



Fit for growth—
Legal considerations for
legal entity restructuring

A COVID-19 response series for in-house counsel

Many businesses anticipated an economic slowdown for 2020, but none could have prepared for a global pandemic making unprecedented demands on employment, cash flows, and supply chains.

Businesses responded with agility and empathy—cutting discretionary spend, furloughing employees, and making use of government loans and aid to help weather the storm. The companies that have surfaced in a strong cash position are more likely to return to growth more quickly.

With the economic environment now very different from pre-pandemic times, companies will need to reflect on whether their structure fits this evolving “new normal”: Is the structure fit for purpose? Can the costs be managed efficiently? And does the structure facilitate effective supply chain management?

The sudden and sharp contraction in many economies will inevitably lead to some tough decisions, including whether to create new entities, transferring assets or entities, or divesting.

THE DRIVERS OF LEGAL ENTITY RESTRUCTURING

The drivers of a legal entity restructure are no different post-COVID than any other time. The pandemic has, however, accelerated the need to reflect on the effectiveness of the structure, and the efficiency of the legal documentation that accompanies a reorganization. Aligning the legal entity structure with the business priorities below will be crucial for an organization's ability to return to growth in the "new normal".

1

A changing customer base

A company usually structures itself around interaction with its customer base: Retailers, for example, have often expanded to areas with high footfall, or changed their models to meet customer demand for online shopping. In a post-pandemic world, companies need to analyse whether their customer base may have changed, whether long-term demand has shifted to an alternative delivery model, and whether new markets may have opened up.

2

Supply chain challenges

The supply chain may have been one of the most difficult challenges to manage during the pandemic. Restrictions to movement between countries caused severe delays, and demand for essential equipment caused sourcing issues for many companies. One of the main considerations for a restructure is whether the current structure facilitates the company doing business in the most efficient way. A change of supply chain may require a change of legal entity structure.

3

Delivering cost efficiency

Cost is one of the most common reasons for restructuring—A company with too many legal entities, or redundant entities, can find the cost of carrying those run into hundreds of thousands of dollars per entity. Many companies that have engaged in M&A activity over the last few years may not have streamlined their structures yet, and may be carrying too many entities, with unnecessarily high running costs.

WHY RESTRUCTURE?

Business effectiveness

Previous recessions have shown that there is a premium on liquidity – companies in the strongest liquidity position after the pandemic are more likely to thrive more quickly.

The companies with the strongest liquidity positions tend to be those with structures that facilitate the group moving capital around most effectively – moving cash to where it is needed, and repatriating cash to the centre or their financing facilities at the right time. The general counsel, working with tax, finance, and treasury, should consider whether the structure helps or hinders a return to growth. In an inefficient structure, where the reason for some subsidiaries is unclear, it becomes a slow and cumbersome process, when speed is key.

Group strategy alignment

Many companies will have set up their structures from a tax perspective, during a time when the business landscape will have been very different. Post-pandemic, however, businesses may be reconsidering their raison d'être, re-focusing on their core business. Whichever their strategy, the corporate structure needs to be aligned.

Reduce cost and improve cash movement

A streamlined corporate structure will facilitate efficiency in operations, with resultant reductions in operating costs. The streamlined structure will also allow cash to be moved at the required speed, rather than tying it up in cumbersome processes through inefficient intermediaries.

Streamlined management, governance and reduced risk

Finding the most efficient corporate structure will help the group reduce management time of inefficient entities, and allow them to refocus on returning to growth. It will also allow them to improve and maintain their corporate governance standards—fewer redundant entities reduce the risk of breaching these standards. In the past, many corporate failures were governance related, and could be traced back to the subsidiary where the corporate governance failure existed.

LEGAL CONSIDERATIONS

THE ROLE OF THE GENERAL COUNSEL

The general counsel's role is critical when considering whether the legal structure facilitates a return to growth. Playing a central role in coordinating a restructure, the GC needs to bring all stakeholders along, make sure they are aligned, and help them navigate the process. The GC needs to be connected with the tax, treasury, finance and operations departments and look at the strategy holistically. Successful restructures often have someone at the center, taking broader responsibility for moving things forward. The legal department is well-placed to perform this role.

PRACTICAL CONSERATIONS FOR THE GC

A corporate restructure can mean divesting redundant entities, changing the ownership structure, or performing intra-group mergers or acquisitions. For each, the GC will need to:

Change of ownership

- Review the existing organizational documents for any restrictions or caveats
- Update the rights and responsibilities of the directors or owners
- Draw up agreements that specify any future buy-out stipulations for management buy-outs

Change of entity structure

- Review the appropriate structure if funding is to be raised from investors
- Consider the legal requirements of the entity documents, the filing requirements, and regulatory implications for changing structure

Mergers or acquisitions of sub-entities

- Create a contract stating:
 - How the sale or purchase will be organized
 - The assets that will be transferred
 - How the transaction will be funded
 - The provisions for liabilities or warranties
 - The workforce or employment law implications (e.g. TUPE)

SUGGESTED APPROACH

EMBRACE DIGITAL

Whichever actions a company wants to take to streamline its structure, the legal department will need to make sure the books and records are up to date, that they have accurate shareholder records to enable the transaction, and access to the Articles of Association to take into account pre-emption rights, and sale and purchase agreements (SPA). If these haven't already been digitized, the GC should consider expediting transforming the way they store and produce them—this will make making and tracking clause changes more easily, and make future valuations quicker and easier.

CREATE A STRUCTURE FIT FOR PURPOSE

The General Counsel has an opportunity to steer the business towards the most efficient structure and help it grow:

1. Review the liquidity position: What are the lessons learned from COVID-19—how can you strengthen the position to return to growth? Is your company structure aligned to your supply chain and your customer base?
2. Engage the right advisors: Use advisors who understand your business objectives in order to advise on the tax and legal aspects of your restructure
3. Work together: Determine the most efficient structure for your company post-pandemic
4. Develop the right strategy—and implement it.

Although restructuring your legal entities is a complex process, one of the most important roles for the GC is to make sure that stakeholders are aligned, and that the legal department is at the center, moving it forwards. Now is the time to take the opportunity to embrace digital and you will be well-placed for doing the analysis again in future, or having to make changes.

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