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Private Equity Alert

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Weil News

- Glenn West and Sara Duran received a Burton Award for legal writing for their article "Reassessing the Consequences of Consequential Damage Waivers in Acquisition Agreements"
- Weil Gotshal received the IFLR America Private Equity Deal of the Year award for our work on Advent International's acquisition of Dominican airports manager Aeropuertos Dominicanos Siglo
- Weil Gotshal advised Advent International in connection with its acquisition of a 51% stake in the processing solutions business of Fifth Third Bancorp
- Weil Gotshal advised Aleris International (a portfolio company of TPG Capital) and affiliated debtors in connection with their $1.61 billion debtor-in-possession financing
- Weil Gotshal advised The Seafood Company (a portfolio company of Lion Capital) in connection with its acquisition of Pinneys of Scotland
- Weil Gotshal advised Summit Partners in connection with an equity investment in FleetCor Technologies to finance FleetCor's acquisition of Corporate Lodging Consultants

Recalibrate Your and Your Management Team's Thinking to Meet Today's Challenges

By Glenn D. West (gdwest@weil.com)

The current economic environment has put stress on traditional approaches to business decision making; and the legal advice that private equity professionals need to assist them in making rational business judgments in this environment is fundamentally different than the legal advice they need in a more favorable economic environment. Accordingly, private equity professionals need to recalibrate their thinking to adapt to the changed circumstances now confronting the portfolio companies for which they are responsible and seek reliable legal advice that has similarly been recalibrated.

Recalibrated thinking can enable private equity professionals to add significant value to the business decisions required to be made by their portfolio companies' management teams. Indeed, focused, "recalibrated" advice to a management team may ensure the continued viability – or the successful turnaround – of a portfolio company facing financial stress. Outlined below are just a few of the ways in which private equity professionals should recalibrate their thinking to assist their portfolio companies in today's economic environment.

- **Replace Blind Contract Compliance with Efficient Contract Compliance.** Most corporate cultures are appropriately compliance-oriented: "Perform your agreements and avoid any breach." While complying with the applicable law remains the operative watchword in any situation, your portfolio company may need to rethink the wisdom of strictly complying with all of its contractual obligations. Too often, a company facing a crisis continues to perform under an onerous contract without considering the possibility that a review of that contract may reveal opportunities for an "efficient breach"; i.e., a situation in which not performing and bearing the consequences of the breach may actually be less costly than performing and avoiding the breach. The law of contract in most cases compensates non-breaching parties for the breaching parties failure to perform, but does not compel performance. While considering such a review may be counter-cultural, conducting such a review may be a prudent, cost saving and fiducially responsible exercise, even after taking into account the cost of any outside counsel necessary to confirm that the consequences of a particular breach will indeed be "efficient."
- **Get a Second Opinion to Make Sure There Really Is a Crisis.** Most people diagnosed with a serious illness would obtain a second opinion from another doctor before undertaking an aggressive course of treatment prescribed by the

doctor who made the diagnosis. Yet, many portfolio companies pursue irrevocable courses of action based on their long-term, local counsel's assessment of their options in what has been determined to be a crisis situation. Before you decide that your portfolio company defaulted on that credit agreement or bond indenture and has no choice but to seek a costly consent, pay a little extra and seek another opinion from a law firm that specializes in that area. You may be surprised to learn that the company's diagnosed serious illness was seriously misdiagnosed.

- **Conduct a Documentation Audit.** When a crisis hits, it is too late to get the missing signature page or the promised collateral that a counterparty has committed to provide. Too often, in the middle of a crisis, when legal documents matter the most, it is discovered that they don't do what your portfolio company's management or you believed they did. Most times courts really do enforce agreements as written, so making uninformed assumptions about the content of those documents can yield very serious consequences. So, conduct a documentation audit and make sure there are no surprises lurking in the company's material agreements that can exacerbate the magnitude of any ensuing crisis. Never assume that what you or your portfolio company's management think the agreement says is actually what it says or means.
- **Review Existing D&O Policies.** An audit is equally important in the D&O insurance arena. Policies obtained on advice of brokers at the lowest prices may lack important endorsements that could seriously affect the value of the policy to the portfolio company's board and its officers if there is an insolvency or bankruptcy. Too often counsel was not consulted in obtaining the policy or any endorsements thereto. Review your D&O policies well in advance of a crisis.

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- **Plan for Crisis.** A crisis, by definition, is an extraordinary, major event (or even perception) that threatens the ongoing viability of a company. A challenge threatens the same consequences, but is mitigated by planning and foresight that prepared the company to deal with the situation in a way that gave it prospects to actually avert the situation's escalation into crisis. Planning for crisis requires taking stock of the business arrangements that could be affected by adverse financial developments. For example, are there cross defaults or ratings triggers? What potential covenants could be implicated by your portfolio company's most recent projections, and when might your portfolio company "hit the wall?" What are the company's "must have" arrangements, as opposed to the ones they have but wish they didn't? Are there actions that the company can take now that will lessen the impact of a crisis later? *Failure to plan for a possible crisis is the number one mistake that businesses make.*
- **Act While You Still Can.** Businesses tend to delay acting on a foreseeable crisis until it has matured into an actual current crisis. At that point, actions that the businesses could have taken in anticipation of, or to potentially avoid or soften the impact of, the crisis are simply interesting theoretical "what ifs." A classic example of this is undrawn lines of credit. Lines of credit are there to provide liquidity when needed. So, if there is no current need for the cash, the conventional thinking goes, there is no need to tap the line. After all, why pay interest on funds sitting in an account drawing no or negligible interest in comparison? The problem with this conventional thinking is that it needs to be recalibrated in challenging times. For example, many lines of credit require, as a condition to their being drawn, that the company's chief financial officer certify that no material adverse change has occurred respecting the company since a specified date. While the company's chief financial officer may be confident making that certification today, has he or she considered whether he or she would be confident making that certification when the money is actually needed?
- **Make Sure You Preserve Your Cash – You Will Need Cash for Almost Anything You Want To Do, Including Filing a Bankruptcy or Insolvency Proceeding.** It is a popular misconception that filing insolvency or bankruptcy proceedings is a result of the company effectively having gone broke. If your portfolio company has in fact gone broke, bankruptcy or insolvency proceedings may have little benefit. It actually takes cash resources to navigate through a bankruptcy or insolvency proceeding effectively and successfully. Make

sure your portfolio company doesn't wait until their cash resources are exhausted to consider their restructuring alternatives.

- **When Others Have a Liquidity Need, Cash May Be Worth More Than Face Value.** Conventional thinking is that cash is cash. If I owe $100, I need $100 to pay that debt. If your portfolio company's counterparty is facing a liquidity need, however, an offered prepayment of cash at a discount to the face liability may generate more interest that they might otherwise have imagined. This may be the ideal time for your portfolio companies to use the market discounts available to de-lever or buy their way out of bad deals.
- **Planning for a Possible Bankruptcy or Insolvency Proceeding is Not Necessarily Conceding Defeat and Does Not Thereby Become a Self-Fulfilling Prophecy.** Normal thinking is that bankruptcy or insolvency proceedings are an end-of-the-world scenario. Although they may well be a last resort for the company itself, they can sometimes provide significant benefits. Moreover, a bankruptcy or insolvency proceeding (which can include "prepackaged," or "pre-negotiated" Chapter 11 plans or asset sales, as well as an out-of-court restructuring in the face of the possibility of a court filing) can be a means of effecting a transaction that is beneficial to the constituencies to whom the board of your portfolio company may be accountable and which could not otherwise be consummated. Recalibrating your thinking allows for the possibility that a bankruptcy or insolvency proceeding of a subsidiary, for example, may actually be beneficial overall to the company. Equally important, *planning for such a contingency makes your thinking much clearer on how to avoid it, and may lead to an understanding of how specific decisions may bring you closer to or further away from it.*

The space provided for this article did not allow for a complete list of all of the ways in which private equity professionals should recalibrate their thinking to meet today's challenges. But remember that recalibrating your and your management team's thinking requires you to focus on what is *possible*, not just what has always been done.

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