

Top 5 private M&A trends

The long-awaited recovery in M&A activity levels, whilst discernible, has been slower than was anticipated at the start of 2010. Fears of a 'double-dip' recession coupled with a 'wait and see' approach to the government's austerity measures means deal levels continue to be well below the market highs of Q1 2008. However, we are seeing an increasing number of transactions progressing beyond the preliminary stages and from those we've identified our top five trends in private M&A deals:

- **Consideration protection**

With buyers nervous about overpaying in the current economic climate, many are looking to protect their investments in acquisition targets. Gone are the days of sellers securing a clean break via a 'locked box' mechanism and some form of post-completion calculation of the final price is back in fashion, either via completion accounts or a working capital adjustment. Earn outs, once used primarily to incentivise management, are also playing an increasing role in mainstream M&A as buyers seek to maximise value from their acquisitions whilst minimising risk.

- **Managing buyer's risk**

Speedy deals (other than stressed or distressed sales) are rare now and the length of time it takes to complete a transaction is frustrating. With buyers in a strong bargaining position, detailed due diligence is common as they look to identify material issues pre-completion rather than rely on a post-completion

remedy under the warranties. Those warranties themselves are the subject of highly focused negotiations with buyers taking increasingly entrenched positions on matters such as compliance and disclosed information. Warranty caps and time periods remain high with low thresholds for claims as buyers are loath to write off even small amounts in respect of such claims.

- **Seller roll over**

With liquidity levels still a problem in the market, many sellers are being asked effectively to fund their own deals, either by accepting deferred consideration, taking loan notes or rolling over into shares in the buyer. The continuing presence of the seller in the target business brings another layer of complexity to a transaction as the parties seek to balance the seller's desire to protect its remaining investment with the buyer's wish for freedom to operate the business to its best advantage post-completion.

- **A creative approach**

As transactions need a little more 'TLC' to get them to completion, a one size fits all approach is unfeasible. Instead of relying on standard documents, advisers are required to adopt innovative solutions creating bespoke structures based on the specific assets involved in the transaction, the nature of the deal and the relative requirements and negotiating positions of the parties. Whilst this could involve changes in the M&A deal structure, at the extreme it might involve abandoning a disposal altogether in favour of a demerger or a joint venture.



- **Tax drivers**

Having seen the lifetime limit of gains which may qualify for entrepreneurs' relief increase to £10 million, many sellers are understandably keen to take advantage of this and to ensure that any transaction is structured appropriately. Similarly, it seems likely that the recent changes in the Enterprise Investment Scheme will make those companies that qualify under that scheme increasingly attractive targets for investors seeking to arrange their investments in a tax advantageous manner.

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Twitter ye not? Acas guidance on social networking

Most people seem to fall into one of two camps: those who spend all of their time on Facebook/Bebo/Twitter etc, and those who either do not understand them or cannot stand them (or both). Difficulties can arise when members of your staff fall into the former camp, particularly if HR and management fall into the latter.

Social networking can cause all sorts of headaches for employers. The top two are set out below.

- One major problem is euphemistically termed the 'productivity virus' when employees spend a part of their working day at their computer keyboard (or mobile phone) updating their status on Facebook, bidding on Ebay or regaling their followers on Twitter with every detail of what they had for breakfast instead of working.
- Some employers have faced problems when employees post derogatory comments on social network sites, either about each other or about the business itself. Often a business will wish to take disciplinary action, but the ability to do so will depend on the circumstances, including (crucially) whether the employee could reasonably have expected disciplinary action to result from his or her actions. An employer with a robust 'acceptable use policy' will be in a better position in this respect.

Social networking sites are a relatively new, and fast evolving, phenomenon and so the law, and HR practice, must try to keep up. Businesses with a robust 'acceptable use policy' are best placed to deal with these. The latest,

very helpful, foray into this field has come from Acas, who have produced guidance notes on social networking. These notes offer helpful tips on how an employer can deal with the issues that arise from social networking, as set out above. They have also produced some specific guidance on drawing up a social networking policy, which sets out clearly why it is important to have a policy, what it should cover and who should be involved. This publication also summarises the relevant legal considerations that need to be borne in mind. Any employer that is considering bringing in a policy on social networking (or updating an existing policy) could do a lot worse than to use the Acas guidance as a starting point.

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The points based system – have you read the small-print?

Since 2005 the UK immigration regime has undergone significant changes with the twin aims of making entry to the UK simpler and strengthening measures to prevent illegal working. The new system, branded the Points Based System ('PBS'), brought together the previous 80 different routes of entry to the UK into a single system consisting of five tiers.

Whilst on the face of it the PBS appears simpler, the current regime contains lots of traps for infrequent users of the system where even the smallest of errors could result in an application for entry to the UK or the right to remain in the UK being refused.

The five tiers in a nutshell

Tier 1 – this route at its inauguration enabled those without a job offer to come to the UK and seek work having satisfied the UK Border Agency (UKBA) that they are economically viable enough to be in the UK without relying on the public purse and sufficiently skilled to contribute actively to the UK economy. New entrants without a job offer are *not* now permitted to enter the UK following the unfortunate abuse of the flexibility of this category by some. Currently, this route is only available to those who wish to set up in business or invest in the UK and, for a limited period only, to post-graduate students. This tier also includes a new category of 'exceptionally talented migrants' so that the creme-de-la-creme of the scientific world and entertainment industry can, subject to strict numbers, come to the UK to work.

Tier 2 – this route covers those individuals with a job offer. A specific employer (sponsor) must confirm the offer to the UKBA as well as agreeing to comply with strict obligations and duties to prevent illegal working. Jobs in this category must be at graduate level or above and the UKBA prescribes set pay rates as well as strict requirements to prove that there is no suitable person within the UK who could undertake the role.

Tier 3 – this route applies to low skilled workers but has been suspended on the basis that any shortages in agriculture, hospitality and food processing can be filled by EEA workers.

Tier 4 – this route is for students; but this category is continually tightening up entry requirements to prevent abuse of the student route.

Tier 5 – this route enables temporary workers to come to the UK to work for a short period, for example, interns coming to experience life and work in the UK or those coming for one-off events such as the Olympics.

The five tiers cover a wide array of migrants who can all benefit the UK economy and add to the variety of cultures in the UK. The PBS can however be complicated and is under constant review leading to changes at very short notice. With the increasingly important role migrants play in many organisations, it is worth taking advice from a specialist to ensure that you are not caught out by the ‘small-print’ on how to use the PBS.

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National Housing Trust has the potential to jump start Scottish construction sector

The Scottish government’s National Housing Trust (NHT) initiative could be a lifeline for the country’s construction sector, following securing of funding for the first project under the new model.

We advised developer Tweed Homes on the project, which will see the construction of 51 new homes in Galashiels.

The project is the first of its kind to be secured under the NHT, which was set up to deliver new mid market (rent at below private market rate) housing stock to a growing section of the population.

The Galashiels deal proved the ability of the NHT model, as one of several initiatives, to help the Scottish government fulfil its affordable housing needs, with a positive knock-on effect for the construction sector.

Scotland’s construction industry has been under pressure for several years and so far there doesn’t appear to be any great cause for comfort on the horizon. However, the NHT is a novel way of accessing low-risk funding for new building projects which has the potential to encourage more activity in the sector.

The project in Galashiels was relatively small but shows that it can be done, and has provided those of us who were involved with some food for thought around how we can make the process quicker and more efficient the next time.

To get the project underway, Tweedside LLP was created as a joint venture between the Scottish government (through Scottish Futures Trust), Scottish Borders Council and Tweed Homes, to deliver and manage the new mid market housing stock in the Borders.

Some £6.25 million has been raised to finance the project. £4.05 million of prudential borrowing was provided by Scottish Borders Council, underwritten by a guarantee from the Scottish government, and a further contribution of £2.20 million of private investment has been contributed by Tweed Homes. The construction phase of the project will be funded by the Clydesdale Bank.

Tweed Homes was the first company in Scotland to sign up to the initiative. To mark the occasion, the Scottish Government’s Minister for Housing & Transport, Keith Brown, opened the first site formally at Balnakiel in Galashiels on 16 August 2011.

A consultation exercise is now underway to build on lessons learned from the first phase of the NHT to streamline the process for future projects.

This addresses a genuine need for affordable housing to a growing sector of the population throughout Scotland and shows what can be achieved when the public and private sectors work together towards a common aim. There is no reason why this sort of project is exclusive to Scotland, there are clear opportunities for the whole of the UK in this type of initiative.

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No win no fee: welcome to Damages Based Agreements (DBAs)

Predicting and controlling legal costs in court cases is of the utmost importance to our clients. Even more now, when cash is tight, businesses need to resolve disputes for the lowest possible cost.

We are always prepared to consider offering alternative funding arrangements. One alternative that has become popular over recent years is the Conditional Fee Agreement (CFA), or so called 'no win no fee' arrangement.

Under the terms of a typical claimant CFA, we do not charge fees if the claim fails but we do add on a success fee if the claim is successful. Ordinarily, most of our costs and the success fee are paid by the unsuccessful defendant. Quite often our clients take out after-the-event (ATE) insurance to cover them for the other side's legal costs should their claim be unsuccessful.

On 29 June 2011 the Legal Aid, Sentencing and Punishment of Offenders Bill had its second reading. Part 2 of the Bill incorporates proposals made by Lord Justice Jackson in his *Review of Civil Litigation Costs: Final Report*. These include abolishing the recoverability of CFA success fees and ATE premiums from the losing party and enabling the use of Damages-Based Agreements (DBAs) or 'US style contingency fees' in most civil litigation.

A typical contingency fee agreement, like a CFA, is also based on the 'no win no fee' principle, but on terms that lawyers will take an agreed percentage of the damages awarded as their costs if the claim is successful. DBAs will therefore enable a business to bring a claim without paying on-going legal costs and remove the costs risk of losing a claim away from the business.

The Bill is awaiting its third reading and then has to pass through the House of Lords before receiving Royal Assent and becoming law in around Autumn 2012. In appropriate cases, we will continue to share with our clients the risks of taking court action and believe that the DBA structure will give the opportunity for us and our clients to pursue many court cases to successful conclusions.

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Marked increase in appeals against late filing penalties

The latest report by the Independent Adjudicators to Companies House shows that the number of appeals against late filing penalties rose by almost 44% for the year to 31 March 2011 when compared with the previous year. In total 44,000 companies appealed against late filing penalties. Whilst the majority of these cases were dealt with by the Registrar, 467 appeals were referred to the Independent Adjudicators.

The number of appeals has increased dramatically since the late filing penalties were increased on 1 February 2009 and the period for filing accounts was reduced by one month under the Companies Act 2006. The average number of cases per month for the 07/08 year, before the new provisions were introduced, was just 4 compared with 39 afterwards.

The report notes that the objective of the increased penalties was compliance and this seems to be having the desired effect with 91% of companies filing their annual accounts on time.

Many of the appeals arose from the fact that the 14 day concessionary period previously allowed to amend and return accounts has been abolished. If accounts are received by Companies House close to the filing deadline and those accounts are rejected with amended accounts not then returned until after the filing deadline has expired, a late filing penalty is now imposed.

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Drastic consequences of failure to update forecasts in sale process

The High Court has allowed a share purchase agreement to be rescinded where the seller failed to inform the buyer that information and forecasts contained in an information memorandum about the target had become false.

Negotiations were underway between GG 132 Limited and Hampson Industries Plc in relation to the potential acquisition of HPA Limited by GG 132. An information memorandum relating to HPA was produced and disclosed to GG 132 containing details of the products manufactured by HPA, its major customers and, in particular, a forecast income projection which included a major increase in orders from CTT its second largest customer.

Whilst the negotiations were progressing, however, CTT informed Hampson's CEO that it wished to exit its supply agreement. Crucially, the CEO did not pass this evidence on to GG 132, claiming at the subsequent trial that he believed the threat to exit was merely a negotiating strategy by CTT to obtain lower prices.

The day after GG 132 completed the acquisition of HPA, CTT confirmed that it would no longer be purchasing from HPA. GG 132 then issued proceedings against Hampson to rescind the share purchase agreement, claiming that it had been induced to enter into that agreement by a fraudulent misrepresentation, namely that the income forecasts produced by Hampson relating to HPA and CTT were correct.

At the trial, CTT gave evidence that in its telephone meeting with the CEO it had told him that it was exiting entirely from the supply agreement and that the decision was final. The court found that the CEO had appreciated that the effect of this decision was to make HPA 'unsaleable' but he had chosen to say nothing to those people within Hampson negotiating the sale of HPA to GG 132. The CEO knew that the forecasts were being provided to potential buyers but kept silent with the intention that potential buyers should rely on them. Accordingly, the necessary intention to establish fraudulent misrepresentation had been proved and GG 132 was entitled to rescind the share purchase agreement.

Comment: There is no general duty to keep a counterparty to negotiations or a contract constantly updated. Where a representation has been made by a party, however, there is a duty to communicate a change of circumstances which the party knows will result in that representation becoming false. If representations are made false by subsequent events, and the party making those (now false) representations knows that they are relied on, then a claim for fraudulent misrepresentation may arise with the possibility of rescission as a remedy.

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The Defamation Bill – Libel law for the 21st Century?

The Defamation Bill was published earlier this year, containing proposals for significant reform to UK media law, although some commentators have already argued that the changes don't go far enough.

Some of the key changes proposed by the bill are:

A new requirement for claimants to show that a statement has caused them 'substantial harm'

However, the bill contains no guidance on what kind of evidence will need to be adduced to show 'substantial harm' – if businesses sue, will this mean that they will now have to show a sharp drop in profits as a result of the statement in question?

A new defence of responsible publication on matters of public interest

A statement may be found to be defamatory but there may be a very good reason for 'publishing' it, usually on the grounds of informing public debate on a major issue.

A new defence of 'truth'

The old defence of 'justification' essentially meant that if a comment is true, then it can't be defamatory. In future it will be a defence to show that the imputation conveyed by the statement is 'substantially true'. Existing cases will still be used as guidance, but the issue should be far easier to deal with.

A new defence of 'honest opinion'

Replacing the old 'fair comment', and following the landmark 2010 case of *Spiller –v– Joseph*, the new defence would protect statements of opinion (rather than fact) made on a matter of public interest where an

honest person could have come to the same conclusion on the basis of the available facts when the statement was made.

A 'single publication rule'

Under the current law, each time a defamatory statement is 'published', it allows a claimant to sue in separate proceedings. In internet libel cases, each hit on a website constitutes a separate publication, meaning that archive material on a site can lead to a libel claim way after the expiry of the usual one-year limitation period. This is a change designed to suit the internet and social media age, but the bill contains no guidance on situations where older material gains a second life and with exposure through social networks such as Facebook or Twitter, failing to deal with the issue of who would be responsible for the newfound attention. Tweets may link to older material, but may be taken as re-publications in a different medium.

The bill answers several very important questions aimed at toughening up the UK's notoriously claimant friendly defamation law but raises a whole set of new ones. No provisions are made to limit costs in libel cases – even if the Jackson Review leads to the abolition of 'no-win, no-fee' cases where lawyers can recover success fees of up to 100% of their costs if successful, libel claims will remain expensive to the point where less-wealthy claimants simply won't be able to afford them. The hotly contested issue of whether businesses should be able to sue for defamation in the first place has been ignored, probably to allay the fears of corporate claimants, even if they will now need to show 'substantial harm' before doing so.

Even though it has not become law just yet, the bill is a very clear indicator of the likely future of defamation law in the UK and provides very useful guidance that can be used immediately to prepare for a more sensible relationship between the law and the media.

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Fund raising just got easier...

Two important deregulatory changes have been made to the circumstances in which a prospectus must be published when securities are offered to the public or admitted to trading on a regulated market. As a result of the changes a prospectus will no longer be required:

- Where the total consideration of an offer in the EU is less than €5 million (up from €2.5 million); or
- Where the number of persons, other than qualified investors, to whom an offer of securities is made is less than 150 (up from 100).

The changes took effect from 31 July 2011 and implement part of an EU directive aimed at simplifying the procedure for companies making public offerings. The government decided to implement these two measures ahead of the 1 July 2012 deadline in a bid to help businesses, particularly SMEs, looking to raise equity finance. By widening the exemptions, fewer offers of securities should require a prospectus in the future and companies should be able to access public capital more efficiently. The government estimates that avoiding the costly production of a prospectus will save UK businesses around £12 million each year.

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