

# DISTRESSED M&A

## United Kingdom



# Distressed M&A

Consulting editors

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Quick reference guide enabling side-by-side comparison of local insights, including market climate and legal framework; transaction structures and sale process; due diligence and mitigation of related risks; valuation and financing; documentation; regulatory and judicial approvals; dispute resolution; and recent trends.

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## MARKET CLIMATE AND LEGAL FRAMEWORK

### Market climate

How would you describe the general market climate for distressed M&A transactions in your jurisdiction?

Following the recent record levels of M&A activity fuelled by the abundance of available debt finance and post-pandemic opportunities, it is anticipated that there will be an increase in distressed M&A transactions as the impact of rising energy costs and general inflationary pressure trigger recessions across multiple markets.

Strategic buyers are likely to be less active as they focus on restructuring operations or look to dispose of non-core operations. Nonetheless, some have sought to strengthen their ability to combat the current market challenges and will seek opportunistic purchases or endeavour to combine with competitors. Financial investors with significant capital to deploy are likely to be more active as buyers, though restrictions on available debt will mean that they will be focused on limited quality opportunities.

Opportunities to participate in distressed M&A transactions are likely to be seen in the retail, manufacturing and transportation industries, which have been hard hit. Financial services (particularly the insurance sector), healthcare and technology-related investing have also remained active.

From the perspective of lenders, concerns about inflation, interest rates, cost of living and high levels of leverage are likely to lead to increased levels of competition for good quality loans. Lenders (both banks and non-bank lenders) will be conscious of any potential downside, so will be looking to tighten covenants where possible. It seems likely that we will see an increase in restructurings, refinancings and distressed financings into 2023.

*Law stated - 24 September 2022*

### Legal framework

What legal and regulatory regimes are applicable to distressed M&A transactions in your jurisdiction?

The UK Competition and Markets Authority (CMA) is granted powers by the Enterprise Act 2002 to carry out its function as the UK merger control authority. The National Security and Investment Act 2021 (NSI Act), which came into effect on 4 January 2022 and has retrospective application, introduced new powers to investigate investments (including minority non-controlling investments) that could give rise to UK national security concerns and prior clearance for relevant deals needs to be sought from the Investment Security Unit within the Department of Business, Energy and Industrial Strategy. In addition, the Secretary of State has the power to 'call in' for review certain transactions that do not give rise to the mandatory filing obligation under the NSI Act, including completed transactions. The NSI Act applies to both UK and foreign investments. The Takeover Panel governs parties' adherence to the Takeover Code for listed companies. The Financial Conduct Authority regulates compliance with the Financial Services and Markets Act 2000 and enforces the market abuse regime. Part 26 (sections 895–901) and Part 27 of the Companies Act 2006 apply in connection with arrangements, reconstructions and mergers. Where the distressed company is insolvent or is imminently facing insolvency, provisions of the Insolvency Act 1986 and the new Corporate Insolvency and Governance Act 2020 will apply. The Pensions Regulator is responsible for regulating and protecting workplace pension schemes.

*Law stated - 24 September 2022*

## Main risk in distressed M&A transactions

Summarise the main risks to all parties involved.

In a distressed M&A transaction, the majority of the risks rest with the buyer. Restricted due diligence is typically conducted. The buyer may also obtain limited or no warranties regarding the target company from the seller. Even if warranties are provided and later prove to be untrue, the buyer may have little or no recourse against the seller. Buyers typically seek to mitigate such risks through pricing but may also look to deferred payments or insurance solutions.

Liquidators can challenge transactions where there has been a transaction at an undervalue or a transaction that has been fraudulently designed to put assets beyond the reach of creditors. Those seller directors that approve such transactions or approve distributions of assets to other group entities may also be exposed to liability. Transactions should therefore be structured on a documented arm's-length basis, particularly where management or the sellers retain any ongoing interest.

Sellers will wish to achieve deal certainty. They will seek to avoid termination rights linked to material adverse changes, third-party consents or deferred or contingent payments. As far as possible, the sellers will require the buyer to do what is necessary to obtain any mandatory regulatory clearances by agreeing to conduct undertakings or post-closing disposals.

A key risk for distressed companies is funded pension liabilities, particularly defined pension liabilities. Where employers leave a multi-employer pension scheme, this may trigger a section 75 debt under the Pensions Act 1995: the buy-out cost of the unfunded liabilities. Where there is a pensions shortfall, the trustees will seek mitigation, perhaps in the form of a contribution, or by way of additional guarantee or security from the parent company or buyers. If the Pensions Regulator utilises its strong anti-avoidance powers, an employer may suffer reputational damage and sellers may face claims for payment of unfunded amounts. Where the transaction is subject to the jurisdiction of the CMA, the CMA may impose an initial enforcement order that requires the target to be 'held separate' from the buyer pending merger control clearance by the CMA. The buyer may also be ordered to divest all or some of the acquired business. Ultimately, under the UK merger control regime, the CMA may only clear a transaction subject to remedies, prohibit a transaction or order a demerger (for a completed transaction). For deals subject to the NSI Act, including foreign investments, a transaction may also be prohibited or cleared subject to conditions following a review. If a transaction subject to mandatory notification under the NSI Act closes before it is cleared it will be void. Individuals may face criminal penalties, including imprisonment of up to five years and possible director disqualification orders, while the Secretary of State also has the power to impose a financial penalty on the acquirer of up to 5 per cent of the acquirer's global group turnover or up to £10 million (whichever is higher).

*Law stated - 24 September 2022*

## Director and officer liability and duties

What are the primary liabilities, legal duties and responsibilities of directors and officers in the context of distressed M&A transactions in your jurisdiction?

When the company is solvent, the directors must act in the best interests of the shareholders as a whole. If the company becomes insolvent or is nearing insolvency, the directors must prioritise the interests of the company's creditors. Directors must be aware of potential liability for wrongful trading, fraudulent trading and misfeasance.

Wrongful trading occurs if a present or former director of the company knew or ought to have concluded at some time before the commencement of the insolvent liquidation or administration that there was no reasonable prospect that the company would avoid going into insolvent liquidation or administration. It is a defence if the court is satisfied that the

director took every step with a view to minimising the potential loss to the company's creditors as ought to have been taken.

Fraudulent trading occurs if in the course of the insolvent liquidation or administration of a company any business of the company is carried on with intent to defraud creditors of the company, or for any fraudulent purpose. For such a claim to be successful, actual dishonesty must be proven against the director.

Misfeasance occurs if a present or former director of an insolvent company has misapplied or retained, or become accountable for, any money or other property of the company, or been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company. The court can grant relief against a misfeasance order if it appears to the court that the director acted honestly and reasonably, and that having regard to all the circumstances of the case it is fair to excuse the director from liability.

*Law stated - 24 September 2022*

### **Differences from non-distressed M&A**

**In general terms, what are the key legal and practical differences between distressed and non-distressed M&A transactions in your jurisdiction?**

In a distressed M&A transaction, the timeline for negotiations between the parties will be accelerated, particularly where the financial situation of the target company is deteriorating rapidly. This is to alleviate the concerns of creditors and potential loss of customers, employees and suppliers. This must be balanced with the greater need to liaise and coordinate with numerous parties, such as lenders, suppliers, customers, employees and landlords, rather than negotiations solely between the buyer and seller.

Owing to the tightened time frame, a distressed M&A transaction will not provide the same opportunity to conduct the extensive due diligence process that would be seen in typical M&A transactions. There will also be limited access to documents, particularly where the seller is acting by their administrators or another insolvency officer.

In a distressed M&A transaction, an exclusivity period is often replaced by a full auction process to enable the assets to be realised for the best price possible.

The purchase agreement is also likely to be drafted differently. Fewer warranties will be given by the seller, and the agreement will need to account for reduced recourse against the seller utilising holdbacks (though these will be resisted by the sell side) and potential insurance solutions.

*Law stated - 24 September 2022*

### **Timing of transactions**

**What key considerations should be borne in mind when deciding when to acquire distressed companies or their assets?**

Acquisition of a company before insolvency will reduce disruption and harm to the brand and business that might arise from a formal insolvency. An asset purchase will allow the buyer to manage the assets and liabilities assumed but may be more complex where third-party consents are needed to approve the transfer of relevant arrangements.

When a buyer acquires distressed companies or their assets prior to insolvency proceedings, they carry the risk of later being challenged by the seller's creditors on the basis of inadequate value. A challenge may also be based on situations where the target company's directors did not give due consideration to their actions, or their actions gave rise to breach of contracts or other regulations, perhaps resulting from the influence of lenders or creditors. At the outset of the transaction, buyers may wish to engage with any lenders who will continue to lend post-acquisition to

discuss possible discounts in the intended rescue plan.

An insolvent distressed M&A transaction can occur following the appointment of an insolvency practitioner. The insolvency process offers the buyer advantages such as a moratorium on creditor action, and may be more clearly able to address pre-insolvency liabilities.

*Law stated - 24 September 2022*

## TRANSACTION STRUCTURES AND SALE PROCESS

### Common structures

What sale structures are commonly used for distressed M&A transactions in your jurisdiction?  
What are the pros and cons of each, and what procedures and legal requirements apply?

Distressed M&A transactions are often structured as asset purchases where the business has entered insolvency. Asset sales offer more flexibility to the buyer as they can cherry-pick assets (mitigating the risks associated with limited due diligence) and avoid inheriting unwanted liabilities. However, additional third-party consents may need to be obtained from contractual counterparties. A further consideration will be that the employee arrangements of those associated with the relevant business will transfer to the buyer automatically under the Transfer of Undertakings (Protection of Employment) Regulations 2006, known as TUPE.

Asset sales may require VAT to be charged in addition to the purchase price, although it is often possible to structure transactions as a VAT-free 'transfer of a business as a going concern'. Where assets include UK real estate, buyers should be aware that stamp duty land tax (in England and Northern Ireland), land transaction tax (in Wales) or land and building transaction tax (in Scotland) may be chargeable in addition to the stated purchase price.

Share sales may be utilised more often pre-insolvency to reduce the need to seek third-party consents to transfer contractual arrangements. It may be that the business is restructured through a hive-down, transferring relevant assets into a new company free from elements that the buyer does not acquire; combining the advantages of an asset sale but simplifying the transfer to the third-party buyer. Care should be taken on hive-downs to avoid crystallising unnecessary tax liabilities. Stamp duty is chargeable on shares and some debt securities at 0.5 per cent of the consideration and is usually paid by the buyer.

Shareholder agreements may be required on the buyer side, for example, if lenders are participating alongside the original owners or management. This will give rise to further antitrust and accounting considerations as to the treatment of any preference instrument.

The insolvency practitioner (typically an administrator or liquidator), when managing the sale process, will normally have the power to effect the sale without seeking third-party or court consent.

Loan-to-own structures broadly involve a lender or an investor lending or acquiring secured distressed debt with the intention of converting that debt to equity. The most common procedures for converting debt to equity are through a consensual contractual swap, a statutory cram-down (ie, schemes of arrangement, restructuring plans or company voluntary arrangements) or an enforcement of share or other security. By opening up a company's debt structure to a loan-to-own lender, companies have access to a larger pool of lenders. However, the borrower may be concerned that a minor breach may result in the enforcement of security. Loan-to-own documentation will typically follow normal loan terms, although depending on how the loan-to-own is structured, it may be necessary to obtain shareholders' approval to allot shares and disapply pre-emption rights.

*Law stated - 24 September 2022*

## Packaging and transferring assets

How are assets commonly packaged and transferred in a distressed M&A transaction in your jurisdiction? What procedural, documentary and other requirements apply?

Distressed M&A may be effected through a share or asset sale. To simplify the sale to the ultimate buyer, the seller may also first seek to reorganise the business through a hive-down by which only the relevant assets and liabilities intended to be acquired are transferred to a special-purpose vehicle.

If these are effected prior to an insolvency process then the normal approvals process will apply. The seller directors have the power to effect the sale subject to any counterparty consents needed under change of control or similar provisions, lender consents or regulatory approvals. Where the seller is listed, it may also need shareholder approval under the Listing Rules. Where the business is insolvent, it may be possible to take advantage of limited exemptions for failing firms in relation to antitrust approvals or from seeking shareholder approval under the Listing Rules.

Distressed M&A may also be effected through a pre-pack administration. This involves arranging a sale of a business of a company prior to that company's administration, but the sale is effected by the administrator of that company after the company enters into administration.

Pre-pack administrations have the benefit of speed and efficiency, thereby enhancing creditor returns. Furthermore, the reality may be that a pre-pack administration is the only viable course of action to avoid liquidation. It should be noted that pre-pack administrations have attracted criticism, for example, for not being transparent (often, unsecured creditors do not know that a pre-pack sale is taking place) and for resulting in conflicts of interest (often, the purchaser is connected to the directors of the insolvent business).

Pre-pack administrations are subject to the Statement of Insolvency Practice 16 (SIP 16), which sets out the principles and compliance standards that administrators are expected to adhere to in the course of effecting a pre-pack administration.

The Corporate Insolvency and Governance Act 2020 introduced a new restructuring cross-class cram-down procedure to eliminate, reduce or mitigate the financial difficulties impacting on the operation of a business as a going concern.

Application to the court is necessary to convene meetings of creditors or members. At the meeting, the participants will be requested to approve the plan. If 75 per cent in value (of creditors' debt or members' shares) approve it, then the plan is approved. Unlike schemes of arrangement, there is no numerosity requirement. The court can bind dissenting voters if certain conditions are satisfied.

*Law stated - 24 September 2022*

## Transfer of liabilities

What legal requirements and practical considerations should be borne in mind regarding the acceptance and transfer of any liabilities attached to the distressed company or assets?

On a share sale, typically all relevant assets and existing and potential liabilities will pass to the buyer, even those of which the buyer may potentially be unaware.

Defined benefit pension schemes are more likely to suffer funding deficits. If the employer withdraws from a multi-employer scheme when the company is sold, the trustees of the scheme may require the employer to continue to pay the seller's share of the deficit. The employer may enter into a withdrawal arrangement with the trustees that apportions the debt in a different way, or appoint a guarantor to be liable for the debt. A share sale in which the pensions liabilities are transferred to the buyer may also trigger the Pensions Regulator to issue a contribution notice

requiring the buyer to contribute to the scheme.

On an asset transfer, the buyer will predominantly assume only the defined liabilities. The buyer can therefore expressly exclude from the sale certain significant unidentifiable or unquantifiable liabilities. As the burden of agreements cannot be assigned, the buyer will need to indemnify the seller for any assumed liabilities unless a tripartite agreement is made with the relevant creditor.

Purchasers in an asset transfer will need to consider the provisions of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). TUPE transfers employees on their current terms and conditions. Similarly, TUPE can cause liabilities connected with the employees to transfer to the buyer, who could become liable for acts or omissions of the seller. Outstanding debts or threatened litigation in connection with employees should be understood before completing the transaction, even where the due diligence process will be condensed under the time pressures of a distressed sale.

In general, tax liabilities will remain with the entity that incurred them. However, in certain limited circumstances, the purchaser of assets as part of an asset sale may acquire liabilities relating to unpaid national insurance contributions.

*Law stated - 24 September 2022*

### **Consent and involvement of third parties**

What third-party consents are required before completion of a distressed M&A transaction? What are the potential consequences of failure to obtain these consents? In what other ways are third parties commonly involved in the transaction?

Where a lender is providing financing, or a company is otherwise seeking to raise finance to acquire distressed assets, existing financing arrangements and debt structures should be analysed as part of the due diligence process to ensure that there will be no breaches of relevant provisions to avoid acceleration of default or cross default.

Other third parties, such as counterparties to material contracts, may need to provide consent in addition to any mandatory regulatory approvals or, in the case of certain listed companies, shareholder approvals that may be required.

*Law stated - 24 September 2022*

### **Time frame**

How do the time frames and timelines for the various transaction structures differ? Can these be expedited in any way?

The timeline for a pre-pack administration can be expedited by early engagement with the proposed administrator and legal advisers. This will enable the purchaser to arrange financing and the company to procure relevant consents (eg, from a qualifying floating charge holder) without delay.

The timeline for a corporate loan depends on whether the loan will be bilateral or syndicated, whether there are multiple tiers of debt, the extent of the security and guarantee package and the extent of the conditions precedent that must be satisfied to utilise the loan.

*Law stated - 24 September 2022*

### **Tax treatment**

## What tax liabilities and related considerations arise in relation to the various structures for distressed M&A transactions in your jurisdiction?

For asset transfers, historic tax liabilities of the business will normally remain with the seller, save in certain limited circumstances where national insurance liabilities may transfer to the buyer. Asset buyers should ensure that an asset transfer is structured as a VAT-neutral transfer of a business as a going concern, or that the buyer can obtain credit for any VAT incurred. Stamp taxes may be payable by buyers in respect of the acquisition of certain shares and securities, and of interests in UK real estate assets.

On a share purchase, historic tax liabilities remain with the target company, so contractual protection or appropriate insurance should be considered. A buyer should give careful consideration before giving value for tax attributes (eg, losses), because anti-avoidance rules may be triggered on a change of ownership that restrict its ability to utilise those attributes against post-acquisition profits or gains, particularly if the nature or conduct of the target company's business will change post-acquisition. If a target has acquired assets intra-group, possible degrouping charges should be considered.

If the target company's debt is acquired at a discount to its carrying value in the target's account a 'deemed release' may occur, causing the target broadly to be taxed on the amount of the discount, except for arm's-length transactions where the target is insolvent or at risk of insolvency and is released from the debt shortly after the acquisition. If the exception is not available, debt capitalisations and debt forgiveness within a corporation tax group can normally take place on a tax-neutral basis.

*Law stated - 24 September 2022*

## Auction versus single-buyer sale process

### What are the respective pros and cons of auction sales and single-buyer sales? What rules and common practices apply to each?

An auction sale broadens the pool of potential buyers. The seller can try to obtain the best possible price and terms, as potential buyers are encouraged to bid against one another. A competitive auction sale can help to alleviate the risk of challenge as a transaction at an undervalue.

However, the seller's business may be inappropriate for an auction sale, particularly in a restricted market with few possible buyers. Auction sales tend to be more expensive for the seller as fees escalate when negotiating with multiple prospective bidders. The seller bears the risk that some bidders, perhaps competitors, will only be seeking information about the company (although this should be mitigated to some extent by confidentiality undertakings). If the auction process is publicly unsuccessful, this could result in other potential investors, competitors in the market and customers suspecting that the target company is in irreparable difficulty, which may render future transactions challenging.

The bidder, meanwhile, will be concerned that an auction sale may carry a higher price than if there were only one potential buyer and reduce the chances of success. The lack of due diligence information and warranty and indemnity protection in a distressed M&A transaction is exacerbated in an auction sale, so the potential buyer bears an even greater risk.

*Law stated - 24 September 2022*

## DUE DILIGENCE

### Key areas

What are the most critical areas of due diligence in a distressed M&A transaction?

The scope of the due diligence should be appropriately limited because of time constraints and limited access to documents. A key area for due diligence is ascertaining why the company is in distress. In the current market, the buyer should assess the pandemic's impact on the business, including supply chain and employment issues.

For share purchases, change of control provisions, restrictive covenants, financing arrangements and tax matters should be examined. For asset purchases, the buyer should identify key contracts and leases, as well as any security registered against the assets. Key areas of due diligence will also relate to insurance, employees, IT infrastructure (including cybersecurity and data protection) and historic acquisitions.

*Law stated - 24 September 2022*

### Searches

What searches of public records should be conducted as part of a due diligence exercise in distressed M&A transactions in your jurisdiction?

Companies House searches should be carried out on the target. Annual reports and confirmation statements should be checked for financial information, liabilities, information regarding shareholders and creditors and any late filings. A Companies Court telephone search is essential to check that no winding-up petitions have been filed. It is prudent to conduct the relevant searches for normal, non-distressed M&A transactions in this context also, such as reviewing IP registers and land registry filings.

*Law stated - 24 September 2022*

### Contractual protections and risk mitigation

What contractual protections and other strategies are commonly used to mitigate diligence gaps in a distressed M&A transaction?

Due diligence gaps arising in distressed M&A transactions are often accompanied by an absence of warranties, leaving the buyer, to an extent, unprotected. To mitigate this risk, a lower price may be paid or elements of the consideration may be held back or escrowed (though these will be resisted by the sellers).

Warranties and indemnities may be obtained, but typically not business warranties where an insolvency officer has been appointed. In the case of financial distress of the sellers, the liability of warrantors is likely to be limited. Warranty and indemnity insurance should be explored. It is possible to obtain synthetic warranties directly from insurers even where no warranties are given by the seller.

The buyer may seek to incorporate an option to terminate the transaction if certain material adverse events transpire prior to closing. The sell side will seek to avoid such provisions, which reduce deal certainty.

*Law stated - 24 September 2022*

## VALUATION AND FINANCING

### Pricing mechanisms and adjustments

What pricing methods, adjustments and protections are commonly used in the valuation of distressed M&A transactions in your jurisdiction and what are the pros and cons of each? How are they used to balance the interests of the parties?

Locked-box mechanisms remain popular. However, there may not be interim accounts to be relied upon as a starting point for pricing businesses and such accounts will not capture any issues associated with business downturn. Traditional closing accounts can be used, but recent market corrections will give rise to questions surrounding how normalised working capital will be assessed. The buy side may seek to bridge the value gap through deferred and contingent consideration. The sell side may resist this, particularly where an insolvency officer is seeking an immediate payment for creditors or where a seller needs cash to meet immediate solvency needs.

Sellers may include an 'anti-embarrassment' clause in the purchase agreement, requiring the buyer to make an additional payment for the assets or shares on the occurrence of an additional trigger event – often the sale of all or part of the assets or shares within a period of time after completion.

Insolvency practitioners will often wish to conduct a form of market auction to satisfy themselves that the best price has been achieved. This is not mandatory, and where the business is in distress they will also be seeking a rapid conclusion.

Where a nominal amount is paid, the potential of any warranty claim should be carefully considered to ensure that the true value of any loss can be recovered.

*Law stated - 24 September 2022*

### Fraudulent conveyance

What rules govern fraudulent conveyance of distressed assets sold undervalue in your jurisdiction? How can clawback risks be mitigated when negotiating the deal price?

A liquidator or administrator of an insolvent company can challenge a transaction at an undervalue under section 238 of the Insolvency Act 1986 provided:

- the company transferred an asset for no consideration or for less than the asset's actual value;
- the company was insolvent at the time of the transaction or became insolvent as a result of the transaction; and
- the transaction was entered into at any time in a two-year period prior to the company's insolvency.

It is a defence if the company entered into the transaction in good faith and for the purpose of carrying on its business purposes, and at the time there were reasonable grounds for believing that the transaction would benefit the company.

When negotiating the deal price, mitigants could include procuring an independent valuation of the relevant assets being acquired, purchasing the assets through an auction and procuring evidence that the relevant company can pay its debts at the time of (and immediately after) the acquisition.

*Law stated - 24 September 2022*

## Financing

What forms of financing are available and commonly used in distressed M&A transactions? How can financing be secured?

Distressed M&A transactions are commonly financed by acquisition financing, special situation and debtor-in-possession loans. Debt may be introduced post-closing. Loans could be made by a syndicate of lenders (including senior and mezzanine) or under a bilateral facility.

Security will commonly include debentures over the target's assets and assets of material members of the target entity's group. Similarly, share security will be granted (where possible) over the shares of the target and material members of the target entity's group. Intercompany debt will likely also be secured. Guarantees may be required from material entities in the group.

*Law stated - 24 September 2022*

## Pre-closing funding

What provisions are typically agreed to secure pre-closing funding of distressed businesses and assets?

Provisions agreed in pre-closing term sheets typically relate to the interest rate, loan size, security and guarantee structure, representations, covenants and events of default and, where relevant, any equity upside.

*Law stated - 24 September 2022*

## DOCUMENTATION

### Closing conditions

What closing conditions are commonly agreed in distressed M&A transactions? How do these differ from non-distressed transactions?

Closing conditions will generally be more limited than in non-distressed transactions. They will focus on mandatory regulatory consents and any third-party consents that are required to effect the transaction, including secured lender consents. Sellers will strongly resist material adverse change clauses given the premium they will apply to deal certainty.

*Law stated - 24 September 2022*

### Representations, warranties and indemnities

What representations, warranties and indemnities are commonly given in distressed M&A transactions?

In distressed M&A transactions, the sellers (particularly insolvency practitioners) are typically reluctant or unable to provide warranties or indemnities. These will rarely extend beyond capacity warranties and limited title assurance. Buyers may look to the management of the target for soft comfort or, where they are to be engaged going forward, harder comfort linked to their incentive package.

Where warranties are available, given the recent pandemic and the conflict in Ukraine, buyers are seeking warranties

relating to supply chain impacts, the target company's compliance with the furlough job retention scheme, government loans, sanctions compliance and health and safety policies. Data security and cybersecurity issues also remain in focus.

*Law stated - 24 September 2022*

### **Remedies for breach**

What remedies are available and commonly sought for breaches of closing conditions, representations, warranties and indemnities in distressed M&A transactions?

Options for recourse against the sellers in distressed M&A transactions are likely to be narrow, particularly where the seller is acting by an insolvency practitioner.

Upon breach of a closing condition, the buyers may decide not to proceed. Damages or break fees will not normally be available. If the transaction completes, in practice, remedies for breaches are likely to be limited. The buyer may request a holdback or escrow arrangement to provide a source of recovery for claims.

Alternatively, the buyer could bring a claim pursuant to any warranty and indemnity insurance policy that it has obtained.

*Law stated - 24 September 2022*

### **Insurance**

Is warranty and indemnity (W&I) insurance available for distressed M&A transactions in your jurisdiction? If so, what provisions and exclusions are commonly included in W&I policies?

Insurance may be available where warranties are given by a distressed seller or by management with limited recourse against those parties. Insurers will be more willing to provide cover where the target company is in less financial distress and the sellers have more direct engagement in the process. To achieve traditional W&I cover, the parties might consider incentivising management to provide warranties and conduct a full disclosure process by offering benefits such as an equity share.

Alternatively, insurance may be available by way of synthetic warranties directly as against the insurer where the warranties are contained in the insurance policy rather than in the purchase agreement. This typically requires a pre-agreed level of due diligence that dictates the scope of cover in addition to standard exclusions for awareness, subjective or opinion-based warranties. Covid-19 exclusions have become more tailored and focused over time. Regulatory compliance warranties are normally excluded from cover or are only partially covered. In respect of tax, insurance will generally also exclude transfer pricing matters, as well as the availability of tax attributes and secondary liabilities – both of which are common areas of concern in a distressed situation.

The parties may be able to utilise 'cash release' insurance to address specific known risks, such as those relating to the environment, tax or litigation.

*Law stated - 24 September 2022*

## **REGULATORY AND JUDICIAL APPROVALS**

### **Merger control**

What merger control rules and filing requirements govern the acquisition of distressed businesses and assets in your jurisdiction? Is the 'failing firm' defence recognised in your jurisdiction?

As the UK merger control regime is voluntary, parties are not required to notify the UK Competition and Markets Authority (CMA) of transactions. However, the CMA may review transactions that have not been notified of its own volition if:

- the turnover of the target is greater than £70 million; or
- a 25 per cent share of supply of goods or services in the UK is created or enhanced by the transaction.

Parties to a distressed sale may submit a short briefing paper to the CMA, explaining why they would not submit a formal notification, and why substantive competition concerns do not arise from the transaction.

The 'failing firm' defence is recognised in the United Kingdom; however, it is notoriously difficult to satisfy. The parties must provide the CMA with compelling evidence of imminent failure and exit from the market and that no less anticompetitive purchase is possible.

*Law stated - 24 September 2022*

### **Foreign investment review**

Are distressed M&A transactions subject to foreign investment review in your jurisdiction? What rules, procedures and common practices apply?

The NSI Act, which came into effect on 4 June 2022, established a new, standalone screening regime for foreign acquisitions of UK businesses and assets (including intellectual property) with national security implications across 17 identified sectors. The NSI Act has retrospective application and the UK government has the power to 'call in' for review transactions that closed on or after 12 November 2020 but before the NSI Act came into force, or within six months of the NSI Act coming into force if the Secretary of State was made aware of the transaction.

*Law stated - 24 September 2022*

### **Bankruptcy court**

What rules and procedures govern the bankruptcy court's approval of distressed M&A transactions in your jurisdiction?

Court approval is not typically required unless a scheme of arrangement under the Companies Act 2006 or a restructuring plan under the Corporate Insolvency and Governance Act 2020 is utilised.

*Law stated - 24 September 2022*

## **DISPUTE RESOLUTION**

### **Common disputes and settlement**

What issues commonly give rise to disputes in the course of distressed M&A transactions and what practical considerations should be borne in mind when seeking to settle such disputes out of court?

Disputes will often be linked to the discovery of previously unknown liabilities or a worse financial position than anticipated. It is most likely that these risks will have been reflected in pricing. Court claims are unlikely to be productive. Recourse is more likely to be against holdbacks, escrows, using informal or formal expert determination, or

insurance. There may also be claims against third parties such as counterparties to the business or its advisers.

*Law stated - 24 September 2022*

### **Litigation and alternative dispute resolution**

What litigation forums are used to resolve disputes arising from distressed M&A transactions in your jurisdiction and what procedures apply? Is alternative dispute resolution (ADR) commonly used?

Sale agreements are normally subject to English law and court jurisdiction rather than arbitration. However, formal or informal expert adjudication is often used to resolve disputes over deferred or contingent consideration payments that may be due.

*Law stated - 24 September 2022*

## **UPDATE AND TRENDS**

### **Recent developments and outlook**

What have been the most significant recent developments and trends affecting distressed M&A in your jurisdiction, including any notable court decisions, regulatory actions and deals? What is the general outlook for future transactions?

The Corporate Insolvency and Governance Act 2020 introduced changes to UK insolvency law with a new moratorium procedure for a company in financial distress: a debtor-in-possession process to facilitate the rescue of a company as a going concern. The company's directors would remain in place and continue to run the business with the protection of the moratorium, preventing creditors (with some exceptions) from pursuing payment or taking enforcement action while the company explores its rescue and restructuring options. The Act also introduced a new 'cross-class cram-down' restructuring procedure.

In February 2022, McColl's Retail Group Plc went into insolvency and Wm Morrison Supermarkets Ltd entered into an agreement to acquire certain assets of McColl's. Although the CMA identified competition concerns, the transaction was able to proceed on the basis of remedies offered by the purchaser. This demonstrated that, while open to commercial remedies, even in the context of a distressed sale the authorities will remain alive to competition concerns.

Businesses across all sectors suffered significant financial implications as a result of the coronavirus pandemic, while new platforms and business models have flourished. Businesses continue to face supply chain issues, in part due to changes arising from Brexit and the zero covid policies in China, but also now due to growing energy costs and inflationary pressures. The UK government has intervened to provide some breathing room against increased energy costs, but it seems clear that UK businesses face a challenging period ahead with greater levels of distressed M&A likely.

*Law stated - 24 September 2022*

## Jurisdictions

	<b>Austria</b>	Wolf Theiss
	<b>Brazil</b>	Machado Meyer Advogados
	<b>Bulgaria</b>	Wolf Theiss
	<b>Canada</b>	Cassels
	<b>France</b>	JEANTET
	<b>Greece</b>	VAP Law Offices
	<b>Hungary</b>	Wolf Theiss
	<b>Japan</b>	Nagashima Ohno & Tsunematsu
	<b>Netherlands</b>	Van Doorne
	<b>Poland</b>	Wolf Theiss
	<b>Portugal</b>	PLMJ
	<b>Romania</b>	Wolf Theiss
	<b>Switzerland</b>	Walder Wyss Ltd
	<b>United Kingdom</b>	Morgan, Lewis & Bockius LLP
	<b>USA</b>	Cravath, Swaine & Moore LLP