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Exits, Ring-Fencing and Other Risk Management Strategies for Multinationals Operating in Geopolitically Volatile Areas

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Key Points

- The past two years have highlighted the vulnerability of some multinationals' operations and even loss of control in the event of geopolitical disruption.
- Drawing on the lessons of 2022 and 2023, businesses should formulate contingency plans to ring-fence units in vulnerable jurisdictions and plan for potential exits.
- Those plans should encompass everything from modified supply chains to IP rights and IT support, cash management and protections for local management.

With mounting geopolitical tensions, multinationals face a very real and immediate risk of being deprived of profits, control or even ownership of some wholly or partially owned local businesses. As a result, business leaders are expected to formulate contingency plans for foreseeable geopolitical and trade threats, including new conflicts, economic sanctions, hostile action by national authorities toward foreign investors and public pressure compelling a withdrawal.

Such contingency plans should set forth the path to a full exit or, at a minimum, to ring-fencing the local business. Applying the "in country for country" approach can help mitigate the exposure risks of the global business, its people and its key assets operating in (or exiting from) volatile areas.

Many multinational companies struggled to extricate their businesses from Russia following the invasion of Ukraine, and several other regions could potentially present similar challenges.

While the issues are often business- and jurisdiction-specific, a number of challenges are foreseeable and need to be factored in to business strategies.

> Contingency plans for foreseeable geopolitical and trade threats should set forth the path to a full exit or, at a minimum, to ring-fencing the local business.

The overall objective of the preemptive actions below is to get the local business to operate in an isolated manner and treat it as an unaffiliated entity. Doing so should:

- Facilitate an exit if that proves necessary.
- Protect the global group in case its shareholders' rights regarding the local business can no longer be enforced and/or the interests of the local management are no longer aligned with those of the global group.

With that objective in mind, business leaders should consider some or all of the following actions.

Formulate a ring-fencing and exit strategy. Companies should take all internal preparatory actions to implement this strategy, even if no decision to exit has been made.

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- **Devise (and keep under regular review) a separation plan** for the local business so it can operate on its own, with minimum support from the global platform.
- **Collect (and continue to update) information for potential third-party buyers**, because accessing due diligence information may become challenging, or even impossible, when a conflict arises and local management is subject to new restrictions and/or pressure from national authorities.
- **Identify all third-party consents necessary to sell the local business** and, to the extent practicable, develop a plan to obtain those consents (or waivers) in advance, or quickly.
- **Prepare for a worst-case scenario** where the global group finds itself subject to conflicting laws. A sale of the local business may not be permitted by authorities in the relevant jurisdiction, while operations as part of an international group could become difficult or impossible due to sanctions and counter-sanctions. Even when businesses are prepared to give up their equity stake, abandoning shareholders' rights may not be permitted in the local jurisdiction and/or would expose local management to increased liability. Identifying structures for giving up the investment (*e.g.*, transfer to local management, with or without a call-back option; transfer to local charity groups or employees) is time-consuming and needs to be considered in advance.
- **Revamp supply chain strategies** to enhance supply chain resilience by:
  - Diversifying suppliers of the local business and substituting, as much as possible, local suppliers for suppliers outside that jurisdiction (especially those that are likely to become prohibited from operating there).
  - Reducing the local business's role as a supplier to the rest of the group, to protect the global business's continuity.

Review on an ongoing basis accumulated cash and cash needs at the local level and consider regular distributions to the parent entity through dividends, under intragroup financing and cash-pooling arrangements, or via alternative value-extraction structures. Once a geopolitical crisis arises, expect the local jurisdiction to impose or increase capital controls, including restrictions on cash transfers outside its borders.

Proactive cash management, including regular offsets of outstanding intragroup payables and receivables, could reduce the amount of potentially "trapped cash" and the group's post-exit exposure. In particular, multinationals should reconsider any "two-step distribution" practices where cash is first transferred to parent entities in the form of loans and subsequently offset against dividends once they can be formally declared. The risk is that, if distributions become prohibited, the offset might not be possible and the local business may be forced to recover payables under outstanding loans to parent entities.

Examine intragroup arrangements involving the local business and implement any necessary amendments to ensure:

- The ability to terminate those arrangements on short notice, ideally with automatic termination upon change of control.
- The termination or replacement, if practicable, of parent guarantees and similar support provided by group entities.
- Arm's length terms that will not jeopardize continuity of the business upon termination by the parent.
- Clarity of ownership, registration and use of intellectual property (IP) rights.

Separate or limit dependence of local IT systems on the global platform. The aim is to (i) facilitate a subsequent divestiture without the need for transitional service arrangements and (ii) minimize the risks that a bad actor might gain access to the global platform through unauthorized entry to the local IT platform. It is critical that multinationals identify and establish arrangements with alternative IT providers locally or develop local IT infrastructure in-house. In addition, to the extent permitted by local law, global groups should consider maintaining offshore backups of local businesses' key contracts, data sources and other important information that may become inaccessible due to local restrictions.

Review IP rights owned, licensed or used by the local business and implement a strategy involving:

- Documenting the use of material IP rights by the local business.
- Replacing (or decreasing), if possible, use of global brands with local brands in an effort to operate the local business on a stand-alone basis and limit the exposure of the global group's IP rights.
- Testing the ability to withdraw trade secrets on short notice (to prevent access or disclosure by third parties following an exit by the parent).
- Planning a minimal use of key group trademark rights post-exit (*e.g.*, a limited license to use key group brands in a safer neighboring jurisdiction, with a plan for the group to distribute or otherwise commercialize limited products in the local jurisdiction under those brands). Minimal use is frequently required to avoid abandonment of trademark rights, which would allow any third party to use or register them. This protection is often assessed against the risk of local authorities suspending treaty exemptions on royalty payments or even prohibiting such payments, resulting in a *de facto* nationalization of licensed IP rights.
- Considering ramifications of unauthorized use of IP rights, either temporarily during rebranding or an unauthorized long-term use, which is likely to require (i) registration of IP rights in neighboring and other relevant jurisdictions to help prevent unauthorized

export of goods or services, and (ii) communications with third parties (*e.g.*, key customers or suppliers) explaining the post-exit use of IP rights.

Consider revising the shareholding structure of the local business to curtail the possibility of abusive claims from the local business, its creditors or local authorities against direct or indirect parent entities within the global group. The risk could be particularly high if the local business becomes insolvent, which could be caused or accelerated by actions taken by authorities in the local jurisdiction. Transferring key assets from the parent entity to affiliates in jurisdictions with robust bankruptcy laws may be a means to reduce temptation for opportunistic or abusive actions.

Alternatively, a parent entity's protection may be optimized if it is incorporated in a jurisdiction that has bilateral investment treaties with the jurisdiction of the local business because that could allow the parent to seek compensation for unfair treatment. Of course, in practice, a realistic remedy may be unavailable until the geopolitical crisis is resolved and awards can be enforced.

As far as practicable, conduct due diligence on all arrangements with local management, including existing protections for them in case of potential investigations. Doing so can help ensure the global group provides the managers with access to independent advisers and reimbursement of fees as they are incurred. Consideration should be given to which members of the management team could operate from abroad and whether a sufficient number of trusted local managers could run the business on the ground if foreign employees are forced to leave.

Once a "local headquarters" team is identified, develop plans to ensure that the team continues to be compensated in the event of restrictions on payments, perhaps with payments to accounts in a more stable jurisdiction.

It may be necessary to clarify which decisions can be made locally — with the team operating the business in an autonomous manner — and which decisions exceed the local management's authority and require the board's or shareholders' approval. Clearly identifying matters that are reserved for the board or shareholders would also reduce the danger of local authorities exerting pressure on local management to take significant actions.

Evaluate in advance the tax, accounting, financial reporting and operational implications for the parent group of any divestiture or restructuring of the local business. In particular, multinationals should consider treatment of any unpaid taxes at the local level (and their potential acceleration) and any taxes arising from restructuring or exits, together with potential funding solutions.

In Sum

The appropriate actions to implement will depend on the business, industry and jurisdiction, but the preemptive measures are ones business leaders can take to formulate solid and tested plans for managing their companies' exposure.