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FEATURED ARTICLE
03/07

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The Takeover Code: Liverpool FC case study

Increased TV revenues from the Premier League and Champions League are distributed in favour of the Premiership's most successful clubs, which allows them to buy better players, repeat their success and reduce the prospect of relegation. Daniel Geey, a trainee solicitor, competition department at Field Fisher Waterhouse, explores how this makes England's successful clubs attractive options for investors, and how the Takeover Code facilitates investment.

Since Roman Abramovich became a household name in July 2003, the English Premier League has once again become the focal point of speculation linking endless potential investors with one of the most popular leagues in the world. Since 2004, Liverpool Football Club and Athletics Grounds plc (Liverpool) has been linked with the ex-Thai Prime Minister Thaksin Shinawatra, ex-Redrow owner and self-confessed Liverpool fanatic, Steve Morgan, a business consortium called L4 allegedly with Hollywood producer Mike Jefferies at the helm, Dubai International Capital (DIC) and their aborted bid, and two Americans. The Americans, George Gillett and Tom Hicks, were successful in having their offer, which valued Liverpool at £218.9 million, accepted by the majority shareholder and current Chairman, David Moores. The intention of this article is to illustrate some of the reasons why people are once again wishing to purchase Premier League clubs and in particular, to examine the events and issues surrounding the takeover of Liverpool.

Background over the last year

The takeover of Liverpool in 2007 follows three high profile acquisitions in 2006 of Portsmouth, Aston Villa and West Ham by owners who are Israeli, American and Icelandic respectively. Interestingly, the combined price for West Ham, Aston Villa and Portsmouth does not add up to equal the price that Hicks and Gillett will pay for Liverpool. Equally, that figure does not include the £215 million personal guarantee given to fund the new stadium. How is it that a club in the same division can be potentially so much more valuable to bidders?

Why invest in Liverpool?

New Premier League TV deals

In mid-January, it was announced that the overseas television rights to the Premier League would add an additional £625 million to the domestic television revenue from BSkyB and Setanta, which already totalled £1.7 billion. The team finishing bottom in the Premier League in the 2007/8 season will earn a minimum of £26 million. To put that into context, the Premier League champions last season, Chelsea, were awarded £30 million. Next season, the champions will earn a staggering £50 million and according to news reports, every top-flight club will see up to a 65% increase in television revenue[1].

Champions League revenues

The money on offer to Europe's top clubs is an extremely tantalising lure to potential investors. Such exposure and revenue take the form of television income and performance related money (depending on the length of time a team remains in the competition) distributed by UEFA, to which is added ticket sales, merchandising, sponsorship and corporate hospitality generated from three (usually) sell-out group matches and home knock-out rounds which all greatly supplement a club's domestic revenue streams (see Fig 1).

Notably, Manchester United's relatively below par performances in the Champions League over the last few years, including in 2005/6 their failure to qualify from the group stage, was said to have cost the club upwards of £20 million, yet, according to the latest Deloitte Report, United were the world's most profitable club in 2005/6, posting a £49.7 million profit.

New stadium

Anfield, which can hold just over 44,000, had fallen behind some of its competitors such as Manchester United (76,000 capacity), Newcastle United (52,000 capacity) and more recently Arsenal (60,000 capacity). A new stadium could cater for the level of demand (both corporate and non-corporate supporter) for each match day game. There is analysis which suggests that Manchester United make up to £2 million extra per match day compared to Liverpool when account is taken of their extra 30,000 seats, and match day merchandising revenues[2]. It seems that David Moores, the current majority shareholder and Chairman of Liverpool, did not have the resources to finance such a large-scale expensive expansion.

Indeed, Arsenal, in their search for finance for the new Emirates Stadium, borrowed over £260 million, which was later converted into a bond issue. This was offset by Emirates Airlines paying £100 million spread over fifteen years for the stadium and shirt sponsorship and up front payments from key sponsors like Nike. Keith Edelman, Arsenal's Chief Executive, stated that the projected turnover resulting from the new stadium was likely to increase revenues by around £55 million per season[3]. Such figures only serve to highlight

Liverpool's need to tap into the larger revenue streams that a new stadium would generate.

The current project

At present, Anfield is very much constrained by its surroundings. The stadium is in the heart of an area much in need of regeneration - the Breck Road area in the Anfield area of the city. The European Regional Development Fund (Objective 1 Funding) has pledged £9 million to fund refurbishment work in Stanley Park and the Gladstone Conservatory; there will be supplemental monies in principle from the North West Development Agency (£8.9 million) and the Liverpool City Council (£1.7 million). The Objective 1 Funding is conditional upon the project being completed by December 2008, which made the announcement of the new investment into Liverpool even more timely.

The regulatory announcement of the recommended cash offer (the Offer) made on 6 February by Gillett and Hicks emphasised Kop Football Limited's (Kop) firm intention to build the new stadium on Stanley Park as part of the strategy to strengthen the team's playing squad and provide stability by supporting the current manager and chief executive. The aim is to create a 60,000 seater stadium which will cost in the region of £215 million. Work is due to commence by April of this year and be ready in time for the 2009/10 league season[4].

New owners and their experience

George Gillett's experience in the sports industry began in 2001 with his purchase of NHL side, the Montreal Canadiens, as well as taking ownership of their home stadium, the Bell Centre. Tom Hicks spearheaded the building of the $325 million American Airlines Centre in 2001 after he had paid $250 million to become the owner of the Texas Rangers in 1998[5]. It is not surprising that Moores, the Liverpool board and Rick Parry, Liverpool's chief executive, thought that Hick's expertise in building, financing and overseeing a successful stadium project would further strengthen the ability of the club to progress.

DIC v Gillett and Co.

When the target board receive an offer or potential offer (in this instance from DIC and then Gillett and Hicks), the directors have a duty to take into account the Takeover Code (the Code) and certain requirements set down at common law (see below, regarding directors' fiduciary duties). It was assumed that the Liverpool board would accept the bid by DIC by the end of January. However it was still possible for Gillett and Hicks to pursue their interest because they had the opportunity, by the end of January, to make their own in-depth investigations into Liverpool by reason of Rule 20.2 of the Code: 'Any information... given to one offeror or potential offeror... must, on request, be given equally and promptly to another offeror or bona fide potential offeror even if that other offeror is less welcome.'

This gave Gillett (and subsequently Hicks, when he joined the bid) the ability (even when their advances late in January were still being rebuffed by a Liverpool board keen to conclude a deal with DIC) to obtain the same level of information that was being given to DIC. This process enabled the Americans to investigate all material commercial contracts that the club had with players, staff, and sponsors, the debt that would have to be taken on board for any proposed bid, the stadium plans and the high level of investment that would be needed to fund the project. It enabled them to assess the various revenue streams including Champions League, Premier League, match day and merchandising income. Without this detail, it would have been almost impossible for Gillett and Hicks to have moved so quickly to fill the void left by the sudden decision by DIC to withdraw from the bidding.

Such a decision by DIC to extricate themselves from the deal could not have been taken lightly. Primarily because;

- under Rule 2.8 of the Code, which governs statements of intent about not making an offer, DIC on 31 January, ruled out a bid for the club, effectively disqualifying them (due to Rule 2.8) from making a second bid until after six months from the date of the announcement;
- around two months of due diligence had been spent at considerable expense to ensure that they were fully familiar with all aspects of the football club.

Compare this to the days, or at best a week, that Gillett and Hicks were afforded to become fully appraised of the activities of a club who (at that time) did not want their involvement - this illustrates the desire and determination of

Fig 1: UK club Champions League revenue against total revenue

English Club	Champions League Run	Champions League earnings	Total 2005/6 Revenue
Liverpool	Winners 2004/5	20.5	121.7
Chelsea	Semi-finals 2004/5	18.8	152.8
Arsenal	Runners Up 2005/6	25	133

All figures in £ million
Source: http://news.bbc.co.uk/1/hi/business/6247603.stm and the Deloitte Football Report 2005/6.

these two Americans to see through their interest in acquiring Liverpool.

On 27 January, in a statement to shareholders, it became apparent that Liverpool had been approached again by Gillett and that the board were giving substantial consideration to a second approach from Gillett and Hicks which valued the club at £500 more per share than the DIC offer. Significant shareholders such as Granada, who own 9.9% of Liverpool, as well as board members (who also were shareholders) and shareholders alike saw the benefit of this extra windfall, which added an extra £8 million to the value of David Moores' shareholding. This prospect, coupled with Hicks' involvement prompted what the DIC spokesman called 'a mental aberration [by the chairman], just when the agreement was about to be reached'.[6]

Kop needed to receive 90% acceptances from Liverpool shareholders in order to compulsorily acquire the remaining 10% under s429 of the Companies Act 1985

Fiduciary duties

The directors have a fiduciary duty to act in the best interests of the club, notably by obtaining the best possible value for its members shares on the best possible terms. Rules 3.1 and 25.1 of the Code stipulate that independent advice must be sought in order to determine whether the price is acceptable and then to pass on this information, by way of the board's recommendation, to its shareholders.

In terms of the common law position, the Court in Heron International v Lord Grade [1983] BCLC 244, stated that; 'where directors have decided that it is in the best interests of a company that a company should be taken over, and where there are two or more bidders, the only duty of the directors... is to obtain the best price'.

Although this extract relates to a recommended bid, there could be considerations to take into account other than the price. Such other factors could lead to a decision which is not in the best interests of the company because, by reference to the Liverpool takeover, £500 extra per share is to be paid to shareholders, with the equivalent of an extra £17.3 million (from the £4,500 per share/ £156.7 million value agreed with DIC) being raised by Gillett and Hicks. Such a figure is almost exactly 10% of the cash purchase price (not accounting for the debt to be taken on in the deal). Of course, the board of Liverpool can only recommend to its shareholders the offers that are placed before it in deciding which one is in the best interests of the company, but could the additional money that Gillett and Hicks are willing to pay to the shareholders, over and above what DIC were willing to offer, have been invested in the club (in the stadium for instance) so that any debt incurred in purchasing the club could have been more serviceable and less onerous? Or was such a price necessary to entice the shareholders to reject DIC and then sell to Gillett and Hicks? Either way, the potential new owners are more out of pocket compared to DIC, which in turn means that the future company probably has more debt to service because of the higher purchase price. To this extent, depending on financing considerations such as interest repayments on the loans which may have been taken out by Gillett and Hicks, accepting the larger bid - good though it is for shareholders - has increased the debt that has to be serviced by the club.

This is in contrast to Lord Cullen's view in Dawson International plc v Coats Paton plc [1989] BCLC, who stated that: 'What is in the interests of current shareholders who are sellers of those shares may not necessarily coincide with what is in the interests of the company. The creation of parallel duties could lead to conflict. Directors have got one master, the company'.

This would suggest that the short term gains of attaining maximum returns for shareholders may be rejected so that the directors of a target company may scruitinise the wider strategy of a bidder wishing to acquire the target, rather than just the money on offer. Interestingly, the Manchester United board refused to recommend the Malcom Glazer bid for the club because although the price was acceptable, the business plan was overly 'aggressive' and the level of debt the club would be saddled with was deemed to be damaging[7].

Therefore, the directors looked beyond shareholder worth and towards the longer-term interests of the club. In Liverpool's circumstances, the board would point to securing funding for a new stadium, the new owners' expertise in sports management, and their increased financial muscle in the transfer market as factors they would have considered when recommending the bid in acting in the best interests of the club.

Control and debt

In order to take total control of Liverpool, Kop needed to receive 90% acceptances from Liverpool shareholders in order to compulsorily acquire the remaining 10% under s429 of the Companies Act 1985 and 75% to make the Offer unconditional. Kop had given all current shareholders until 26 March 2007 the incentive of priority ticket purchasing rights (which is the equivalent of a lifetime ticket offer for fans) for all home cup matches, cup finals and a guaranteed season ticket for the new stadium along with a premium of around £1,700 per share[8] on the going market rate prior to DIC becoming involved.

Those who have irrevocably accepted the Offer from Kop are David Moores, the Chairman and 51.5% majority shareholder, and Director Terence Smith (with a 0.8% shareholding). Added to this is ITV Production Limited's (ITV) undertaking to sell to Kop its near 10% shareholding (with further undertaking conditions so that they may accept a higher bid if received within a certain timeframe). With the guaranteed 52.3% of Moores and Smith (as long as the Offer does not lapse or is withdrawn) and the conditional undertaking from ITV, Kop has assurances to purchase approximately 62.2% of Liverpool. The unconditional watermark was reached on 9 March 2007, when the club announced to the Stock Exchange that offers to buy 80.7% of the shares in Liverpool had been accepted by shareholders[9]. This number increased by 27 March to 98.6%, thus invoking the compulsory purchase of the remaining shares[10].

Although Gillett was quoted as saying that Liverpool had been purchased "with no debt on the club" (i.e. not akin to the Glazer takeover, where he effectively mortgaged the club's assets to fund and supplement his own funds to purchase United), it would be extremely surprising if the £218.9 million Offer was to be funded without most, if not all, of the cash being in the form of loans, which in the future will need to be serviced and repaid through increased revenue and profits from the club. One would suspect that same financing issues would be

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considered appropriate for building the new stadium (like Arsenal's subsequent bond issue to finance the Emirates Stadium). It would be unrealistic for supporters to expect the new owners simply to find £215 million for funding of the new Anfield stadium in addition to the purchase price without more than a little help from the city's financial institutions[11]. The three sentences about financing the purchase of the club in the Offer document give little insight into how either the purchase of the club or the funding for the stadium will be structured and without any official comment, it can only be a matter of speculation as to how much cash upfront Gillett and Hicks are providing from their own pockets. Newspaper reports have speculated that there will be an annual £21 million interest charge to be paid by the new owners, who would recoup this yearly payment through dividend payments to Kop[12].

New future

Initial reports are that the current Chief Executive, Rick Parry, will continue in his role, David Moores will become Honorary Life President, with Foster Gillett (who is the managing partner of the Montreal Canadiens) taking a hands on approach in the 'commercial, communications and marketing areas'[13] and Thomas Hicks Jnr. making up the initial Kop board alongside their respective Co-Chairmen fathers.

The next step is ultimately the hardest in satisfying expectations. The new owners will have to reassure the club's manager, Rafael Benitez, that large amounts of money will be made available for team strengthening in the transfer market, and will have to win over supporters who will also expect world class players and a world-renowned new stadium to arrive. Ultimately, the Offer document marks the intentions of the new owners. In the end as ever, money invested and trophies won will signal whether the takeover of Liverpool has been a successful transaction for shareholders, the new owners and stakeholders alike.

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