KEY POINTS

- There is an obvious danger to a lender seeking to enforce the terms of an interim facilities agreement that has been used to fund an "illegal" acquisition in the face of the well-known defence of *ex turpi causa oritur non actio*.
- The illegality test could be satisfied where the lenders fund an acquisition and the offeror has refused to follow the remedies prescribed by the Competition and Markets Authority (CMA) or the European Commission (EU). The practical reality is that the bidder would have to follow the remedies prescribed when closing the deal.
- If the offeror refuses to follow the remedies, a conceivable decision by the court so that no one profits from the illegality could be allowing recovery of capital but barring any payment to the lenders of interest or fees.

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Takeover Code Changes 2021: can lenders be forced to fund an illegal deal?

The new edition (13th) of the Takeover Code took effect on 5 July 2021. One of the amendments to Rule 13 removed the special status given to UK and EU competition clearances, in part due to recognition of the diminished role of the European Commission in domestic takeovers. A question arising therefrom is how will this impact firm financing put in place by lenders to support the takeover offers? In this article, the author looks at the possible legal and practical answers to this question.

WHAT ARE THE CHANGES?

Prior to the implementation of the new rules, opening of a Phase 2 investigation either by the Competition and Markets Authority (CMA) or the European Commission (EC), allowed the offer to lapse. By contrast, regulatory clearances in any other jurisdiction conferred no such automatic right, but rather were subject to the Takeover Panel's consideration. Withdrawing an offer for such clearances would only be allowed by the Panel if they were found to pass the threshold of "material significance" in the context of the offer.

Since 5 July 2021, the regime for CMA and EC clearance became the same as for any other jurisdiction. The Takeover Panel now has the power to force an offeror to close a bid, even when such bid was found to be against UK competition policy, unless convinced that this was of "material significance".

To reflect this approach, Rule 13.5(a) of the Takeover Code was amended as follows:

> "An offeror ~~should not~~ may only invoke ~~any~~ a condition or pre-condition so as to cause the offer not to proceed, to lapse or to be withdrawn with the consent of the Panel. The firm offer announcement and the offer document must each incorporate language which appropriately reflects this requirement. The Panel will normally only give its consent if the circumstances which give rise to the right to invoke the condition or pre- condition are of material significance to the offeror in the context of the offer. This will be judged by reference to the facts of each case at the time that the relevant circumstances arise."

Guidance on factors to be taken into account when considering "material significance" is given in the revised Practice Statement No 5. With respect to regulatory clearances, the Panel made the following additions:

> "4.3 In the case of a condition relating to there being no Phase 2 CMA reference (or equivalent reference or process), the factors that will be taken into account will also include:
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> *a)* whether the reference or process would be likely to result in a serious risk of material damage to the business of the offeror and/or the offeree company; and
>
> *b)* the utility of requiring the offeror and/or the offeree company to pursue the reference or process where the prospect of the clearance being obtained is low."

IMPACT OF THE CHANGES TO RULE 2.7 ANNOUNCEMENTS

Rule 2.7 announcements now include a small, but significant change to the standard disclaimer about the requirements of Rule 13.5. This is visible from the Rule 2.7 announcement of Brown Bidco Limited (a Blackstone SPV) for Signature Aviation plc dated 5 February 2021 (before the changes) and the Rule 2.7 announcement by Aristocrat (UK) Holdings Limited for Playtech plc dated 17 October 2021 (after the changes). The first reads:

> "Under Rule 13.5(a) of the Code, Bidco may not invoke a Condition so as to cause the Acquisition not to proceed, to lapse or to be withdrawn unless the circumstances which give rise to the right to invoke the Condition are of material significance to Bidco in the context of the Acquisition. The Conditions contained in paragraphs 1, 2 and 3(a) above and, if applicable, any acceptance condition if the Offer is implemented by means of a takeover offer, are not subject to this provision of the Code.",

where Condition 3(a) is approval from the EC.

By contrast, Aristocrat's offer for Playtech did not exclude any of the Conditions in para 3 (including EC approval) and introduced the following language in relation to the "material significance" test to match the new guidance:

> "This will be judged by reference to the facts of each case at the time that the relevant circumstances arise."

IMPACT OF THE CHANGES TO CERTAIN FUNDS FINANCING

In a situation where the CMA or EC enter: (i) Phase 2 investigations; or (ii) worse, do not approve the takeover and require certain

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actions to be taken, the analysis for the bidder and its financiers is different.

For the bidder, the question is whether the investigation or remedy required is of such a material significance in the context of the acquisition, that it is able to convince the Panel it ought to be allowed to lapse the offer. If the Panel agrees, the lenders would be off the hook as well.

However, if the Panel disagrees, the question for the lenders is whether: (i) in the case of a Phase II referral, how long (if at all) they would need to extend the certain funds period; or (ii) in the case of a lack of approval, would they still need to fund the deal?

Extending the Certain Funds Period

The answer to the first question appears more straightforward. Taking the Playtech bid as an example, the Certain Funds Period as defined in the Interim Facilities Agreement itself includes a long stop date "that is the first Business Day (the 'Offer Outside Date') following the date falling eight (8) weeks after the date specified as the long-stop date for the Offer in the Offer Document".

But here is the wrinkle. The Long Stop Date in the Playtech 2.7 Offer Document is defined as:

> "30 November 2022, **or such later date as may be agreed in writing by Aristocrat and/or Bidco and Playtech (with the Panel's consent and as the Court may approve (if such approval is required)**". (emphasis added)

Effectively, this takes away control from the lenders and leaves it entirely with the bidder and the Panel. As long as the bidder and the Panel are happy to keep the offer music playing, the lenders would have to dance to the tune.

Changing this position is possible on a commercial level, but it is very difficult because any mismatch between the long-stop dates in the Offer Document and the Interim Facilities Agreement will likely cause problems for the financial adviser to give the required cash confirmation.

Illegality

The more complicated question arises with respect to takeovers that have failed to receive competition clearance from a relevant authority. At first sight, the analysis is no different for deals before and after the new Code changes. In either case, the lenders would only be obliged to fund if (to quote the Playtech deal again):

> "3(a)(ii) no Major Event of Default is continuing or would result from the making of the relevant Interim Loan; and
>
> (iii) it is not unlawful in any applicable jurisdiction for such Interim Lender to make, or to allow to have outstanding, that Interim Loan."

The first limb would be heavily fact-dependant on the type of action required by the competition authority. A significant divestment could rise to the level of breaching a customary Major Undertaking on Fundamental Changes or Dispositions of Property and as such become a Major Event of Default. Given that the bidder would have to make the divestment at the very latest after acquiring the target, the Major Event of Default most likely "would result from the making of the relevant Interim Loan", which has enabled the acquisition.

The second limb, arguably, does not take the position much further – and indeed is directed more towards sanctions that would prevent a particular lender from funding, rather than competition clearance. The practical reality of a situation where the CMA or EC does not grant approval and the Panel does not allow the offer to lapse is that the bidder would have to follow the remedies prescribed when closing the deal and this would remove any illegality.

What about the law?

The obvious danger to a lender would be seeking to enforce the terms of an interim facilities agreement that has been used to fund an "illegal" acquisition in the face of the well-known defence of *ex turpi causa oritur non actio*. Following the decision in *Patel v Mirza* [2017] AC 467, the court now needs to judge whether a claim is contrary to public policy by [101 (Lord Toulson)]:

> "(a) considering the underlying purpose of the prohibition which has been transgressed, (b) considering conversely any other relevant public policies which may be rendered ineffective or less effective by denial of the claim, and (c) keeping in mind the possibility of overkill unless the law is applied with a due sense of proportionality."

Predicting an answer based on such a "balancing" test is notoriously difficult, but it would apply to the lenders only where they have funded an acquisition and the offeror has refused to follow the remedies prescribed by the CMA or EC – an uncanny situation. If that were the case, a conceivable solution where no one profits from the illegality would be allowing recovery of capital, but barring any payment to the lenders of interest or fees.

CONCLUSION

It is hoped that the question posed by this article is largely academic. If the remedies prescribed by the CMA, EC, or any other regulatory authority are so drastic as to transform the deal, there is a compelling argument that such a situation easily satisfies the "material significance" threshold under Rule 13.5 of the Code and the Panel should allow the offer to lapse.

On the other hand, if the remedies are not of "material significance" – then the bidder should be able to renegotiate any financing terms prior to the closing date and follow the remedies required (which would remove any illegality).

In either case, lenders now are advised: (i) to bear in mind the consequences of potential remedies that could be prescribed by the CMA or EC when drafting the Major Events of Default in the interim financing agreements; and (ii) that they are likely to see increased Certain Funds commitment periods where the CMA or EC open Phase II investigations. ■

Further Reading:

- Impact of the new Takeover Code on financing public bids (2021) 10 JIBFL 684.
- Scheming to get round the Takeover Code: does it work? (2008) 9 JIBFL 476.
- LexisPSL: Competition: Practice Note: Merger control and the Takeover Code.