HERBERT SMITH FREEHILLS

M&A STANDPOINT
COMMITTED TO THE DEAL

POUs can help to navigate political uncertainty and to secure the support of target boards and wider stakeholders, but in our view, future use will remain rare.

The Takeover Code's post offer undertakings (POU) regime is designed to facilitate the giving of specific, objective commitments that are legally binding and enforceable, and which could not be accommodated by private contractual arrangements or relevant undertakings to regulatory authorities.

Softbank's recent £24 billion acquisition of ARM,a leading UK technology company, illustrates how this new public M&A tool can be deployed, allowing bidders to navigate with political uncertainty with binding commitments to invest in the UK.

POUs will not become a common feature of UK public M&A. This first deployment of POUs, on which we advised the UK Takeover Panel, highlights how bidders can harness governmental and community interest in cross-border M&A but also why, in our view, POUs will remain rare.

POUs offer flexible innovative takeover technology to facilitate obtaining crucial political and wider stakeholder support. Whilst in the case of ARM they were used to secure UK Government support for a recommended takeover, in future they may provide the keys to unlock hostile situations, by allowing bidders to make binding commitments to wider stakeholders, so enabling bidders to apply further focussed pressure to a target board.

21st Century Fox's US$11.7 billion current offer for Sky (on which we are advising Sky) illustrates the continued role for statements of intent. 21st Century Fox made clear that its intention to maintain the Sky HQ, complete a US$1 billion investment programme at the site as well as the maintenance of, and investment in, Sky's technology hub and the creative community in the UK were intention statements, not POUs.

POLITICAL CONTEXT

Governments, politicians and regulators around the globe are increasingly focusing on the effects of cross border M&A on:

- ownership and control of critical infrastructure
- technology
- data
- tax policy and receipts
- industrial policy
- investment
- research and development

In recent months we have seen increasing governmental interest in cross border investments, with reviews of investments, proposals to change regulatory regimes and to introduce new approval tests or add further grounds to block cross-border investments:

- Prime Minister Theresa May's review of (and subsequent changes to) Chinese investment in the Hinkley Point nuclear power station
- reviews by the German Economics Ministry of Chinese investments into chip equipment maker Aixtron and lighting company Osram
- in Australia, the government mandated that all sales of public infrastructure must be reviewed by the Foreign Investment Review Board, leading to the blocking of A$10 billion-plus bids by State Grid and CKI for Ausgrid

Brexit and change of Prime Minister

Shortly after the Brexit referendum, and two days before her appointment as Prime Minister, Theresa May gave a leadership campaign speech which indicated an intention to take a potentially more interventionist approach to cross-border M&A.

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Against this changing political landscape and policy, Softbank engaged with the new Prime Minister to offer binding commitments to invest in the UK. A successful £24 billion investment in ARM would clearly give a boost to the Government and the UK, signalling long term investment into the UK post the Brexit referendum.

Softbank's commitments were that five years after completion it would double the number of UK ARM employees, with at least seventy per cent. of those employees being technical employees, and over that five year period to maintain ARM's headquarters in Cambridge.

ARM has since made an investment in Allinea Software which will count towards satisfaction of these committments.

DEVELOPING INDUSTRIAL STRATEGY - LONG TERM INVESTMENT POST BREXIT

As the UK Government reviews whether to seek to change the application of the public interest test to UK merger control rules and develops its industrial strategy under the new Prime Minister, we expect to see greater focus on cross-border takeovers. The nature and scale of Government interest and intervention will be shaped by the timing and terms of the UK's Brexit, how the UK merger rules are modified, the terms of any new rules regulating ownership of critical infrastructure and the desire of bidders to secure government support.

It is not yet clear what the Prime Minister has in mind regarding the planned review of the public interest test in the Enterprise Act 2002, and whether the political rhetoric of what was expected to be an early speech in a contested party election process will be watered down, as other themes outlined in that speech have been.

Regardless of the nature and extent of those changes, the UK Government may informally seek to encourage greater use of POUs to secure medium term investments into the UK as we chart our Brexit course.

UNDERTAKINGS, FROM CHOCOLATE TO TECH VIA PHARMA

Public and political interest in the ownership of, and investment in, key businesses, and the impact that strategic announcements about future investment can have, illustrate the reasons for the development of and role for POU technology.

Kraft's 2010 bid for Cadbury was a high watermark in hostile public M&A. The acquisition of Cadbury led to UK politicians seeking to review the Takeover Code; many of the resulting changes were designed to reduce the period of "siege" that a target might undergo during a hostile bid or possible bid.

Investment in UK manufacturing became a key issue. Cadbury's 2007 decision to close its Somerdale factory and move manufacturing lines to Poland offered Kraft an opportunity to show commitment to invest in the UK. Kraft's statements that it "would be in a position to continue to operate" the Somerdale factory and "invest in Bourneville, thereby preserving UK manufacturing jobs" was given significant prominence by Kraft. Shortly after its offer was declared unconditional as to acceptances, Kraft announced that it would not be able to keep Somerdale open. The political,

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community and employee reaction was obvious. How could statements of such prominence and of such significance be made and then withdrawn, and what were the consequences?

The UK Takeover Code provides that such statements of belief should only be made if the bidder honestly and genuinely holds that belief (a subjective test) but also only if it has a reasonable basis for so holding that belief (an objective test). The Takeover Panel publicly criticised Kraft as whilst it ruled that Kraft held an honest and genuine belief that it could keep Somerdale operational, the Takeover Panel held that given Kraft did not know the details of Cadbury's phased closure of Somerdale and its investment in new facilities in Poland, without this information, Kraft's belief, no matter how well-intentioned, that it could continue to operate the facility on a commercial basis was, in the opinion of the Takeover Panel, not a belief which Kraft had a reasonable basis for holding.

In September 2011 the Takeover Panel revised the Takeover Code so that parties to an offer making statements of intention about action they intended to take following an offer would be held to such statements for twelve months after the offer period.

Pfizer's 2014 possible offer for AstraZeneca saw another US bidder announcing significant commitments to invest in the UK. These were made against a backdrop of questions from the UK Government and the UK scientific community regarding future investment in research and development, and a concern as to whether it might be moved or future investment made outside the UK. Pfizer wrote an open letter to David Cameron, Prime Minister, setting out what it stated to be binding commitments to address the concerns. Pfizer's voluntary commitments included:

- establishing the combined group's corporate and tax residence in England
- completing a planned research and development hub in Cambridge
- basing key scientific leadership in the UK
- employing at least twenty percent of the combined group's research and development workforce in the UK
- retaining substantial manufacturing facilities in the UK

In contrast to the usual twelve month statements of intention, Pfizer offered these as long term binding commitments for a minimum of five years.

NEW PUBLIC M&A TECHNOLOGY - POUs

Given the significance and the uncertain legal status of the commitments offered by AstraZeneca and Kraft in late 2014 the Panel consulted on changes to the Takeover Code to create a new framework for legally binding long term commitments. A key theme of the Takeover Code is that parties to an offer

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should make statements with due care and attention, and they should be held to what they say, this underpins the key Takeover Code principle of avoiding false markets. The Takeover Panel recognised that intention statements, commitments and undertakings were a key part of the battle for control but also wanted to ensure that its rules did not dissuade parties to an offer from giving information about future plans.

The review restated the principles around standards of care and the making of statements of intention as to conduct after the end of an offer period. The Takeover Panel distinguished between post-offer statements of intention and the newly created post-offer undertakings. POUs are binding commitments, made voluntarily by a party to an offer relating to action they will take following the offer. As such the party making the commitment will be held by the Takeover Panel to comply with it.

POUs must be specific and precise, readily understandable and capable of objective assessment (and not dependent on a subjective assessment of a party to an offer). POUs can be made subject to specific conditions or qualifications, like conditions to an offer, but not general qualifications such as a MAC.

Given the binding nature of such commitments, parties are required to consult with the Takeover Panel before making a post-offer undertaking. The Takeover Panel will want to ensure that any POU is specific and precise, capable of objective assessment, how compliance might be monitored by a monitoring trustee and to determine what reports will be made to the Takeover Panel and what might be published regarding compliance. Parties offering POUs should therefore allow sufficient time and be able to provide the Takeover Panel with information needed to understand and evaluate any proposed POUs.

Parties to future offers are expected to make much greater use of statements of intention, and to announce POUs to address specific issues. Where they use a combination of POUs and statements of intention, regarding their future actions, parties will need to be careful to ensure that market participants and stakeholders understand the differences between them, if there was a misunderstanding, clarifying that a statement of intention is not actually binding could damage the presentation of a package of carefully crafted undertakings and intention statements. Before an offer is made, parties to an offer might also look to announce an intention to offer POUs on terms to be finalised as part of the offer, but care should be taken here and the Takeover Panel should be consulted. Equally a bidder might agree (as Softbank did) to announce a POU to procure that the target company enter into specified POUs.

Where bi-lateral contracts are more appropriate, or undertakings to regulators, POUs cannot be used. They are designed to provide a framework for broader commitments to be given and enforced.

Parties offering POUs must comply with the terms of any POUs. Non-compliance would only be excused should a party be able to rely on a condition or qualification, having first consulted with the Takeover Panel and obtained consent to rely on it.

The Takeover Panel has at its disposal all of its compliance and investigation powers as well as any bespoke monitoring arrangements put in place to call for detail as to progress that is being made on satisfying POUs.

The Takeover Panel will also be able to apply to Court to seek to enforce POUs. The Companies Act 2006 provides power, on the application of the Takeover Panel, for the High Court to make such orders as it thinks fit to secure compliance where there is a reasonable likelihood that a person will contravene or has contravened the Takeover Panel's rules. Failure to comply with a court order may be contempt of court, punishable by a fine or custodial sentence.

FUTURE USE OF POUS

The commitments given by Softbank, together with those proposed by AstraZeneca illustrate the areas most likely to be considered for future POUs. The current Prime Minister's developing policy on industrial strategy, and the nature and terms of Brexit illustrate how such commitments may become even more important as political rhetoric becomes policy and law. We believe we will see further focussed use of POUs, guaranteeing investment in the UK, retaining jobs in the UK, the creation of new jobs, perhaps the creation of workers' groups to facilitate employee engagement with boards, maintaining and creating R&D and manufacturing capability, retaining or moving headquarters to the UK, maintaining listings on the London Stock Exchange, as well as retaining and moving tax domiciles to the UK. POUs will not be part of every public offer, but as the UK Government prioritises on securing long-term investment into the UK and cross-border M&A continues to be highly political, we expect to see focussed use of POUs to navigate political uncertainty and to secure the support of target boards and wider stakeholders.