European M&A and Corporate Governance Hot Topics

Quarterly Update (February 2020)

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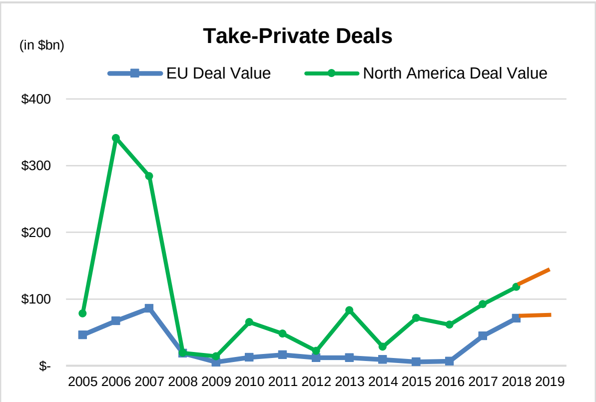
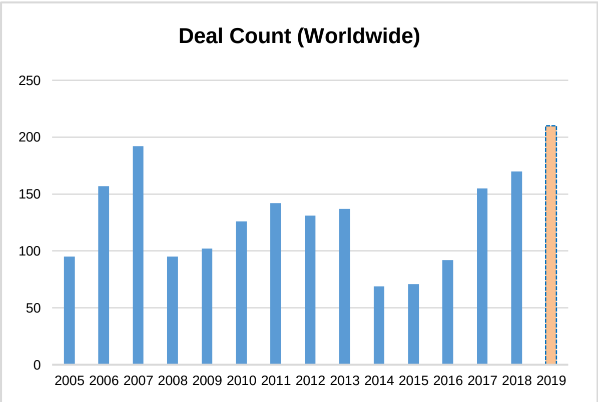
1. Public M&A: Take-Private Deals in Europe

- **Background:** European take-private deals by PE firms have significantly increased since 2016 both in terms of deal value and deal count, although trends vary greatly from one EU jurisdiction to another. Various factors might explain why EU markets have recently seen an increasing number of PE take-privates (or public-to-private deals), *i.e.*, the acquisition by a PE firm – not a strategic investor – of a listed company and its subsequent delisting. In the current low interest rate environment, PE firms feel pressure to find yield for the significant amount of funds they have under management. Undervalued listed issuers make for appealing targets as public multiples (especially in certain industries) are affected by adverse stock market developments, trade wars and rising risks of a market correction. Take-privates are often viewed as more complex and associated with higher litigation and execution risks, which, on the one hand, has traditionally deterred some PE firms to go down this path, but, on the other hand, also means less competitive bidding than a standard private M&A PE transaction.

- **Market Trends:** Historically, the overall take-private deal volume in North America was significantly greater than in Europe, but data show that from 2016 to 2018 the growth of deal volume in Europe and North America is comparable. 2019 was a strong year in the US/North America compared to 2018, while figures will be slightly above, or remain similar to 2018, in Europe.

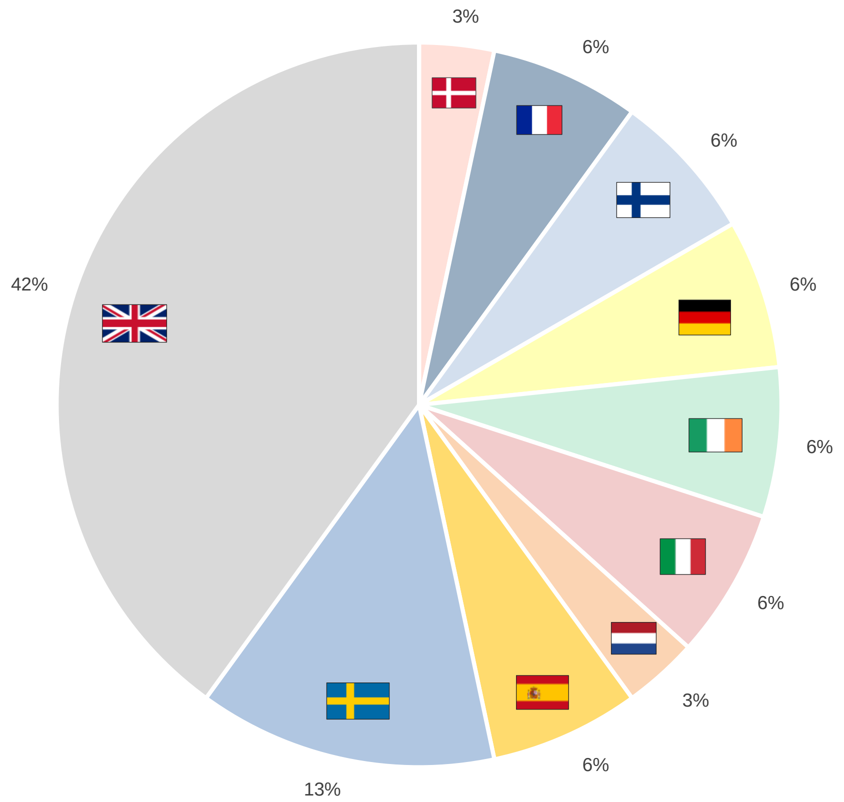




Source: Bain & Company, Reuters Graphics. Data includes PE take-privates and transactions launched by corporates. YE2019 figures are estimates based on 1H19 and 3Q19 data.

As shown below, more than 40% of large EU take-private deals (above $500m) by PE firms involve UK targets, while the remaining deals are split among other EU jurisdictions.

EU Take-Private Deals 2018–2019 above $500m
(Number of Announced Deals by Target Jurisdiction)



Source: S&C, based on Bloomberg/MergerMarket data. Data includes only PE take-privates.

- **Selected recent transactions:**
  - acquisition of **Inmarsat** (UK) by a consortium of Apax, Warburg Pincus and two Canadian pension funds (CPPIB and OTTP), approved by the UK High Court in December 2019, despite opposition from Oaktree on the basis that the offer did not fully reflect the true value of the target;
  - **Axel Springer SE** (Germany), which KKR, acting in concert with legacy shareholder Friede Springer and CEO Mathias Doepfner, intends to take private in a follow-on delisting offer in Q1 2020 (KKR acquired a 43.54% stake via a tender offer in 2019);
  - **Merlin Entertainments** (UK), taken private in November 2019 by a consortium comprising Kirkbi (the investment arm of the family owners of Lego), Blackstone and CPPIB, through a scheme of arrangement;
  - acquisition of **Cobham** (UK) by Advent in January 2020 in a recommended £4bn cash acquisition implemented by way of a scheme of arrangement;
  - **April** (France), which CVC is taking private after acquiring a c. 65% stake from its majority owners. CVC now owns c. 99% of April's shares and is expected to launch a delisting offer followed by a squeeze-out after April announces its YE2019 earnings.

- **Deal Trends:** PE firms develop new strategies to approach listed targets through more complex structures, including by forging alliances with existing shareholders (*e.g.*, KKR/Springer; CVC/April; PAI/Wessanen) or teaming up with strategic buyers (*e.g.*, Blackstone and CPPIB partnership with the family owners of Lego via their investment arm to make a combined offer for Merlin; Mediaset and F2i combined efforts to take EI Towers private). PE firms are also targeting larger companies than before, and this trend can be expected to continue given the increased amount raised by PE firms for their buyout funds in 2019 (*e.g.*, Blackstone is reported to have raised $26bn for its latest BCP VIII fund; Advent raised $17.5bn for its GPE IX fund; Cinven raised €10bn for its seventh fund; KKR raised €5.8bn for its biggest EU fund to date).

- **Key Considerations**:

  - **Reaching 100%.** PE firms, together with strategic investors/existing shareholders with which they may have joined forces, generally will seek to ensure that they reach full ownership of a target company in order to achieve the deal's objectives, including unrestricted access to the target's cash-flows, unrestricted exercise of governance rights, and consolidating the target from a tax standpoint (so as to offset the financial charges of the debt incurred by the acquiring entity against the target's profits). The likelihood of securing these objectives will depend on how the take-private is structured.

    For instance, in the UK, a take-private may be structured as either a contractual offer (with a 90% threshold for the squeeze-out, excluding shares held by the PE firm and its associates at the time the offer was made) or a scheme of arrangement, whereby the consent of the High Court and a simple majority in number of target shareholders (excluding the PE firm and its concert parties) present at the meeting representing a 75% majority in value of the votes cast is sufficient to acquire all of the target shares subject to the scheme. Bidders' preference for the scheme of arrangement is evidenced by its use in almost all significant UK take-privates (above $500m) in 2018 and 2019. One of the strengths of the scheme is that, if approved, bidders receive full ownership of the target or, if not approved, bidders walk away from the deal without being left as minority shareholders in a listed company (to the extent that the bidder has not built a stake in the target).

    This is not the case in certain other EU jurisdictions, such as Germany and France, where take-privates are implemented through tender offers, followed by delisting procedures and/or a squeeze-out of minority shareholders. Such measures would be subject to a bidder reaching relevant thresholds. In Germany, bidders would benefit from an unrestricted access to a target's cash-flows upon securing a domination and profit-and-loss transfer agreement (DPLTA), which requires approval by 75% of votes cast by target shareholders (*i.e.*, in practice a PE bidder would have to acquire between 60% and 70% of the target's voting rights, and a tender offer is then subject to a corresponding minimum acceptance threshold). By contrast, in France, tender offers may not be conditioned upon reaching the 90% squeeze-out threshold, which may result in bidders not being able to delist the target company and form a French tax group, while they nonetheless acquired a significant stake in a listed target.

    The burden that may result from an unsuccessful take-private that fails to reach applicable squeeze-out thresholds may be alleviated by implementing various "debt push-down" measures to increase the amount of debt economically supported by the target company. However, certain jurisdictions such as Germany restrict debt allocation by onerous financial assistance rules. Means to increase the stake initially acquired in a tender offer include a follow-on delisting offer (with a premium over the preceding tender offer price) which exerts a pressure to tender on shareholders that shy away from illiquid stock. In EU jurisdictions where the squeeze-out threshold is 95% (*i.e.*, Belgium, Italy, Lithuania, Luxembourg and the Netherlands), as per the EU Takeover Directive, relocating the target company to another EU jurisdiction with a lower squeeze-out threshold could also be considered. This forum shopping factor was part of the rationale for France's PACTE law lowering in May 2019 the squeeze-out threshold from 95% to 90%.

In addition, negotiating with the remaining minority shareholders may result in a favorable outcome, although bidders would generally have to pay a premium over the tender offer price and/or agree to a rollover investment of those minority shareholders in the acquiring entity (*e.g.*, CVC/April). This is true in particular where transactional activist(s) use(s) a public M&A scenario to build up a stake in the target of a tender offer. Such activists are an integral part of the deal-making environment in Germany (*e.g.*, Elliott and AOC/Stada), and increasingly in France (*e.g.*, Elliott/Altran), and warrant particular attention when structuring a take-private transaction.

– **Corporate Governance Aspects.** Take-privates generally require the support of key shareholders (either through voting agreements or block trades/irrevocable commitments) and the target board's recommendation. It is not unheard of that certain shareholders, including target's managers, roll over equity or invest alongside the bidders in the acquiring entity. Managers may also benefit from performance or transition awards in connection with the take-private. This leads to various corporate governance considerations that take-private players should bear in mind.

  In particular, in the UK, target management incentivisation schemes are subject to special rules. Where it is proposed that management who are also shareholders will receive incentives then (a) such schemes must be disclosed, and the independent financial adviser to the target company must state publicly that in its opinion the arrangements are fair and reasonable; (b) where the value of the arrangements is significant or the nature of the arrangements is unusual, the consent of the Takeover Panel will be required, and a vote by target shareholders may also be required; and (c) if the arrangements will result in the managers becoming shareholders in the acquiring entity on a basis that is not being offered to all other shareholders, a vote by target shareholders will also be required. In Germany and France, any benefits granted to members of the management/supervisory board will have to be disclosed in the offer document and the target boards' reasoned statement, and conflicted board members should recuse themselves from transaction-related deliberations.

  In cases where a significant shareholder initiates the sale of its stake in a listed company, similar conflicts of interests may arise vis-à-vis the target and the other shareholders. The seller's interests are likely to diverge from those of other shareholders, especially where the seller needs to exit a particular business, has achieved expected returns on investment or is under specific liquidity constraints. In this context, board members affiliated with the selling shareholder would be subject to a conflict of interests and should not participate in transaction-related deliberations and, depending on circumstances, consider resigning.

  EU jurisdictions deal with how a bidder can acquire a significant stake from a single shareholder differently. In France and Germany, the sale of a controlling stake may trigger a mandatory bid for the company whose board should abide by higher (self-imposed) corporate governance standards, such as implementing a bid review process whereby (independent) board members, assisted by outside counsel and financial adviser(s), evaluate the terms of the block trade and overall take-private; in addition, financial advisers could be asked to provide fairness opinions on the terms of the transaction. In the UK, the bidder should bear in mind that stakebuilding may make it more difficult to implement a scheme of arrangement, particularly if the significant shareholder is likely to have voted in favor of the scheme. Stakebuilding may also make it more difficult to squeeze-out minority shareholders following a successful contractual offer, if it occurs before the offer has been made.

– **Due Diligence.** Due diligence is typically more limited than in private deals, but this should be put into perspective, given the amount of information available regarding a public target (which include, *e.g.*, the annual report and the audited financials). Any non-public information provided as part of the due diligence exercise will need to be carefully reviewed to determine beforehand whether (a) it can be made publicly available, including from a business/competition standpoint, and (b) if made available and the transaction falls through, the listed target would not be in a difficult position – this is true, in particular, for business plan and earnings guidance that were not intended to be made public.

2. The Deal after the Deal: Integrating a Public German Target

- **Life after Closing:** Once a public takeover offer for a German target company has settled, the bidder will often times hold a *de facto* majority in the voting rights of the company but fewer than all of its shares outstanding. Under these circumstances, German law does not permit for a "short-form merger" or other form of facilitated merger integration. Instead, any transaction between the bidder and the company will have to comply with arm's-length principles and cannot be consummated if the negative effect of an action is not quantifiable. Losses incurred at the level of the company as a result of factual control will have to be compensated for by the bidder, and an audited "dependency report" lists all individual measures between bidder and target in a given financial year. The bidder may even be prohibited from any privileged access to inside information at the level of the company. As these restrictions are not conducive to operating an integrated (combined) business, recent transactions such as Bain and Cinven/Stada, Praxair/Linde or Morgan Stanley Infrastructures/VTG have undergone one or more of the following options in a "second step" after the offer.

- **Domination & Profit-and-Loss Transfer Agreement (DPLTA):** The implementation of a DPLTA generally grants the bidder access to the cash flows of a target company and lets it issue binding instructions to its management board. As compensation for its significant governance rights, the bidder will have to grant outside shareholders a put right, as well as a "guaranteed dividend" (which may consist of bidder shares or cash, depending on circumstances). The adequacy of any compensation so granted is subject to appraisal proceedings in court which may span over multiple years during which an exit compensation bears 5% interest p.a. The implementation of a DPLTA requires a 75% majority in the company's general meeting, and shareholders' contestation claims may delay its effectiveness to up to 9 to 12 months after closing.

- **Squeeze-Out Proceedings:** Once a bidder holds at least 90% of the company's shares, German law knows three different forms of squeeze-out proceedings. If 90% of the shares are held by a bidder at any time after closing, the general meeting of the target company may resolve upon a merger, as a result of which outside shareholders receive a cash compensation ("merger squeeze-out"). In addition, once 95% of the shares are held in a target company, German corporate and takeover law provides for two additional types of squeeze-out proceedings.

- **Delisting Offer:** Separately, bidders have since 2016 used the option to launch a "follow-up tender offer", in connection with which the target company's management board applies for a delisting of the company's shares. Such a "delisting offer" may not be subject to any closing conditions and requires the bidder to offer a cash compensation that is no less than the six-months volume-weighted average price of the target company's shares. However, in order for the target shares to be delisted, no minimum participation of the bidder is required either prior to the launch nor upon closing of the follow-up offer. The delisting offer generally follows the same stringent statutory framework and timeline as the original bid and is often times consummated on the basis of a delisting agreement with the target company as part of which target companies have negotiated further concessions such as the bidder's support of certain capital measures

3. Brexit Update and Proposed Changes to Public Interest Interventions

- **Brexit Update:** Following the UK's December general election, the UK has left the EU on January 31, 2020. The election returned a Conservative majority government committed to exiting the European Union on that date, and the European Union (Withdrawal Agreement) Bill 2019-2020 has since been enacted.

  Although market participants are generally more than satisfied that the outcome of the Brexit negotiations' first phase is now clear, residual uncertainty remains as to the scope of the future economic partnership to be agreed between the UK and EU. The Bill enshrined the end date of the transition period (*i.e.*, the period during which the UK will retain access to EU markets on current terms) in law such that it cannot be extended beyond December 31, 2020 without a vote in Parliament, and UK government policy is not to seek an extension. Some commentators – and the EU Commission president – have expressed doubts about whether a comprehensive free-trade agreement (as opposed to a 'no quota, no tariffs' deal or a limited set of sector-by-sector deals) can be negotiated and ratified within that time frame.

  As negotiations enter the next phase, investors may, therefore, again, adopt a 'wait and see' approach. On the other hand, PE firms have an unprecedented supply of dry powder stored, and the UK economy is expected to remain open and globally minded irrespective of the final settlement with the EU. A lifting, if not a complete dispersal, of the Brexit fog may help to sustain a healthy level of take-private activity in the UK.

- **Public interest interventions:** Following the election, the UK government has confirmed its plans to introduce a National Security and Investment Bill to strengthen the government's powers to review takeovers on national security grounds. While the Bill has not been published (only brief details have been provided, in the background notes to the Queen's Speech), it is likely to build on the National Security and Investment White Paper released in July 2018. Key features of the White Paper included: a broader scope extending beyond merger transactions (to, *e.g.*, acquisitions of assets or significant minority shareholdings); an extended timetable for review; and new powers to impose conditions or ultimately to block or unwind transaction features giving rise to the concerns.

  Were these reforms to be implemented, take-privates in sensitive sectors or of otherwise sensitive companies are likely to carry a greater degree of execution risk. If the response to the U.S. CFIUS regime's increasing prominence is a guide, early engagement of advisers to assess and manage these risks will become an essential part of transaction planning in the UK.

  Indeed, the UK government is more frequently using its current powers to intervene on public interest grounds. In 2019, it directed the UK Competition and Markets Authority (CMA) to investigate five deals – and a further deal was referred to the CMA in January 2020. Prior to 2019, the CMA would typically investigate no more than one or two transactions per year on public interest grounds. This trend seems likely to go only in one direction as the end of the Brexit transition period draws closer.

  An EU regulation on foreign direct investment screening (2019/452/EU) was introduced on April 11, 2019 and its provisions will apply from October 11, 2020 – including to the UK during the Brexit transition period. Among other things, the new framework creates a cooperation mechanism where Member States and the European Commission may exchange concerns about specific investments and will allow the Commission to issue opinions when it considers an investment threatens the security or public order of more than one Member State or could undermine a project of interest to the whole EU (such as Horizon 2020 or Galileo). In January 2019, the previous UK government stated that the UK's involvement in the EU framework following the transition period will be tied to the negotiations on the UK's future economic partnership with the EU.

4. Shareholder Activism Controversy in France

- **Reports on Shareholder Activism Spark Controversy in France:** Shareholder activism has been heavily discussed among various French institutions, organizations and think tanks during Q3 2019. This started on October 2, 2019 with the presentation by Messrs. Woerth and Dirx of the recommendations of the "*Mission d'information sur l'activisme actionnarial*" (the "**Parliamentary Committee**") of the Finance Commission of the French National Assembly, later published as part of the full report of the Parliamentary Committee. The full report is available here. On November 7, 2019, a working group of the French *Club des Juristes* published its report and recommendations regarding shareholder activism, which are available here. On December 10, 2019, AFEP, an industry body representing France's largest companies, issued its report on shareholder activism, which is available here (in French only), while Paris Europlace, an organization in charge of promoting and developing the Paris financial marketplace, published the proposals of its working group on shareholder governance and market practices on January 6, 2020. These proposals are available here (in French only).

- **Transparency and Accountability:** The above mentioned recommendations and proposals aim primarily at improving transparency of market transactions and ensuring that activists can be held accountable in case of breach of applicable transparency principles. For instance, the Parliamentary Committee recommends lowering the threshold for disclosure of equity or voting rights ownership (including derivatives and similar instruments) in listed companies from 5% to 3%. AFEP suggests revising ownership reporting rules to also apply to puts and sales of calls. The Parliamentary Committee and AFEP also advocate for additional disclosure requirements for stock borrowing and lending. Several organizations also suggest reviewing the rules applicable to ownership thresholds set forth in companies' bylaws (including the penalties applicable in case of violation of those rules) and enhancing both disclosures regarding short positions and short-selling requirements in excess of certain volume limits.

  Regarding activists themselves, the *Club des Juristes* recommends that they be required to disclose, throughout their campaigns, their ownership, the type of financial instruments they hold and whether they hedge their positions. The *Club des Juristes* and AFEP also note that information disseminated by activists should comply with disclosure principles similar to those imposed on persons disseminating investment recommendations. Finally, several reports support new requirements for activists to make public, or to provide issuers with, information provided to other shareholders.

- **Next Steps:** The debate about shareholder activism is expected to continue in 2020, although no parliamentary proposal, nor government-backed bill, is expected. On January 8, 2020, Mr. Robert Ophèle, President of the AMF, stated in his New Year's greetings that the AMF intends to clarify its approach to shareholder activism by the end of Q1 2020. Mr. Ophèle's full speech is available here.

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