EVERSHEDS SUTHERLAND NICEA

"Breaking the String"

M&A auction deals may end up being a nightmare if you act for a prospective buyer.

For some reason seller's advisors tend to design processes in which the roles of the parties are almost fully defined upfront and the issues around which there may be some room for discussion to complete a transaction are artificially capped as if that would irretrievably benefit the seller.

I have always thought that this approach is wrong.

Very frequently, these sorts of rigid procedures defined in the so-called process letters that bidders receive together with a draft of a typically unbalanced sale and purchase agreement - that they are virtually not allowed to touch up, if they want to remain as an eligible candidate- far from benefiting the seller irritate bidders and not unfrequently jeopardize the transaction itself.

Although as a first sight this strong approach may look promising to a seller, sometimes paradoxically proves being detrimental for everyone and particularly for the seller itself, as buyers, sometimes absurdly straitjacketed by the process defined by the advisors, find themselves forced to simply impact risk on prize compromising, therefore, the PE house own exit, when not to abandon the transaction if the liability regime foreseen in the sale and purchase agreement looks no more than decoration.

Unfortunately, this approach has become widespread in recent years and many prospective investors (both industrial and financial) have internally decided not to be involved in these auction processes as a general policy, on the grounds that it is not worth taking part in a process that is perceived as unfair.

The above, not only because the number of eligible bidders invited to an auction process may be surprisingly high, being hence the options to succeed proportionally low, but also because in the unlikely event that the bid offer presented is finally chosen by the seller, the terms and conditions assumed may be too cumbersome compare, to those that would probably be agreed in a bilateral negotiation process.

Sellers and, particularly, advisors, rely so much on auctions as a company value’s multiplier that sometimes are used in a context where do not fit well. A good example is when the seller is looking for a co-investor to jointly develop a project rather than a pure buyer. In these cases, metrics are not so simple. The seller cannot only rely on the interaction between price versus liability regime to compare offers. Obviously, many other elements come into play and will have to be properly weighted up. There may be hundreds of nuances amongst bidders on how they see a joint venture should work. But probably, these nuances not only become more acute but somewhat escalate to something structural when industrial and financial investors are invited to the same auction process. The approach of an industrial investor will undoubtedly differ from that of a financial investor. The understanding of the business itself and the level of involvement in the project will be completely dissimilar when not contradictory.

Pity is that, in the overall, you have the impression that the more aggressive is the design of an auction process the harder is to meet the initial expectation of the parties. The design of the process itself does not allow parties to explore both flexible and enlightening angles which enables the closing of a deal a transaction in a more constructive manner to everyone, based upon a general principle of mutual trust and the conviction that a deal is only good when both parties end up reasonably satisfied. Unreasonable stiffness leads to mistrust -not caution- and that is too frequently the starting of a bad deal.

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