AIJA Deal Points Survey - Market Standards for Share Deals (M&A Commission)

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Executive Summary of the UK

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Introductory remarks for National Reporters (NRs)

Deal points studies are often used by deal practitioners as a resource for market trends when negotiating acquisition agreements. The studies usually present a statistical breakdown of how key provisions are treated in a sample of publicly or otherwise available M&A contracts. The value of the deal points studies is that they give the practitioner a much better sense of M&A drafting trends than she or he could get by doing an own research.

Against this background the M&A Commission has decided to launch an "**AIJA Deal Points Survey**" with the goal to gather and analyze market standards for share deals in various AIJA jurisdictions. The overall objective of the survey is to gain a better understanding of market trends in share deals from the perspective of AIJA members so that we may share the insights with all interested AIJA members and thus improve our knowledge and general fitness when it comes to negotiating deal terms in share deals.

The AIJA Deal Points Survey will be conducted on the basis of the following documents:

- **Questionnaires** in the form as attached hereto as Exhibit 1 to be filled out on a case-by-case basis, i.e. one questionnaire each for each transaction covered;
- **Executive Summaries** in the form as set out hereinafter, with the goal of summarizing the findings from the various questionnaires; and
- **General Report** (to be drafted by the General Reporters) on the basis of the Executive Summaries received from the NRs.

The Questionnaires and the Executive Summaries are to be drafted by all interested NRs, i.e. each NR should fill out Questionnaires and provide an Executive Summary in respect of the information she or he put together in the Questionnaires. It may well be the case (and even desired) that there are several NRs in one and the same jurisdiction where each of them is expected to fill out Questionnaires and an Executive Summary (independently from each other or, if they want, in cooperation with each other). Thus, we are looking to receive numerous Executive Summaries and Questionnaires from NRs even if they are in the same AIJA jurisdiction.

The Questionnaires attached hereto are straight-forward and can be answered within reasonable time. Obviously, the more Questionnaires are filled out, the better the sample for the Executive Summaries will be. However, in order to adopt a reasonable and time-efficient approach, we would expect that each NR covers 3 to 5 transactions, i.e. fills out 3 to 5 Questionnaires and drafts 1 Executive Summary covering the respective Questionnaires, unless NRs team-up and provide an Executive Summary in respect of many more Questionnaires. We leave it up to the NRs whether they want to join efforts or not. NRs with highest number of transactions will win a prize!

The transactions to be covered by the NRs should meet the following criteria:

- Private share deals only (not asset deals)
- Survey is not restricted to certain industries
- Deal value at least EUR 1m
- Closings taken place after 1 January 2014

Please note that the Executive Summaries do not necessitate full sentences everywhere. NRs can e.g. simply insert a number where we ask about the number of transactions which fall into a certain category, or they can provide comments/findings in the form of bullet points.

To sum up, each NR is kindly requested to provide us with a completed Executive Summary together with all copies of the completed Questionnaires (including annexes thereto).

Deadline for submission: 15 January 2016.

1. General Statement

M&A in the UK is on the decline in terms of deal numbers. The Office of National Statistics' (the "**ONS**"), which tracks mergers and acquisitions worth at least £1 million (EUR 1.3 million), latest release[1] revealed that there were just 72 domestic and cross-border M&A (which includes domestic M&A, outward acquisitions and inwards acquisitions) involving a change of majority share ownership for the third quarter of 2015 (compared to 67 in Q3 2014, 116 (excluding outward acquisitions) in Q3 2013, 87 in Q3 2012, 242 in Q3 2011, 193 in Q3 2010). Domestic M&A (UK companies acquiring other UK companies) reported 31 successful transactions in the third quarter of 2015, the lowest since the ONS first began to publish quarterly data in 1969. The M&A market has not, despite much positive thinking, returned to the levels of activity seen before the 2008 to 2009 recession and does not appear to be growing.

On a positive note, the UK has been found to be one of the best countries in the EU in which to start a business. Accordingly to the Legatum Institute, an international think tank and educational charity focused on promoting prosperity, the UK "now ranks the best in Europe for people starting businesses[2]". In the 'Entrepreneurship & Opportunity Sub-index' the UK came top, due in part, to the low startup costs (it takes less than 48 hours and costs less than £100 to incorporate a company in the UK) and favorable climate for entrepreneurs in the UK.

This is something that we (the Corporate/Commercial team at Kingsley Napley LLP) have noticed. Although we are still instructed on a number of medium to large acquisitions per year, my workload increasingly consists of smaller angel or VC investments into startups. We are also seeing a rise in US VC firms looking across the pond at UK startups, particularly to those London based technology companies.

As general market trends in respect of the 4 deal questionnaires, I would note:

- We normally always see extensive lists of representations and warranties
- Vendor due diligence is almost never undertaken in the UK
- Buyers increasingly refuse to accept disclosure of all the documents in the data room or of the full due diligence report prepared by the Buyers (and shared with the Seller). This rather makes a mockery of the principle in English law of "Buyer beware" as specific disclosures then have to be made against an extensive list of representations and warranties. This is however, balanced against what is in the actual knowledge of certain representatives at the Buyer
- We almost always see MAC clauses in share purchase agreements ("**SPAs**")

[1] http://www.ons.gov.uk/ons/taxonomy/index.html?nscl=Mergers+and+Acquisitions

[2] http://www.prosperity.com/#!/

- We have recently seen a number of very high net worth clients not instructing lawyers and going through their family office (who are neither lawyers nor experts in the necessary jurisdiction) instead. This changes the whole dynamic of a deal and often significantly increases the workload
- Liability for breach of warranties is normally limited to the total consideration received by the seller/s. It is normally always on a joint and several basis where there is more than one seller
- Warranty and Indemnity insurance is becoming more prominent on larger deals particularly in competitive bid situations
- In the UK, exchange and completion regularly happens simultaneously, unless regulatory approval (such as approval from the Financial Conduct Authority ("**FCA**") for a change of control) is required.

2. Summary of Transaction Details

I have reported on 4 deals which took place between June 2015 and January 2016. The largest of the 4 deals was that of the acquisition of a property management company, which owned a portfolio of over 500 properties, for EUR 94 million. The smallest was the acquisition of 60% of the share capital of a company which collects leads (for marketing purposes, to sell on), with a put and call option over the remaining 40% of the shares in the company, for just over EUR 1.3 million.

Of the 4 deals, 2 were for 100% of the issued share capital, one was for 60% but with the option to call for the remaining 40% at a set price and one for was 75% of the company.

The 4 deals fall into different industry sectors. The deal valued at EUR 94 million was in respect of a property management company (with an extensive property portfolio). The deal valued at EUR 47 million was in respect of a financial services business. The deal valued at EUR 4 million was for 75% of a restaurant and the deal valued at EUR 1.3 million was in respect of a company that collects and sells marketing leads to the insurance industry.

In 3 of the 4 deals we acted for the buyer and in the financial services company deal, we acted for the majority shareholder sellers (with the minority shareholders having separate legal representation). Of the 3 deals in which we acted for the buyer, we represented a fund in two of them. The deals were almost all UK based and all the targets involved companies which employed less than 200 people.

Only one of the deals involved a competitive auction process.

Of note is that the deal worth EUR 1.3 million came through an AIJA contact (thank you!).

3. Letters of Intent

Letters of intent were signed in just 2 of the 4 deals. We would expect a letter of intent to be signed in respect of larger deals and the reason a letter of intent was not signed in respect of the property management company deal was because it was a competitive tender process and our client entered into an SPA (with warranties just in relation to title of shares) before we undertook due diligence. The client was keen to secure the deal and was prepared to lose a EUR 650,000 deposit if it decided not to go ahead with the deal after completing its due diligence. Under the SPA, they had one month from exchange to close the deal.

The two letters of intent that were signed were not binding in character other than in relation to exclusivity in one case and exclusivity, costs, termination, confidentiality and governing law in the other. Exclusivity was granted for longer than one month in both cases (closer to 3 months).

4. Due Diligence

As I mentioned above, vendor due diligence is almost never undertaken in the UK and wasn't undertaken in respect of any of the 4 deals I am reporting on. Data rooms were available on 3 out of the 4 transactions (the restaurant deal worth EUR 4 million being the exception) and were all virtual. All 3 virtual data rooms were managed by a law firm (albeit one was run on a third party platform) and a formalized Q&A procedure was followed in one out of the 4 deals. The right to print/make copies was granted in all 3 deals but each data room had a set of rules governing the same which every party accessing the data room had to accept before entering it governing confidentiality and the number and use of copies made of the documents in the data room.

5. Purchase Agreement

Transaction

All 4 SPAs and all ancillary documents were in English. Rather unusually for the UK, none of the deals simultaneously exchanged and completed. This was because two of the deals required FCA change of control approval (which should take a maximum of 60 business days but can take a lot longer in practice), one had a gap of just over a month to give the buyer time to move funds out of Russia and one had a gap of a month between exchange and completion to allow the buyer to secure approval from its investment committee and, unbeknown to the sellers, carry out legal due diligence and raise debt financing.

Purchase Price

In 3 of the 4 deals, consideration was in the form of cash. In the case of the fourth, it was a combination of cash and loan notes in the new purchasing vehicle. 2 of the 4 deals relied on a price adjustment mechanism by way of closing accounts and in the other 2 deals, the purchase price was determined in advance (although a locked box mechanism applied in one of these 2 deals).

Payment of the purchase price was different in all 4 deals. Where closing accounts were used, in one deal the full amount was paid on closing (with an adjustment following a couple of months later) and in the other, the full amount in respect of 60% of the shares was paid on closing (with a later adjustment) with the buyer and the seller having a call and put option in respect of the remaining 40% of the shares. Where the price was determined in advance, and in the deal in which no locked box mechanism applied, payments were made in installments with retention by the buyer. Where the locked box mechanism applied, a cash payment was made and loan notes issued on closing with the cash payment representing the agreed profit ticker (from the locked box date until completion) following 2 business days later.

2 of the 4 deals were financed through a combination of debt and equity and one of them was financed by way of equity. We had no visibility of the financing of the fourth deal.

MAC clause

3 of the 4 deals contained a MAC clause allowing the buyer to pull out between exchange and completion in the case of a material change. 1 of the 4 deals did not but this was down to the fact that the warranties were given at exchange and not repeated at completion.

Reps & warranties

All 4 deals were subject to an extensive list of relatively standard warranties (general and tax). Indemnities were provided by the sellers in 3 of the 4 deals in respect of specific risks identified during the DD and in respect of tax. These specific indemnities were not subject to limitation provisions (other than statutory time limitations) in 2 of these 3 deals. In the remaining deal, the indemnities were subject to the limitation provisions.

Limitation of liability

Liability in respect of a breach of warranties was limited to 24 months and liability in respect of tax warranties was limited to the statutory period, which in the UK is 7 years, in all 4 deals.

In the restaurant deal (in which we acted for the buyer), the individual minimum claim amount was set at 1.66% of the purchase price. There was no basket and no maximum liability threshold.

In the financial services deal (in which we acted for the majority shareholder sellers), the individual minimum claim amount was set at 0.1% of the purchase price, the basket was set at 1% of the purchase price and the maximum cap was set at the purchase price received by each seller.

In the property management company deal (in which we were acting for the buyers), there was no individual minimum claim amount and no basket. The sellers' maximum liability for breach of the SPA was limited to the total consideration received by them but the sellers maximum liability in respect of a breach of the warranties was limited to £1.00. This is because the buyer took out warranty and indemnity insurance.

In the leads business deal (in which we were acting for the buyer), the individual minimum claim amount was set at 1.47% of the purchase price and the basket was set at 4.4% of the purchase price. The maximum liability cap was set at the total consideration received by the sellers.

Disclosures

As indemnities under an SPA in English law tend to be uncapped, disclosure is not normally made against then. Disclosure is instead made against the general and tax warranties by way of a disclosure letter.

In 2 of the 4 deals disclosure letters were produced. In the property management company deal disclosures were not made as the sellers' liability for breach of warranties was capped at £1.00 (due to insurance being in place). In the remaining deal, the seller simply did not produce a disclosure letter (we were acting for the buyer in this case!).

Full data room disclosure or disclosure of the full contents of the due diligence report was not given in any of the 4 deals. In the deals in which disclosure letters were produced, public information such as the contents of the Company Registry, were treated as disclosed. In one of the deals in which a disclosure letter was prepared, the warranties were not repeated on closing, so there was no update between signing and closing. In the other, a second disclosure letter was produced on closing.

6. Conditions Precedent

None of the 4 deals required merger filings to be made as a condition of closing. As I have mentioned above, 2 of the 4 deals required FCA change of control approval and the financial services company deal was conditional upon the target receiving consent from banking counterparties and various other conditions being met.

In 3 of the 4 deals the warranties were repeated on closing but a MAC clause was only included as a condition precedent in 1 of these 3 deals. Legal opinions are not sought in deals involving solely UK companies.

7. Non-Competition/Non-Solicitation/Restrictive Covenants

3 of the 4 deals required the sellers to be subject to restrictive covenants post-closing. The restrictive covenants in respect of 2 of these 3 deals were in a shareholders' agreement (which was entered into at the same time) rather than the SPA itself.

In the property management company deal, the value was in the portfolio of companies the target owned, so no restrictive covenants binding the sellers were considered necessary. In the rest of the deals, the non-compete and non-solicitation covenants were 24 months in length from closing in the case of one of the deals and from the date on which the sellers ceased to be shareholders in the case of the other 2 deals.

None of the SPAs contained liquidated damages clauses and although all the documents containing the restrictive covenants included blue pencil clauses, of note is that in England and Wales courts are only allowed to delete unenforceable wording to the extent that the other provisions that are enforceable would not be altered in the process. The English courts do not have the power to completely alter a restrictive covenant clause to make it work.

Only one of the 4 deals contained a non-disparagement covenant and none contained a non-embarrassment covenant.

8. Governing law & Jurisdiction

The governing law in all 4 deals was that of England and Wales.

In 2 of the 4 deals, jurisdiction was exclusive to the courts of England and Wales. In one of the remaining deals, jurisdiction was non-exclusive meaning either party could elect to bring proceedings in the courts of any other country which has jurisdiction and in the remaining deal, the buyer could elect to bring proceedings in any jurisdiction but the sellers could not.

9. General Information

2 of the deals had a cross border element. In one the buyer was a German company and in the other the Seller was a Cypriot company, with the ultimate beneficial owner being a Russian national.

We worked opposite Thrings LLP, Warners Solicitors and Evesheds on these deals and alongside Ince & Co, who advised the minority shareholders on the financial services deal. In the restaurant deal, the seller did not appoint a lawyer but rather went through his family office.

The financial leads deal worth EUR 1.3 million came through an AIJA contact (thank you!).

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