

Company Sales: Dealings with Auction Bidders



CLIENT ALERT

The legal action brought by Terra Firma against Citigroup in the New York District Court in relation to the handling of the sale of EMI through an auction process has highlighted, at an international level, the considerations that should be at the forefront of the minds of the seller and its financial advisers when conducting such sales.

Background

Despite the higher costs associated with their operation, auction processes have been increasingly utilised by sellers of companies in the current depressed market. By attracting a number of potential bidders, a seller may hope to achieve better sales terms, including a higher price, than would otherwise be the case. However, a seller and its advisers must keep tight control of the auction, and ensure that their dealings with bidders are fair, if they are to avoid future disputes arising from the process.

Terra Firma accused Citigroup, the financial advisers running the sale of EMI by auction process, of providing it with misleading information with the intention of encouraging Terra Firma to offer a higher price for EMI than it would otherwise have offered. Specifically, Citigroup was accused of indicating that there was another bidder involved in the latter stages of the auction process when in fact there was not. Although Terra Firma's claim was unsuccessful, this was due to a lack of evidence and the issues raised by the case still remain key.

Position under English Law

A seller will usually, and would be expected to, indicate in its bid instructions that all bidders will be treated equally throughout the process. The scenarios in which a seller may be tempted to deal with bidders in a potentially unfair manner during an auction process include:

- scenario one – the seller or its advisers provide misleading information



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to a bidder relating to the number of other bidders involved in the process or the value of their bids;

- scenario two – the seller favours one bidder over the others and throughout the process provides additional information and assistance to that bidder (either by the use of distinct data rooms for the bidders or on an informal basis).

Although English law will not penalise a seller for making an incorrect, although reasonably held, opinion and will allow some leeway for marketing ‘puff’, it will not permit a seller to benefit from making false statements of fact. The case of *Smith New Court Securities Limited v Scrimgeour Vickers (Asset Management) Limited (1996)* held that a broker who had deliberately misled a bidder into believing that other bidders were involved in an auction process, and who had provided false information as to the offer price contained in other bids, was guilty of fraudulent misrepresentation.

The remedies available for fraudulent misrepresentation are rescission and damages. Although not always available, if rescission is awarded this will result in the seller being required to take back the target company from the buyer and return the sale price. Damages would be calculated as the amount required to put the buyer into the position it would have been in if the misrepresentation had not been made. A claim for breach of warranty may also be possible. To avoid these penalties a seller must avoid the course of action outlined in scenario one above.

A seller will usually be free to deal with the provision of due diligence information to bidders in an auction process as it sees fit. However, as noted above, the bid instructions often state that the bidders will be dealt with in an equal manner. Such an assertion may form a representation, or even a contractual term, between the bidders and the party issuing the instructions (ie the seller or its advisers). A breach of such a representation or contractual provision may entitle a bidder to damages or indeed rescission, if the breach is sufficiently material. A seller should therefore avoid the course of action outlined in scenario two above, unless the instructions have made it clear that such action may be undertaken.

As regards either scenario, sellers should bear in mind that, in the event that a civil claim is issued against them in an English court, they will be obliged to disclose all documentation retrieved pursuant to a reasonable

search which is relevant to the case which is or has been within their control. This includes not just documentation which supports the seller's case, but also documentation which is adverse to the seller's case or which supports another party's case. The term 'document' covers not just paper documents but electronic documents wherever they may be stored (including on laptops, blackberries and mobile phones), up to and including the metadata attached to the document. A failure to comply properly with disclosure obligations can result in committal for contempt of court. Sellers should therefore not assume that a bidder has no ability to discover what has gone on behind the scenes in an auction process.

The *Terra Firma* case also demonstrates the importance of creating an evidentiary trail. Terra Firma's claim failed because it was unable to produce clear written records of the conversations in which, it was alleged, the seller had been told about the other bidder. Sellers and bidders should ensure that any conversations and issues they regard as important are properly documented, in case they find themselves in dispute at a later date.

Other Considerations

Other important considerations for a seller include:

- A seller will want to avoid making an offer to bidders that is capable of acceptance by them, until such time as the seller is ready to do so. The bid instructions and all other bid correspondence must be carefully drafted to avoid this.
- A seller must consider the extent of the due diligence information that it is happy to release to bidders at the start of the process. The seller may wish to withhold certain key business information for disclosure to a smaller number of preferred bidders at a later stage of the process, but it must ensure that this is permissible under the terms applicable to the conduct of the bid.
- Approaches to bidders located in the United Kingdom in connection with a sale of shares will constitute a financial promotion (ie an offer to engage in investment activity during the course of business) under section 21 of the Financial Services and Markets Act 2000. Approaches, and the bid instructions, should be approved by the seller's financial advisers, unless an exemption is available.
- Most common law jurisdictions, including the United Kingdom, do not incorporate a duty to negotiate in good faith in their law. Parties to an



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auction process subject to English law can therefore terminate at any time prior to signing legally binding documents. This may not be the case in certain other jurisdictions, notably many civil law jurisdictions (for example, France), where damages may be payable by a party that does not make a reasonable attempt to agree the transaction.

- Where the auction process involves bidders from different jurisdictions, care should be taken that the laws of those other jurisdictions do not apply to the process. In addition, dealings with such bidders must not breach local laws relating to the promotion of investment opportunities. Local law advice should be taken in each instance.

Public Companies

The City Code on Takeovers and Mergers (the '**Code**') will generally apply to sales of public companies incorporated and managed and controlled in the UK, the Channel Islands or the Isle of Man. The Code sets out a formal procedure for making an offer as well as the circumstances in which a person is required to make an offer for all of a company's shares. An auction process relating to a public company should be designed so as not to conflict with the requirements of the Code.

The provision of due diligence information relating to companies whose shares are listed on a market in the United Kingdom must be considered especially carefully. It is a criminal offence for an individual who holds 'inside information' to deal, or encourage others to deal, in securities when in possession of inside information relating to those securities. 'Inside information' is specific information relating to a company's securities that is not public and that would be likely to have an effect on the price of those securities if made public. The penalties for committing insider trading include fines and imprisonment. However, insider trading may also constitute the civil offence of market abuse and the Financial Services Authority often has the option to pursue either claim.

If a bidder receives material due diligence information then it will not be able to acquire further shares in the target without breaching the insider trading regime unless: (i) the information is disclosed to the market by the target; or (ii) the bidder announces an offer for all of the target's shares. This may significantly disrupt an auction process and a seller should therefore carefully consider the information being disclosed.



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Practical Steps

A seller and its advisers should consider the following key points in advance of opening an auction process to potential bidders:

- the process, and the requirements at each of its stages, must be clearly defined and understood by all members of the sale team and clearly set out in the bid instructions;
- the bid instructions must be carefully drafted to permit the process to be varied at any time by the seller – the seller must consider whether it will state that all bidders will be treated equally as regards the provision of information;
- the information to be provided to bidders, and the process for dealing with bidders' requests for further information, must be organised – certain information may be withheld until the later stages;
- consideration must be given to the drafting of any share purchase agreement that is to be provided to bidders for comments – the aim is often to provide a fair draft that can justify a demand for minimal comments only from bidders;
- consideration should also be given to the dispute resolution provisions governing the auction process; this is particularly the case if overseas or international parties are involved, as this might give rise to issues concerning jurisdiction and enforcement of any resulting order or award; and
- as highlighted by the *Terra Firma* case, the seller must avoid misleading statements as to bidders' intentions or offers – ideally the seller should avoid making comments about other potential bidders or their bids at all.

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