Business Finance and Restructuring

Looking ahead to 2017
Major legislative changes

Reform of English corporate insolvency framework
The Insolvency Service is reviewing responses to its consultation on significant reforms designed to improve the restructuring tools available to companies. These include:

- a new pre-insolvency temporary moratorium – lasting for three months, with the possibility of extension;
- helping businesses to continue trading through the restructuring process, by preserving essential supplies;
- developing a new flexible restructuring plan, which would enable a rescue plan to bind secured as well as unsecured creditors and introduce a cram-down mechanism (whereby the court would have the discretion to overrule dissenting classes in certain circumstances); and
- exploring options for rescue financing, including super-priority status and the ability to override negative pledge clauses.

We expect the government to push this forward in 2017, particularly given the opportunity for reform presented by Brexit and the Conservative Party’s manifesto pledge to be in the top five worldwide in the World Bank’s “Doing Business” rankings by 2020.

Recast EC Insolvency Regulation
The updated and extended Insolvency Regulation will enter into force on 26 June 2017.

- It contains substantial reforms, including:
  - more prescriptive rules on centre of main interest (COMI) – a company will not be able to rely on the “registered office” presumption if it has shifted its COMI within the 3 months before opening insolvency proceedings;
  - extending the scope of the regulation to apply to pre-insolvency and rescue proceedings in various jurisdictions (but note that schemes of arrangement remain outside the scope of the regulation); and
  - the introduction of co-ordination proceedings for groups of companies.

New Insolvency Rules
Significantly modernised and consolidated Insolvency Rules will apply from 6 April 2017. Unusually, the new rules will apply to all cases (absent a specific savings provision).

Pre-pack pool
The operation of the revised SIP 16 and pre-pack pool will be kept under review. After a slow start, the pool appears to be settling into its stride – but will this be sufficient to address past concerns, or is legislative intervention needed?

Market Outlook
The relatively low level of restructuring activity in Europe has been driven primarily by supportive monetary policy and the impact of QE. Strong financing markets at low interest rates supported many corporates that would be restructuring in less benign conditions. This may start to change in 2017. The US interest rate cycle has turned. The US Federal Reserve has just raised interest rates and the market, at the time of writing, is predicting 2-3 further US interest rate hikes in the course of next year. The dramatic dollar strengthening in 2016, coupled with rising US rates, will have an impact on Europe, as well as, most significantly, in emerging market dollar debt. S&P expects the 12 month default rate for speculative-grade European corporates to increase modestly to 2.1% by the end of September 2017.

The impact of the Trump presidency will no doubt extend beyond US borders, raising concerns for renewable energy companies and manufacturing suppliers to US companies, for example. Notwithstanding the firming up of oil prices amid commitments from oil producing countries to cut global production by around 2% we expect a continuation of large-scale oil and gas restructurings in 2017. We expect emerging markets restructurings into 2017 and more generally across shipping and some natural resources businesses.

The state of the high-yield market has allowed companies to stave off more shareholder-unfriendly restructurings (at the price of greater leverage) – but Brexit/US uncertainties could contribute to further weakness and see familiar names come back around.

The lack of maintenance covenants in the prevailing cov-lite environment means creditors may be stuck on the side-lines as debtors’ financial position worsens and enterprise value continues to drain. The market will have to rely on management and financial sponsors to be sensible in identifying situations where they need to engage with their creditors (and bearing in mind variances in directors’ duties across different jurisdictions).

We anticipate further “toggle restructurings”, in which alternative restructuring plans are proposed simultaneously and “Plan A” is implemented if the requisite conditions are met but, if not, the restructuring automatically switches track (or “toggles”) to implement “Plan B”. Large scale multiparty debt restructuring remains a huge challenge to manage in Europe outside a court process and we do expect continued attention to court alternatives, for example Chapter 11.

The drive to increase scrutiny of schemes of arrangement, led by Snowden J, will no doubt continue in 2017. Parties must exhibit the utmost candour with the court and prepare to disclose all material facts which may be relevant, whether or not the scheme faces opposition. We also expect to see further instances of the “standstill scheme” seen in Apcoa, Metinvest and DTEK.

Financial pressures on care homes in the UK are mounting in light of rising costs (including the introduction of the Living Wage) and a lack of funding from local authorities. Parts of the financial services sector look vulnerable amidst weak profits, increasing costs and continued market uncertainty. The shifting European retail environment also presents potential restructuring candidates for 2017.

The Brexit effect?
The Supreme Court’s judgment on the “Article 50” case is likely to come in early January. Theresa May has pledged to trigger Article 50 by the end of March 2017, marking the start of a two-year exit process. The EC Insolvency Regulation and the EC Judgments Regulation will remain in force until Brexit occurs; what follows is up for negotiation. This has the potential to dramatically impact the UK’s restructuring and insolvency landscape.

Corporate governance
The government’s recent green paper on corporate governance reform attempts to give company boards and shareholders more responsibility for improving standards of business behaviour. Enquiries into BHS and Sports Direct highlighted shortcomings in this regard. We envisage a renewed focus on directors’ duties and emphasis on shareholders’ ability to hold companies to account on executive pay and performance, the implications of which will no doubt affect the restructuring market.
### Harmonisation

European harmonisation efforts will continue in 2017, as outlined below, although the extent (if any) to which these will apply in the UK will be up for negotiation as part of the Brexit talks.

#### European insolvency & restructuring law

Proposals to introduce certain R&I standards across the EU will continue next year, as the European Council and the European Parliament review the European Commission’s proposals (published on 22 November 2016). The Commission proposals focus on three key elements:

- common principles on the use of early restructuring frameworks, designed to help companies continue their activity and preserve jobs;
- rules to allow entrepreneurs to benefit from a second chance, as they will be fully discharged of their debt after a maximum period of 3 years; and
- targeted measures for Member States to increase the efficiency of insolvency, restructuring and discharge procedures.

#### Banking legislation reforms

The European Commission’s package of banking legislation reforms, released in November, is designed to “tackle remaining weaknesses” in the EU financial system. This includes changes to minimum requirements for eligible liabilities and own funds under the European Bank Recovery and Resolution Directive and a proposed new requirement for non-EU banks with a large EU presence to establish intermediate financial holding companies within the EU.

#### Non-bank financial institutions

Harmonisation efforts are also underway for the recovery and resolution frameworks for certain types of non-bank financial institutions. The European Commission has proposed new rules for the recovery and resolution of central counterparties. Also, the European Insurance and Occupational Pensions Authority has opened a consultation on the potential harmonisation of recovery and resolution frameworks for insurers.

### NPLs

Weil’s advice to KKR on the establishment of a revolutionary new Greek NPL platform in 2016 paves the way for the management of underperforming exposures in other jurisdictions. The uncertain fortunes of Monte dei Paschi di Siena (and its billions of NPLs) will no doubt affect the market in 2017.

### Case law developments

#### Lehman – Waterfall litigation

We expect judgment from the Supreme Court in the Waterfall I dispute in 1Q2017. The Court of Appeal will hear the Waterfall IIA and IIB appeals in April. Waterfall IIIA is going to trial at the end of January and Waterfall IIIB is likely to go to trial in September. Together, these cases will determine the fate of the c.£7 bn surplus in the estate of Lehman’s main operating company in Europe.

#### Schemes of arrangement

We expect the 2016 trend of heightened judicial scrutiny to continue into next year – generally and particularly as regards restructuring fees e.g. lock-up, co-ordination and work fees. Watch out especially for potential scrutiny of fees by reference to the purchase price of debt in the secondary market.

Watch out also for a continued focus on creditor domicile (in the context of the EC Judgments Regulation) – parties will need to identify not only what proportion (by number and value) of creditors are UK-domiciled, but also the exact basis on which they can be said to be UK-domiciled.

#### Cross-border recognition

The extent of assistance available under the Cross-Border Insolvency Regulations and common law principles of comity for e.g. Chapter 11 proceedings is a recurring theme in Weil’s practice. Watch out for cases testing the extent of “any additional relief” available in this regard.

### 2016

This year Weil...

- played a key role in the restructuring of Edcon, the South African retail group, in one of the largest EMEA leveraged deals of the year

- continued to advise Lehman, going to the Supreme Court to appeal the Waterfall I judgment, a dispute in relation to the distribution of c.£7 bn surplus assets in Lehman’s main operating company in Europe

- wrote an influential policy paper, together with Frontier Economics for the Association of Financial Markets in Europe (AFME), on European insolvency law reform, much of which was adopted by the European Commission in the form of the EU Business Restructuring Directive

- was consistently called on by long-time client KKR Credit to advise on significant cross-border transactions including on its investment in shipping loans and establishment of a shipping portfolio management company and on the establishment of a Greek NPL platform

- acted for a number of multinationals in their high stakes situations including: 1Malaysia Development Berhad on its dispute with IPIC; Endeavour Energy in its Chapter 11 bankruptcy proceedings; and BHS on its landlord company voluntary arrangements (CVAs)

- advised on the largest recent UK High Yield restructuring to date, the restructuring of EnQuest, the largest independent UK oil producer in the North Sea
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