Acquisition Finance Trends (UK)

A Practical Guidance® Practice Note by
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This practice note discusses trends for acquisitions and related financings governed by English law, particularly highlighting the difference in approach to the United States (U.S.) markets and also addressing certain key commercial and documentation developments.

For more information on acquisition finance in the United States, see Acquisition Financing Fundamentals. For more information on the essential aspects of acquisition finance law and policy in other countries, see Acquisition Finance in International Jurisdictions.

Summary of Acquisition Finance in the UK

The United Kingdom (UK) approach to private acquisition financing differs to the U.S. market in that parties will typically satisfy (or have solely within the offeror's control) all material conditions to the availability of financing at the time of signing the acquisition agreement. This is commonly known in deals documented under English law as a "certain funds" transaction. The approach to "certain funds" in private transactions is rooted in the UK City Code on Takeovers and Mergers (the Code) governing public company acquisitions. The Code requires that an announcement of a firm intention to make a bid should only be made when an offeror "has every reason to believe that it can and will continue to be able to implement the offer". See Rule 2.7(a) of the Code.

The "certain funds" provisions developed in order to give the offeree the required certainty that the relevant acquisition funds will be available ahead of completion. According to the Code, responsibility for compliance with such provisions rests not only with the offeror, but also with its financial advisor who is required to include a cash confirmation that sufficient resources are available to the offeror to satisfy full acceptance of any cash component of the bid. As the private acquisition financing market became more competitive through the early 2000s, with private equity sponsors (and hedge funds) often competing in hotly contested bid processes or auctions, an informal and market-driven "certain funds" approach became the benchmark standard for offerors in private acquisitions, thereby steering all cash resources to be in place and preparing the offeror to deliver on any potential acquisition. Not only does this approach guarantee (subject to any flex rights) the pricing and terms associated with any financing through to transaction completion, but assists a private equity sponsor in dispelling the concern of a vendor about contracting with a special purpose vehicle (being the nature of a typical bid-vehicle) with likely little or no assets. These commercial drivers have shaped market practice and, even outside an imposed legal or regulatory framework, provide certainty for all parties.

In practice, the certain funds documentation in the private market can vary from the presentation of commitment papers with accompanying term sheet (ideally well-negotiated, long-form and accompanied by an interim facilities agreement with a conditions precedent satisfaction letter), right through to a fully negotiated long-form facilities agreement (with a conditions precedent satisfaction letter). The "certain funds" nature of the transaction looks to ensure that there are very limited drawstops which, if triggered, mean that the lenders can refuse to fund the offeror. Typically the financing documentation will include the concept of a "certain funds period", which must be long enough to contemplate the long-stop date of any acquisition process by mirroring the terms of the underlying acquisition agreement, and during which the usual rights of the lenders (e.g., to accelerate any drawn loans or cancel commitments) are suspended during this period. The triggers during a certain funds period are limited to a handful of "major defaults" and "major representations", which are events that the market has accepted as being sufficiently material as to result in a drawstop of funds. These events are usually limited only to representations and covenants given by the offeror in its capacity as borrower and its parent (each typically a holding company or special purpose vehicle) to a lender, and not to the underlying operating companies within the target group. They are also generally limited to matters which are, to one degree or another, within the control of the borrower/offeror or which concern matters of fundamental concern (e.g., insolvency and commencement of insolvency proceedings). As an aside, it is worth noting that the inclusion of major defaults and representations relating to compliance with sanctions and anti-bribery or corruption provisions has been a matter of some contention in the past few years. It has been standard to include specific provisions concerning sanctions and anti-bribery or corruption in facilities agreements, although the provisions do not naturally fall within those that are necessarily within the control of the borrower/offeror. It is now customary for certain funds-style transactions to, as a minimum, find these provisions included indirectly by way of the lender's obligation to fund during the certain funds period being made subject to illegality, or otherwise by way of an "unlawfulness" major event of default. In terms of conditions precedent, it is usual for the borrower/offeror to request a conditions precedent satisfaction from the relevant agent or lenders confirming the status of each of the documentary and/or evidential conditions precedent to funding. Ideally, only those which are dependent upon the acquisition itself (e.g., payment of the purchase price) should remain outstanding and all others should be satisfied or within the control of the offeror (e.g., dating of documents).

Market practice has developed such that the nature of the above means that an underlying acquisition agreement under English law will not have a so-called "financing out" (as is typically the case in transactions with a U.S. nexus) that excuses the offeror from performing its obligations under the acquisition agreement if adequate financing becomes unavailable. This puts the risk solely on the offeror/borrower to deliver the financing at completion and incentivizes the "certain funds" approach. Once the competitive nature of any transaction has fallen away and an offeror/bidder has been chosen, the vendor will still focus on the progress of the financing, but ultimately it becomes the offeror/borrower's risk. In a similar vein, the lenders will remain focused on the underlying mechanics of the acquisition agreement (for example including any long-stop period/outside dates, conditionality, warranty protection, disclosure and assignability) but they do not have to analyze any provisions relating to "financing outs" in the same way as they would do in the U.S. In addition, there will still be significant time and focus dedicated to the conditionality and related conditions precedent in the underlying commitment papers and/or full-form finance documents in order to ensure there is no risk in delivering the financing at completion.

The above establishes the framework and principles behind the documentation underpinning acquisition financing arrangements, but it is equally important to consider the nature of the underlying documentation and the commercial and market drivers. Overall, there has been a gradual erosion of the more bank-friendly provisions, and an increase in flexibility afforded to sponsors and also opportunistic creditors looking for the ability to invest within pre-existing credits. In order to track the development of the debt markets, it is necessary to examine briefly the history of where we have got to today. As a general rule, including pre-dating the 2008 global crisis, sponsor-led, private acquisitions have typically been financed either by way of leveraged loans or high yield bonds (or by a combination of both). In today's European loan market, acquisition financing generally takes the form of all-senior or senior and mezzanine/second-lien structures, typically with a bullet repayment profile (or limited amortization across different tranches). In the high yield market, whilst there is a broader range of options, we often work with senior secured notes coupled with a super-senior revolving credit facility. For larger financings, it is common for senior secured notes to sit alongside senior unsecured notes, accompanied further by a senior secured term loan and revolving credit facility. Whatever the underlying structure, the continued buoyancy of the leveraged finance market in recent years has given participants the opportunity to import sponsor-friendly drafting and technology from the U.S. leveraged loan and global bond markets into the European leveraged loan markets. Particularly, following the global financial crisis, there was a huge demand for liquidity coupled with an influx of new debt providers into the European markets – for example, direct lenders, debt arms of private equity houses, and pension funds. The traditional bank lender therefore became somewhat marginalized and with competition for investment high, the sponsor / borrower market has been successful in achieving flexible market terms. In practice, historically the bond markets allowed more flexibility to borrowers or issuers, with incurrence-based covenants only and documentation that grows alongside the underlying business, however traditionally the loan markets were more rigid, with a suite of maintenance covenants and fixed baskets. With the increased demand for liquidity and investment following the recovery of the markets since 2008, we have continued to see a rise in the number of "term loan B" or "cov-lite" financings, typically being a term loan (carrying bullet repayment at maturity) with a revolving credit facility. These financings contain bond-style incurrence-style covenants only (including growth or grower baskets), together with one "springing" leverage-based financial covenant which is only tested if the revolving credit facility is drawn by a particular percentage (e.g., 30% or 40% by way of cash). There is usually generous capacity to incur additional debt (including often priming debt) and to make restricted payments out of the group. Another area of focus has been the ability to move assets around (and sometimes outside of) the covenant group. The provisions have led to increased optionality, particularly if assets can be moved outside of the covenant group and then levered with additional debt, and that additional debt in turn being reinvested within the group. In addition, reporting requirements have become limited, and with no (or limited) financial covenant testing and no maintenance covenants, the so-called early-warning signs indicating a distressed credit have somewhat diminished. Finally, a much monitored change to the documentation has been the modification of the EBITDA definition (being earnings before interest, taxes, depreciation, and amortization), a metric which is pervasive through the documentation and is underlying many of the tests a borrower may pass in order to avoid an incurrence-related breach or satisfy a financial covenant test (if any). Documents across the bond and the loan markets often now allow add-backs for one-off costs or projected earnings, and the flexibility (including, for example, to mitigate the costs of the Covid-19 pandemic) can have a real impact for a borrower in inflating its EBITDA. This flexibility within the EBITDA definition has been seen alongside the development of pro forma synergies, where the documentation has morphed to often allow for uncapped, self-certified synergies arising out of a number of vaguely defined events covering acquisitions, disposals, restructurings, or other cost saving initiatives. As a whole, creditor protection has diminished, and yet equally this presents opportunity for investment and injection of new capital into a structure.

Continuing Impact of COVID-19

Prior to the COVID-19 pandemic, the London M&A/ leveraged finance market continued to be affected to some degree by uncertainty over the terms of the UK's eventual exit from the European Union (EU) and the (then) upcoming elections such as the 2020 U.S. presidential election, 2021 German federal election, and 2022 French presidential election were also identified as having potential global macroeconomic effects. However, whilst there were mixed views as to the ultimate effects of the foregoing, for the most part there was a sense of "business as usual" and with the demand for liquidity remaining high, pricing and documentary terms remained competitive. The COVID-19 pandemic has obviously had a material impact on the European leveraged loan and high yield markets. As we noted previously, initially there were a number of immediate themes including unprecedented draws on revolving credit facility lines and requests to tap incremental facilities. In addition, through both 2020 and 2021, existing documentation was scrutinized by both borrowers and existing or potential investors alike, particularly as to the ability to incur additional debt, the extent to which assets may be moved outside the documentation restrictions, and whether there are any freely available assets that may be used as future collateral. The market has also continued to see an influx of waiver and consent requests, as borrowers ask for short to medium term covenant relief or additional headroom. Many lenders have spent time in connection with these requests reconsidering whether any documentary changes should be made, for example the "turning off" of certain flexibilities (i.e., the ability to move assets outside of the secured group (see above)) or to otherwise tighten indebtedness or disposal covenants. In addition, through 2021 we have seen a resurgence of the types of debt re-profiling experienced after the 2008 financial crisis (e.g., covenant resets and maturity extensions), and ultimately a continuing number of credits that require additional liquidity. The wave of full refinancings or restructurings has been slower to hit than expected – in a large part due to the level of short to medium-term amendments and waivers, as described above – but we expect these to hit through 2022. It is too early at this stage to hypothesize whether the sponsor-friendly provisions we have seen develop over recent years will retrench in time, but for now the opportunities they create and the potential lifeblood they breath into a company likely means they are here to stay for some time at least. Clearly, there is a huge degree of opportunity, and the expectation is that the markets will be busy in one form or another through the coming months in 2022.

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Amy Kennedy structures leveraged financing arrangements for complex leveraged buyouts and other private equity transactions.

In addition to her leveraged finance experience, Amy leads fund financing transactions, including subscription lines. She has also worked on a range of complex international and cross-border banking and restructuring transactions. Amy is also experienced in more general lending, including investment grade and corporate transactions.

Her clients include private equity sponsors, banks and other financial institutions (including non-bank alternative capital providers) and corporates (including client portfolio companies).

Amy has experience with complex senior/mezzanine/second-lien structures, payment-in-kind (PIK) lending, high yield, unitranche/private placement and U.S. financings. Amy has also represented both banks and corporations in Islamic/Shari'ah based lending, including co-conventional structures.

Amy has worked across a number of sectors including oil and gas, telecommunications, real estate and retail.

Amy is co-leader of our environmental, social and corporate governance (ESG) group and has experience in cutting-edge green and sustainability-linked financial products in the public and private debt markets.

Prior to joining Akin Gump, Amy was a partner in the global finance and private equity practice groups in a leading global law firm. She has practiced in London, New York and Dubai.

In 2019, Amy was identified by The Lawyer as one of their "Hot 100" and named a "Rising Star in Finance" at the annual Euromoney Legal Media Group Europe Women in Business Law Awards. She is also included in Legal 500 UK 2020 for Real Estate—commercial property investment and Real Estate—property finance. She is also ranked as Highly Regarded in IFLR1000 2020 for Banking. Amy is listed by the Euromoney Legal Media Group's inaugural Rising Stars Awards for the practice area category banking and finance and also as a Rising Star in the country category for the United Kingdom.