts may have moved from being profitable to loss-making, so ability to terminate, reliance and business continuity become critical).
- ▶ **EU grants and funding** – does the business receive any grants or other funding from the EU? If such funding or grants were to be terminated when the UK leaves the EU, what impact would that have on the business?
- ▶ **EU law/regulations** – do any contracts refer specifically to EU laws or regulations? Do any contracts grant rights or impose restrictions within the EU, such as distribution rights or non-compete clauses? Whether or not such rights or restrictions would continue to apply in relation to the UK following Brexit would be a matter of contractual interpretation for the courts.
- ▶ **IP** – it is hoped that a regime will be put in place to allow companies that rely on (for example) EU trade marks (previously community trade marks) and Community designs for protection in the UK, to automatically receive an equivalent trade mark in the UK, but this is another unknown and might necessitate considerable IP housekeeping.
- ▶ **Termination rights** – will Brexit trigger an early termination clause in any long term contracts?

▶ Trading into and within the EU –

- ▶ Does the business import or export significant quantities of goods (or key materials, components or ingredients) into or out of the EU and/or move them across EU internal borders? The point of entry of such products, where they are made, where value is added and their manner of distribution across the EU will all come under close scrutiny as new tariff structures potentially emerge.
- ▶ Does the business provide services in the EU, which may rely on EU "passporting" or equivalent provisions / local regulatory compliance?
- ▶ What does the legal and operational architecture of such arrangements look like (e.g. locations of manufacturing sites) and how much legal and commercial flexibility is there to reconfigure them to optimise any new tariff arrangements?
- ▶ **Key counterparties** - are any key suppliers or customers materially impacted by any of the above, creating any P&L impact, uncertainty or continuity risk going forward for the target itself?
- ▶ What **Brexit planning and analysis** has been done by the target and what **lobbying** activity is it involved with and does its position and activity map well with your own?

Merger Clearances

M&A transactions may, if they involve large enough parties, be subject to scrutiny by the European Commission under the EU Merger Regulation, or if they don't meet the EU thresholds, by the Competition and Markets Authority (**CMA**) in the UK. The "one stop shop" principle of the EU Merger Regulation provides that, in general, mergers will not be reviewed for their effects in the UK by two agencies – if the EU Merger Regulation applies, the CMA will not have jurisdiction to review.

In the future, unless agreement is reached on the continued application of the EU Merger Regulation in the UK post Brexit, the one stop shop principle will cease to apply. Deals affecting the UK which trigger both the EU Merger Regulation and the UK jurisdictional thresholds would then be subject to parallel scrutiny by both the European Commission and the CMA. This could present significantly greater regulatory hurdles for the parties involved and scope for divergent decisions.

Given the timetable for Brexit (at least 2 years away), for deals under consideration now, this will not affect processes and timelines. In the short term, the question will be to what extent the CMA will be encouraged to take account of industrial policy considerations in its review of mergers.

MAC Clauses - private M&A deals

Whether buyers will be able to rely on Brexit (or any of the possible events leading up to and following on from Brexit) to trigger a MAC will depend upon the specific wording of the MAC clause. For those currently drafting MAC clauses, the courts are likely to interpret a general clause quite narrowly so care should be taken in spelling out what constitutes a MAC - especially if one wants to capture any specific consequences of Brexit and the process taking us towards it. Given the number of critical elections across Europe in the coming year, for some transactions wider consideration might also be given to those processes.

MAC Clauses- Deals subject to the City Code on Takeovers and Mergers (the 'Code')

Offerors of bids subject to the Code may also seek to rely on a MAC clause. It is, however, unlikely that the Takeover Panel (**Panel**) will diverge from its current practice, as contained in the Code, which provides that (except for the acceptance condition and certain other regulatory or legally required conditions), *'An offeror should not invoke any conditionso as to cause the offer not to proceed...unless the circumstances are of material significance to the offeror in the context of the offer'*.

Whether a circumstance is of sufficient material significance will be judged by the Panel at the time of those circumstances arising. Past practice indicates that such circumstances would need to be sufficiently materially adverse so as to *'strike at the heart of the purpose of the transaction'*. That threshold was set high by the Panel, in relation to the purported utilisation of a general MAC condition by WPP Group plc, during its bid for Tempus Group plc, when the Twin Towers attacks occurred during the course of its bid. The Panel concluded, in that case, that the threshold for material significance had not been met.

It is also a requirement of the Code that, before a bid is firmly announced, an offeror has sufficient financial resources to pay the purchase price should a bid become unconditional. Few conditions to bid financing would be allowable and they would, in all likelihood, not include Brexit-related conditions. Cross-border bidders will clearly need to take account of currency volatility in finalising their financing arrangements.

Consideration / adjustment clauses

Wherever the transaction envisages future payments or adjustments, currency movements and risk (and hedging strategies) clearly need to be considered even more carefully than usual, for example in relation to:

- ▶ payment and funding (and receipt) of the consideration where there is a delay to completion and any translation into or from any other currency is required; and
- ▶ computation of completion account provisions and earn out provisions, including recognition of earnings or asset or liability values in other currencies (and again in respect of the payment of any deferred or adjusted consideration, where a currency translation is required).

Additional seller limitations

We have seen various examples of sellers limiting their liability under a warranty claim where such liability is attributable to legislation relating to Brexit. Although limiting liability where liability is attributable to new legislation is not a new concept, singling out Brexit related legislation certainly is and should be considered carefully, deal to deal, sector to sector.

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