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By a number of measures, it could be argued that it has been some time since the outlook for the M&A market looked healthier. The past year has seen a boom in deal making, with many markets seeing post-crisis peaks and some recording all-time highs. Looking behind the headline figures, however, a number of factors suggest deal making may not continue to grow as rapidly as it has done recently.

One key driver affecting global figures is the widely expected rise of US interest rates. Cheap debt has played a significant part in the surge of US deal making in the first few months of 2015, and the prospects of a rate rise may have some dampening effects. However, the most recent indications from the Federal Reserve have suggested that any rise will be gradual and some market participants have pushed back predictions for the first rate rise to December 2015. Meanwhile, eurozone and UK interest rates look likely to remain low for some time further.

The eurozone returned to the headlines in June as the prospect of a Greek exit looked increasingly real. Even assuming Greece remains in the euro (as now seems likely), the crisis has severely damaged the relationship between Greece and its creditors. The brinksmanship exhibited by all parties means that meaningful progress cannot occur except at the conclusion of a crisis: the idea that reform will benefit Greece has been lost and each measure extracted by creditors is couched as a concession. However, while the political debate has become ever more fractious, the market’s response to the crisis has been relatively sanguine. This is largely a result of the fact that the volume of Greek debt is no longer in the market, but in the hands of institutions. But it is also a sign of the general market recovery and expectations that major economies will continue to grow.

Perhaps one of the more interesting emerging trends in the last year is the interplay between growth and productivity. Some commentators have suggested that the recent rise in deal making is a symptom of a climate in which businesses remain reluctant to invest in capital and productivity. Pessimistic about the opportunities for organic growth, companies instead seek to grow profits through cost savings on mergers. It is difficult to generalise about such matters: inevitably, deal drivers will vary from industry to industry, from market to market. However, if synergies have been the principal motivation in
much of the year’s deal making (it certainly has been in a number of large-cap deals) then it may be that the market is a little farther from sustainable growth than some would like to think.

I would like to thank the contributors for their support in producing the ninth edition of The Mergers & Acquisitions Review. I hope that the commentary in the following chapters will provide a richer understanding of the shape of the global markets, together with the challenges and opportunities facing market participants.

Mark Zerdin
Slaughter and May
London
August 2015
I OVERVIEW OF M&A ACTIVITY

Globally, 2014 has been a bumper year for deal making and the UK has been no exception. Across Europe, total deal value climbed 39 per cent in 2014 to €671.5 billion, with the UK accounting for nearly one-quarter of that value.\(^2\)

In the UK, 48 firm offers were announced for Main Market or AIM companies in 2014, up from 39 in 2013. There has been a disproportionate increase in value: 24 of the firm offers were for Main Market companies (compared to nine in 2013) and nine offers had a value of over £1 billion (compared to three in 2013). This trend towards higher value M&A is also reflected in Europe, where the 39 per cent increase in value corresponded to only an 8 per cent increase in volume.\(^3\)

The UK figures appear particularly strong when taken in the context of a politically uncertain 18 months, and a market in which some of the largest deals ultimately failed. The outcome of the May 2015 general election was the most uncertain for a generation and, accordingly, had a significant negative impact on business confidence in the first quarter.\(^4\) The (unexpected) majority government quickly restored that confidence, although the impact of a promised referendum on EU membership remains to be seen.

Meanwhile, the aborted approaches by AbbVie Inc for Shire plc in November 2014 and Pfizer Inc for AstraZenica plc in May 2014, mean the value of UK M&A in 2014 was £100 billion lower than it might have been. Although both deals were driven by conventional M&A motivations, they can also be characterised as ‘inversions’,

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1 Mark Zerdin is a partner at Slaughter and May. The author would like to thank Richard Batstone for his assistance in preparing this chapter.

2 Mergermarket, Deal Drivers, EMEA 2014 Full Year Edition.

3 PLC, Public M&A Trends and Highlights 2014.

4 Deloitte, CFO Survey Q1 2015.
structured to take advantage of US tax rules on the repatriation by US companies of profits earned overseas. As discussed below, the amendments to those rules, announced by the US Treasury on 22 September 2014, make similar deals less likely.

As in previous years, the scheme of arrangement was the most popular method for implementing bids and was utilised by 31 of the firm offers in 2014, compared to 17 contractual offers. The increase in deal volume also saw a small number of hostile offers, which are typically structured as contractual offers. However, amendments announced in the government’s 2014 Autumn Statement target the regulation of reduction schemes (discussed in part VIII below) and it will be interesting to see how the market reacts to the new landscape.

Moving into 2015, the market remains buoyant. The first quarter of 2015 saw total UK deal value reach £48 billion, triple that recorded in the first quarter of 2014 and the highest quarterly value since 2009. Significantly, over half of this activity has been driven by bidders from outside Europe. As ever, there are also reasons for caution. In the UK, productivity growth (conspicuous by its absence from the economic debate preceding the general election) has slumped. Against this background, some commentators have suggested the recent rise in deal making is a symptom of a climate in which businesses remain reluctant to invest in capital and productivity. Pessimistic about the opportunities for organic growth, companies instead seek to grow profits through cost savings on mergers. Indeed, the Shell/BG Group mega-deal (discussed further below) is predicted to generate £1.6 billion in synergies by 2018.

The UK average productivity figures hide some important nuances. Productivity fell by 0.2 per cent in the fourth quarter of 2014 and is, overall, lower than it was in 2007 (by contrast, American workers’ output per hour is 9 per cent higher than in 2007). However, there have been marked productivity gains in the transport-manufacturing sector, for example, with productivity increasing by 56 per cent since 2009. The laggards, by this measure, are the finance and insurance sectors, which have seen a 10 per cent fall in productivity since 2009. The deal boom may well continue into the second half of 2015, but the drivers will vary considerably from industry to industry.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The Companies Act 2006 (the 2006 Act) provides the fundamental statutory framework and, together with the law of contract, forms the legal basis for the purchase and sale of corporate entities in the UK. In addition, the City Code on Takeovers and Mergers (the Takeover Code, or the Code) regulates takeovers and mergers of certain companies in the United Kingdom, the Isle of Man and the Channel Islands. The Takeover Code has statutory force, and the Takeover Panel has statutory powers in respect of the transactions

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6 The Economist, A zeal for deals (18 April 2015).
7 The Office for National Statistics, Labour Productivity, Q4 2014.
8 The Economist, The productivity puzzle, Under the bonnet (30 May 2015).
to which the Takeover Code applies. Breach of any of the Takeover Code rules that relate to the consideration offered for a target company could lead to the offending party being ordered to compensate any shareholders who have suffered loss as a consequence of the breach. In addition, breach of the content requirements of offer documents and response documents may constitute a criminal offence. The Panel also has the authority to issue rulings compelling parties who are in breach of the requirements of the Takeover Code to comply with its provisions, or to remedy the breach. These rulings are enforceable by the court under Section 955(1) of the 2006 Act. The Code has a wider scope than the EU Takeovers Directive, and applies if the offeree (or potential offeree) is a UK public company and in some instances if the company is private or is dual-listed.

The Financial Services and Markets Act 2000 (FSMA) regulates the financial services industry and makes provision for the official listing of securities, public offers of securities and the communication of invitations or inducements to engage in securities transactions. Following the substantial amendments to the FSMA, brought about on 1 April 2013 when the Financial Services Act 2012 (the FS Act) came into force, financial regulation in the UK is split between two new bodies: the Financial Conduct Authority (FCA), which regulates conduct in retail and wholesale markets, and the Prudential Regulation Authority (PRA), which is responsible for the prudential regulation of banks and other systemically important institutions. As a consequence of the FS Act, over 1,000 institutions (including banks, building societies, credit unions and insurers) are now ‘dual-regulated’. The FSMA also established a regime to prevent market abuse. The UK Listing Authority Sourcebook of Rules and Guidance (which includes the Listing Rules, the Prospectus Rules, and the Disclosure and Transparency Rules (DTRs)), promulgated by the FCA in its capacity as the UK Listing Authority (the competent authority for the purposes of Part VI of the FSMA), includes various obligations applicable to business combinations involving listed companies and contains rules governing prospectuses needed for public offers by both listed and unlisted companies. The Listing Rules, in particular, set out minimum requirements for the admission for the admission of securities to listing, the content requirements of listing particulars, and ongoing obligations of issuers after admission. The Criminal Justice Act 1993, together with the Listing Rules, the DTRs and the Takeover Code, regulate insider dealing.

The merger control rules of the United Kingdom are contained in the Enterprise Act 2002, although the rules do not generally apply to mergers in relation to which the European Commission has exclusive jurisdiction under the EU Merger Regulation. In addition, specific statutory regimes apply to certain areas, including water supply, newspapers, broadcasting, financial stability, telecommunications and utilities, and these separate regimes may have practical implications in merger situations.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Takeover Panel: Changes to the Takeover Code, post-offer undertakings and post-offer intention statements

Pfizer's high-profile bid for AstraZenica in July 2014 provoked strong debate in the UK on the appropriate political oversight of corporate transactions. Pfizer's history
of making severe efficiency cuts to its acquired businesses caused many to fear that a successful bid would result in cuts to research jobs and erode the UK science base. These concerns culminated in Pfizer writing directly to the Prime Minister setting out certain commitments it intended to comply with if the acquisition was completed, including in relation to R&D activity and UK jobs. Such ‘commitments’ are unusual: typically a bidder might make statements of intention with regard to its operations in the year following the bid. By contrast, Pfizer’s ‘commitments’ were to apply for five years following the bid. At the time of the bid, the Code did not provide a framework for distinguishing ‘commitments’ from mere statements of intent. In particular, while such commitments were considered to be binding under the Code, Pfizer would not be bound in the event of a material change of circumstances.

In response to the bid, the Code Committee issued, on 15 September 2014, consultation PCP 2014/2, which provided a number of proposals for the regulation of statements made during the course of a bid relating to any particular course of action to be taken (or not taken) following the bid.

Following the conclusion of the consultation, the Code Committee issued, on 23 December 2014, RS 2014/2 confirming the new framework. The new rules (which took effect from 12 January 2015) draw a distinction between:

a. post-offer undertakings, for example, statements relating to any particular course of action that an offeror or offeree company commits to take, or not take, after the end of the offer period and with which it will be required to comply for the period of time specified in the undertaking, unless a qualification or condition set out in that undertaking applies; and

b. post-offer intention statements, for example, statements relating to any particular course of action that an offeror or offeree company intends to take, or not take, after the end of the offer period, which will be required to be accurate statements of the party’s intention at the time that they are made and based on reasonable grounds.

The new Rule 19.7 strengthens the post-offer undertaking (POU) framework by providing a number of specific requirements on a bidder that wishes to make a POU. These include:

a. a requirement to consult the Takeover Panel in advance of making a POU;

b. requirements to submit written reports to the Panel (at such intervals as the Panel may determine) after the end of the offer period; and

c. enabling the Panel to require the appointment of an independent supervisor to monitor compliance with the POU.

In its response to comments made on PCP 2014/2 the Code Committee discussed the nature of the qualifications and conditions to which a POU may be subject. A number of respondents to the consultation noted that a party ought to be able to make a POU subject to general force majeure events or material changes in circumstances. It is the Committee’s position that a party will be permitted to include a qualification to a POU that provides that the POU will no longer apply where the Panel determines that the party is unable to comply with the POU as a result of an event, act or circumstance beyond the party’s control. The Panel, then, will permit a party to be released from
a POU only where it is objectively unable to comply with that POU; it will not be sufficient that it is merely more difficult to comply with.

This new framework would appear to go some way to addressing the concerns that were raised in the Pfizer bid. However, as noted above, it is rare for parties to make firm commitments during the bid period and it is expected that it will be some time before the new framework is put to the test.

ii Takeover Panel: Changes to the Takeover Code, clarification by potential competing bidders of their position

On 14 November 2014, the Code Committee issued RS 2014/1, which provides for a number of miscellaneous amendments to the Code. The amendments, which came into effect from 1 January 2015 include a change to the timetable governing potential competing bidders. Under the previous rules, where it had been announced that a publicly identified competing bidder might make a competing offer (or where the offeree referred to the existence of a potential competing bidder that had not been publicly identified), the potential bidder was required to clarify its position by a date to be determined by the Panel.

Under the new rules, a potential competing bidder will, instead, be required to clarify its position on or before day 53. Where an offeror has announced a bid intended to be implemented by a scheme of arrangement, the latest date by which a competing bid must be clarified will normally be the seventh day prior to the date of the shareholder meetings. However, the Panel retains the discretion to permit potential competing bidders to clarify their position by a later date.

In its response to the consultation on the proposed changes, the Code Committee acknowledged the risk that if the first offeror were to set a final closing date that was on or after day 53, its offer may lapse due to shareholders holding out on the announcement of a second offer. However, the Committee consider that this risk is outweighed by the flexibility which the fixed day 53 deadline brings to competing offerors: providing enough time for potential offerors to make a competing offer increases the likelihood of dual competitive offers.

iii Small Business, Enterprise and Employment Act

The Small Business, Enterprise and Employment Act (SBEE Act) received Royal Assent on 26 March 2015. Although its title suggests that it will only affect small businesses, the SBEE Act implements substantial changes to company law and corporate governance which will impact on all companies.

One such change is the introduction of the ‘Persons with Significant Control’ register (PSC register). From January 2016, companies will be required to maintain a PSC register setting out the details of people with significant control over the company. This register will be filed at Companies House and will be publicly available (although the obligation to file the information will only apply from April 2016).

People with significant control are individuals who hold (directly or indirectly) 25 per cent of a company’s shares or voting rights; control rights to appoint or remove a majority of the board; or otherwise have the right to, or actually do, exercise significant influence or control over the company.
The new regime will not apply to publicly traded companies (as such companies are already subject to similar disclosure obligations), but will likely have some impact on private equity structures. Following consultation with the British Venture Capital Association, the government’s initial proposals for the PSC register were amended so that limited partners will not be registered on the PSC register solely because they are limited partner of limited partnership. This amendment is welcome relief for the private equity industry which commonly makes use of limited partnerships in investment structures. However, the exemption only applies in respect of limited partnerships registered under the 1907 Act (and would exclude, therefore, limited partnerships registered in other jurisdictions including Jersey and Guernsey). Practitioners will need to be mindful of the increased transparency that will apply in transactions making use of such structures.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

In contrast to its sluggish GDP growth, Europe has seen another surge in foreign direct investment (FDI) in 2014. And in a turgid year for Europe, the UK reaffirmed its position as the leading market for foreign investors. In 2014, the UK accounted for 20 per cent. of all European FDI inflows, representing an increase of 11 per cent year on year. In total, the UK attracted 887 FDI projects in 2014, generating 31,198 jobs. The UK also led as the favourite European destination for Japanese FDI, attracting 47 projects.9

The coming year brings the prospect of conclusion to negotiations surrounding EU free trade agreements with Japan and the US. Both agreements would likely strengthen investment ties, although both negotiations have been beset with problems. One driver of uncertainty over the next 18 months, however, will be the UK’s impending referendum on EU membership. In a recent survey by EY, 72 per cent of investors cited access to the European single market as important to the UK’s attractiveness, and the outcome of the referendum has the potential to change investor perceptions dramatically. In the meantime, 31 per cent of investors have indicated they will either freeze or reduce investments until the outcome is known.

Turning to M&A, as in 2013, the UK was second only to the US as a global destination for foreign acquirers: 115 transactions involving foreign buyers were completed in 2014 with a value of £89 billion (compared to a total value of £46.6 billion in 2013).10 By contrast, the proportion of non-UK bidders in public M&A transactions fell in 2014. Of the 42 firm offers announced in 2014, 54 per cent involved a non-UK bidder or bidders, down from 62 per cent in 2013. The US remained the foremost foreign acquirer, accounting for seven bids with a combined value of £4.6 billion. Nevertheless, Asian markets will likely play an increasingly significant role in UK and European M&A, as is highlighted by the acquisition of Three by Hutchinson Whampoa and the presence of Chinese bidders in the auction for Novo Banco. The latter may also highlight an emerging interest among Chinese investors to participate in the investment opportunities provided by ongoing privatisation programmes across Western countries.

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9 EY, UK Attractiveness Survey 2015 Executive Summary.
10 Allen & Overy, M&A index Q4 2014.
V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

i Insurance and financial services

Both the insurance and financial services industries have faced challenges in 2014. However, there are a number of trends that seem likely to generate deal making in the near future, albeit (as noted above) consolidation and synergy driven, rather than expansionist.

The overhaul of the UK pensions industry, which removed requirements for pensioners to purchase annuities, has had a negative impact on many UK insurers. It seemed natural then when Friends Life Group Limited, which had made selling annuities a key part of its strategy, was approached by Aviva plc. The £5.6 billion deal, announced on 2 December 2014, will create a business with 16 million customers and will more than double Aviva’s corporate pension assets under administration. The deal will allow the Friends Life business to benefit from Aviva’s asset management business and is expected to generate substantial synergies. However, given the complexity of integrating the management of legacy products, it remains to be seen whether the deal can generate the value hoped for.11

In the broader financial services industry, the disposal of state-owned assets, acquired in the aftermath of the financial crisis, looks set to carry on through 2015. In his June Mansion House speech, Chancellor George Osborne announced the government’s intention to continue to sell down its 19 per cent stake in Lloyds and to begin its disposal of its 79 per cent stake in RBS. While the UK’s plans will likely result in a drip feed of shares into the public market, other European government assets are being sold off wholesale. In Portugal, Novo Banc, SA, which was created through the resolution measures applied to Banco Espírito Santo in August 2014, is being disposed of by way of an auction sale. The presence of Asian investors in the auction process underscores the growing importance of Asian investment in the European markets.

ii Technology, media and telecoms

The technology, media and telecoms sector has had a strong showing in 2014 representing 13 per cent of UK deals by volume, with a total value of £11.6 billion. In 2015, in one of the most significant telecoms deals of recent times, BT Group finalised a deal to acquire EE Limited for £12.5 billion. BT, which operates the UK’s largest telecoms and broadband network, is seeking to build on its package offering by acquiring the UK’s largest mobile phone network. BT will become the largest operator to offer a bundled broadband, landline, mobile and pay-TV package (known as ‘quadplay’), alongside TalkTalk and Virgin Media. The deal, which was approved by BT’s shareholders on 30 April 2015, is part of a trend of consolidation in the telecoms market (EE is itself a joint venture between Deutsche Telekom’s UK T-Mobile business and Orange SA).

The announcement of the BT/EE deal was followed, on 24 March 2015, with the confirmation that Telefonica would sell 0₂ to Hutchinson Whampoa, the owner of

Three, for £10.25 billion. The deal will create the largest mobile operator in the UK, surpassing EE with a combined network of 31 million customers representing 42 per cent of subscribers.

Unsurprisingly, both deals are the subject of regulatory scrutiny. Operators argue that tie-ups are good for consumers, as cost savings provide businesses with additional cash to invest in their networks. Regulators will be giving careful consideration to whether these benefits outweigh the potential cost of reducing the number of network operators from four to three.

iii Oil and gas
Persistently low oil prices, which have almost halved since their peak of US$115 per barrel in June 2014, were always likely to precipitate consolidation within the oil and gas industry. However, even against these expectations, there has been some surprise over how quickly Royal Dutch Shell moved to take over BG Group. The deal, announced on 8 April 2015, will see Shell pay £47 billion in cash and shares for BG, making it the largest energy deal for a decade.

For Shell, the deal will swell its depleting oil and gas reserves by a quarter. While the 50 per cent premium offered to BG’s shareholders makes it a compelling deal, for Shell it still represents a relatively cheap alternative to investing in production and exploration. The deal also allows the combined business to cut costs in midstream and downstream activities, where margins are typically wider. 12

The combined business will also become the world’s largest independent producer of LNG, in which BG has particular expertise. LNG has been a key growth area for Shell, with operations in Australia and Brazil. However, the strength of the combined business will attract scrutiny from regulators in a number of jurisdictions, including China’s Ministry of Commerce (Mofcom). By some predictions, BG Group could, by itself, become China’s biggest LNG supplier by 2017. In addition to typical competition issues, Mofcom will also likely consider China’s industrial policy concerning security of supply and the combined business’ potential pricing power. It is possible, therefore, that Mofcom will require significant disposals or other behavioural remedies as a condition to approving the deal (similar, say, to those required in the Glencore/Xstrata deal).

The announcement was followed by speculation that other deals may be in the mix. Tullow Oil, an African-focused explorer, saw its stock climb 4.5 per cent on the announcement, although the difficulties of completing a pan-African deal may mean actual bids are not forthcoming.

iv Tax inversions
Some of the largest potential deals of 2014, including AbbVie’s £32 billion approach for Shire in November 2014 and Pfizer’s £69 billion bid for AstraZenica in May 2014, were at least partially motivated by US tax-planning considerations. Unlike many advanced economies, the US continues to tax domestic corporations on their worldwide income, including income attributable to non-US subsidiaries. The regime, therefore, creates a

strong motivation for US multinationals to avoid repatriating non-US profits to the US. Accordingly, transactions designed to avoid the regime through restructuring have grown in popularity.

These ‘inversion’ deals are reminiscent of the series of high-profile migration transactions, seen around 2008, where UK-based groups left the UK for jurisdictions such as Ireland. At the time, the UK regime meant that non-UK profits were often taxable at full UK tax rates (whether or not repatriated) and prevented UK groups from restructuring themselves without significant tax costs. However, while the UK’s reaction was to introduce a more permissive regime, the US has sought (through measures announced by the US Treasury Department on 22 September 2014) to tighten the rules further.

It was already the case that under anti-inversion rules most US groups could not simply restructure under a new non-US holding company in order to migrate. Instead, the transaction needed to be combined with a merger with a non-US counterparty that resulted in the counterparty’s former shareholder owning more than 20 per cent of the combined group. The amended rules restrict the ability to manipulate the sizes of the US and non-US business to meet the 20 per cent requirement and extend the circumstances in which non-US profits become taxable when they are lent upstream to the new non-US parent.

It seems likely that the US’s latest stance will suppress deal making in this area in 2015. Indeed, AbbVie abandoned its bid for Shire (despite becoming subject to a US$1.64 billion break fee) partially in consequence of the tightened rules.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

i Public M&A financing

In PLC’s ‘What’s Market’ review of the 42 firm offers announced in 2014, where the consideration was at least partially in cash, the bidder’s cash resources alone were the means of financing in 20 of those offers. There was an increase in the use of debt facilities to fund offers, with debt facilities being used by 18 bidders in 2014, compared to 11 in 2013. No firm offers announced in 2014 involved equity financing.13

As in previous years, in a number of offers, the Takeover Panel granted a dispensation from Rule 24.3(f) of the Takeover Code, which provides that bidders must disclose details of how the offer is to be financed. Rule 26.1(b) (which became Rule 26.2(b) on 1 January 2015 following changes to the Code) provides that such a description must be published at the time of the announcement of the firm offer. Descriptions of debt facilities that will finance the offer must also be disclosed, including details of any market flex provisions in those facilities. Such disclosure may lead to an increase in the costs to the bidder of financing the bid: if potential syndicates are privy to the parameters within which a lead arranger is willing to provide finance, they may have the leverage, in negotiating the facility, to push pricing to the higher end of the flex.

13 PLC, ibid.
Accordingly, the Takeover Panel waived the requirement of Rule 26.1(b) in respect of a number of the offers announced in 2014.

The effect of such a dispensation is that the bidder’s lender has a grace period of 28 days in which to syndicate the loan before the offer document must be published. If the loan has been syndicated by that date, the offer document need not disclose any market flex provisions (as they will, by then, be irrelevant). The requirement remains, however, if the facility has not been syndicated by that date. For example, in Toscafund Asset Management LLP, Penta Capital LLP and Matthew Riley’s offer for Daisy Group plc, market flex arrangements were not disclosed at the time of announcement. Instead, the bidders’ Rule 2.7 announcement noted that such arrangements would be disclosed if the syndication of the senior facilities had not been completed by the date on which the offer document was issued.

ii ‘Cov-lite’ loans

The rise of the European ‘covenant-lite’ loan market has been a favourite topic for commentators over the last few years. The market in 2014 has, finally, caught up with expectations: covenant-lite structures are now a permanent feature of large-cap European acquisition finance. Lending volumes rose to £13.6 billion across Europe in the first 11 months of 2014, an almost eightfold increase on the total for 2013. 14

Covenant-lite loans, which are devoid of standard financial maintenance covenants (such as, for example, leverage and interest ratios) have been a key feature of US markets for some time. Eurozone investors, confronted with a weakening currency and persistently low interest rates, have now caught up with the trend. For the moment, covenant-lite loans have been restricted to the top end of the market where borrowers have more proven or established credit stories.

However, it seems likely that there will be a loosening of terms in mid-market deals too, particularly as the US credit market may be becoming less attractive. While 2014 saw a spike in European borrowers accessing US markets to finance European focused deals, currency fluctuations and the prospect of rising interest rates are likely to dissuade borrowers in 2015. Further, guidance issued by the Federal Reserve in May 2015, which aims to cap leveraged loans at six times a buyout target’s EBITDA may also serve to depress the US market. 15

iii High-yield bonds

Overall, 2014 was also a flush year for high-yield bonds. Around €50 billion of bonds were issued in Europe to fund acquisitions in 2014, a 150 per cent increase on the €20 billion issued in 2013. 16 However, it has been a year of two halves for the bond market. Good liquidity in the first half of the year meant that mid-market issuers (and even some first time issuers) were able to complete issuances. However, a number of significant insolvencies led to a retreat in the second half of the year. The vagaries of the

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14 DLA Piper, Acquisition Finance Debt Report 2015.
15 Financial Times, Euro leveraged loans take on American Flavour, 31 March 2015.
16 DLA, ibid.
high-yield bond market are particularly challenging for mid-market issuers seeking to finance acquisitions. When the market retreats it may close altogether for mid-market issuers, with dire consequences for a deal.

VII PENSIONS AND EMPLOYMENT LAW

i Collective redundancies ‘at one establishment’

Redundancies are often a feature of M&A transactions. The obligation to consult employees on collective redundancies under section 188(1) of the Trade Union and Labour Relations (Consolidation) Act 1992 (TULR(C)A 1992) is therefore an important consideration. The obligation is triggered ‘where an employer is proposing to dismiss as redundant 20 or more employees at one establishment within a period of 90 days or less’.

The words ‘at one establishment’ have been the subject of some legal controversy recently, due to the Woolworths case (USDAW and Wilson v. WW Realisation 1 Ltd (in liquidation), Ethel Austin Ltd and Secretary of State for Business, Innovation and Skills). The case is discussed in detail in Section V of the EU Overview chapter, but it essentially concerned a challenge by the trade union USDAW that the words ‘at one establishment’ in section 188(1) contravened the Collective Redundancies Directive (CRD). USDAW’s position was that the trigger should apply much more widely, across the employer’s entire undertaking, rather than by reference to each separate establishment.

The ECJ has now rejected this argument, and upheld the concept of considering redundancies at each establishment separately, rather than across the employer’s whole undertaking. It confirmed that an ‘establishment’ for these purposes is the entity to which the workers made redundant are assigned to carry out their duties. It should consist of a distinct entity, having a certain degree of permanence and stability, which is assigned to perform one or more given tasks and which has a workforce, technical means and a certain organisational structure allowing for the accomplishment of those tasks. The establishment need not have any legal, economic, financial, administrative or technological autonomy from the wider undertaking.

The decision has been welcomed by UK employers, as it restores the status quo that existed before the Woolworths case. Employers can be reassured that they will only need to consider undertaking collective redundancy consultation where 20 or more redundancies are proposed at one establishment within a period of 90 days or less. This will have a particular impact in sectors such as retail, where a business may operate multiple small sites. Purchasers of this kind of business who foresee the possibility of post-transaction redundancies should, therefore, bear in mind the need to assess the trigger for consultation on a local basis, by reference to each ‘establishment’, rather than across the business as a whole. This should limit the need for consultation, which if triggered can significantly affect the timetable for the transaction, as well as creating additional administrative burdens for the employer and the potential for financial exposure if the requirements of the legislation are not met.

18 (98/59/EC).
Holiday pay – historic claims

Another hot topic currently is the calculation of holiday pay. This has relevance in an M&A context as the purchaser will need to consider the potential for historic liabilities where holiday pay has been underpaid, and whether appropriate indemnity protection is required.

The calculation of holiday pay is governed by the concept of ‘a week’s pay’ in Sections 221–224 of the Employment Rights Act 1996. The mechanism is complex, and depends on whether the employee has normal working hours and whether their remuneration varies depending on the type or amount of work done. The effect is that in many cases it is simply base salary which is taken into account in the calculation. Additional payments such as overtime, bonuses, commission, and allowances are not typically added in.

This approach has now been called in question by a string of cases starting with British Airways plc v. Williams, in which the ECJ confirmed that employees were entitled to receive holiday pay that included allowances and supplementary payments that were ‘intrinsically linked’ to the performance of their duties. Then, in Lock v. British Gas Trading Limited the ECJ confirmed that holiday pay must include an amount in respect of commission that the employee would have earned had he not been on holiday. Most recently, in Bear Scotland Ltd v. Fulton the Employment Appeal Tribunal held that holiday pay must include an amount in respect of compulsory overtime (i.e., that which the employee is obliged to work if offered by the employer).

What these cases have failed to do (as yet) is determine how holiday pay should be calculated to include these additional payments – for example, over what reference period the payments should be judged. This is due to be determined by an employment tribunal in the Lock case, at least in respect of commission. However, given that at the time of writing an appeal has just been lodged by British Gas, the uncertainty may remain for many months.

This has led to a concern among some businesses that they may face exposure for unpaid holiday pay. Initially it was thought that such claims could potentially be made over a period stretching back to the introduction of the Working Time Regulations in 1998. However, Bear Scotland restricts the ability of workers to bring retrospective claims for underpaid holiday pay. Such claims must be brought within three months of an underpayment of holiday pay, and can only extend to previous underpayments if there is no more than three months between each underpayment. If there is a gap of more than three months, the chain is broken and the claim cannot extend back any further. There is also a technical issue about the type of holiday taken each time (i.e., whether it is holiday

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21 [2014] EUECJ C-539/12.
22 [2014] UKEATS/0047/13/BI, UKEAT/0160/14/SM.
prescribed by the Working Time Directive,\textsuperscript{24} or under the Working Time Regulations 1998\textsuperscript{25} or any contractual arrangements), which will make it difficult for employees to establish a long chain of underpayments.

In addition, the Deduction from Wages (Limitation) Regulations 2014\textsuperscript{26} came into force on 8 January 2015. These regulations introduce a further limitation on historic claims of this sort, which will mean that claims can only be made in relation to the two years preceding the date of the claim. This new limit will apply to claims presented to an employment tribunal on or after 1 July 2015.

These new limitations are good news for employers, as they limit their exposure to historic claims for holiday pay. However, some level of exposure may well remain a live issue for the foreseeable future. In an M&A context, this issue may be material in industries with atypical remuneration structures and a high proportion of overtime and bonuses, particularly on transactions involving significant numbers of employees. Purchasers in these circumstances should consider seeking an indemnity to cover any potential historic liability for holiday pay. They should also be aware that liabilities may continue to accrue until the correct calculation of holiday pay is finally settled.

\textbf{iii } Fair Deal 2013

Fair Deal 2013 is a non-statutory policy that requires new employers to provide employees who have transferred from the public sector to the private sector with occupational pension schemes that offer pension benefits for future service that are ‘broadly comparable’ to their previous public sector schemes. This requirement applies to transfers from public bodies such as the NHS, certain schools and academies, and central government agencies. As part of this protection for ex-public sector employees, the new employer, rather than providing a new scheme, can apply to participate in the employees’ public sector scheme, thereby allowing the employee to continue in that scheme. The Fair Deal 2013 guidelines must be followed from April 2015. However, transfers that do not comply with Fair Deal 2013 but are at an advanced stage of completion may go ahead unless it is ‘legitimate and desirable’ to stop them.

\textbf{iv } Abolition of contracting out for DB schemes

With the introduction of the reformed state pension in April 2016, contracting out of the state pension in defined benefit schemes will be abolished. Employers will therefore lose the national insurance rebate to which they were entitled if they had contracted out of the state pension. This could be a relevant consideration for companies seeking to take on the contracted-out defined benefit scheme of a target (although such schemes are rare nowadays), as the employer would face increased national insurance contributions. However, with the introduction of the Occupational Pension Schemes (Power to amend scheme rules to reflect the abolition of contracting-out) Regulations 2015, employers

\textsuperscript{24} (2003/88/EC).
\textsuperscript{25} SI 1998/1833.
\textsuperscript{26} SI 2014/3322.
are now able to amend scheme rules governing accrual rates and member contribution levels in order to compensate the employer for the loss of the national insurance rebate.

v Employer’s duty of trust and confidence in the context of its communications to members

The case of *IBM United Kingdom Holdings Ltd and another v. Dalgleish and others* greatly expanded the situations in which an employer could face liability for breaching its duty of trust and confidence if it reneges on representations and promises in its communications to members.

In the *IBM* case, the employer had closed its scheme to future accrual despite having given past indications as to the strength of the scheme’s funding. Although the employer had never specifically stated that the scheme would not be closed, the wording of its communications was found to be sufficient to give rise to a reasonable expectation among its members that it would not be closed.

This case reinforces the need to be careful not just of the specific contents of communications to members, but also of the impressions those communications may give. When employers make decisions with regards to occupational schemes that could have a detrimental impact on members, they need to consider what impressions have been given in previous communications and whether a further communication needs to be made. This applies even in situations where there is no separate statutory requirement to consult members of a decision.

Since 2013, potential offerors are required under the Takeover Code to disclose in the offer documents their intentions for a target’s pension schemes. If the offeror does not intend to make any changes to the target’s scheme, it must make a negative statement to this effect. The offeror will therefore have to take care of the contents of these disclosures, especially in light of the *IBM* case. If the offeror states that it will do A in respect of the scheme, but in fact does B, members could argue that the offeror had given rise to a reasonable expectation, and had then disappointed that expectation, thereby breaching its duty of trust and confidence. The *IBM* case lowers the threshold at which a member could have such an expectation and therefore increases the risk for all employers in all their communications to members, including for employers after an acquisition.

**VIII TAX LAW**

i Takeovers effected by cancellation scheme

Before March 2015, the takeover of a UK company was often effected by way of a cancellation scheme: the target’s shares were cancelled in return an issue of shares by acquirer to target shareholders. This had the advantage of avoiding the stamp duty charge (at 0.5 per cent) that would arise on a transfer of the target’s shares.

The UK government announced in the 2014 Autumn Statement that this type of tax planning should not be available and regulations were duly produced, which changed UK company law so as to prevent the use of a cancellation scheme to effect a takeover.

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27 [2014] EWHC 980 (Ch).
ii  Offering shareholders a choice of income or capital

At the same time, the government announced that it would legislate to remove the ‘unfair tax advantage’ provided by special purpose share schemes, commonly known as ‘B share schemes’, which allowed shareholders to choose to receive a return of value as capital rather than income for UK tax purposes. For many retail shareholders in the UK, a capital receipt is more tax-efficient.

The Finance Act 2015 contains provisions that apply where an individual shareholder has a choice to receive a distribution of a company or an ‘alternative receipt’, which is of the same, or substantially the same, value and would not, but for the new legislation, be charged to income tax. From 6 April 2015, any such ‘alternative receipt’ will be deemed to be a distribution and so subject to income tax in the hands of a UK individual.

The legislation has, so far at least, had the desired effect of discouraging UK companies from offering a choice of income or capital. Certain shareholders – typically with larger holdings – are likely to prefer income and an income return is easier to effect. We expect that in future the most common form of return of value will be, simply, a special dividend.

iii  The UK as domicile of choice

The UK’s approach to corporate taxation over the past few years has in several respects aimed to promote the attractions of the UK. This has resulted in successive reductions in the rate of corporation tax, which now stands at 20 per cent, and a less stringent regime for ‘controlled foreign companies’. Combined with longstanding strengths such as extensive double tax treaties and the absence of a dividend withholding tax (for UK companies other than REITs), one result has been that the UK has been a popular tax jurisdiction for US groups that redomicile through ‘inversion’ (see Sections IV and V, supra).

However, the UK’s banks may not be feeling so well disposed to the Chancellor. New rules seek to restrict to 50 per cent of taxable profits arising after 1 April 2015 the extent to which carried-forward losses can be utilised by banks and building societies. And the bank levy continues to increase, now being set at 0.21 per cent. The seemingly inexorable rise in the levy has led some UK banks to consider (or be asked by major shareholders to consider) relocation from the UK and it may be that the government will signal a new approach in its post-election budget scheduled for 8 July.

iv  Anti-avoidance

The appetite for aggressive tax avoidance has been reduced by the General-Anti-Abuse Rule (GAAR) that was introduced in 2013, though the courts will for some time be working their way through schemes that predate the GAAR. The court of public opinion is strongly in favour of companies, particularly multinational companies (MNCs), paying their ‘fair share’ and this was one of the driving forces behind the new diverted profits tax (DPT), which was brought in with effect from 1 April 2015.

The DPT is designed to protect the UK tax base and has two main targets: where there is a substantial UK operation but sales to UK customers are made from outside the UK, avoiding a UK permanent establishment (PE); and where the UK operation
makes deductible payments (e.g., royalties for IP) to a non-UK affiliate, these are taxed at less than 80 per cent of the rate of corporation tax and there is insufficient ‘economic substance’. As a deterrent, the rate applicable to the ‘diverted’ profits will be 5 per cent higher than the rate at which tax would otherwise be payable.

The government also continues to chip away at schemes that are not aggressive but are nevertheless disliked by HMRC, by using specific anti-avoidance rules for particular transactions or more general but (in name at least) targeted anti-avoidance rules. The Finance Act 2015 (the FA 2015) introduced legislation to counteract ‘loss-refreshing’ arrangements that have been popular in the past, converting carried-forward losses into current year losses. Current year losses are more flexible than carried-forward losses and are more easily utilised by groups: they can be surrendered to shelter the profits of other companies in the group, whereas in most circumstances carried-forward losses may only be used by the same company and against profits of the same activity in relation to which the losses arose.

The FA 2015 has also put a stop to group companies using the ‘late paid interest’ rules to control the timing of deductions. This measure was not unexpected as HMRC disliked groups using what were supposed to be anti-avoidance rules in order to control the timing of deductions.

v Transparency and tax disclosure

The European Parliament announced on 1 June 2014 that it had passed a resolution calling for MNCs to adopt country-by-country reporting (CBCR) and make beneficial ownership information publicly available. The UK is taking the lead on implementation of both of these measures and was the first country to require companies to keep a public register of people with significant control. Following this up, the FA 2015 contained a power to make regulations implementing the OECD’s guidance on CBCR.

vi Oil and gas

The UK’s oil and gas sector is expected to see more M&A activity and it is certainly receiving attention from the government. The FA 2015 contained a package of changes designed to encourage investment in the sector following concerns about its future viability. The supplementary charge was reduced from 32 to 20 per cent from 1 January 2015 and the rate of petroleum revenue tax will be reduced from 50 to 35 per cent from 1 January 2016.

These lower rates, combined with simplified and more generous allowances, offer welcome support to the industry. The package is expected to encourage over £4 billion of additional investment over the next five years, though the fall in oil prices has undoubtedly made the North Sea a very challenging proposition.

The government is also expected to persevere with measures to promote the UK’s nascent shale gas industry.
IX COMPETITION LAW

i The new UK merger regime

The Competition and Markets Authority (CMA), which took over the competition functions of the Office of Fair Trading (OFT) and the Competition Commission (CC) on 1 April 2014, has now been in operation for over a year. This change was enacted by the Enterprise and Regulatory Reform Act 2013 along with a series of additional reforms to the framework for UK competition law enforcement. These reforms were intended to strengthen the UK merger control regime by extending the regulator’s formal information gathering powers and, increasing its ability to prevent parties from taking pre-emptive steps that may prejudice the outcome of an investigation. The reforms are also intended to streamline the merger control process through the use of new statutory time limits and by capturing the efficiencies of having a unitary authority.

Under the CMA regime, separation is retained between a Phase I review (previously undertaken by the OFT) and a Phase II review (previously undertaken by the CC). Phase I decision-making is now undertaken by the Senior Director of Mergers (or another senior CMA official). Phase II decision-making is undertaken by an independent panel of experts. In much the same way as CC panels were formed under the old system, these experts are drawn from a pool of senior experts in a variety of fields.

Notification continues to be ‘voluntary’ in the sense that there is no obligation to apply for CMA clearance before completing a transaction. The CMA may, however, become aware of the transaction through its market intelligence functions (including through the receipt of complaints) and impose interim orders preventing further integration of the two enterprises pending its review. There is a risk that it may then refer the merger for a Phase II investigation, which could ultimately result in an order for divestment.

The CMA has a statutory time limit of 40 working days at Phase I to reach a decision. It may, however, extend this period in certain exceptional circumstances such as if it is waiting for information from the merging parties. Information can now be obtained at Phase I through formal information gathering powers with penalties for non-compliance.

Whilst undertakings in lieu of reference to the CC had to be given in anticipation of an adverse decision, under the new regime, the merging parties have five working days from the substantial lessening of competition decision (the SLC decision) to offer undertakings to the CMA (although may still offer them in advance should they wish to do so). Where the parties offer undertakings, the CMA has until the 10th working day after the parties received the SLC decision to decide whether the offer might be acceptable as a suitable remedy to the substantial lessening of competition. If the CMA decides the offer might be acceptable, a period of negotiation and third-party consultation follows. The CMA is required to decide whether to accept the offered undertakings, or a modified form of them, within 50 working days of providing the parties with the SLC decision, subject to an extension of up to 40 working days if there are special reasons for doing so.

At Phase II, the CMA must issue its decision within a statutory maximum of 24 weeks, extendible in special cases to a period of up to eight weeks. Where remedies are required, the CMA now has a statutory period of 12 weeks (which may be extended by up to six weeks) following the Phase II review within which to make a decision on any
remedies offered by the parties (no fixed period was previously imposed upon the CC to consider any remedies offered by the parties following its final report).

The CMA has strong powers to suspend or reverse all integration steps in either proposed or completed mergers; and severe financial penalties may be imposed for breaches of any interim orders or undertakings (capped at 5 per cent of the aggregate group worldwide turnover).

ii Treatment of mergers by the CMA

The number of merger decisions made by the CMA in the 2014–2015 financial year (83) was up from the 65 decisions taken in the preceding financial year, but still someway down from the peak of 210 merger decisions made by the OFT in the 2005–2006 financial year. Of the 83 cases decided in the year, six were referred for Phase II review, which is around 7 per cent of cases, down from 12 per cent in the preceding year. Undertakings in lieu of a reference were accepted in four cases, up from zero in the preceding year.

At the time of writing, three of the six transactions referred to Phase II have been cleared, one has provisionally been found to give rise to a substantial lessening of competition, one is still under review and one has been abandoned. A total of three Phase II decisions were published by the CMA in the 2014–2015 financial year, down from 12 published by the CC in the previous year. Two were unconditional clearances and one permitted the transactions to proceed subject to divestments.

iii Statements and guidelines relevant to mergers published in 2014

Prior to becoming fully operational on 1 April 2014, the CMA had consulted on various new guidance documents. In January 2014, it published a new set of jurisdictional and procedural merger guidelines, at the same time adopting various existing OFT and CC guidance, notably the OFT and CC joint merger assessment guidelines and the CC guidance on merger remedies. This is reflective of the fact that the changes to the UK merger regime are largely procedural rather than substantive.

Guidance on merger fees

The CMA has also issued guidance on how to pay fees due on mergers qualifying for investigation. Fees are payable on the announcement of the CMA's decision (or the Secretary of State's in public interest cases) whether or not to refer the merger for a Phase II investigation. The CMA's practice is to send an invoice to the merging parties after a decision has been announced, and payment must be made within 30 days of the date of the invoice.

Fees vary according to the value of UK turnover of the target:

\[ a \] £40,000 for turnover of £20 million or less;
\[ b \] £80,000 for turnover above £20 million up to £70 million;
\[ c \] £120,000 for turnover above £70 million up to £120 million; and
\[ d \] £160,000 for turnover exceeding £120 million.

The fees must be paid to the CMA in sterling, net of any transactional costs, and in strict accordance with the payment methods prescribed in the guidance.
X OUTLOOK

2014 saw a resurgence in global M&A. Deal values in the first quarter of 2015 far outstripped those seen in the first quarter of 2014, pushing values to their highest since 2009. Even the ‘reasons for caution’ in the ubiquitous predictions of ‘cautious optimism’ seem less pointed. Greece might yet leave the eurozone (it had not, at the time of writing) but a Grexit would not cause the kind of catastrophic widespread damage it would have done just a few years ago. On balance, it has been many years since the outlook for the UK M&A market looked rosier.

It is a sign of our times, however, that markets cannot rebound without a rush to be the first to call the top. To be sure, US deal making, which hit a US$243 billion all-time monthly record in May 2015, will be unlikely to continue on its current trajectory (already, Charter’s announcement of its three-way US$90 billion acquisition of Time Warner Cable and Bright House is compared to AOL’s 2000 acquisition). But around the world, there is still room to grow. At least some of the US activity is due to the widely held belief that the Federal Reserve will, in September 2015, begin to tighten monetary policy. In the UK, however, futures prices suggest that in early 2018 interest rates will still be only around 1.5 per cent. On this basis, at least, UK M&A growth may be more sustainable.

One legitimate fear is the capacity of Western economies to respond to a downturn. The IMF expects 2015 to be the first year since 2007 in which every advanced economy expands. But many economies have been expanding for some time (America’s began to grow in 2009). Eventually, in the coming years, Western economies will face a recession. At that point, the question will be whether those economies have sufficiently recovered to weather the storm.
 Appendix 1

ABOUT THE AUTHORS

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Mark Zerdin has been a partner at Slaughter and May since 2007. He advises on a wide range of corporate and commercial transactions for both corporate and private equity clients. His principal areas of work are public takeovers, private acquisitions and disposals, private equity investment, initial and secondary public equity offerings and joint ventures.

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