

BANKING & CORPORATE FINANCING | BY JOHN D. MARKLAND

How certain can you get?

Certainty of funding is increasingly the focus of attention in leveraged buyouts—the seller wants proof that the buyer has the cash needed to consummate the deal. The past 18 months has seen a convergence between US and European market practice in this regard in leveraged acquisition finance transactions. Unusually, it is the US market which is moving closer to European market norms.

All of the excitement has focused on the conditions to which the availability of finance for leveraged acquisitions is subject. In Europe, it is now customary for LBO borrowers to get ‘certain funds’ commitments from their banks. Market practice in the US is moving closer to that position. The result is a more equitable alignment of interests between borrowers and financiers.

So, what are we talking about?

The ‘certain funds’ concept derives from UK public M&A transactions where, under the UK Takeover Code, financial advisers are required to provide a ‘cash confirmation,’ confirming that the bidder has the necessary financial resources available to consummate the offer.

This means that if the purchaser in a public deal is planning to borrow to cover the offer price, the banks lending the money need to forego the typical broad-ranging funding conditions to which they are accustomed. Banks would be accustomed to be able to refuse to fund if there was a material adverse change in the target group. Under the certain funds regime, this is not permitted, at least not as a separate condition. As a rule of thumb, the only conditions which can survive in the certain funds regime are ones within the control of the purchaser.

So, the certain funds concept has its origins in the UK public M&A markets. However, in the last few years, private equity sponsors have forced banks to offer the same reduced conditionality regime in private deals across Europe. This has allowed private equity sponsors to avoid having to ask for a financing condition in their purchase agreement and means that they can equate their certain funds cash funding position as being on a par with that of corporates/trade buyers, and thus remove what had traditionally been perceived as a disadvantage for sellers in dealing with financial buyers.

The certain funds regime also brings in a 90 day so-called ‘clean up period’ for the purchaser to remedy technical (non-materially adverse) defaults relating to the target group following completion, and this concept has also migrated across to the private sphere.

The certain funds practice is now so pervasive in Europe that the Loan Market Association (a trade body set up by the banking community in London to support the development of the European syndicated loan markets) now includes wording for the certain funds and clean up period concepts in their standard form leveraged finance loan agreement.

In the US, there has not historically been the same regulatory driver for banks to have to accept certain funds’ conditionality, but there has been enormous market pressure in recent months to reduce closing conditionality. This has led to the so-called Sungard approach (named after the deal in which it was first adopted) being used in a number of US deals in the last year.

Under the Sungard approach, the purchaser no longer has a financing condition in the purchase agreement (the effect of which would have been to excuse the purchaser from completing the acquisition in the event that financing was not available). In fact, the purchaser may be required to pay a reverse break-up fee for failure to close the acquisition because of either a purchaser breach or failure/unavailability of financing. To protect against the possibility of a failure of financing, the purchaser will now typically insist that its banks severely limit their funding conditions compared to the broad funding conditions that until recently were commonplace in US deals.

Following this model, the closing material adverse change condition will be the same (or very nearly the same) as the purchaser’s material adverse change condition (if it has one) in the purchase agreement, and the closing date representations regarding the target and its business will typically be the same as the representations that the purchaser receives from the seller in the purchase agreement.

The effect of all this is to narrow very significantly the circumstances in which the purchaser would be required to proceed under the purchase agreement notwithstanding that the lenders were excused from performance. In fact where the conditions in the finance documents can be aligned with those in the purchase agreement in this way the effect is quite similar to that achieved under the European certain funds approach.

So what of the future?

Although the Sungard model has been eagerly seized upon by strong sponsors in large US deals, this approach is still in its infancy, and it remains to be seen whether it becomes market standard, particularly in mid-market deals and where not necessitated by a reverse break-up fee in the purchase agreement.

The effect of this convergence has been to realign risk allocation as between banks and borrowers in leveraged M&A transactions. Essentially, the banks are being required to take substantially the same risks as the borrower with regard to the condition of the target, a proposition which has prevailed for some time in Europe but which is slowly becoming more prevalent in the US. ■

John D. Markland is a partner based in the London office of law firm Kirkland & Ellis International LLP.

He can be contacted on: +44 (0)20 7469 2170 or by email: jmarkland@kirkland.com

This article first appeared in FinancierWorldwide’s April Issue 2007.

© 2007 FinancierWorldwide Limited. Permission to use this reprint has been granted by the publisher. For further information on FinancierWorldwide and its publications, please contact James Lowe on +44 (0)845 345 0456 or by email: james.lowe@financierworldwide.com