UIA 8th Winter Seminar

Legal Challenges and Impacts of Financial Crisis

M&A with Distressed Companies
Structuring Issues and Pitfalls

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Introduction (1/2)

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Introduction (2/2)

- Companies in financial distress
  - What is financial distress?

- Distressed M&A
  - Does financial distress impact an M&A deal?
  - Which additional considerations apply?
  - Who is exposed in a distressed M&A deal?
  - Structuring issues and precautions taken in practice
    a. Seller’s precautions, taken by its board of directors / management
    b. Buyer’s precautions, as buyer of distressed company or business
  - What are the crucial points for outside counsel?

- Comparative view
  - How do other jurisdictions address distressed M&A?
Case Study – The Facts (1/2)

Shareholders
- Board of directors
- Management

SwissCo
- Division A
- Division B

SubCo
- Employees

Potential Buyer(s)
- Buyer A
  - Asset Purchase
- Buyer B
  - Share Purchase
- Buyer C

Creditors
Authorities
Case Study – The Facts (2/2)

- SwissCo is a share corporation
- SwissCo faces financial difficulties
  Board of directors considers / evaluates options:
  - Financial restructuring (recapitalization, operational measures, etc.);
  - Divestiture of Division B with related assets, liabilities, contracts, employees (asset deal) or sale of SubCo (share deal).
- Informal talks with potential Buyers
- Parties seek advice on appropriate structuring of transaction and process with the aim of limiting risks
Distressed M&A – Particulars (1/2)

- SwissCo - financial distress situation
  - Business, strategic and operational perspective
  - Legal perspective / criteria
    - illiquidity situation
    - loss of capital situation
    - (threatened) over-indebtedness

- Risk of bankruptcy, moratorium or similar procedure
  - Need for a forward-looking focus (creditors‘ / administrator‘s view)
  - relevance for process, structuring and pricing of M&A deal
Distressed M&A – Particulars (2/2)

- Arguments of creditors / administrator / shareholders
  - Violation of fiduciary and other statutory duties
  - Inadequacy of consideration
  - Favoring of creditors by use of proceeds
  - Favoring of creditors through (unusual) deal structure

- Legal means to enforce potential claims
  - Challenge validity of M&A transaction
  - Claw-back claims (avoidance actions, actio pauliana)
  - Director’s liability
  - Criminal charges
Seller’s Side – Considerations (1/3)

- Negotiation and approval of M&A deal
  - Preparation and negotiation of structure and terms
    - Board of directors
    - Delegation of parts to a committee or to executive management
  - Approval of transaction
    - Board of directors
    - Shareholders‘ approval if transaction leads to change of company‘s purpose and/or to a de facto (partial) liquidation

- Approvals and third party consents (e.g. authorities, creditors, contract parties)
Duties of Board of Directors

- Ultimate management and oversight, financial planning
- Fiduciary duties
  - Safeguard interests of the company
  - Proper structuring and process of M&A deal
  - Aim to achieve highest price / fairness of price
    - Alternative buyers, auction process
    - Valuation, fairness opinion
  - Duty of loyalty: avoid or properly address conflicts of interest
- Special duties in financial crisis
  - Duty to analyze financial status, to propose financial restructuring measures and, in a worst case, to notify bankruptcy judge
  - Equal treatment of creditors
Seller‘s Side – Considerations (3/3)

- Avoid or mitigate risk of claw-back claims
  - Type of avoidance actions under Swiss bankruptcy law
    - Voidability of gifts or transactions not at arm‘s length
    - Voidability due to insolvency
    - Voidability for intent
  - Claimant: bankruptcy estate or creditor(s) of SwissCo
  - Respondents: Buyer of business or shares or other party otherwise benefitting from transaction
  - Suspect period(s)
  - Consequences: unwinding of transaction

- Pre-transaction financial restructuring

- Other aspects (e.g. tax, employee matters)
Buyer‘s Side – Considerations

- Focus of due diligence review
  - Regular dd review topics
  - Financial situation of Seller

- Deal structure and purchase agreement
  - Request corporate approvals from Seller
  - Request financial restructuring
  - Staggered purchase price payment
  - Asset deal vs. share deal
  - Depending on financial status of Seller
    - Limit acquisition to assets (e.g. shares of SubCo)
    - No set-off of claims in lieu of payment of purchase price in cash

- Other precautions
Critical situations / pitfalls

Critical situations (examples)

- Seller is faced with (threatened) over-indebtedness
  - Need for financial restructuring
  - Immanent risk of favoring creditors (e.g. asset deal with liability transfer)

- Fast „fire“ sale
  - Risk of inadequacy of price
  - Risk of inadequate M&A process (e.g. due to timing, other constraints)

- Debt / asset swap transaction
  - SwissCo sells assets to a Buyer (also a creditor) and purchase price is not paid in cash, but by set-off of claims
  - Risk of favoring creditors

- Bankruptcy or moratorium procedure is inevitable and initiated
  - Seller’s scope of action changes and additional rules apply
  - Involvement of administrator, bankruptcy or moratorium judge
Discussion

- Distressed M&A deals involve cross-over legal topics and require careful analysis
- Financial distress adds complexity to M&A deals
- Common topics in different jurisdictions
Thank you for your attention

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