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THE FIFTH HERBERT SMITH FREEHILLS AND NLU DELHI
**INTERNATIONAL NEGOTIATION
COMPETITION**

THE HAILICOPTER
HIGH DRONES INC

7-9 SEPTEMBER 2018

GENERAL BACKGROUND INFORMATION

The parties

AirCoach plc

- AirCoach Plc ("**AC**") is a British public listed company, based in Farnborough, that manufactures and sells aeronautical products worldwide and its client base comprises well-known international commercial airlines, in particular in Europe and Asia. AC is listed on London Stock Exchange's main market and has a market capitalisation of approximately US\$700 million.
- In 2015, AC's longstanding CEO, Charles Thomas, was asked to resign after pressure from its significant shareholders (including two activist investors) for failing to innovate and to keep up with new technologies. Following Charles Thomas' departure, AC was successful in recruiting a new CEO, Dennis West, a well-regarded expert in the aerospace industry and who has worked for an industry prime based in the US for over 20 years, for an initial tenure of three years.
- Dennis West was quick to react to the shareholder backlash and within three months of his arrival was able to strike a deal with High Drones Inc., an American technology start-up, which has developed technology for a driverless air taxi called the *Haillicopter*.

High Drones Inc.

- High Drones Inc. ("**HD**") is an American technology company founded in 2008 by a group of four friends who were studying software engineering at the Palo Alto University of Technology. With financial investments from two Japanese high net worth individuals and the venture capital arm of Pratt & Martin (an industry prime and one of the world's biggest aerospace / defence companies), HD spent six years developing this revolutionary software for the *Haillicopter*.
- The software was successfully tested at Pratt & Martin's facilities in Colorado, which generated a great deal of interest in the industry. It was claimed that the *Haillicopter*, once fully developed and integrated, will be able to safely carry 30-50 passengers on a four-seven hour duration flight. Following successful testing, industry experts were expecting Pratt & Martin to acquire HD but that did not happen as Pratt & Martin reportedly wanted to focus only on defence manufacturing and space travels.
- In 2015, and after his appointment as the CEO of AC, Dennis West approached HD to acquire the company, which HD turned down. Dennis West had met one of the founders, Mark Cohen, of HD back in 2009 when the four founders were looking for investments and Dennis West has since been in touch with Mark Cohen, whom he has mentored over this period of time. The parties eventually agreed to enter into a joint venture with AC to develop, manufacture and commercialise the air taxi the *Haillicopter* through a joint venture company, AC Haillicopter Ltd.

Background

AC Haillicopter Ltd ("**AHL**") was incorporated in 2015 and received initial contributions of US\$20 million from each of AC and HD. Most of HD's contribution came from Pratt & Martin's venture capital arm.

Whilst AC brought its pre-existing network in Europe and Asia to the joint venture and its expertise in aircrafts (and engines), HD contributed the revolutionary software and technology that HD had previously developed in relation to flying autonomous vehicles. HD retained all the necessary intellectual property

registrations and patents it had registered during development of the software and technology and granted a licence to AHL to use the relevant technology for a royalty of US\$1 under a short form IP Agreement.

At incorporation, AHL also took out a working capital loan of US\$100 million from HSBC, with the bank requesting a guarantee from each of AHL's parent companies as a condition to making the loan. Given AC's status as a large listed company and its assets in the UK, it was agreed between the parties and then with the bank that

GENERAL BACKGROUND INFORMATION (CONTINUED)

AC would provide the necessary security in respect of this loan.

AC and HD each hold 50 per cent of the shares in AHL and their relationship is governed by a short form shareholders' agreement (the "**SHA**"), which was hurriedly agreed and entered into between the parties as AC was keen to make an announcement then. The SHA includes the following provisions:

- *Board:* the board of directors of AHL (the "**AHL Board**") consists of two directors from each of AC and HD, with AC having the right to appoint the chairman who does not have a casting vote;
- *Financing:* it allows for AHL to obtain third party financing but it does not contemplate any shareholder financing;
- *Dispute resolution:* any shareholder dispute should first be escalated to the "Monitoring Committee" (which comprises the CFOs and the GCs of each of the two shareholders). Failing resolution, it should then be escalated to the CEOs of AC and HD for determination. The SHA contains LCIA arbitration with London as the seat; and
- *Shareholder reserved matters:* an unusually short list of reserved matters, which covers: (i) alteration to AHL's share capital; (ii) change of name and scope of AHL; and (iii) variation to the IP Agreement.

(The SHA does not include any provisions in relation to transfer restrictions but given the success of the joint venture, AC has suggested that these should be included, but nothing has been agreed so far.)

Since 2015, AHL has expanded significantly and now employs: (i) over 60 software engineers and developers based in California; and (ii) 20 dedicated aeronautical engineers based in Farnborough (who are on a secondment from AC, at a cost). AHL prides itself on promoting a young, creative and inclusive culture and in 2018 it was recognised by the Aviation Times as one of the most upcoming companies to work for.

Recent flight tests have shown that the software to be used for the *Haillicopter* is at an advanced stage of integration, but it still requires some fine-tuning and further testing before it could be fully integrated for commercial use into the

aircrafts (which includes the airframe, manufactured by AC, and the engines, sources from third party).

AC does not build its own engines in-house. It purchases standard, high-tech engines from a third party and subsequently alters them to suit the specifications of each particular aircraft. It is an express term of the SHA that AC will provide Bold Boys SpA ("**Bold Boys**") engines for the manufacture of the *Haillicopter*, engines which AC has historically used for all its aircrafts. However, HD has recently discovered that AC entered into a contract with Romper GmbH ("**Romper**") for its aircrafts. HD has asked AC to confirm that the contract with Romper is not in relation to the *Haillicopter*, but has not yet received any confirmation.

Both AC and HD (and their respective shareholders) are generally happy with the achievements of the AHL joint venture to date, as it has been able to hit all milestones. This view was further endorsed by Pratt & Martin's CEO at the Farnborough air show in July 2018 where during a presentation he said, "*we are delighted to have seen the progress that HD and AHL have made to date and value enhancement for us, and are keen to further support them*".

HD has benefitted from AC's expertise in manufacturing and industry contacts, whilst AC acknowledges that it would never have been able to develop the software required for the *Haillicopter* without HD. In addition, the *Haillicopter* has generated positive publicity for both companies and AHL has received a small number of initial pre-orders from some of the biggest airlines in Europe and Asia, which wish to be early entrants into the new air taxi technology market.

On 1 August 2018, AHL was approached by Interline Limited ("**Interline**"), one of the biggest airport operating companies in Asia and which is AC's existing customer. Interline is interested in pre-ordering 500 air taxis provided that AHL agrees to modify the prototype of the vehicle to take off and land vertically (similar to a helicopter), so that there would be no need for new purpose-built runways, and it has asked for AHL to submit its final proposal by 30 September 2018. This represents a great opportunity for AHL.

It has been calculated that modifying the design of the *Haillicopter* to allow for vertical take-off would require a further contribution to the joint venture of US\$125 million. At the 15 August meeting of the AHL Board, the AC appointees on the AHL Board

GENERAL BACKGROUND INFORMATION (CONTINUED)

expressed that obtaining further financing from HSBC (or any other bank) in the current financial market where the interest rates are quite high would be expensive and they therefore have recommended that the two shareholders should make further investments in AHL to seize this lucrative opportunity from Interline.

The ACT appointees said that AC would be open to making a further investment into the business but given its extensive support and co-operation till date (and, given that, going forward more work would be done in Farnborough to integrate the software into the aircrafts and its role in securing Interline's interest), the investment should be at a 20 per cent discount to the share price at which AC and HD subscribed for in AHL at the time of its incorporation. However, HD is of the view that given the work done over the last few years, any further investment in AHL should be at a higher price (if not the same). No conclusion was reached.

The AHL Board went on to discuss expanding AHL's scope and working towards creating separate work packages, which would bring in revenue. The AC appointees proposed AHL should enter into strategic partnerships with Airbus or Boeing to supply the "auto-piloting" aspect of the software. The auto-piloting aspect will allow Airbus / Boeing aircrafts to have only one pilot and will significantly reduce any risk of air crash. The HD appointees were not supportive of this proposition and instead suggested that AHL should look to invest in the business of space mining, which one of the AC appointees on the AHL Board thought was a "preposterous idea".

The meeting took a sour turn and the directors agreed that it would be most efficient to escalate the matter to the Monitoring Committee for it to discuss the matter in relation to Interline (and external financing), auto-piloting and space mining to the Monitoring Committee, which has agreed to meet on 8 September 2018.

High Drones Inc.

Confidential information

1. HD's board of directors (the "**HD Board**") was surprised by the turn of events at the AHL Board meeting, which it thought could have been easily resolved at the AHL Board level. The HD Board suspects that AC will seek to negotiate greater decision making power and an increased shareholding in the joint venture company in exchange for giving further security and a new guarantee in relation to the new loan. In principle, the HD Board accepts that AC will take on further equity in exchange for greater financial risk, but wants to keep this to a minimum and this further investment should be at least at a 10 per cent premium to the share price at which AC and HD subscribed for in AHL at the time of its incorporation. In a worst case scenario, it could consider no premium. Also, if AC were to acquire another 10 per cent shareholding in AHL, it is likely to result in it being a "significant transaction" for AC under the Listing Rules that apply to AC and would thus require AC to make an announcement on the London Stock Exchange. Any such announcement would require AC to set out the details of the investment (including price), which would not be ideal.
2. HD believes that the true value of the *Hallicopter* prototype lies in its software development, and is keen to stress this to AC in any negotiations.
3. The HD Board thinks that whilst a loan from HSBC (or any other bank) is relatively expensive, this is a good way to avoid any creeping control from AC.
4. The HD Board also thinks that, notwithstanding any further investment from AC, it should still have equal voting rights in relation to certain important decisions, for example, matters with a value over US\$15 million, and is therefore keen to include a number of new shareholder reserved matters. In addition, the HD Board would like veto rights in relation to any decisions taken in relation to software and aircraft (and engine) specifications.
5. At this stage, HD does not have any funds to invest in AHL and Pratt & Martin's venture capital arm is unable to make any firm commitment; however it has confidentially informed the HD Board that given AHL's success, its ultimate parent might be open to acquiring AHL in due course, but are conscious that AC are likely to resist. Both HD and Pratt & Martin have discussed this and they think that it would be a good idea to include either: (i) a pro-rata tag / drag-along right in favour of HD; or (ii) a put and call option in favour of HD and then work through it to gain control of AHL, such that AC's shareholding is reduced to sub-25 per cent. They also think that it would not be a good idea to do so until the Interline order has been placed, and in the longer run it should have a commercial agreement with AC for the European and Asian markets given its strong existing network there. The Interline order is crucial to demonstrate the success of, and investments in, the *Hallicopter*, and it would be fatal for the technology if the final proposal is not submitted by 30 September 2018.
6. HD and Pratt & Martin are also considering replicating the intellectual property developed by AHL for Pratt & Martin's use in the defence sector. However, they do not think that AC will allow for that to happen and are therefore considering if HD / Pratt & Martin should hire AHL's chief technology officer to take advantage of his learnings over the last two years.
7. HD strongly believes that AC's idea to sell the "auto-piloting" aspect of the software to the likes of Boeing / Airbus could result in them reverse engineering the software and introducing product which would compete with the *Hallicopter*, and therefore it wants to persuade AC away from such an idea. It also thinks that space mining would be a natural fit for its significant shareholder, Pratt & Martin, and could be revolutionary; Mark Cohen in particular is a big supporter.
8. Further investigation by HD has revealed that AC made the decision to change supplier to

High Drones Inc.

Confidential information (Continued)

Romper at a board meeting in 2017, due to the fact that Romper engines were cheaper, yet made in the same factory as the Bold Boys engines. The HD Board feels that AC should have consulted it before it decided to go with Romper and not Bold Boys, and it fears that if not opposed / resisted (as a matter of principle), this would create a bad precedent allowing AC to change key components / specifications without HD's consent. The HD Board is also keen to sign an agreement with AC providing that any losses stemming from any manufacturing defects in the aircraft / engines will be covered by AC. Other than this point, the HD Board is not interested in the manufacturing side of the *Helicopter* and does not care that AC is not using the Bold Boys engines.

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