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US/UK M&A: RISK ALLOCATION

In our second article in the US/UK M&A series we explore deal certainty and the different appetite for, and measures that are used to apportion risk between the parties.

Choice of English law

There is a widely held perception that UK style and English law governed M&A transactions are broadly seller friendly, while US style and governed M&A transactions are more buyer friendly; although there is some truth in this, in practice this is driven by the negotiating strength of the parties and different market practice rather than the choice of governing law.

In practice, UK sellers are often unwilling to expose themselves to an unfamiliar US judicial system which is perceived to be more litigious than the UK and where the costs associated with fighting any claim are likely to be higher. US buyers should be aware that, as with most US states, English law is based primarily on common law, developed by judges sitting in courts, and creates binding precedent for future cases. Choosing English law to govern an M&A transaction provides an element of certainty for the parties as it provides access to the English courts and that large body of judicial precedent as well as the consistency and fairness of the English courts. In terms of negotiating the document, the use of English law as opposed to the law of Delaware or New York (for example) is unlikely to have any significant impact on the terms save perhaps in relation to the duration of non-compete covenants and potentially around the buyer's ability to bring claims post-closing even when it was aware of the underlying issue where English law may be less favourable to buyers.

Conditionality and risk allocation

In a UK style M&A transaction there is usually greater certainty; market practice favours simultaneous signing and completion of the SPA perhaps to a greater extent than is the case in the US. Generally, UK style M&A transactions are subject to a very limited range of closing conditions; these are usually limited to obtaining necessary regulatory or anti-trust approvals, any other regulatory clearances and consents that are necessary and obtaining shareholder approval for the transaction itself (if required). Conditions which are solely for the buyer's benefit – such as financing conditions – are not usually accepted. In addition, reverse termination or reverse break-up fees are quite rare.

In the UK, if there is an interval between signing and closing to accommodate the buyer, a UK seller may be less willing than a US seller to accept a "no material adverse change" condition or any other condition which requires the full set of commercial warranties to be accurate at completion or any financing condition. Where MAC clauses are agreed to, UK convention is for these to be tightly drafted and keenly negotiated to limit any get out for the buyer as much as possible; the opposite is arguably true in the US, where the clauses are broader and drafted for the buyer's benefit. In addition, UK deals often rely heavily on covenants that require the target business to be operated on a normal and consistent basis in the period up to completion.

Because conditions are used in a limited way in UK style transactions, there is generally less room for a buyer to manoeuvre to get out of the deal after the SPA has been signed, so there is more certainty for the parties involved in the transaction. UK practice also means that business risk between signing and closing falls on the buyer more heavily than in a US style M&A transaction.

In contrast, in the US, a gap between signing and completion is commonplace; market practice regards this as time for the buyer on leveraged deals to put its acquisition finance in place, and US buyers are familiar with the ability to walk away from a transaction in this interim period in the event of a material adverse change. The obligation of the buyer to consummate the transaction in a US style transaction is customarily subject to numerous closing conditions including: (i) receipt of necessary competition/anti-trust conditions; (ii) receipt of other necessary regulatory approvals; (iii) confirmation that the warranties and representations remain accurate; (iv) compliance with all relevant covenants as at closing (subject to a materiality standard); (v) that no material adverse change has occurred with respect to the target company; and (vi) sometimes a finance condition. These provisions are weighted heavily in favour of the buyer; its ability to walk away from the transaction after signing the transaction documents and before closing mean that there is less certainty for the parties involved in the transaction.

Specifically, in relation to financing, UK sellers (especially in auction situations) often require a buyer to proceed on a "certain funds" basis. This concept is familiar to the UK market as it is driven by the public M&A regime; in practice it means that the buyer must be able to demonstrate the availability of financing before the transaction documents are signed (rather than rely on a finance condition contained within the SPA). In some cases, especially if the buyer's home jurisdiction imposes capital controls on the flow of its funds out of the jurisdiction, a buyer may be required to deposit, or put a percentage of, the purchase price in an escrow account at signing of the SPA. These funds act as security for the transaction proceeding and usually structured such that the buyer would forfeit them if they failed to complete the transaction.

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Warranty and Indemnity insurance ("**W&I**") is increasingly common in both UK and US transactions – it is advisable to consider whether it is appropriate early in the transaction process, and if so, what level of coverage is required. Coverage in the US is often more comprehensive, with fewer general exclusions and the ability to recover for breach of warranty on an indemnity basis, meaning that policies there are often significantly more expensive than the UK W&I policies.

Lewis Silkin regularly works with US financial and corporate buyers on M&A deals across a wide range of sectors on UK domestic and cross-border transactions. We'd be delighted to discuss any questions you may have regarding UK deal practice at an early stage in any discussions you may be having in relation to possible UK acquisitions.

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