Recent developments in M&A including the use of derivatives and sovereign funds

15 October 2008

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This session directly addressed the dramatic changes in the financial markets and the corresponding effects in the mergers and acquisitions climate. The well organised format covered key market developments, key practice developments, and key legal developments, including legislative changes recently enacted or expected to be passed. Also covered in this session, and of particular interest, was the financial crisis and the resulting drop in total deal activity, particularly involving private equity players; the effect of derivatives which allow stealth acquisitions; and governmental reaction to the financial crisis and the call for stricter disclosure.

Rick Hall highlighted the four key areas of M&A activity, namely: Routine Strategic M&A Transactions, Big Ticket Strategic Cash M&A Transactions, Private Equity M&A Transactions and Distressed Financial Institution M&A Transactions. He then noted that the most dramatic drop-off has been seen in the private equity category, due primarily to the disappearance of credit lines. As recent events have shown, those transactions involving distressed financial institutions are extremely active. With regards to transactions involving distressed financial institutions, he pointed out the interesting trend of governmental influence manifested by significant pressure to quickly sell or obtain capital injections, limiting reliance on due diligence and effectively creating the so called 'Paulson' defence for the breach of fiduciary duties. Another development of note is the increased difficulty in moving those deals affected by the market changes to closing and the increase in litigation. Private equity firms are increasingly employing MAC's, including financing conditions and reverse break-up fees or liquidated damages to renegotiate deals. Mr Hall contends that the generally accepted assumption that private equity firms do not renege on deals, in order to maintain their reputations, has all but disappeared.

Craig Cleaver highlighted the increased intervention by the UK Government in the area of distressed financial institution transactions which has extended to the relaxation of antitrust rules to such an extent as to have effectively waived such rules. And further, intervention by way of governmental purchase of distressed bank assets. As in the United States, the United Kingdom mergers and acquisitions environment has suffered dramatic decline in both overall deal activity and deal sizes, with a significant wave of distressed bank transactions. A particularly notable transaction is the Bradford & Bingley sale where Banco Santander was permitted to only buy deposits and the government absorbed the liabilities.

Christian Cascante discussed the importance of recent developments in Germany which, despite a relatively stable sub-prime climate, has seen a dramatic decrease in transactions, particularly those involving private equity. Mr Cascante raised the important topic of the effects of cash settled Total Equity Return Swaps which allows for the accumulation of majority voting rights without enlivening those disclosure requirements which would be required for an outright purchase of shares. Concern over this issue was a recurrent theme throughout the remainder of the session and dominated the Q&A. Mr Cascante discussed Germany's response to this phenomenon through the Risk Limitation Act which amplifies notice requirements

and increases registered shareholder disclosure of beneficial ownership interests.

Horacio Varela discussed both the climate in Argentina – which is experiencing significant investment from Brazilian companies – and the increase in Argentine Government intervention, particularly with respect to antitrust regulations. This government intervention has, since 2006, increased the waiting time for government antitrust approval two-fold. The practical response in the market has been to effect financial closings prior to the official receipt of the approval following careful scrutiny that gives sufficient comfort that approval will be received. In the event that the risks appear too high, interim administrative structures are employed. In Argentina, transactions predominantly involve local or regional investors, especially Brazilian companies, seeking to consolidate Latin American operations.

Corina Bove spoke of the strong growth in foreign investment in Uruguay during 2007 and attributed it to Uruguay's welcoming and stable legal framework. There has been particularly strong growth in foreign investment in agrarian land. A relevant legislative development in response to such growth and the concern for who has actual ownership of Uruguayan land is the Agrarian Land Statute, drafted to ensure that the nation is not harmed by the land purchases of foreign corporate investors.

Dieter Guicke discussed the growing alarm in Switzerland over the 'barbarians at the gate' fear factor with respect to recent acquisitions of 'old Swiss industrial pearls' through the use of cash settled derivatives. Mr Guicke discussed the various defensive strategies to protect the vulnerable entities and gave examples of several transactions where innovative procedures were employed to block unwanted purchasers. Swiss regulators directly responded to the issue by not only lowering disclosure threshold but also by aggressively altering regulations to require disclosure of so-called 'disposal rights' which includes the purchasing of puts and the writing of calls. This development effectively mandates the disclosure of actual investor economic interest and deters hidden stake-building.

Paul Cronheim described the Dutch environment before the crisis as 'the sky is the limit' and commented that the Netherlands has shared the dramatic decrease in M&A activity, also primarily in the private equity area. Recent Dutch legislation has developed stronger protections for shareholders, resulting in increased shareholder activism. The Netherlands is also contemplating the effects of the derivatives markets on acquisitions. However, at present, influence created by purely 'economic stakes' has yet to be regulated.

Christian Hoedl described the effect of the overall credit crunch in Spain combined with a serious 'homemade' economic crisis. Private equity transactions are also markedly low but, Mr Hoedl explained that, as is typical in the Spanish market, middle market private equity players remain active. Spain has also confronted the issue of equity derivatives and the disclosure of shareholdings in listed companies. New regulations create stricter disclosure and, in practice, the interpretation of beneficial ownership tends to require that even the purchase of cash settled equity derivatives triggers the obligation to disclose such shareholding. He noted however that that was not the case in two high profile transactions, ENDESA and ABN AMRO and the resulting litigation.

Ezra Davids reported that M&A activity continues in South Africa, particularly for purely local deals, but that there has been a marked decrease in large transactions. Mr Davids discussed the particular importance of black South African economic empowerment transactions in the current environment. Such transactions are based on regulation requiring specific target ownership by black South Africans according to sectors and include deals where major companies are selling up to 25 per cent equity stakes to black South African shareholders. New regulations relax certain restrictions such as the prohibition on financing the purchase of a company's own shares. Additional regulatory developments which will affect the South African M&A market are the modernisation of the Companies Act expected to come into effect in 2009 or early 2010, which among other things, provides for statutory mergers and minority shareholder dissenting rights.

There were numerous issues of common concern among the jurisdictions represented on the panel. The credit crisis has clearly had a severe negative impact on the role of private equity in M&A and has precipitated a significant drop in the number and value of transactions. Common to those jurisdictions represented on the panel is that transactions involving distressed financial institutions and select strategic transactions represent the bulk of deals done or in execution during 2008. The obligation to disclose the purchase equity derivatives as a stake holding was hotly debated. The Swiss and Spanish approach to interpret ownership of cash settled equity derivatives as a beneficial ownership, thereby triggering disclosure requirements, caused concern for a slippery slope, where liberal interpretation could extend to disclosure requirements for bondholders. The meaning of the measure 'acting in concert' to connect the equity derivative purchaser to the financial institution selling the put (who will have purchased the actual shares as a hedge) is believed to be central to determining whether disclosure is required.

Overall, concern that the full extent of the financial crisis has not yet been felt creates an air of uncertainty combined with uncertainty over the new face of the credit markets given that the banking industries of major economic powers have been nationalised. The predominant view was that the industry would not see an upturn until at least the end of 2009.