

M&A transactions:

What are the golden rules for designing a new incentive structure for listed companies and others, in anticipation of, or immediately following, an M&A transaction?

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M&A transactions: What are the golden rules for designing a new incentive structure for listed companies and others, in anticipation of, or immediately following, an M&A transaction?

- General principles
- In anticipation of the transaction
- During the transaction
- After the transaction

General Principles

- Golden Rule 1 - Why does client want a new remuneration arrangement?
 - do existing incentive arrangements work?
 - why are they introducing it now?
- Golden Rule 2 - Think about corporate duties (and conflicts)
- Golden Rule 3 - Think about tax and accounting (or make sure client has asked somebody else to do so!)
- Golden Rule 4 - If directors will participate, is it consistent with the Remuneration Policy?

Before the transaction - when might this be relevant?

- Potential takeovers
- Demergers and other corporate transactions
- Private equity structures
 - Incentives in portfolio companies

Potential takeovers (1)

Case Study 1: UK PLC

- July 2018 - Client asks for a review of its share plans
- August 2018 - It becomes clear that client is concerned about potential for a bid - although no bidder has emerged
- September 2018 - LTIP amended to give greater discretion to RemCo on a takeover
- October 2018 - ?

Potential takeovers (2)

Case Study 1: Potential issues:

- Is shareholder approval required for changes? What about participants?
- Takeover Code - Rule 21 - applies “during the course of an offer, or even before the date of the offer if the board of the offeree company has reason to believe that a bona fide offer might be imminent”
- Is it “consistent with” the Remuneration Policy?
- Is a change appropriate? - is it a change which shareholders would approve if you asked them?
- Hindsight risk - and inaccurate reporting.

Demergers and other corporate transactions

Consider:

- How will retained and demerging employees be affected under current plans?
 - how do you deal with inequities of treatment?
 - how do you deal with perverse incentives?
 - adjustment? / amendment? / dividend equivalents?
- How will timing of the transaction impact on plans - can performance against targets be calculated - will payouts need to be pro-rated?
- If awards need to be adjusted/existing plans need to be amended - does that require shareholder/participant approval?

Case Study 2: Whitbread

- April 2018
 - Announced intention to demerge Costa
- June 2018
 - Wrote to shareholders explaining that:
 - Existing plans and Remuneration Policy were not sufficiently flexible in the circumstances
 - New PSP for key individuals to reward and incentivise on demerger (or earlier sale)
- 27 June 2018
 - New Remuneration Policy and new PSP approved by shareholders. Awards granted.
- 31 August 2018
 - Costa agreed to be sold to Coca-Cola
- Early 2019?
 - Expected completion of sale - PSP will pay out

Whitbread (2)

Case Study 2: Potential issues:

- Shareholder approval
- Consistency with Remuneration Policy
- Acceptability to shareholders - consultation
- Excessive reward?

Private equity structures

Golden Rule 5: Make plan robust - you will probably have to operate it!

- Number one issue for plans put in place in private equity owned portfolio companies is - don't hinder the exit:
 - is it clear when - on what corporate events - payout is triggered? What about sales of part? Restructuring? New money?
 - do drag and tag rights work in the right circumstances?
 - how is management payment to be calculated? Who makes the decisions? What rights of challenge? Does dispute process hinder the exit?
- Good and bad leaver provisions
- Control of unallocated share of equity

Private equity structures

Golden Rule 6: They really care about tax!

- Consideration of growth shares or EMI
- More tolerance for offshore structures
- Close coordination between corporate, share plans and tax advisers

What about during the transaction?

- Retention awards
 - on a public takeover - consider Rule 21 of the Takeover Code
 - on private M&A - likely to be caught by warranties (or restrictions on conduct between signing and completion)
 - Who is picking up the cost of retention - seller or purchaser? Indemnities may be needed. Don't forget the PAYE obligations and cost of employer NICs
- Promises of incentivisation
 - on a public takeover - consider Rule 16 of the Takeover Code:
 - 16.1 - special deals with favourable conditions
 - 16.2 - incentivisation for management

Takeover Code - Rule 16.2

Except with the consent of the Takeover Panel where an offeror has:

- (i) entered into; or
- (ii) reached an advanced stage of discussion on proposals to enter into

any form of incentivisation arrangement with members of the offeree's company's management:

- details of the arrangement must be disclosed
- independent adviser must state that in its opinion the arrangements are fair and reasonable
- negative statement required
- where significant and/or the nature of the arrangements is unusual in the context of the relevant industry or good practice the Takeover Panel must be consulted and consent to the arrangements obtained
- Takeover Panel may require that the arrangements be approved at a general meeting of the offeree company's shareholders (separate vote of independent shareholders)

What about after the transaction?

Golden Rule 7: Think about incentivisation before this stage!

- May be the subject of discussions well in advance of the deal
- What about comparability between bidder/purchaser workforce and target workforce?
- Will target executives get a windfall? How might you lock them in?
- Is there a TUPE transfer? May be the case even if main deal is buying shares
 - If so consider issues around preservation of benefits - Mitie Managed Services v French
 - Can you replicate existing schemes or provide schemes of equivalent value?
- Is there an opportunity/requirement to review Remuneration Policy? If so, consider what changes to plans might be implemented at the same time.

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