PRACTICE

How a client can protect its interests if a service provider is taken over

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KEY POINTS

- NEC4 service providers may be taken over by new owners during the service period, which could adversely affect client relationships.
- In NEC4 contracts, change of control is only provided for in the FMC and FMS through option X28.
- The option allows the client to terminate under specified circumstances, so clients may wish to consider including it in other long-term NEC4 service contracts.

The value of a service provider is influenced by the quality and length of its service contracts, which can make them attractive targets for a takeover. As such clients often include 'change of control' provisions in long-term service contracts that give them certain rights if this happens.

In the NEC4 suite of contracts, the only such provision is option X28 in the NEC4 Facilities Management Contract (FMC) and NEC4 Facilities Management Subcontract (FMS). This article explains how the clause works, particularly in the context of UK regulations, and suggests it could be appropriate for other long-term NEC4 service contracts.

Change of control

Control of an organisation relates to the capacity to exercise significant influence over the direction and operation. In principle the source of organisation control should be fairly straightforward to identify, although the way in which an organisation is structured may make this more difficult.

There are various ways by which a change of control could occur, including changes to the senior executive appointments, a transfer of shares or voting rights, re-structuring of an organisation group, changes to the financial structure, a merger or acquisition, or a split or division.

Note that a change of control is different to assignment or novation, which is essentially where interests under a contract are transferred, with assignment expressly dealt with under the core contract clauses.

Recent examples of a change of control in the facilities management sector include Kingdom Services Group acquiring Red Support Services Ltd and Green Support Services Ltd; RSK Group acquiring technical facilities management and energy solutions company Richard Irvin FM; Atalian Global Services merging some regional operations with OCS Group; and Airedale Maintenance Services Ltd being sold to the Trios Group.

UK regulations

In the UK, the Panel on Takeovers and Mergers has overseen takeovers and merges of British companies since 1968. It administers the City Code, which is a set of general principles and rules governing conduct.

The Companies Act 2006 codified existing UK legislation and company law and set out governance requirements, including provisions in relation to a change of control. It also placed the Panel on Takeovers and Mergers within a statutory framework.

In the UK a company is obliged to identify and register people with significant influence or control, as required by part 21A of the Companies Act 2006 and provisions within The Register of People with Significant Control Regulations 2016.

NEC4 FMC and FMS option X28

Option X28 in the NEC4 FMC contains rights and obligations in relation to a change of control event. Note that option X28 within the NEC4 FMS subcontract is the same as that within the FMC, apart from the different parties and named roles.

Definition of change of control

Change of control is defined in clause X28.1 as: 'where an individual, company or partnership, other than the *Service Provider*, has taken control of the *Service Provider* after the Contract Date so that the individual, company or partnership exercises, is able to exercise or is entitled to acquire direct or indirect control over the *Service Provider's* affairs' (bullets omitted).

The definition resembles that in the Income and Corporation Taxes Act 1988 and Corporation Tax Act 2010 although option X28 does not provide examples of how such control may be obtained, which is probably because NEC contracts are designed to be used anywhere and not just the UK.

Notification of change of control

Clause X28.2 says: 'The *Service Provider* notifies the *Service Manager* and the *Client* if a change of control is expected to occur, unless if it is prevented from doing so by a regulatory authority. The *Service Provide*r notifies the *Service Manager* and the *Client* immediately if a change of control has occurred.'

A notification is required as this may not constitute a reason for another form of communication, such as an early warning. In addition to the Panel on Takeovers and Mergers, a 'regulatory authority' may be one of the following: the Competition and Markets Authority (Enterprise and Regulatory Reform Act 2013), the Financial Conduct Authority (Financial Services Act 2012) or the Prudent Regulation Authority (Financial Services Act 2012).

If a change of control has occurred, the requirement is to notify immediately, although there is no corresponding sanction if this is not given.

Right of termination

Within eight weeks of becoming aware of a change of control event, the client has the right to terminate. There are three specified reasons stated in clause X28.3, the first of which is: 'the financial position of the individual, company or partnership which has taken control of the *Service Provider* does not meet the financial position stated in the Contract Data'.

A balance sheet details the assets, liabilities and equity for a particular year. Specific calculations can be applied to the balance sheets for current and recent years to determine a financial position. This assumes, however, that the balance sheets represent a true account, which, for example, was determined not to be the case with Carillion following liquidation in 2018.

The second reason to terminate is: 'the Change of Control contravenes the ethical principles of the *Client*'. Ethical principles guide the manner by which an organisation undertakes its operations. A code of ethics may be either compliance- or value-based, depending upon the type and intent of the organisation. These can be demonstrated by the requirements under NEC4 clause 10.1 (compliance) and 10.2 (value).

The intention of many businesses is to operate by working with like-minded organisations, with common examples of ethical principles including discrimination, diversity, employee relations, sustainability and environment.

The third reason to terminate is: 'there is a conflict of interest that cannot be resolved'. The Companies Act 2006 requires directors of a company to be proactive regarding a conflict of interest, and imposes specific duties in relation to this. Although option X28 does not provide for what the conflict of interest is or who it involves, the client retains the right to terminate where it cannot be resolved.

Termination procedures

Clause X28.4 details the processes that apply upon termination: 'If the *Client* terminates for a change of control the termination procedures followed are P1 and P4 and the amount due on termination is A1 and A2.'

Amount A1 (see clause 93.1) and A2 (see clause 93.2) recognise that this is a 'neutral' reason for termination and is not due to a failure on the part of either party. Where option X11 on termination by the client is also selected, then the client may terminate for any reason although the stated amount due differs from that under option X28.

Conclusions and recommendations

Completing the required information for option X28 in NEC4 FMC and NEC4 FMS within the contract data requires careful consideration. Due diligence at the procurement stage to understand a supplier's organisation, structure, financial position and business risks may determine whether there is a possibility of a change of control occurring.

Although X28 is only included within the NEC4 FMC and NEC4 FMS contracts, it could be a beneficial option for other NEC4 service contracts where the service agreement is for a long term. If option X19 on termination by either party is included, either party may terminate for any reason after the minimum period of service.

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