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WHAT'S INSIDE

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KEY OPERATIONAL CONSIDERATIONS TO ENSURE BUSINESS CONTINUITY IN A CHANGE OF CONTROL TRANSACTION

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In the current business environment, we are witnessing a growing trend of lenders actively acquiring companies in distressed situations, which can lead to a Change of Control Transaction ("CCT"). Just like any disruption in normal business activity, it is critical to take certain steps to maintain business continuity through a CCT. There are several key areas that need to be evaluated and managed to ensure a smooth transition.

CCT generally refers to an occurrence that materially alters the equity ownership of a legal entity and may result in a change in management and board composition. The market commonly views a change of control as a situation where a single equity holder, or consortium of equity holders, transfers an equity stake greater than 50% to another party or parties. However, contracts or legal instruments may contain explicit definitions with thresholds that can be higher or lower than 50%.

Corporate transactions that can give rise to a change of control include mergers and acquisitions ("M&A"), the sale of equity securities, or a debt for equity conversion. While asset sales technically do not result in a change of shareholder ownership of a business entity, many contracts will define the sale of substantially all assets as a change of control.

As we have experienced, more lenders are acquiring companies in distress. Using senior debt holdings as leverage, lenders would either convert their debt to equity in an out-of-court restructuring or use the US Chapter 11 Bankruptcy proceeding either to credit bid in a Section 363 sale process or convert their debt to equity in a Plan of Reorganization. Two recent transactions are an example of a change of control: Spirit Airline's 2025 financial restructuring where a debt-for-equity swap gave bondholders majority control over the business and WeWork's 2024 Chapter 11 plan which transferred the company's equity to a group of lenders.[1]

Change of Control Provisions

Many successful bankruptcy cases have involved transactions that resulted in a change of control through a Section 363 sale process or through a Plan of Reorganization. These types of transactions require a careful assessment of existing contracts and agreements that may contain change of control provisions. In addition, the new owners and/or management team may have a different vision that will impact the strategy for potentially renegotiating, transitioning, or terminating contracts as needed. A successful transfer to new ownership will require an effective process for evaluating contractual obligations, adapting to new business needs, and developing a plan that will facilitate a smooth transition while considering the business's strategic and financial goals.

A change of control provision generally provides the party and/or counterparty with certain rights or remedies to terminate the contract in the event of a change in ownership, allowing the party to avoid being forced into a contractual obligation with a different counterparty. For example, a supplier may not wish to continue honoring the contractual requirements under a vendor agreement if the counterparty was acquired by a competitor or an adverse party in a lawsuit. Similarly, a lender may have a change of control covenant that allows for the termination of the loan document if the borrower has a new owner with a different credit profile.

Contracts will define specific events and parameters that would violate a change of control provision. To the extent a potential transaction may breach a change of control provision in critical agreements, the parties to the contract may proactively negotiate and seek a consent or amendment to avoid termination of the agreement.

Under a Chapter 11 Bankruptcy, contracts with change of control provisions are generally enforceable pursuant to Section 1124(2) in the Bankruptcy Code. Irrespective of an in-court or out-of-court transaction, contracts with change of control provisions will need to be managed carefully.

Potential Risks and Pitfalls

CCT can be in the form of an asset sale or an equity sale. An asset sale allows for a purchaser to pick and choose contracts to be part of the acquisition. Generally, most

[1] Knauth, Dietrich, "Spirit Airlines gets court approval for $795 million debt deal," Reuters (February 20, 2025), https://www.reuters.com/business/aerospace-defense/spirit-airlines-gets-court-approval-795-million-debt-deal-2025-02-20/. Knauth, Dietrich, "WeWork cleared to exit bankruptcy and slash $4 billion in debt," Reuters (May 30, 2024), https://www.reuters.com/legal/wework-cleared-exit-bankruptcy-slash-4-billion-debt-court-says-2024-05-30/.

contracts can be assigned to the purchaser; however, there may be contracts with clauses that restrict assignments or will need to be novated in the case of government contracts.

In an equity sale, the purchaser is buying the ownership stake of the business entity. Any contractual obligation associated with the entity will be part of the equity sale. The purchaser essentially assumes all the rights and obligations of unexpired contracts where the business entity is a party to the contract.

A transaction that takes place within a Chapter 11 Bankruptcy process will often provide more optionality to a purchaser. Under Section 365, US Chapter 11 bankruptcy provides an ability for debtors to assume or reject pre-petition executory contracts and unexpired leases. Contracts with favorable terms can be assumed by the debtors as long as monetary and non-monetary defaults are cured. In addition, debtors have an opportunity to renegotiate and modify contracts or exit contracts that are viewed to be above-market or onerous.

Contract assignments are generally not necessary in an equity sale within a Chapter 11 bankruptcy process as the purchaser will own the shares of the business entity that is a party to the contract. However, in a section 363 asset sale, contracts that will be transferred as part of the asset sale will need to be cured and assumed by the debtors before being assigned to the purchaser. Anti-assignment clauses are generally unenforceable in bankruptcy; however, section 365(c) does provide an exception that prohibits assignment when (1) the counterparty does not consent to the assignment and (2) where applicable non-bankruptcy law bars assignment of certain types of contracts (e.g., personal service contracts under state law, Anti-Assignment Act, Patent Act, Copyright Act, Lanham Act).

Under a Chapter 11 bankruptcy, a party who is purchasing the equity, or will become the majority owner from a debt-for-equity conversion, may be able to negotiate with debtors to reject or modify certain pre-petition contracts before consummating a transaction.

Any contract that contains a change of control provision will provide certain rights or remedies for the counterparty to terminate the contract. As part of the legal due diligence process, the purchaser should examine whether critical contracts have change of control provisions that could be exercised by the counterparty. When examining these provisions, it is essential to consider the related operational aspects in more detail.

High Level Operational Considerations

Legal Entity

A CCT may or may not include a change in the legal entity owning the business:

No change in the legal entity owning the business: a change in ownership of the existing legal entity which owns the business providing the underlying security.

Lenders take over ownership of the existing legal entity from the current equity owners.

New legal entity is created to own the business: a new legal entity is set up which acquires all impacted assets from the existing (old) legal entity.

Perimeter Definition

In a CCT, the basic Perimeter must be confirmed before further evaluation can proceed. Key questions to consider include:

- Has the Lender or Company or Debtor defined what will change from a Perimeter perspective. i.e., what will be left in or out as part of the CCT?
- What are the non-core assets, if any, and what are the related disposal strategies, e.g., sale, spin off, joint venture, etc.?

Strategy Changes

Considerations include:

- Has the Lender or Company or Debtor confirmed the Day 1 strategy for each market, location, country, and legal entity which is part of the Perimeter?
- Is the Lender or Company or Debtor implementing a new strategic vision?
- Is a strong management team in place or does there need to be a new management team?
- Is there a new business plan to track performance?
- Have cost rationalization initiatives or optimization goals been identified and evaluated?
- Have plans been developed to retain talent that are critical for leadership and support to ensure business continuity post-transaction close?

Other Considerations

As the Lender or Company or Debtor evaluates the components of the perimeter and what strategy changes might result from the CCT, some items to consider include the following:

Legal Entities

- Examine legal entities by country, and local sponsors (in countries where a regional partner who is also a shareholder is required)
- Confirm whether a new legal entity needs to be set up and whether there is a need to transfer any assets between legal entities
- Examine corporate governance documents, including company registrations, Bylaws, and Articles of Incorporation

Regulatory and Tax Implications

- Examine new compliance and filing requirements at various markets, locations, states, countries where the business operates
- Make changes with various state/local governments, customs registrations, etc., as a result of changes in ITIN/EIN, VAT, and other registrations
- Review transfer pricing policies and processes which in turn might impact the supply chain for procurement and sales
- Review tax strategy and structure, ensuring tax efficiency (e.g., impact to pre-existing Net Operating Loss (“NOL”s) from change of control)

Banking and Payments

- Secure new credit facilities
- Replace or pay guarantees of the prior ownership, including counter guarantees, financial guarantees, surety bonds, regulatory guarantees, etc.
- Update bank account signatories
- Execute new Know Your Customer (“KYC”) documentation, as needed
- Exit from shared cash pooling arrangements, e.g., Zero Balance Accounts (“ZBA”)
- Set up new credit cards and P-cards
- Consider changes in interest rates and bank charges
- Implement new treasury solutions, as needed

Contracts

- Review all contracts, including vendor, customer, and employee agreements, to determine any impact of change of control
- Identify any changes to Terms and Conditions (“T&C”)
- Identify areas affected by loss of scale or leverage
- Identify comingled vendor contracts which are used across the equity owners’ portfolio which the business relies on for Day 1 business continuity
- Look for any increases in procurement or sale tariffs due to changes in legal or tax structure

Insurance

- Make required changes to insurance policies
- If required, procure new insurance, and update it for new Directors & Officers ("D&O") and business liability requirements

Real Estate

- Make required changes to lease agreements and real estate strategy
- If required, replace any guarantees, and update for any other requirements arising from the change of control
- Ensure transfer of contracts from/to the business to support Day 1 business continuity

Shared services and TSAs

- Confirm any shared services that the business gets as part of the previous equity owners' network for Human Resources (payroll, benefits, etc.), Information Technology, operational services, audit (internal and statutory), Accounts Receivable, Accounts Payable, Travel and Expenses, treasury processing, reporting, tax, etc.
- Evaluate the need for Transition Services Agreements ("TSAs") or other commercial agreements between the business and/or other previous equity owner entities to support Day 1 business continuity

Data and IP

- Access to IP, systems, data, websites, etc. including new or transfer of relevant contracts and licenses

Communication Plan

- Design Day 1 (and +/- 45 days) communication plan
- Identify all stakeholders including customers, regulatory and other government agencies, employees, lenders, previous equity owners, and vendors
- Create communication content, ownership and timeline

Organization design

- Confirm Day 1 organization design changes:
    - In board of directors and any impact to the business's ongoing operations
    - In management (e.g., equity owner oversight roles, Chief Financial Officer, Chief Operating Officer, strategy, Project Management Office)
    - In local sponsor (as required)
    - In organization structure, reporting lines, by country, by operational requirements, by location, by function (e.g., within finance and global finance, etc. across all functions)
    - In Delegation of Authority ("DOA") matrix to support approvals and payments on Day 1 and beyond.
- Additionally, any changes in DOA will need to be updated and tested in the Enterprise Resource Planning/IT systems for the relevant functions
- Develop new statutory reporting as necessary

Onboarding

- Identify whether any employees need to be onboarded to existing or new legal entities and accompanying impact to benefits and systems (e.g., transfer of pension, health care benefits, payroll)

Other

- Develop retention plans
- Be clear about distribution network, e.g., will distribution channels remain or are new distributors needed? Local licenses to sell?
- Identify anything being left out of transferring assets/systems/employees due to the CCT and the impact on Day 1 business continuity for the business

Next Steps

Current and Day 1 operating models: What is changing between now and Day 1?

- Functional leaders should evaluate their global end-to-end processes as part of the operating model review (e.g., Procure to Pay, Order to Cash, Record to Report, Hire to Retire, etc.)
- Every function should conduct an operating model evaluation across its people, processes, systems, contracts that it uses currently and evaluate "what changes" on Day 1 as a result of the above questions (and associated change of control).
- This evaluation will be across all functions, global or not, e.g. Finance and Accounting, IT, HR, real estate, operations, regulatory and compliance, legal, etc.
- Every function should create a Day 1 checklist and mitigation plan to address those items that could change on Day 1

Centralized Transaction Team

- Create a list of key tasks expected due to the change of control using the above list focusing on a detailed operating model comparison as explained above
- Bucket the list of key tasks into “one time” and “run rate” activities
- Identify mitigation plans needing to be put in place to ensure Day 1 business continuity, for example:
    - Updating DOA matrix will need some IT resources, internal communication to employees, etc.
    - Changes in signatories would have to be coordinated across previous equity owners and lender representatives and relevant banks
    - New facilities might need additional collateral from lenders
- Quantify the cost/dollar impact from the key tasks, issues, and mitigation plans being put in place

Conclusion

CCT requires careful consideration of contractual terms and potential operational challenges that could impact business strategy under new ownership. Proactively identifying and managing these issues is crucial to prevent disruptions after the transaction closes. While not exhaustive, these areas provide a solid starting point.

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