

Select 2020

Prepared for Turbulence?

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Prospects for 2020 Turbulence

- Is turbulence on the cards?
 - End of a long boom
 - Trade Tensions and Economic Nationalism
 - Coronavirus
- Could Turbulence be worse than before?
 - Integrated Supply Chains
 - Reliance on digital assets
- Signs of Turbulence
 - China
 - Global growth
 - UK insolvencies

Storm clouds on the economic horizon?

- China GDP growth:
 - 2018: 6.6%; 2020: 6.1%
 - slowest year on year growth since 1990
- US:
 - total filings broadly flat. 2,018: 755,369; 2019: 757,497
 - Chapter 11. Jan 19: 366; Jan '20: 630
- United Kingdom insolvencies in 2019
 - 2019, 17,196 corporate insolvencies – highest number since 2013
 - 8.2% and 24% increase in administrations and creditors voluntary liquidations
 - Construction and retail seen the highest increases
- Coronavirus:
 - impacting supply chains of 94% of Fortune 1000
 - Significant downgrade in growth or possible recession

Agenda

- Anson Holdings Group - questions from the business to the in house legal team
 - Trading impacts
 - Is Distress Different In a Digital World?
 - Director's Duties
 - Listed Company Issues
 - Distressed M&A
- Conclusions

Anson Holdings PLC ("Anson")

- Anson is a United Kingdom manufacturer of low volume, premium quality, motor vehicles. Components are manufactured in Spanish, German and French subsidiaries with an important Chinese supplier. There is also a US distribution subsidiary.
- Anson is listed on the London Stock Exchange. Its share price has been volatile given the uncertain future of automotive power trains, weak consumer confidence in Europe and the Far East along with high costs incurred by Anson in developing a new luxury SUV.
- Electrix Limited ("Electrix") supplies the electronic components at the heart of all Anson's vehicles. These include an intelligent driving system that allows the vehicles' operations to be modified to reflect individual driver preferences and styles. Driver data, vehicle location and journeys are all stored in the cloud.

Anson (cont'd)

- Electrix is in severe financial difficulty. Any interruption of supplies by Electrix will mean that Anson Group's vehicle production will itself cease within two weeks of such interruption. There is also concern about continued supply of critical parts from China.
- Every week of lost production will cost Anson £10 million.
- Anson's banking facilities are already close to being fully drawn down. It has a bond repayment due by the end of June 2020 so there is little headroom for any further deterioration in Anson's own trading conditions.

Questions from the business

- What issues do Electrix problems raise for Anson and how best can it protect itself?
- What additional issues are raised by the stored data generated from the intelligent driving system?
- What are the duties of Anson's directors in the event that Anson loses production and incurs losses?
- What additional issues arise by virtue of Anson's listing on the London Stock Exchange?
- If the worst comes to the worst, how – and how quickly – might Anson put one or more subsidiaries or itself up for sale?

What issues do Electrix problems raise for Anson and how best can it protect itself?

Failing Suppliers: Issues

- "Just in time" and "sole sourcing" – not all they might seem to be!
- Effect on Anson bank, bond and other contractual documents – defaults?
- How long would it take Anson to find a replacement supplier to Electrix?

Failing Suppliers – protection and quid pro quos

- Expedited payments or supplier funding?
- And in return?
 - Renegotiate [favourable] pricing terms
 - Escrow arrangements for source codes
 - Immediate transfer to Anson of title to tooling and/or hardware produced by Electrix
 - Right of entry to Electrix premises to collect finished products
 - If Anson provides funding to Electrix, could Anson take security from Electrix in return?
 - Even the failure of a small supplier can result in disproportionate costs or losses to that supplier's customers

What additional issues are raised by the stored data generated from the intelligent driving system?

Distress in the Cloud

- Moving activities into the cloud reduces possession and control over data and activities
- Key risks are:
 - loss of access to data
 - termination/interruption of contractual provision
- Precise impact will be depend on nature of cloud use
- PAAS and SAAS type arrangements will often be highest risk

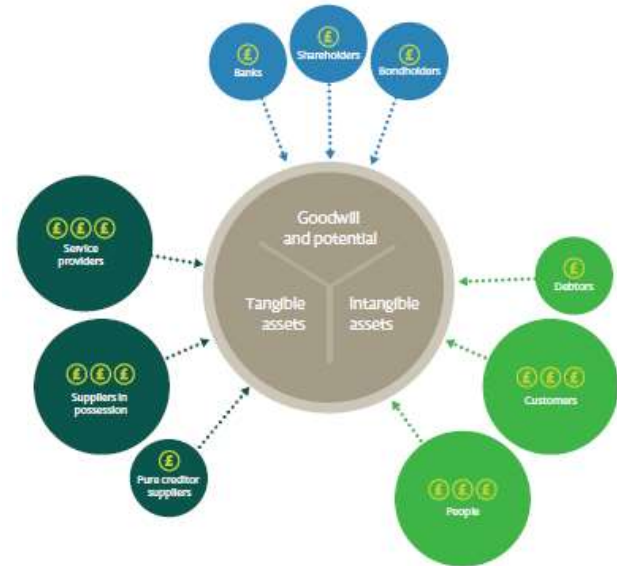


Distress in a Digital World

Old



New



What are the duties of Anson's directors in the event that Anson loses production and incurs losses?

Directors' duties – what changes in a distressed situation?

- When in the "twilight zone": **duty to consider or act in interests of creditors**
 - When in financial difficulties, the interests of creditors take precedence over the interests of shareholders (position under common law but also reflected in the Companies Act 2006 (s.172(3)))
 - When is the switch? When directors know or should know that the company is or is likely to become insolvent ("likely" means probable, not some lower test)
- Wrongful trading (s.214 Insolvency Act 1986) - usually the principal concern of a director (or shadow director)
 - On application by the relevant insolvency practitioner, the Court may require a contribution to the assets of the Company from a current or former director:
 - Where the Company has gone into "insolvent liquidation" or "insolvent administration"
 - At some point before, that Director knew or ought to have concluded that there was no reasonable prospect that the Company would avoid going into insolvent liquidation or insolvent administration ("**reasonable prospect**" test)
 - The Court will not make an order if the Director took **every step with a view to minimising the potential loss to the Company's creditors** as he ought to have taken

Practical steps

When faced with financial difficulties, what should directors do?

- Ensure they have up-to-date and accurate financial information available
- Hold regular, full board meetings and ensure the commercial decisions of the directors are reported in full in the company's minutes
- As soon as a director is aware that there is no reasonable prospect of avoiding insolvent liquidation, or has concerns that this may be the case, he or she must raise the problem with the rest of the board
- Consider separate advice (legal and financial)
 - Independent from the company's advisers
- Continual reassessment of the situation
- Resigning won't get you anywhere!

What additional issues arise by virtue of Anson's listing on the London Stock Exchange?

Issues for distressed public companies

Market disclosure issues

- MAR provides that an issuer such as Anson:
 - must inform the public as soon as possible of inside information that directly concerns that issuer (*Article 17(1), MAR*)

Delayed disclosure by Anson

- Anson may delay disclosure of inside information to the public if:
 - immediate disclosure is likely to prejudice the issuer's legitimate interests;
 - delay of disclosure is not likely to mislead the public; and
 - the issuer is able to ensure the confidentiality of the information (*Article 17(4), MAR*)
- Anson must notify the FCA (immediately after delayed inside information is disclosed) if it has delayed the disclosure of inside information and, if the FCA so requests, explain how the conditions permitting delay were met (*Article 17(4), MAR*)
- Anson could not delay disclosure of the fact that it is in financial difficulty or its worsening financial position especially if materially different to previous public announcements or market expectations

Issues for distressed public companies

Proposals to shareholders to effect reconstruction or refinancing

- LR 9.5.12 – any circular sent to shareholders with proposals for a reconstruction or refinancing (eg placing or rights issue) must include a working capital statement

Disposal of part of Anson's listed group

- Ordinarily any sale of the main operating business is likely to constitute a Class 1 and perhaps a related party transaction and require shareholder consent – this may be problematic because of timing constraints
- Limited circumstances where listed companies in severe financial difficulty can avoid Class 1 shareholder approval (LR 10.8) (eg Southern Cross, 2013; Ark Therapeutics Group 2013)

Disposal of shares in Anson and Takeover Code implications

- Ability to withhold identity of potential offeror and to dispense with put up or shut up (PUSU) deadline to make a formal offer if formal sale process (eg Flybe Group)

Issues for distressed public companies

Possible delisting of Anson

- The Listing Rules limit the ability to delist without shareholder consent (special resolution) and at least 20 business days' advance notice (LR 5.2)
- A delisting is permitted without any requirement for shareholder approval or advance notice in the case of the appointment of an administrator or the passing of a resolution for winding up
- Pre-pack administration for a PLC: DTZ and Blacks are good examples

Other matters to watch out for:

- Need to watch requirement for shareholder approval for substantial property transactions with directors (section 190 CA 2006) but where a company is in administration or liquidation, this obligation does not apply (section 193 CA 2006)
- Serious loss of capital (section 656 CA 2006) – requirement to convene a general meeting after discovery that net assets of a public company have fallen to less than half its called up share capital (eg Polemos 2012; Southern Cross, 2013)

If the worst comes to the worst, how – and how quickly – might Anson put one or more subsidiaries or itself up for sale?

Distressed M&A - How is it different to non-distressed M&A?

Issues for the buyer of distressed companies/assets

- Timetable drivers can be different, and more material:
 - Cashflow may be tight; Planning is key
 - May have a key milestone date pending (eg covenant test/year end/wages bill)
 - “Smell” of stress can exacerbate/accelerate problems
- Publicity – linked to above points, can be very delicate
- Reps/Warranties – likely to be limited:
 - Will be none if buying in a formal insolvency process
 - May be of limited value if buying solvently but seller will cease trading soon afterwards
 - Puts more weight on depth of due diligence, if you have time to do it and seller can pull it together in time
- Risk areas revolve around change of control in contracts, employees and pensions

Distressed M&A - How is it different to non-distressed M&A?

	Buying Pre-insolvency	Buying Post-insolvency
Due diligence	Possible	Possible but much shorter time frame
Exclusivity	Possible	Very unlikely
Purchase company or assets	Possible	More likely to be assets only
Risk of clawback	Preference/undervalue issues. Good faith defence	Much less risk where insolvency practitioner involved
Representations/ warranties	Possible but limited value	Title and capacity only if lucky. List of disclaimers. No personal liability for IP
Buyer beware	Yes	Yes
Retention/escrow	Possible	Unlikely

Distressed M&A - How is it different to non-distressed M&A?

	Buying Pre-insolvency	Buying Post-insolvency
Speed/conditionality to close	Important	Very important
Material adverse change	Difficult	Very unlikely
Funding	Important	Cash now is king (ie not deferred)
Change of control landlord consents	May have opportunity to obtain	Less opportunity to obtain
Employee/pension issues	Buyer will assume risk	Buyer will assume risk
Anti-trust/regulatory consents/ shareholder approvals	Still relevant	Still relevant
Contract race	Possible	Likely
Release of security over assets/ shares being acquired	Buyer must check	Likely
Insurance available	Possibly	Unlikely

How are we going to deliver the sale?

Implementation techniques

Fully consensual

- Private sale of shares, businesses and/or other assets
- Subscription for additional shares
- Public offer or scheme
- Creditor consent?
- Shareholder consent?

Cram –down

- Creditors scheme of arrangement
- Members' scheme of arrangement
- Transfer scheme of arrangement
- Drag rights in SHA or articles
- Compulsory acquisition procedures under a public offer

Creditor led process

- Secured creditor enforcement
- Loan-to-own
- Debt for equity swap
- NewCo structuring considerations

Insolvency process

- Administration
- Moratorium
- Can the business be traded in administration pending a sale
- Funding
- Do we need to "pre-pack"?

To "pre-pack" or not to "pre-pack"?

- A "pre-pack" is a sale of a company's business and assets negotiated before, then implemented through, an insolvency process – usually administration
- The administrator will complete the sale immediately after appointment
 - Buyer could be a third party purchaser, management or a creditor through a new company
 - New company continues business, with liabilities left behind in the seller
- Advantages
 - Allows purchaser to "pick and choose" assets
 - May facilitate business continuity
 - Will require careful stakeholder management – eg UK Pensions Regulator and Pension Protection Fund
- Potential pitfalls
 - Ensuring "full market value"
 - Creditor reporting? The requirements of "SIP 16"
 - Pre-pack pool – if sale to "connected party"

The International Element

- UK holding company and US subsidiary – "creditor in possession" – v – "debtor in possession"
- To file or not to file? European – v - US approach to directors' duties – Continental tripwires?
- Cross-border co-operation procedures – European Insolvency Regulation and UNCITRAL Model Law

Conclusion

In Conclusion.....

- With suppliers think the unthinkable. Know how quickly and for how much you could re source
- Digital can exacerbate risks if not managed carefully
- Directors of a distressed company must do their best for creditors and that means taking and acting on good advice
- In a distressed, listed, company, the balance between maintaining market confidence and not misleading investors is a fine one
- Distressed M and A can bring good rewards but needs speed, and good due diligence as there will be none of the usual reps and warranties
- Think in 3 dimensions...

Further Resources

Five Minute Workout (<https://www.hlbriworkoutblog.com/>)

Supply Chain Analysis Tool (<http://www.hlcomplexcontracting.com/supply-chain-toolkit>)

Supply Chain Disruption Tool (<https://www.hoganlovellssupplychaindisruption.com/>)

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