NILUFER VON BISMARCK

CORPORATE ACQUISITIONS AND MERGERS IN THE UNITED KINGDOM

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Nilufer von Bismarck, partner of Slaughter and May. Nilufer von Bismarck has a broad financing, corporate, and commercial practice. Her practice includes private and public mergers and acquisitions, joint ventures, IPOs, and other UKLA work, financings, equity and debt capital markets transactions, and corporate governance. Nilufer has worked in a range of industries, including financial services, telecoms, infrastructure, retail, media and pharmaceuticals.

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DEFINITIONS

Accounting Regulations	the Large and Medium Companies and Groups Regulations (Accounts and Reports) Regulations 2008 and the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008
AIM	the Alternative Investment Market of the London Stock Exchange
CA85	the Companies Act 1985
CA06	the Companies Act 2006
CAA	the Capital Allowances Act 2001
City Code	the City Code on Takeovers and Mergers
CJA	the Criminal Justice Act 1993
Companies Act Accounts	company accounts prepared under UK GAAP
CTA10	Corporation Tax Act 2010
DPA	the Data Protection Act 1998
DTRs	the Disclosure and Transparency Rules published by the FCA
EA	the Enterprise Act 2002
EPC	Energy Performance Certificate
EP Code	The Employment Practice Code issued by the Information Commissioner
EU	the European Union
FCA	the Financial Conduct Authority
FPC	the Financial Policy Committee
Fraud Act	the Fraud Act 2006
FS Act	the Financial Services Act 2012
FSA	the Financial Services Authority (now obsolete)
FSMA	the Financial Services and Markets Act 2000
HMRC	HM Revenue & Customs

IAS	International Accounting Standard
IFRS	International Financial Reporting Standards
IP	intellectual property
ISDX	the ICAP Securities & Derivatives Exchange
IT	information technology
LA	the Limitation Act 1980
MA	the Misrepresentation Act 1967
Market Abuse Directive	Directive of the European Parliament and of the Council 2003/6/EC on insider dealing and market manipulation (market abuse)
Merger Regulation	Council Regulation (EC) No. 139/2004
MiFID	Directive of the European Parliament and of the Council 2004/39/EC on markets in financial instruments
OFT	the Office of Fair Trading
Panel	the Panel on Takeovers and Mergers
Prospectus Directive	Directive of the European Parliament and of the Council 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading
Prospectus Regulations	Commission Regulation 809/2004/EC implementing Directive 2003/71/EC of the European Parliament and the Council as regards information contained in prospectuses as well as the format, incorporation by reference, and publication of such prospectuses and dissemination of advertisements
PRA	the Prudential Regulation Authority
PSM	the Professional Securities Market of the London Stock Exchange
Secretary of State	the Secretary of State for Business, Innovation and Skills
SETS	the Stock Exchange Electronic Trading Service
London Stock Exchange	the London Stock Exchange plc

Takeover Directive	Directive of the European Parliament and of the Council on takeover bids (2004/25/EC)
TCGA	the Taxation of Chargeable Gains Act 1992
Third Parties Act	the Contracts (Rights of Third Parties) Act 1999
TOGC	the transfer of a going concern as defined in Article 5(1) of the VAT (Special Provisions) Order 1995
TUPE Regulations	the Transfer of Undertakings (Protection of Employment) Regulations 2006
UK	the United Kingdom

PRIVATE ACQUISITIONS

Overview

Introduction

[01] This section, dealing with private acquisitions, considers the legal structure of the acquisition of shares in private companies incorporated in England and Wales or of their assets. It provides an overview of what a private acquisition involves, aiming to identify the key legal issues that usually arise during the course of a typical transaction.

[02] For those embarking on an acquisition for the first time, it is a summary of what to expect. For those who have more acquisition experience, it deals with recent trends, perhaps most notably the influence of private equity on acquisitions, which has contributed to the popularity of sales by limited auction or tender process and the particular legal points posed as a result. It covers matters of concern to both purchasers and sellers and attempts to put all legal issues into their commercial context.

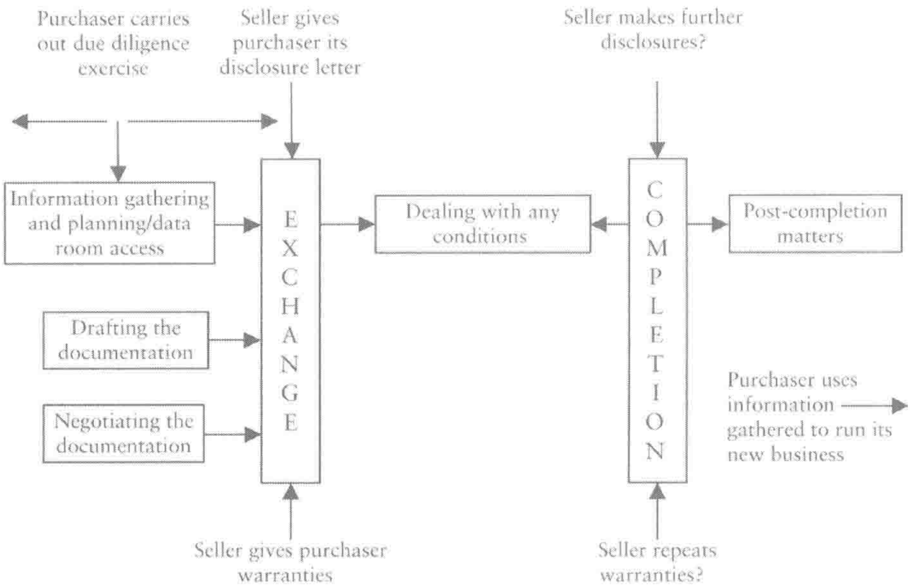
[03] Before launching into the detail, we should begin with a basic outline of what an acquisition involves. The following is a very simplified cascade of events:

- striking the basic deal (and sometimes recording it in heads of agreement);
- information gathering and planning;
- drafting the principal documentation;
- negotiating the principal documentation;
- exchanging the acquisition agreement (often referred to as 'signing');
- if the acquisition is conditional, dealing with the conditions (e.g., seeking shareholder approval or various merger, regulatory, or industry consents);

- completing (often referred to as 'closing') immediately after exchange, if there are no conditions, or, if there are, after those conditions have been satisfied; and
- dealing with post-completion matters.

[04] Diagram 1 shows the basic stages of an acquisition.

Diagram 1



The Type of Acquisition: Shares or Assets?

[05] Before embarking on the acquisition, it is necessary to consider whether it should be a shares or assets deal. Often the decision is tax-driven.[1] Leaving aside detailed tax considerations, the advantages and disadvantages of the purchaser acquiring the assets of the target company (together comprising the target's business) or the shares in the target company are as follows.

[06] In the case of assets' acquisition, the only assets (or, indeed, liabilities) acquired by the purchaser are usually those it expressly agrees to take on board (with the notable exception of any employees automatically transferred by the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE Regulations)).[2] On a share acquisition all assets, liabilities and obligations are

[1] See the tax section of Specialist Areas, below.

[2] See the employment section of Specialist Areas, below. The government is currently consulting on proposed changes to the TUPE Regulations which are expected to become effective in October 2013.

acquired by the purchaser, including those it does not want and those of which it may be unaware.

[07] A share purchase is conceptually simpler in pure legal terms. The only asset being transferred is the shares in the target company. In contrast, an asset purchase is more complex in that each of the separate assets constituting the target business needs to be separately transferred to the purchaser. This may require more consents and approvals. For example, the transfer of contracts with suppliers and customers will invariably require the consent of those third parties. It should, however, be borne in mind that set against this is that it is common for such contracts to contain 'change of control' clauses, which means that the consent of the relevant third party often needs to be sought even in the context of a share deal.

[08] Although, in theory at least, an acquisition of shares as opposed to assets is more straightforward because it involves the transfer of only one asset (i.e., the shares), share deals can in fact be more complex, because they often involve more than one seller. There may be a large number of shareholders with whom a purchaser needs to negotiate in the context of a share sale. Often these shareholders have conflicting interests and may be separately represented, which can make negotiation of the documentation protracted. In the context of an asset acquisition, the purchaser usually needs to negotiate with only one party, the selling company.

[09] From a tax point of view, an asset purchase is simpler than a share purchase, because the purchaser is not buying a company (and therefore its tax history). Instead, it is buying assets and the purchaser's tax treatment (and that of the seller) will depend on the principles and tax charges that apply to those assets.

[10] The prohibition on providing financial assistance for the acquisition of a company's own shares,[3] Part 7 of the Financial Services Act 2012 (FS Act) (regarding misleading statements and impressions) and section 21 of the Financial Services and Markets Act 2000 (FSMA) (which places restrictions on promoting the sale of shares) are irrelevant in the context of asset sales (unless the assets to be purchased include shares).[4]

[11] Although both asset and share sales can involve lengthy warranty negotiation, generally speaking, a purchaser's expectation as to the number and scope of warranties is less in the context of an asset sale and the seller will be more reluctant to give fulsome warranties. On a share sale, the purchaser will want and expect comprehensive warranty cover in view of the fact that it will be acquiring all assets, liabilities and obligations.

[12] Sellers often prefer to proceed by way of share sales rather than asset sales. This is for two principal reasons:

[3] Since October 2008, this prohibition only applies to the acquisition of shares of a public company and to financial assistance provided by a public company for the acquisition of shares in its private holding company. See Consideration and the section dealing with acquisitions of public companies, below.

[4] The statutory provisions noted in this paragraph are considered more fully below.

- Asset sales can involve potential double taxation charges, particularly when the seller is a company that has individual shareholders. Chargeable gains arise in the company's hands when it sells the assets to the purchaser and shareholders may then be taxed on the sale proceeds when these are distributed to them by the company. A disposal of shares, on the other hand, puts the sale proceeds directly into the hands of the selling shareholders. Further, sale proceeds arising on the disposal of shares by a trading company or the holding company of a trading group may be exempt from tax as a result of the substantial shareholding exemption.
- Sellers often want a 'clean break'. The break is cleaner (but not altogether clean, because there is always the potential risk of warranty, covenant or indemnity claims) in the context of share sales. With asset sales, the seller is more likely to be left with liabilities it must sort out and with assets of little or no value (e.g., obsolete stock). Liabilities can be ongoing rather than just historic, particularly in the context of contracts that have been assigned rather than novated.

[13] In contrast, purchasers often prefer to proceed by way of asset purchases rather than share purchases. This is also for two principal reasons:

- In asset sales, purchasers may be more selective about what they acquire. They can 'cherry pick' rather than take a company complete with all its liabilities. Liabilities (and particularly tax liabilities) can generally be left behind.
- There may be certain tax advantages available to a purchaser if the deal proceeds by way of an asset purchase. The purchaser will not, generally speaking, inherit the seller's tax history. In addition, and perhaps most notably, the purchaser may be able to claim capital allowances or relief for expenditure incurred on the purchase of intangible fixed assets and goodwill (when such expenditure is recognized in the company's accounts) so reducing its future liability to corporation tax.

[14] The purchase of land assets will attract stamp duty land tax at the applicable rate and the tax arising will depend not only upon the cash consideration paid, but also upon the debt assumed or released by the purchaser.

[15] The rates of stamp duty land tax for acquisitions of non-residential property are usually:

- 1% of the total consideration (including the assumption of any debt) if more than Pound Sterling (GBP)150 000 but no more than GBP250 000.
- 3% of the total consideration (including the assumption of any debt) if more than GBP250 000 but no more than GBP500 000.
- 4% of the total consideration (including the assumption of any debt) if more than GBP500 000.
- The rates of stamp duty land tax for acquisitions of residential property differ from these rates in some respects, and can also be considerably higher (the Finance Act 2012 introduced a rate of 15% for certain transactions).

[16] Stamp duty was reduced in scope by the Finance Act 2003, which provided that stamp duty proper was chargeable only on instruments relating to stock and marketable securities. Where the consideration exceeds GBP1 000, the rate of stamp duty in respect of transfers of shares is normally 0.5%, rounded up when necessary to the nearest multiple of GBP5. No stamp duty is generally payable if the consideration is below this threshold.

[17] The 'hive-down' represents a hybrid of share/asset deals. The seller transfers assets to a new company (usually a newly formed subsidiary), excluding assets and liabilities the purchaser does not want, and then sells the shares in that company to the purchaser. Hive-downs are not commercial solutions to the shares or assets dilemma but are usually tax motivated. In particular, the hive-down structure may be used in the context of a liquidator sale. Here the primary advantage is that the purchaser leaves unwanted liabilities behind but has the opportunity to acquire unused trading losses. It is important to bear in mind that losses arising before a change in ownership cannot always be carried forward and so hive-down structures must always be vetted by tax specialists.

[18] If it appears that a de-grouping charge under section 179 Taxation of Chargeable Gains Act 1992 (TCGA)[5] could arise in respect of the hived-down assets when the new company is sold to the purchaser and that the substantial shareholding exemption in Schedule 7AC TCGA would not be available to exempt the gain, a possible solution may be to 'hive up' assets. On a hive up, the company that already owns the business assets transfers to its parent company the assets and liabilities that the purchaser does not want. The transferor company, rather than the transferee, leaves the group.

Summary of Legislation and the Regulatory Framework[6]

Distinguishing between Companies

[19] A company may be unlimited, limited by guarantee or limited by shares (the vast majority are limited by shares). In addition, it may be public or private.

[20] A public company must be designated as such (usually by the abbreviation 'plc') and hold a certificate from the Registrar of Companies demonstrating that it meets certain statutory requirements. The most important of these is that the company has a minimum authorized share capital[7] and that the shares have been paid up to the extent of 25%. Any company that does not meet these requirements is automatically a private company. A private company is not required to limit the number of its members or to restrict the right to transfer its shares, but is prohibited by law from offering its shares to the public.

[5] See the tax section of Specialist Areas, below.

[6] The legislation and regulation of particular relevance in the context of acquisitions of public companies is considered more fully in the section dealing with acquisitions of public companies, below.

[7] Section 763 Companies Act 2006 (CA06) prescribes an authorized minimum for a public company's nominal share capital of GBP50 000 or its equivalent in Euros, which, as prescribed by the Companies (Authorized Minimum) Regulations 2009, is EUR57 100.

[21] The second important distinction is between those companies whose shares are actively marketed and those in whose shares there is no market. This distinction is not a legal one, but it is nevertheless vital for an understanding of the relevant regulatory framework.

Statutory Control over Corporate Acquisitions

[22] Although there exists a vast body of company law (primarily embodied in the CA06) regulating the constitution and operation of companies as well as the manner in which they are laid to rest, there are very few legal sanctions to control the manner in which they are bought, sold, and dismembered.[8] To the extent that private acquisitions of companies or businesses are made for straightforward cash consideration, the law leaves the seller and purchaser free to reach whatever bargains they choose.

[23] The Financial Services Authority (FSA), which until 31 March 2013 was the regulator of all providers of financial services in the UK, was disbanded with effect from 1 April 2013 as part of the implementation of a new financial regulation regime in the UK. This regime, which was brought into effect by the FS Act, has seen the creation of three new bodies, the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA) and the Financial Policy Committee (FPC). The new regulatory regime became substantially operational on 1 April 2013 and the FCA assumed responsibility for most of the FSA's functions relating to corporate acquisitions and mergers.

[24] A public company may be a 'listed' company and have its shares traded on the London Stock Exchange.[9] Originally published by the FSA and now the responsibility of the FCA, the Listing Rules, Prospectus Rules, and Disclosure and Transparency Rules (DTRs)[10] govern, *inter alia*, admission to listing and the continuing obligations of listed companies and that must be observed in any private company acquisition when either the acquiring or the target company is a listed company or a member of a group in which one company in the group is a listed company.

[25] In addition, the City Code on Takeovers and Mergers (City Code)[11] applies, broadly speaking, when the target company or *societas europaea* has its registered office in the United Kingdom (UK)[12] and any of its securities are admitted to trading on a regulated market in the UK. The City Code also applies to public and private target companies that do not have securities traded on a regulated market but

[8] Although regard must be had to, for example, 'change of control' provisions of the kind mentioned in para. 32 below and the provisions dealing with financial assistance (Part 18, Ch. 2 CA06), which may have a bearing on the transaction contemplated by the parties. Financial assistance is considered in Consideration and the section dealing with acquisitions of public companies, below.

[9] A public company may also have its shares traded on other exchanges such as the Alternative Investment Market of the London Stock Exchange (AIM) or the ICAP Securities & Derivatives Exchange (ISDX) – both AIM and ISDX are 'multilateral trading facilities' for the purposes of the City Code.

[10] These rules were originally located in the FSA Handbook and can now be found in the FCA Handbook, which can be located at www.fca.org.uk/handbook.

[11] Considered further in the section dealing with acquisitions of public companies, below.

[12] The City Code also extends to the Channel Islands and the Isle of Man.

are considered by the Panel on Takeovers and Mergers (the 'Panel') to have their place of central management and control in the UK. The City Code does not apply if the target company is an open-ended investment company. As discussed below,[13] the City Code only applies to certain types of private company, chiefly when the equity share capital of the target company has, at any time during the ten years prior to the offer, been to some degree publicly held. The status or residence of the offeror is immaterial. Certain provisions of the City Code will also apply when the Panel has shared jurisdiction over a company with another European regulator, in the circumstances contemplated by the Takeover Directive.[14] The City Code will not apply on an asset purchase.

[26] The rules of the City Code are designed to ensure that all the shareholders of a company which is the subject of a takeover offer are treated equally, that such shareholders are given sufficient information to decide whether or not to accept an offer for their shares and that improper tactics are not adopted to frustrate such an offer.

[27] The implementation of the Takeover Directive in the UK by Part 28 of the CA06 increased the extent to which the regulation of takeovers has a statutory basis by putting the Panel on a statutory footing.[15] A breach of certain rules in the City Code may be a criminal offence under the CA06.[16] The implementation of the Takeover Directive in the CA06 also made other changes to the regulation of takeovers, including the creation of an optional regime for companies to override defensive devices that may be put in place prior to a bid being launched and modifications to the provisions dealing with residual minority shareholders following a successful takeover bid (known as 'squeeze-out' and 'sell-out' rules).[17]

[28] The UK competition authorities exercise through the Enterprise Act 2002 (EA) an effective right of veto over certain UK acquisitions that are substantial in terms of size or market share. The Office of Fair Trading (OFT) may refer the transaction to the Competition Commission for detailed investigation if certain tests are satisfied.[18]

[29] Part 7 of the FS Act sets out three offences relating to misleading statements, misleading impressions and misleading statements and impressions in relation to benchmarks, with the first two offences being most relevant in the context of corporate acquisitions and mergers.[19] Under section 89 (Misleading statements) of the FS Act, any person who makes a statement knowing that it is false or misleading

[13] See the section dealing with acquisitions of public companies, below, at para. 649.

[14] Certain amendments to the application of the City Code are being introduced by the Panel with effect from 30 Sept. 2013. These are considered more fully in the section dealing with acquisitions of public companies, below.

[15] See s. 942 CA06.

[16] See the section dealing with acquisitions of public companies, below, at para. 655.

[17] Chapter 3 of Part 28 CA06.

[18] The EA is considered in greater detail below. See the competition section of Specialist Areas.

[19] Part 7 of the FS Act, which has been in force since 1 Apr. 2013, repeals section 397 of FSMA (Misleading statements and practices), which prohibited misleading statements and practices in relation to investment business.