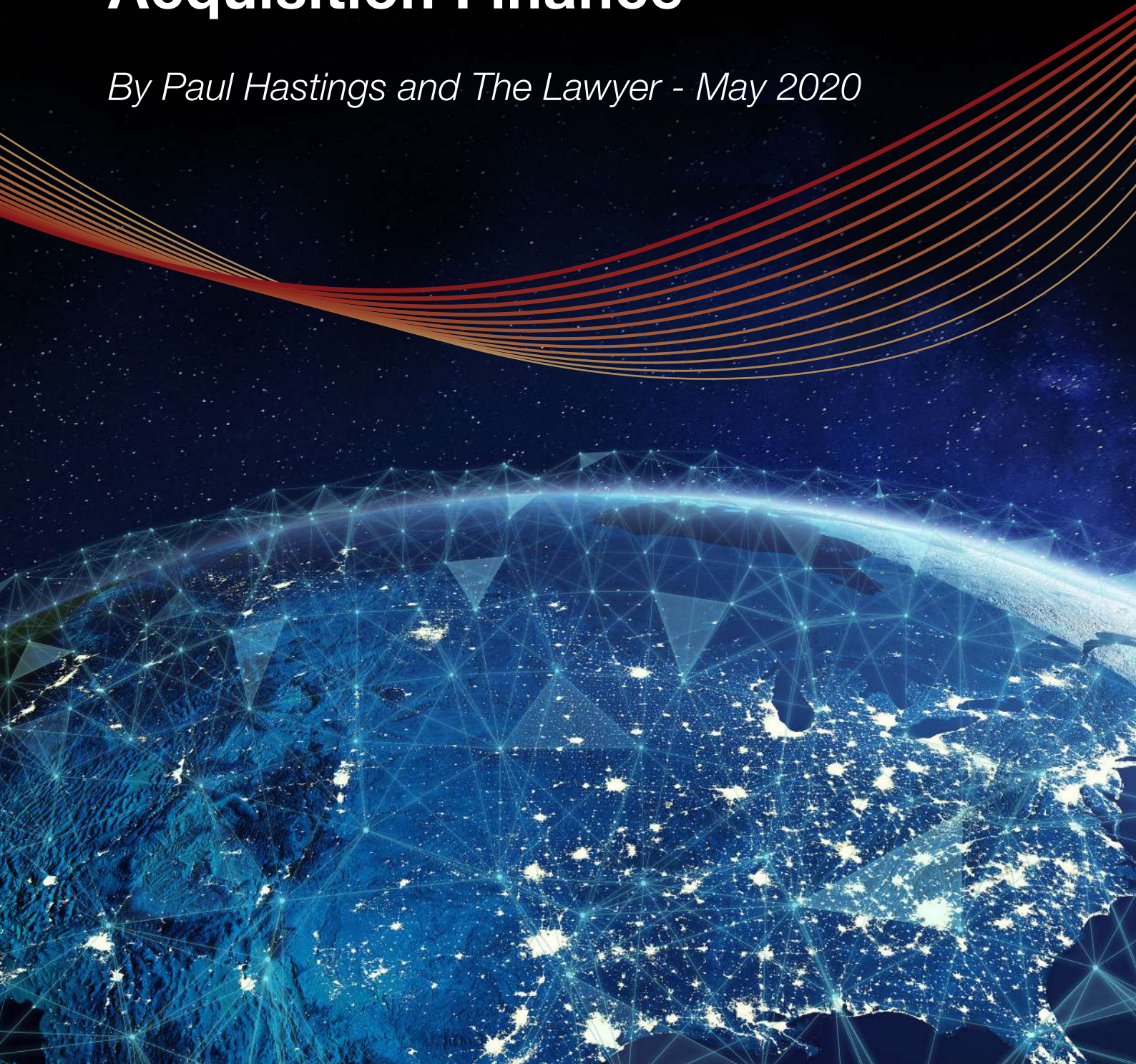


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Paul Hastings Translates Trends in Transatlantic Acquisition Finance

By Paul Hastings and The Lawyer - May 2020





Contents

A transatlantic future	4
The US influence on the European market	7
The rise of the non-bank lenders	8
The patchwork of Europe	10
The political impact	12
Case Study: Financing Bain's Acquisition of Kantar from WPP	15
Team structure	16
Conclusion: what next?	19

Key takeaways

- The convergence of documentary terms, investors and commercial approaches across the European and US loan markets has remained steadfast – a sentiment shared by 65 per cent of survey respondents.
- Non-bank lenders are playing an influential role in deals across the loan market, including financing larger buyouts that would previously only ever have been capable of being bank financed. 2019 saw Blackstone's credit division, GSO, offer to make a €1.5bn unitranche proposal to back Advent International's acquisition of Evonik's plexiglas business, demonstrating the rising power of credit funds.
- The 'transatlantic' nature of both the dealmakers and the deals themselves are now a common feature of the legal landscape – and City firms are striving to ensure they have the resources and necessary expertise to credibly serve the needs of their clients as a result.
- There is no real consensus on ideal team structure. Interviewees broadly agreed, however, that the ability to efficiently mobilise a cohesive team across jurisdictions is key.
- Key discussion: what are the consequences of convergence? If convergence has been facilitating borrowers' ability to 'import' more flexible terms and looser covenants from different markets, there may be adverse consequences from such 'cherry-picking' in the long run, particularly in a sustained downturn.
- While the risk is that convergence may serve to amplify global market shocks (including the current COVID-19 pandemic crisis) due to the integration of the debt markets, on the other hand it may also mean that market participants are able to react to such shocks more robustly and in a more coordinated manner for the very same reasons.

A transatlantic future

As pressure builds within the global economy, the relationship between the world’s two largest corporate and financial markets – Europe and the United States – continues to develop.

The transatlantic nature of both dealmakers and deals themselves are now a common feature of the legal landscape – and City firms are striving to ensure they have the teams, resources and necessary cross-border expertise to credibly serve the needs of their clients as a result.

Uncertainties surrounding the future political and trading relationship between the UK and the European Union, the prospect of global trade and oil price wars, global health pandemics, and the strain on world currencies are just some of the storm clouds that are getting dealmakers thinking. And like the dealmakers, City firms also have a close eye on the prospects of a sustained downturn and a future era where global crises such as the COVID-19 pandemic could arise with unfortunate regularity.

About the project
It is through this lens that the relationship between Europe and the US in acquisition finance is analysed in a joint project by Paul Hastings and *The Lawyer*. The analysis has focused on convergence and divergence between those two markets, with a focus on where convergence is important, the way participants take advantage of the differences, the impact of geopolitical and market pressures as well as global shocks, and the ‘ideal’ team structure for financing large transatlantic M&A deals.

Research has involved analysis of survey responses from personnel working in financial services, private practice law firms and corporate organisations. Insights were also gained through interviews with partners and heads of leveraged finance from both the legal and financial services sectors.

A roundtable discussion was also held in order to gauge the opinions of high-ranking personnel working at law-firms, lenders and corporate entities.

A nuanced convergence
“Convergence has been a feature of the loan market for some time now. And this partly results from the increasing sophistication of sponsors and borrowers who have been more willing to cross markets in search of more favourable structures, terms and pricing for the financing of their deals – and also because of the enormous growth and diversification of the lender base, which has created a lot of competitive tension, opening up the field,” comments Luke McDougall of Paul Hastings.

The common feeling is that the European and US markets – in terms of documentary terms, investors and commercial approaches – are converging, as demonstrated by 65 per cent of our survey respondents. This is primarily evidenced by the proliferation of American- or New York-style credit agreement terms and mechanisms in the European loan market. This will be discussed in greater depth in the remainder of the report, but one thing to bear in mind is that the question of convergence is nuanced, shaped by jurisdictional differences, competition regulation, monetary policy differences, and geopolitics.

For example, European borrowers may be inclined to ‘cherry-pick’ advantageous or flexible US-style loan terms but these will evolve to include and reflect the national laws into which they’re implanted. Amin Doulai of Paul Hastings summarises this, saying: “The regulatory, legal and even cultural differences across jurisdictions really matter – simply dropping a term or a structure from a deal in one jurisdiction straight into another deal in another jurisdiction doesn’t really work – it requires a lot of upfront analysis to avoid any unintended consequences. Properly adapting these sorts of things to the local jurisdiction is critical.”

Other US systems diffusing into the European loan market include the bridge to high-yield bond product, which is now relatively common within the European large-cap market. US influence is also shown by the prominence of the unitranche debt product in the European middle market, which has driven the increased role of non-bank lenders.

Breakdown of respondent organisations



Source: The Lawyer

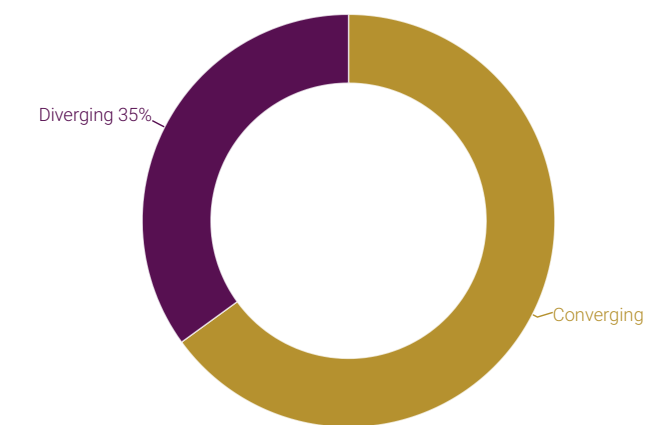
There is also a much quicker transfer between US and European markets than used to be the case. An example of this is in the use of net short lender provisions which first arose in the US but the debate almost immediately transferred into Europe. HSBC’s leveraged and acquisition finance director Sandeep Bose-Mallick says “European deals have acknowledged that they need to deal with net short lenders. But as of yet I would say that European dealers are still deciding how best to deal with the concerns the borrowers and sponsors have.”

An uncertain future
The interaction and integration of the markets will also play a significant role in the midst of the devastating effects of the COVID-19 emergency, as borrowers and lenders in both the US and European markets attempt to navigate through the tremendous commercial and social shocks resulting from it.

Such types of global crises raise a number of thorny legal issues that are both common and relevant across jurisdictions and markets – for example, COVID-19 has already raised critical issues for borrowers and lenders globally in relation to the applicability and limits of force majeure clauses, the use of EBITDA add-backs and adjustments to address the sudden and unexpected decline in revenues, the use of undrawn committed lines for emergency liquidity purposes and the means by which potential financial covenant breaches can be cured (as well as the usual attention to restructuring and bankruptcy contingency planning).

It will be highly relevant for borrowers and creditors of all sizes to be aware and closely survey how others across the globe are dealing with these common issues stemming from a common crisis, and global law firms can assist with potential solutions and ideas originating from any part of the world. And for the bigger players, such as the larger international private equity sponsors, international corporates and large investment banks, a highly coordinated approach to these issues across jurisdictions may be warranted. Challenging times may lay ahead, but the prospects for innovation remain high, facilitated through this convergence.

Do you think the European and US acquisition finance markets are converging or diverging?



Source: The Lawyer

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The rise of the non-bank lenders

Dry-powder

One clear example of US influence, and of divergence between the European and US M&A and high-yield bond markets, is in the growing role of non-bank funding sources, in particular the rise of dedicated credit and direct lending funds and their vast amounts of ‘dry-powder’ which they are ever desperate to deploy.

A third of our survey respondents selected ‘disintermediation by non-bank funding sources and increasing role of direct lenders throughout the market’ as a rising trend in acquisition finance. Other popular responses here included ‘continued control by sponsors of lending terms’ and ‘increasing role of debt advisors and legal counsel in running competitive debt processes.’

One of the first clear demonstrations of the enormous lending capacity of some credit funds was shown in February 2019 by US asset management firm Ares’ £1bn unitranche debt refinancing of telecoms firm Daisy Group. In March of that same year, GSO, Blackstone’s credit division, made a €1.5bn unitranche proposal to back Advent International’s acquisition of Evonik’s plexiglas business. These deals would only ever have been capable of being bank-financed just a few years ago.

“The credit funds and direct lenders don’t just bring additional choice and liquidity to the mid-market, they are also bringing their own sector specialism and industry expertise – and in each of their sweet spots, they know their industry fundamentals, exactly what to watch out for during diligence and the terms to focus on during documentation – the evolution has been striking,” comments Luke McDougall at Paul Hastings.

More variety, more headaches?

This trend and the move away from bank intermediation was discussed at the roundtable event. One participant stressed that direct lenders are now playing a huge role. “When I’m advising my clients, we

can introduce them to 10 to 15 direct or non-bank lenders and say ‘here are a huge variety of debt solutions to choose from’.”

This can in turn provide a headache for lawyers operating in Europe and lead to deals slowing down. “With the emergence of credit funds, we’re finding that they can’t often fund as quickly as banks can, and as easily on a multi-currency basis,” says Mayer Brown’s Stuart Brinkworth. “These aspects can make deals slightly more challenging in terms of execution.”

So what impact are these alternative lenders having on the banks themselves? “I guess the impact is that we’re seeing them more and more on deals,” says HSBC’s Bose-Mallick.

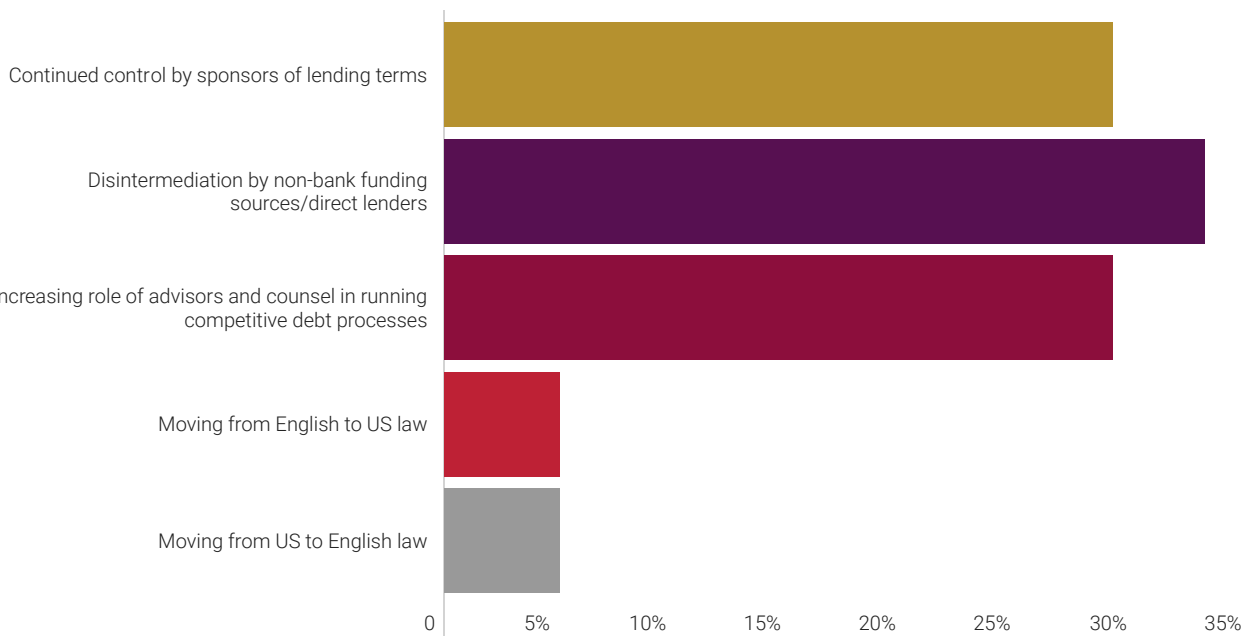
“They offer speed of execution. But I still would say that banks are still very relevant in terms of our underwriting capacities. We definitely see them as another player in the market but we’re not panicking just because there are direct lenders out there.”

Alternative lenders in an unsure economy

The role of alternative lenders and non-bank financial institutions in the loan markets will undoubtedly continue to evolve in step with the overall health of the global economy. And so while to date the focus has been on the increasing origination and underwriting capabilities of alternative lenders and credit funds, the focus could change as the storm clouds gather.

Indeed, a significant portion of the non-bank lending universe is comprised of dedicated special situations and distressed debt funds that specialise in seeking investment opportunities in dislocated markets and challenging credits. And so, as the fallout from global shocks such as the COVID-19 crisis and the oil price wars begin to point towards a potential sustained downturn in the market, it is likely that these institutions and their strategies will play an increasingly influential role in providing liquidity and taking up opportunities.

What do you believe are the top three rising trends in acquisition finance?



Source: The Lawyer

“Banks are still very relevant in terms of our underwriting capacities”

Sandeep Bose-Mallick, HSBC



The patchwork of Europe

The regulation spiderweb

The European approach to deals – and the ability to import US terms and legal technology into deals – will depend on the number and identity of the particular European jurisdictions involved.

Unlike the US with its relatively homogenous approach to regulation, security, insolvency and commercial law, Europe remains a patchwork of legal approaches and (often) tighter regulatory standards.

The heterogeneous approach among European countries in relation to regulation, security and insolvency law has often slowed the convergence process – for example, the European and US approaches to first lien/second lien financing structures are very distinct due to the inability in Europe to take comprehensive all asset security in many cases.

Fried Frank’s Kathryn Cecil elaborates on this: “The thing that’s interesting to watch in Europe is that there are a number of different jurisdictions and regimes – you just don’t see that much of a difference in the US.”

“So if you’re putting together any kind of security, that complexity is something that takes a little bit of time if there are European jurisdictions involved.”

European harmonisation

Notwithstanding the current reality, European policy makers are making attempts towards harmonisation, as demonstrated by the European capital markets union. However, while the desire at the macro level is evident, progress is often hampered by individual country regulators that have at times been less accommodating towards proposals for regulatory change.

This is particularly apparent in various individual European jurisdiction approaches towards non-bank lending, where a lot of market evolution has taken place. The regulatory approach in the UK towards bank and non-bank lending following Brexit also remains an open and pressing question, including whether the UK will use regulation as a competitive tool to attract market participants.

The complexity doesn’t end there. History has shown that regulatory approaches are constantly changing and ever subject to political pressures of the time – resulting in once apparent convergence quickly turning into clear divergence. For example, European and US regulators have been talking about regulating ‘excessive’ leverage in the bank market since the beginning of the last decade, culminating in the introduction in the US of the ‘leveraged lending guidelines’ in 2013.

This was closely followed in Europe with the ECB introducing similar guidelines in 2017.

Trump and US deregulation

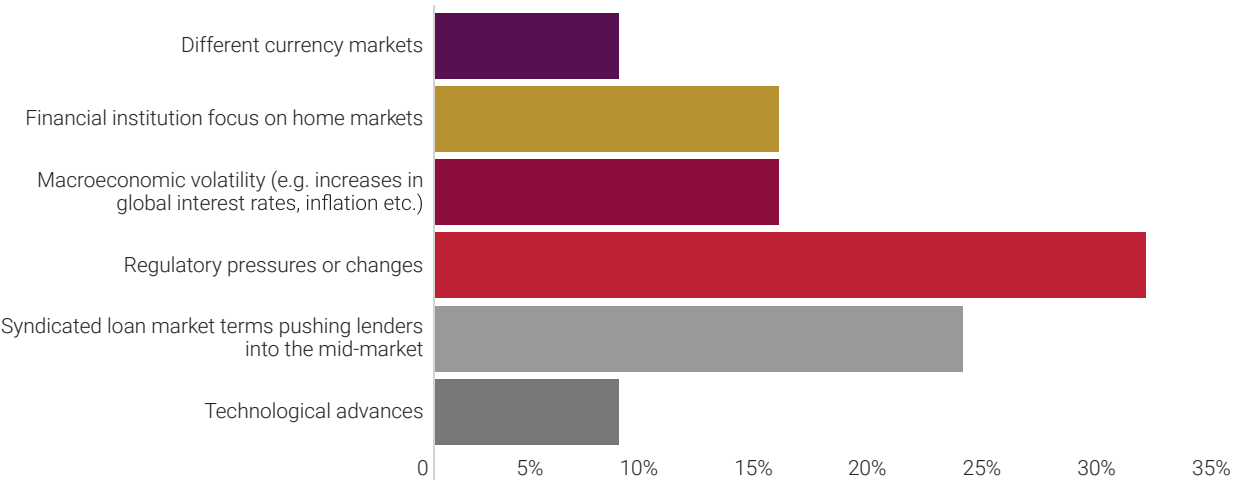
The US regulatory approach towards excessive leverage has been waning as a result of the Trump administration’s focus on competitive deregulation, while European regulators remain steadfast on the issue. The Bank of England, for its own part, has also raised concerns on the same topic, warning the market in late 2018 of its concerns on the rapid growth of leveraged lending and the increasing role of non-bank lenders in the market. It is clear that the regulatory arena remains in flux.

These types of regulatory differences were selected within 31 per cent of responses as a circumstance in which divergence in

acquisition finance could occur. Concerns around this have grown post-Donald Trump’s election in 2016, after which Republicans in Washington have been keen to roll back regulation. European countries, meanwhile, tend to push for further regulation – heightening the chance of divergence.

But of course, regulatory approaches rarely remain static, and the next challenge will clearly be how regulators, central banks and government treasuries across the world will respond to the significant social and economic challenges posed by the COVID-19 crisis. Indeed, as they face their biggest trial since the financial crisis of 2008, it remains to be seen what the permanent regulatory outcome will be.

In what circumstances could you see divergence occurring?



Source: The Lawyer

The political impact

The benefits of convergence

When asked to select what they felt were the most important aspect of convergence in transatlantic finance markets, 44 per cent of respondents selected mutual recognition and third country equivalence advances.

Convergence can also make deals easier from a sponsor/borrower perspective, says Bose-Mallick. “It’s useful for sponsors and borrowers to have one set of terms and flexibility for any deal that they do. It’s very useful to have the same terms across a portfolio of companies.”

The impact this has for lenders is, however, less significant. “I think because there’s been so much convergence, the gap between the documents in the two markets has narrowed so much that we don’t think of convergence as negative or positive in either way,” says Bose-Mallick. “It’s just where the market is.”

M&A players are broadly keen to avoid political interventions, which can severely slow down an acquisition and cause a spike in expenditure, and convergence between two markets and a move towards mutual recognition can help with this.

Of course, where the intervention is cited on national security or other politically sensitive grounds, mutual recognition may not help. In 2018, the UK Government mandated a series of commitments on Melrose plc in relation to its hostile acquisition of GKN as a result of public and union pressure over jobs. In a more recent transatlantic context, political intervention resulting from defence-concerns significantly slowed down the £4bn purchase of Cobham by US equity giant Advent International. Both examples show that political and security pressures can never really be totally contained or managed by dealmakers at the outset.

Brexit – opportunity or concern?

Market differences were selected within 60 per cent of responses when those who believed the European and US acquisition finance markets were diverging were asked why they held that belief.

One respondent said that “Brexit can only drive a wedge”. Other concerns in the modern context have involved the US/China trade dispute and the collapse of the Turkish Lira.

Opinions on the impact that these types of large international events have on the M&A market vary. On Brexit, for example, interviewees were broadly both unsure of its true impact while quietly optimistic about its effect on the market.

DLA Piper’s Dwyer says that while the City readied itself for the exit two years ago, there is still some concern about what could happen to the wider economy.

“The worry from a City perspective has moved from ‘oh my gosh, how do we deal with the change in regulation’ to ‘what’s the impact on the real economy?’ The legal structures have already been amended in order for us to keep doing business – but the risk is now around Brexit’s macro-economic impact” says Dwyer.

This uncertainty has, however, provided some opportunity, says Cecil. “Some of the bigger UK assets were reasonably cheap [because of Brexit], so you have a lot of people queueing up to make deals happen. When there are those kinds of risks there are also opportunities, so they can actually be a positive.”

Mayer Brown’s Brinkworth goes one further, prophesising that the UK’s election of a majority government will encourage a healthier trading environment and saying: “I think that the UK has been underweight for the last year because people had shied away from doing UK deals due to Brexit

uncertainty – I think that will definitely change this year.”

One roundtable participant downplayed Brexit’s impact. “When we talk about the terms of finance and how finance is constructed and underwritten, convergence is relatively unaffected by Brexit because the two dominant laws (New York and English) never really had a European law component.”

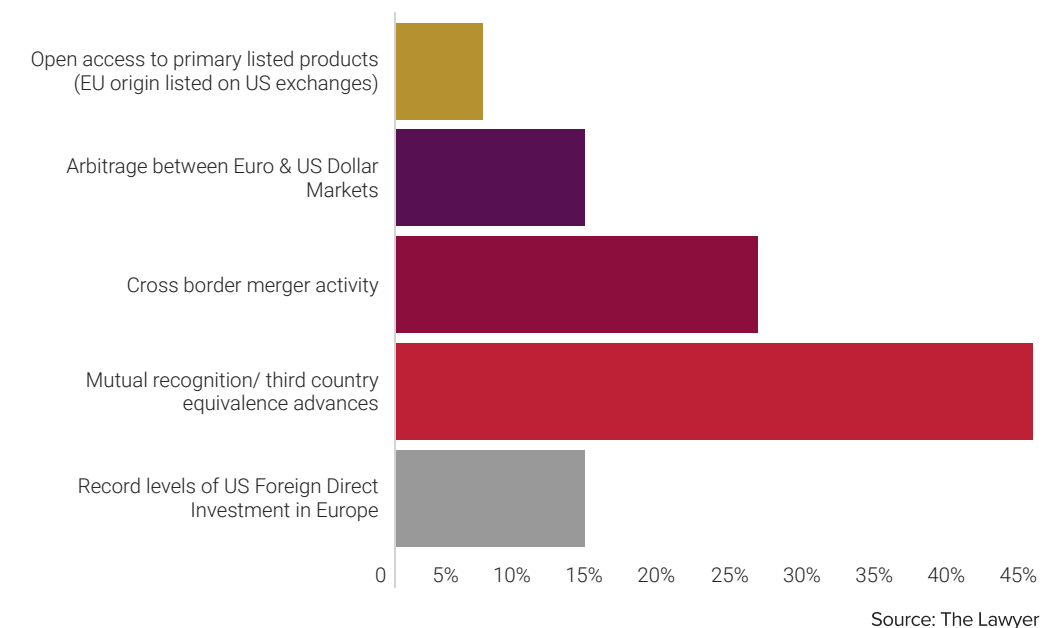
The impact of these wider geopolitical events was succinctly summarised by Latham & Watkins’ Roberto L Reyes Gaskin: “The mismatch between what sellers want and what buyers are willing to pay, as well as what financing parties are able to support and underwrite, grows and

gets amplified with geopolitical risk.” He adds: “It can lead to an outcome where the deal is put on hold or the deal gets done at a much higher rate than what might otherwise have occurred. So, I think that these are the kind of wild cards but that being said, [2019] was still a very good year for deal making.”

Opportunities

Respondents were asked to name the top three opportunities for their acquisition finance teams over the next 12 months. Geographic expansion was the most popular response, selected within 29% of responses. This was closely followed by ‘concentration in financial centres’ and ‘increase focus on core products’, both of which were selected in 25% of responses.

What are the most important aspects of convergence?



An aerial night photograph of a city, likely New York City, showing a dense urban landscape with numerous skyscrapers and a major highway with light trails from traffic. Overlaid on the image are several white and orange curved lines that connect different points across the city, suggesting a network or flow of information and capital. The lines originate from various points in the city and converge towards the right side of the page, where the text is located.

Case Study: Financing Bain's Acquisition of Kantar from WPP

Paul Hastings

The important role that lawyers play in advising the financing of large cross-border acquisitions was demonstrated by Paul Hastings in 2019. The firm advised several banks (including Bank of America Merrill Lynch, Barclays, Credit Suisse, Deutsche Bank, Goldman Sachs, Mizuho, Morgan Stanley, Natwest, Nomura, and RBC) as arrangers on private investment firm Bain Capital's acquisition of a majority stake in market research business Kantar from WPP. The financing package was around \$3.1bn in total.

Kantar employs more than 30,000 people in 100 countries, and held majority and minority stakes in private and public traded entities. This made for a complex M&A process, given the complexity of the target business and the constant currency adjustments used in financial statements, resulting in a difficult verification process on high yield notes and a highly bespoke offering memorandum. Separation plans were devised by M&A counsel for each individual country, all of which were reviewed by Paul Hastings.

Paul Hastings inputted on a novel dual-silo structure driven by the WPP rollover and a multi-staged closing process with key thresholds and milestones built into the financing terms as well as multiple pro rata drawdowns of debt from high yield notes, escrow accounts and loan facilities. The financing need was met through tapping both the US and Euro markets, and

included senior secured and senior debt, both loans and bonds.

Having 11 banks on a deal, including underwriting out of both London and New York, required a full complement of Paul Hastings lawyers across London and New York and in specialist areas. The European practice of 'virtual trees' was fused with more traditional approaches to provide timely advice on both markets to each individual bank. This transatlantic team handled capital structure changes during the course of the deal and also provided critical cross-border advice regarding arrangements between the underwriting banks when difficult market conditions were encountered.

Initial closing occurred on 6 December 2019, with over 90 per cent of the target business acquired upfront, a further closing in February and a further (final) closing is due in May 2020.

Luke McDougall was the lead partner on the deal. He had assistance from partners Peter Schwartz, Ed Holmes, Richard Kitchen, Shekhar Kumar, Randal Palach, David Makso, Arun Birla, Garrett Hayes, Olivier Vermeulen and Fritz Kleweta. Lead associate was Lauren Winter.

The deal was a great demonstration of the challenges now routinely faced and met by law firms operating seamlessly across Europe and the US and across all the major products used in global acquisition finance.

Team structure

The Paul Hastings Approach

Paul Hastings employs a London-based team of four partners and 13 associates for leveraged finance and private credit, plus two partners and two associates for financial restructuring. The fully integrated team has expertise in both English and New York law, and across large-cap and mid-market deals. The team's product expertise covers the entire capital structure: subordinated debt, high yield bonds, senior loans and a variety of other products used in the market. This includes syndicated bank loans, direct lending unitranche loans, Italian mini bonds, and French unitranche notes. Globally, the Paul Hastings leveraged finance and private credit team comprises 36 partners and more than 90 associates.

Paul Hastings' product agnostic approach is what is typically most appreciated by clients. The team is able to adapt the financing product to suit the client's particular needs rather than selling advice on a particular financing product.

Paul Hastings' approach is better suited to how its clients are internally configured. The team is able to work towards the same strategy while ensuring continuity of message and maintaining a high-standard of service. The approach cultivates collaboration and dexterity of the firm's lawyers, all of whom are client-facing, service-driven and entrepreneurial.

Divergent opinions

Given the nuances and external pressures influencing activity in the transatlantic deal market, is there a particular legal team structure best suited to get deals successfully done? The divergence in approaches adopted by law firms here would suggest not. "I don't think there's a one-size-fits-all approach," says Fried Frank's Cecil. "I think it depends on the transaction and how the firm is set up."

Survey respondents were asked to state, as a client, what they would look for when

appointing a firm to support their acquisition finance transaction. 'An understanding of what the favourable terms are in each market' was the most popular response, selected within 33 per cent of responses.

Paul Hastings' Luke McDougall comments: "The days are long gone where City finance lawyers could be parochial about their practice and areas of expertise. The acquisition finance market has fundamentally evolved. Our clients – some of the most sophisticated dealmakers in the world – play across geographies, markets and the entire spectrum of debt products. And they fully expect their legal counsel to be able to do the same in a credible, completely integrated and proficient manner."

Transatlantic differences

There are some transatlantic differences here too, particularly when looking at the magic circle. Magic circle firms, namely Allen & Overy and Clifford Chance, have taken a product-specialist approach to team structure; that is, employing a specialist lawyer to "keep in a glass case and break in case of emergency", as one senior lawyer put it.

US firms such as Paul Hastings, meanwhile, tend to avoid the product-specialist route, instead employing professionals with a broad range of expertise and knowledge of multiple jurisdictions. This is a view shared by another US firm, Latham & Watkins.

"From where I'm sitting, it's going to require the ability to mobilise teams across different jurisdictions and work in a cohesive manner," says Latham & Watkins' Gaskin. "That's what I think is the magic formula for being able to execute these deals and reduce the risk of missing something. The key is being able to work cohesively and collaboratively with governing laws across offices, time zones – spotting the issues and solving them. That's

the magic formula, which sounds very simple but isn't intuitive, necessarily, because it's complicated and these deals move very fast."

Mayer Brown meanwhile has a slightly different approach. "We have European teams in Germany and France, and we obviously have strong US coverage, but they tend to deal with US domestic transactions rather than cross-border deals," says Mayer Brown's Brinkworth. "We don't tend to staff deals across borders unless they involve those particular jurisdictions."

DLA Piper is happier to involve other firms where necessary to cover knowledge gaps. Partner Mark Dwyer says that they will get another firm on board when they can't cover an aspect of local law. However, the firm does where possible like to stick to a one firm approach, "because then you only have to have one argument," says Dwyer.

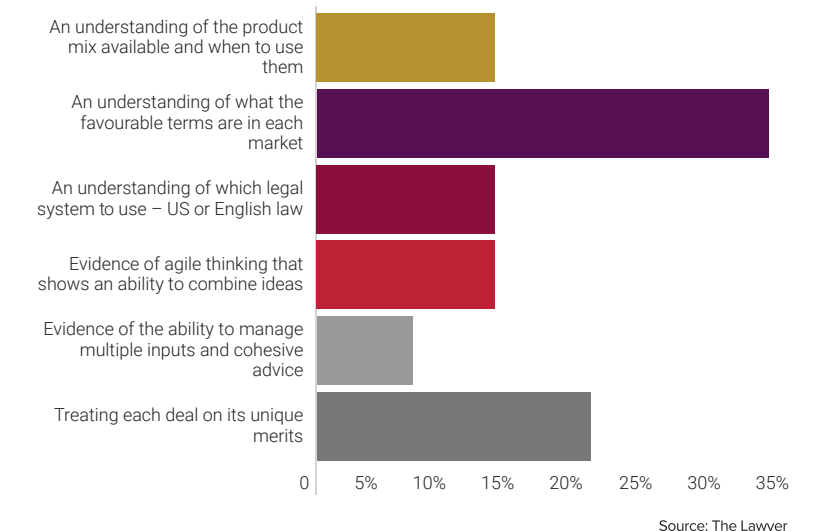
A common theme

The common thread here, a broadly transatlantic approach to team structure, diverges from the results of our survey to an extent, highlighting the lack of a 'one-size-fits-all' approach, to paraphrase Cecil. Thirty per cent of respondents indicated that they take a 'sector-focused approach to finance', with the same percentage indicating that they ensure that they provide the 'best services of the firm across all practice areas and geographies'.

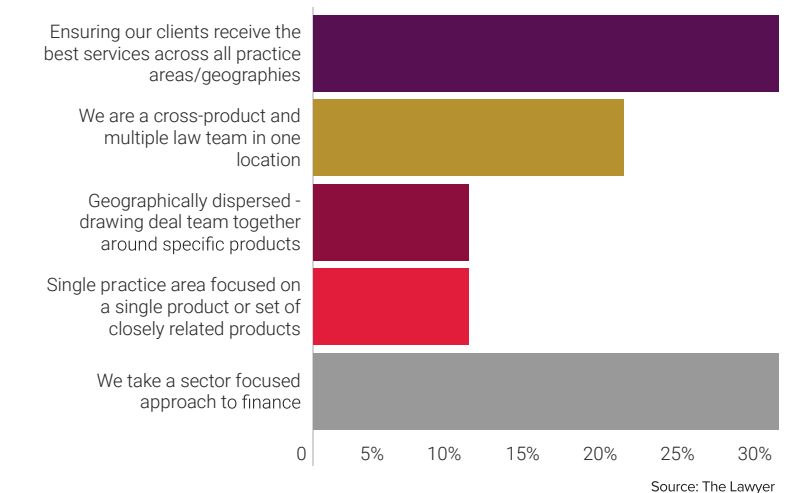
But a clear takeaway from the roundtable participants was that team structure specifics aside, firms remain fundamentally judged by their ability to deliver excellent client service. This was a theme echoed by McDougall of Paul Hastings, stating: "Of course, as lawyers one of our key roles is to document the deal, but that doesn't mean simply delivering up a stack of papers to the client and then moving on to the next thing. The real value lies in – and clients deserve – lawyers that know the market and

can deliver the smoothest path from term sheet to closing by leveraging that knowledge, and then helping guide the client through the life-cycle of the deal until maturity or refinancing. That requires real management and coordination at a firm level and an unwavering commitment to the relationship".

What are you looking for when appointing a firm to support your acquisition finance transactions?



Which statement best describes the structure of your finance practice?





Conclusion: what next?

So we can categorically say that the markets are converging. But what are the consequences of convergence, and should we be stopping to consider those consequences before they snowball?

There are undoubtedly nuances to each market, and in many cases the local provisions that are being replaced through convergence may have been in place for a reason.

“At some point, there will be a credit event,” explains Mizuho’s Barclay. “That’s the opportunity for people to rip up a few things and realise where we’ve gone too far.”

The health of the market currently isn’t providing the impetus for people to stop and consider the way things are heading. “Early indicators through covenants and greater restrictions were helpful and those may inadvertently be swept aside,” explains Barclay. “But that’s not a question you get to ask in a good market, and in a bad market maybe its too late to ask the question.”

“I think from a legal perspective, there will be some plumbing to be done when they realise that a fundamentally US-style structured document will not work as well in some of the heavily unionised European geographies.”

One roundtable participant went one further, commenting: “Lawyers need to understand European jurisdictional quirks to know that not only will New York law products not work in Europe, but there are a lot of dangers in bringing a US perspective in where it does not fit.”

And while it’s not certain yet, global shocks like the COVID-19 crisis could be the beginning of a longer-term downturn and the “bad market” Barclay refers to.

While the risk is that convergence might serve to amplify these types of global market shocks due to the integration of the debt markets, on the other hand it may also mean that market participants are able to react to these shocks more robustly and in a more coordinated manner for the very same reasons.

If you would like to discuss any of the findings in this report, please contact **Luke McDougall** (lukemcdougall@paulhastings.com) or **Amin Doulai** (amindoulai@paulhastings.com) at Paul Hastings’ London office.



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