SLAUGHTER AND MAY/

SALES OUT OF ADMINISTRATION IN THE UK - THE TOP FIVE THINGS FOR POTENTIAL BUYERS TO KNOW

Beyond Borders – Part of the Horizon Scanning series

The fallout from the COVID-19 pandemic has seen some well-established and high profile names, particularly on the British high street, enter into UK insolvency processes. Debenhams, Arcadia, Laura Ashley, Oasis, Warehouse and Jaeger are just some of the big names that have collapsed into administration over the past year. Another thing that all of these brands have in common is that they were bought out of administration by investors looking to uncover their underlying value and restore them to their former glory.

Administrations have typically been happy hunting grounds for specialist distressed hedge or private equity funds. These institutions traditionally had the upper hand in this area. Their knowledge of distressed markets, combined with the fact that they are comfortable with complexity and legal risk and their governance and funding structures, allow them to move quickly and decisively. Such speed is a key factor for administrators running a very accelerated M&A process where their priority is a quick and certain sale.

An emerging trend in the recent run of high profile insolvency deals is that the successful buyer has often been a blue chip corporate, rather than a specialist distressed investor. This change may be motivated by corporates looking to improve their own offering by acquiring a high-profile brand within their own industry. It may also be driven by a strategy to invest in their business in order to help combat the profound effects that COVID-19 has had on certain sectors (retail in particular). These corporates have their own advantages in the race to secure big deals for prestigious brands that have entered into administration, as they are able to exploit operational and technical synergies, and institutional know-how, that specialist investors may not have such ready access to. As a result, they may also be able to offer more competitive pricing, which is another key factor for an administrator looking to maximise value for creditors.

Negotiating a sale with administrators will often have its own unique features, such as a lack of representations and warranties in the purchase agreement and relatively limited due diligence but also discounted pricing to reflect these points. In addition to those key features, we have set out below five key things for any prospective buyer to be aware of when seeking to purchase a business out of administration. These should be borne in mind by all prospective buyers, from domestic purchasers looking to consolidate their position to overseas buyers looking to establish themselves in a new market with a high profile acquisition.

What are administration sales?

At a high level, administration is an insolvency process that is intended to secure the rescue of the relevant company. The administrator must aim to achieve one of the following objectives in the following order of priority:

1. rescuing the company as a going concern;
2. achieving a better result for the company's creditors as a whole than would be likely if the company were wound up without first going into administration; or
3. realising some or all of the company's property to make a distribution to one or more secured or preferential creditors.

To help them achieve these aims, administrators are given broad powers to trade the company or dispose of its assets.

Although the primary goal of administration is the rescue of the company, in practice it very rarely results in that outcome. Instead, the focus is on the sale of assets to maximise value - which typically involves a sale of the business as a going concern.

Sometimes, a company may be in administration for a while, either trading or in a "mothballed" state, before its business is sold following the conclusion of a marketing process. Other times, the business may be sold immediately following the company's entry into administration as part of a transaction that was negotiated before its entry into administration, in a process known as a "pre-pack" sale.

Top five things for potential buyers to know

1. Be prepared to move quickly

An auction process run by administrators will largely follow the same structure as in a solvent scenario, but will likely be on a much shorter timeline. There is often pressure on potential buyers to sign and complete as quickly as possible. This is due in part to the difficulty of trading in administration for any length of time, given the danger of running out of cash and the fact that key employees will likely be seeking to move, or actually moving, on to new jobs.

Another pressure point comes from the imperative for the administrator of seeking to minimise outgoings and maximise returns for creditors (particularly as an ongoing administration will lead to greater administration expenses, thereby diluting creditors' recoveries).

A lengthy (or indeed any) exclusivity period is also unlikely, given the administrators' duties to maximise value to creditors and the difficult position they would find themselves in if a higher bid were submitted after they had granted exclusivity. Particularly in a competitive process, potential buyers who come prepared and are able to deliver on an accelerated transaction timetable are likely to present a compelling offer to administrators.

2. Understand who you are dealing with

The range of stakeholders in an administration sale will normally be wider than in a solvent sale, typically involving not just the administrators but also (often indirectly) the company's creditors and, where the seller has a defined benefit pension scheme in deficit, pension trustees and the Pensions Regulator.

The management team itself may have a much smaller part to play (and their focus may be elsewhere) and, although buyers are ordinarily permitted access to management to facilitate due diligence and transition/integration planning as the transaction progresses, it should be borne in mind that the company's directors do not have the authority to agree transaction terms. The administrators will negotiate and sign the transaction documents on behalf of the company, not management. Generally the administrators will be free to do so without consultation with the company's directors, creditors or shareholders, or direction from the court.

However, creditors (including pension trustees where there is a defined benefit pension scheme in deficit) may seek to exert an indirect influence over the administrators and could also have a direct impact on the timing of the transaction, particularly where their consent is required for certain matters (for example, the release of assets subject to a fixed charge).

Given that the administrators will also likely sign the transaction documents in their personal capacity (to ensure they gain the benefit of certain releases and exclusions of liability), they may need to complete their own internal reviews and sign-off procedures before execution can take place, which should be factored into the timetable.

3. Minimise conditionality

Administrators are usually focussed on execution risk and will be reluctant to progress bids which are subject to any, or at least any significant, conditions. As mentioned above, they will aim to sign and complete the transaction as soon as possible in order to minimise the leakage of cash from the business – particularly where liquidity is in short supply.

Bidders should avoid any form of financing conditionality as this is likely to be unacceptable to administrators. Moreover, a certain funds confirmation may be required upfront in the offer letter and/or in the transaction documents.

With regard to antitrust and other regulatory clearances, bidders will be expected to take all steps possible to avoid the transaction being conditional on obtaining such clearances (for example, by carving out parts of the target business or having phased closings). In some cases, conditions can be avoided by completing the process for obtaining antitrust and other regulatory clearances before signing. Where this is not possible and a pre-closing condition cannot otherwise be avoided, administrators will typically seek enhanced protections including hell-or-high-water commitments and/or non-refundable deposits. Bidders can improve their position by preparing any relevant filings in advance (even prior to the final auction round). Early engagement with regulators will help them understand the imminent risk of the business's collapse and the time-critical need to obtain any relevant approval.

4. Beware of TUPE risk

The UK Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE") will apply even where the seller company is in administration. Broadly, this means that employees assigned to the business that is being sold will be transferred automatically on their existing employment terms to the purchaser along with the relevant business. As a result, it is not possible to cherry pick employees and certain employment related liabilities in the same way as you would with other assets and liabilities.

In addition, if, under a transitional services agreement agreed as part of the sale, an employee of the seller is engaged in the provision of the services to the purchaser, there is a chance that TUPE will apply to transfer the employee to the purchaser when the agreement expires.

TUPE is particularly important in an administration sale context as: (i) TUPE related claims are likely to be focussed on the purchaser given the seller's insolvency; and (ii) in a reversal of the common practice in a solvent sale, administrators will usually require broad indemnities from purchasers for any liability as a result of failing to comply with TUPE.

In order to mitigate the risk of any TUPE related liabilities, purchasers should:

- be particularly mindful of the asset perimeter of the transaction and the TUPE analysis so that they have a clear picture of which employees will be subject to a TUPE transfer; and

- seek comfort (whether contractual or practical), so far as possible, from the administrators that they are carrying out the seller's information and consultation obligations properly and ensure that they provide all relevant information to the administrators so that this I&C can take place, so as to minimise the risk of subsequent claims against the purchaser.

5. Manage information flows

Another consequence of the wider range of stakeholders, destabilised management and employees and the time pressure typical of an administration sale is that information will be exchanged among various parties through a number of different channels, which may lead to the prospective buyer receiving conflicting information.

This can happen during the due diligence process, where the administrators are often working with imperfect information in the first instance, the distribution of which may be limited further by a phased due diligence process.

Attrition of the company's personnel can complicate matters, and stakeholder dynamics may mean that buyers have limited access to management, or no access at all until very late in the process. This can result in inefficiencies and mismatches between the information exchanged between transaction team members, on one hand, and operational personnel, on the other. It can also be an issue when negotiating the terms of the transaction documents, where, particularly in a time-pressured environment, operational matters may be negotiated in parallel to the main transaction terms.

It is important to maintain clear lines of communication between operational personnel and the transaction teams (including the administrators themselves), in particular by documenting meetings appropriately and regularly circulating updates, to avoid creating a disconnect between the parties as to what has been agreed or what they believe has been agreed.

The future

Predictions, as ever, are hard, but it seems fair to say that the UK economy is likely to be entering into a new (and potentially very challenging) period in light of the fallout from the COVID-19 pandemic. This brings with it the possibility that more businesses with strong underlying potential may struggle to remain afloat, which may present valuable opportunities for keen eyed investors.

One thing that seems fairly certain is that these sorts of deals will likely continue to attract a great deal of public and regulatory interest and attention. Among the new things to consider in this regard will be the so-called "pre-pack reforms", which are on track to be implemented by the end of April. These reforms will require either that a prospective purchaser obtains a third party opinion, or that the administrator seeks creditors' approval, prior to a substantial disposal to a connected party that takes place within eight weeks of the company's entry into administration. Newly introduced pensions legislation that strengthens the Pension Regulator's powers, including introducing criminal and civil sanctions for a range of stakeholders, will also need to be considered in any distressed situation involving a defined benefit pension scheme (see our briefing on the new Pension Schemes Act 2021 here). It will be interesting to see how any new rules will work in practice and what effect they may have on distressed M&A in general.

Key contacts

Andrew Jolly

Partner - Corporate

T +44 (0)20 7090 3034

E andrew.jolly@slaughterandmay.com

Ian Johnson

Partner - Restructuring and Insolvency

T +44 (0)20 7090 4732

E ian.johnson@slaughterandmay.com

Thomas Vickers

Partner - Restructuring and Insolvency

T +44 (0)20 7090 5311

E thomas.vickers@slaughterandmay.com

Joshua Bauernfreund

Associate - Restructuring and Insolvency

T +44 (0)20 7090 3447

E joshua.bauernfreund@slaughterandmay.com

Sarahanne Jackson

Associate - Corporate

T +44 (0)20 7600 1200

E sarahanne.jackson@slaughterandmay.com

This briefing is part of the Slaughter and May Horizon Scanning series

Click here for more details. Themes include Beyond Borders, Governance, Sustainability & Society, Digital, Navigating the Storm and Focus on Financial Institutions. Beyond Borders explores how crossing physical borders became challenging for most citizens during 2020, but investment flows and operations continued on a global basis. This theme looks at some key aspects of managing risk and maximising the value or opportunities in a regulatory and transactional context, and considers what is on the horizon for working beyond borders in 2021.