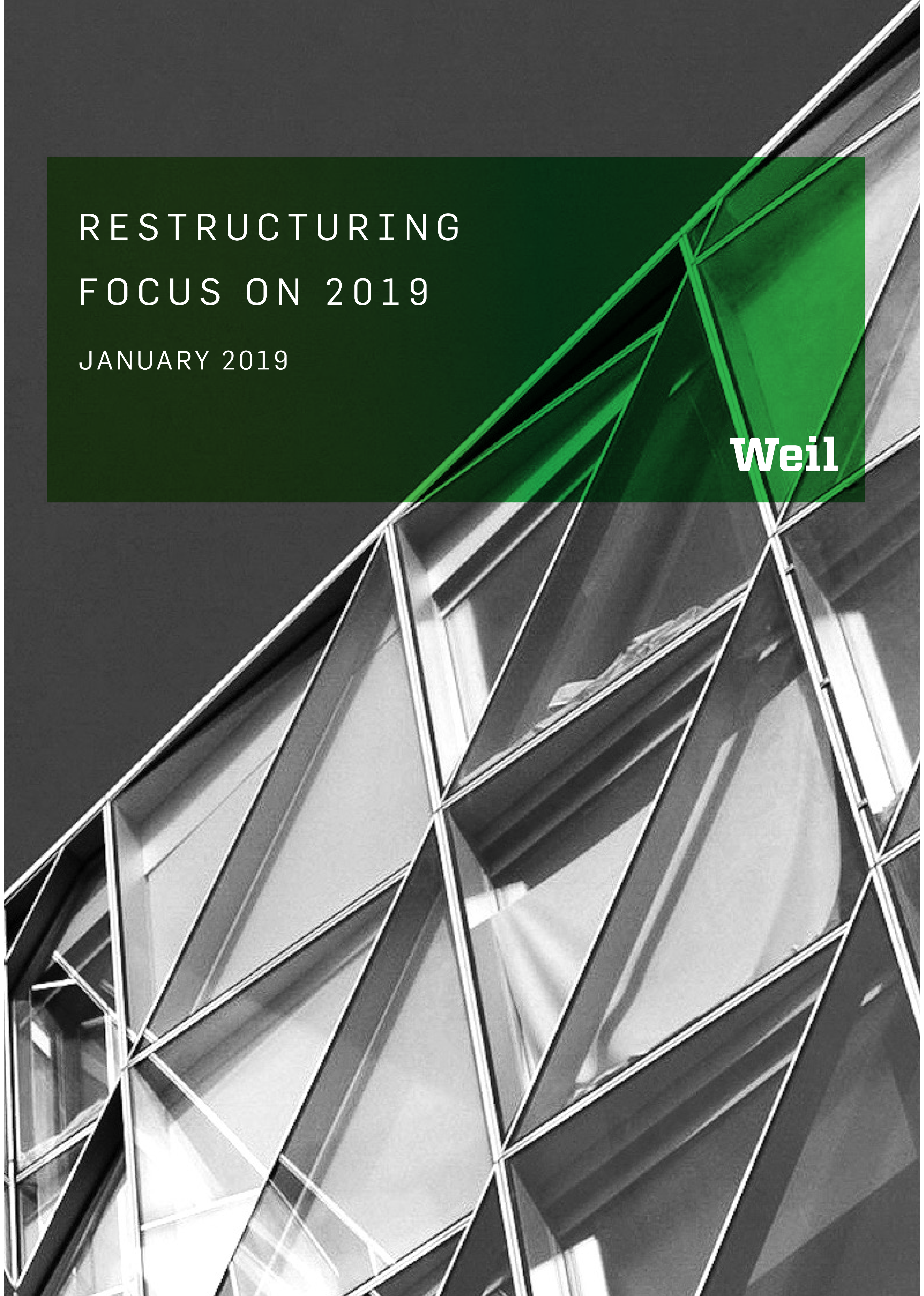
RESTRUCTURING FOCUS ON 2019

JANUARY 2019

Weil



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VIEW FROM THE TOP

With the spectre of Brexit looming large, the challenges and opportunities facing players in the restructuring market are both considerable and nuanced. Even outside the scope of Brexit, a number of complex commercial and legal developments are afoot which will require consideration when dealing with distressed situations in 2019.

With a flourishing DIP financing market in the US, financiers are increasingly looking to Europe's distressed situations and presenting innovative structures to find another market in which to invest their capital and to explore new ways to enter the distressed credit market.

The effect of standardised intercreditor agreements has not solved the uncertainty of how to deal with key provisions in a restructuring. Stakeholders should be looking to identify the pitfalls and opportunities such provisions afford, at an early stage, in order to reduce significant risk or increase advantage.

A notable development in global restructuring is the increase in dissenting stakeholders seeking to use governance concerns to attack unfavourable restructuring proposals. The Claire's Accessories bankruptcy highlighted debtor tactics that can be used to mitigate such claims. On the other side of the same coin, creditors focus on governance and the spectrum of options that can be considered is broad. In these circumstances the impact of negotiation is critical to the restructuring.

The long overdue movement to reform UK insolvency rules has taken a significant step with BEIS issuing its response to certain consultations in the Autumn of 2018. Weil's view is that such reform is necessary if we are to protect the economy from another Carillion-style failure. A Chapter 11-like alternative to a CVA or Scheme has been suggested.

Brexit, if there is one, provides an added complication. Although a moving target, our take is that the UK is at risk of losing its status as a desirable restructuring hub if every effort to find a suitable replacement to the EC Insolvency Regulations is not made during the transition period. A hard Brexit will be very damaging in this respect.

At the same time the EU is introducing new reforms, with some member states pushing these changes through early in the three year implementation period. Key changes include: a new chapter 11-style process, a cram-down mechanism and, new money protection.

In 2018 our team:

– Was called on by **Westinghouse Electric company**, a subsidiary of Toshiba Corp, in relation to is $9.8bn Chapter 11 proceedings, together with our US and European colleagues

– Acted for an ad-hoc committee of bondholders on the restructuring of **ENQUEST**, the largest UK Oil producer in the North Sea

– Played a leading role on the restructuring of **Claire's**, the accessories and jewellery retailer

– Advised on **EDCON'S** high yield bond restructuring and exchange offer, backstopped by a South African Scheme of Arrangement

– Was instructed by the joint provisional liquidators of **Abraaj Investment Management Limited**

– Advised long-time client **Pillarstone** on the restructuring of health care services provider Famar SA and its subsidiaries

– Acted for the Ad Hoc Committee of noteholders in relation to the **Dana Gas** high-profile sukuk restructuring

– Advised **Netcare International SA** in relation to the restructuring of General Healthcare Group

NEW MONEY CONSIDERATIONS – SOMETHING FOR ALL INVESTORS?

LIQUIDITY AS FLASHPOINT

– Cov-Lite / Bond deals with minimal covenant protection mean the liquidity/ maturity wall is often the flashpoint for negotiations

– The maturity wall can be brought forward if auditors need visibility on refinancing / repayments to be able to provide a "going concern" opinion

– There is now a burgeoning market for third party financiers to play a role in delivering bridge financing providing such investors with potentially significant strategic and / or economic advantage

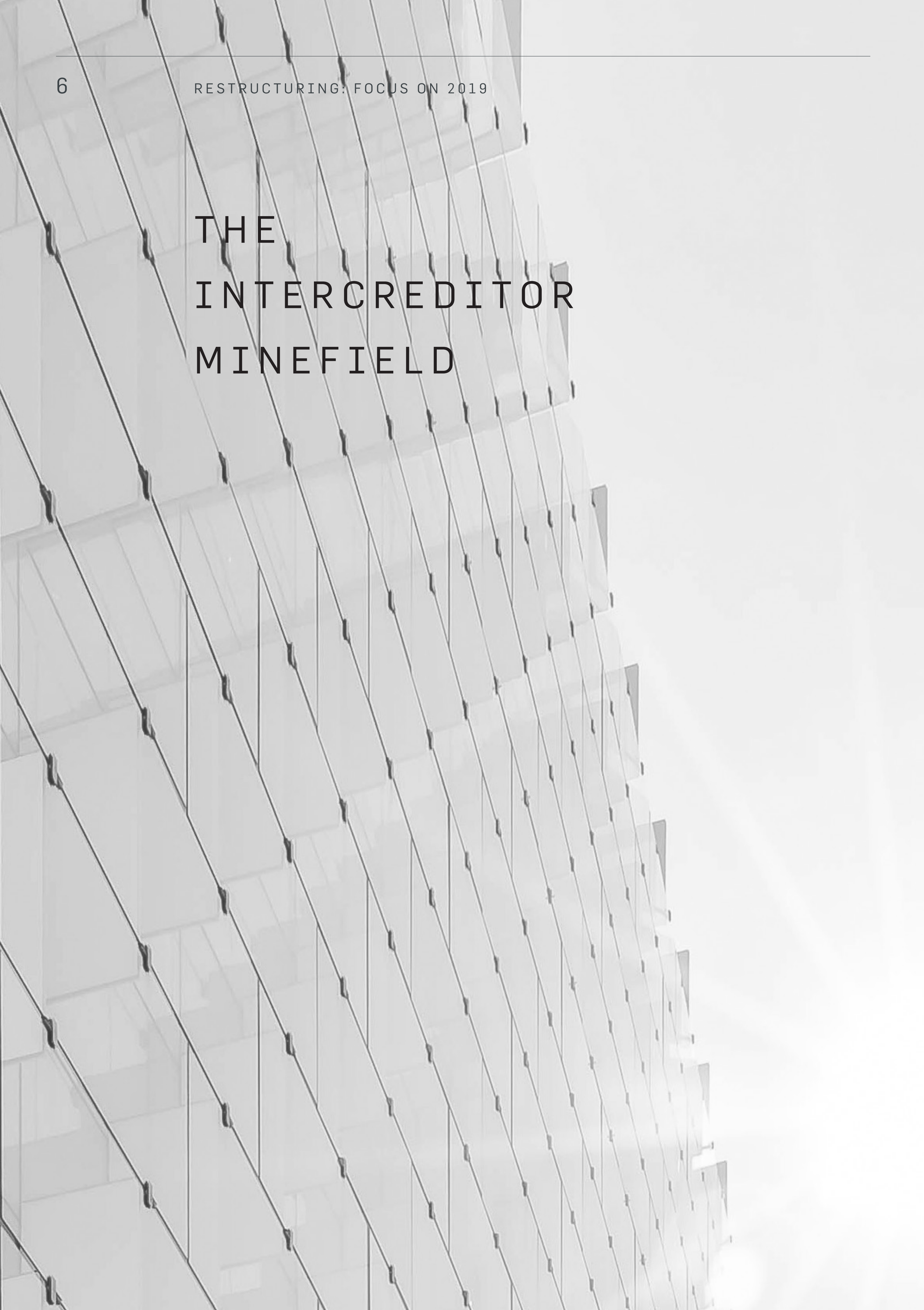
MAXIMISING THE STRATEGIC OPPORTUNITY

– Reconsidering information rights and flows when new money is provided
– Conditioning new money on reformed governance of debtor, minimising disruption from uncooperative sponsors / other creditors for the benefit of the restructuring process
– Dictating a timeline of process going forward, and veto rights over process (governance, contingency planning, etc)
– Ensuring a 'seat at the table' which different investors use in different ways (e.g. loan to own investors, strategics)
– From the point of view of the company / board it is crucial to secure a supportive creditor in a strategically relevant position of the capital structure (e.g. to remove potential default triggers and gain the benefit of positive undertakings to support a company-led transaction)

TYPICAL STRUCTURING CHALLENGES

– Factual circumstances determine the ability of a distressed group to incur further indebtedness. However, given the increased degree of standardisation in terms of debt documentation across the market, there tends to be a number of common solutions presented:
    – raising debt at non-obligors, which debt would rank structurally senior to the existing debt and secured over separate collateral
    – raising debt at an "unrestricted" subsidiary outside the restricted group after transferring assets to the unrestricted subsidiary using investments baskets in the existing debt (the "J. Crew" Option)
    – raising debt at obligors secured by assets that do not form part of the security package securing the existing debt
    – tapping existing baskets and refinancing / upsizing super-senior facilities

– Visibility on the restructuring process, or at least certainty of repayment of bridge, is often difficult as liquidity needs may arise early in a process when a restructuring plan is not yet developed or agreed
– Director duties can also drive the approach to the new money, including in relation to:
    – the commercial terms of such new money and the identity of the provider
    – how such funds are distributed to other group entities
    – even the question of whether new borrowing is preferable to simply defaulting on financial indebtedness (together with a formal or de facto standstill) – or other routes to access funds (disposals, capital raise, etc)



THE INTERCREDITOR MINEFIELD

Despite the LMA producing standardised intercreditors for the most commonly used capital structures, many of the key provisions in intercreditors are not predictable and can be complex to negotiate. Notably, distressed disposal provisions can vary significantly and this can present either great opportunities to advance preferred implementation routes or can operate so as to completely restrict options. The challenges presented by these provisions are often not clear from the descriptions provided in Offering Memoranda. Therefore, the ability to diligence these matters ahead of acquiring a position in the debt can be limited.

DISTRESSED DISPOSALS

- Typically, the distressed disposal provisions appear to authorise the Security Agent to release security / guarantees and liabilities provided the criteria for a "Distressed Disposal" are met and provided any value protection provisions (e.g. market testing) have been adhered to. However, we have seen over the last 12 months a surprisingly broad range of divergence including ICAs that:
  - Require further instructions from the Instructing Group to release guarantees
  - Require further instructions from the Instructing Group to release security
  - Require no further instructions from the Instructing Group for any matter and indeed allow for a Distressed Disposal to be implemented by the Group with only the support of one class of creditor
  - Do not allow in any instance the release of primary borrowing liabilities without consent of all relevent creditors
- These idiosyncrasies have proven to be significant and the ability to implement transactions has turned on these provisions, either by enabling a work-around by disenfranchising a dissenting class of creditors or by ensuring that the Instructing Group have the final sale in any sale process

VALUATION ISSUES

- Despite the development of standardised debt documents, issues around the acceptability of non-cash consideration, the need for market testing and / or a valuation in the case of a distressed disposal for cash, and on what terms a Security Agent is entitled to demand reliance on valuation work are not uniform and can prove to be significant hurdles when approaching a restructuring
- In addition to these documentary items, ensuring the Security Agent is comfortable with the process, and in the case of any valuation, has reliance on it, ensures a smooth transaction and provides a greater degree of certainty of execution
- There are two, seemingly contradictory trends, that we have noticed emerging when considering the role of the Security Agent. The first is that there have been a number of incidents where it appears that Security Agents have been persuaded to take steps that favour the sponsor or the company which have later impacted the ability of creditors to execute an optimal restructuring process. The second is that, perhaps as a response to that first point, other Security Agents are becoming excessively conservative in their approach and are holding-up implementation of fairly standard restructuring steps in order to obtain indemnification and other protections. It is not really a surprise to us that, against this backdrop, the identity of the Security Agent in any transaction is now a matter of key importance and that newer entrants to the agency market, who focus on acting both pragmatically and commercially, are routinely being appointed on new deals and replacing agents on deals in restructuring situations

OPTION TO PURCHASE

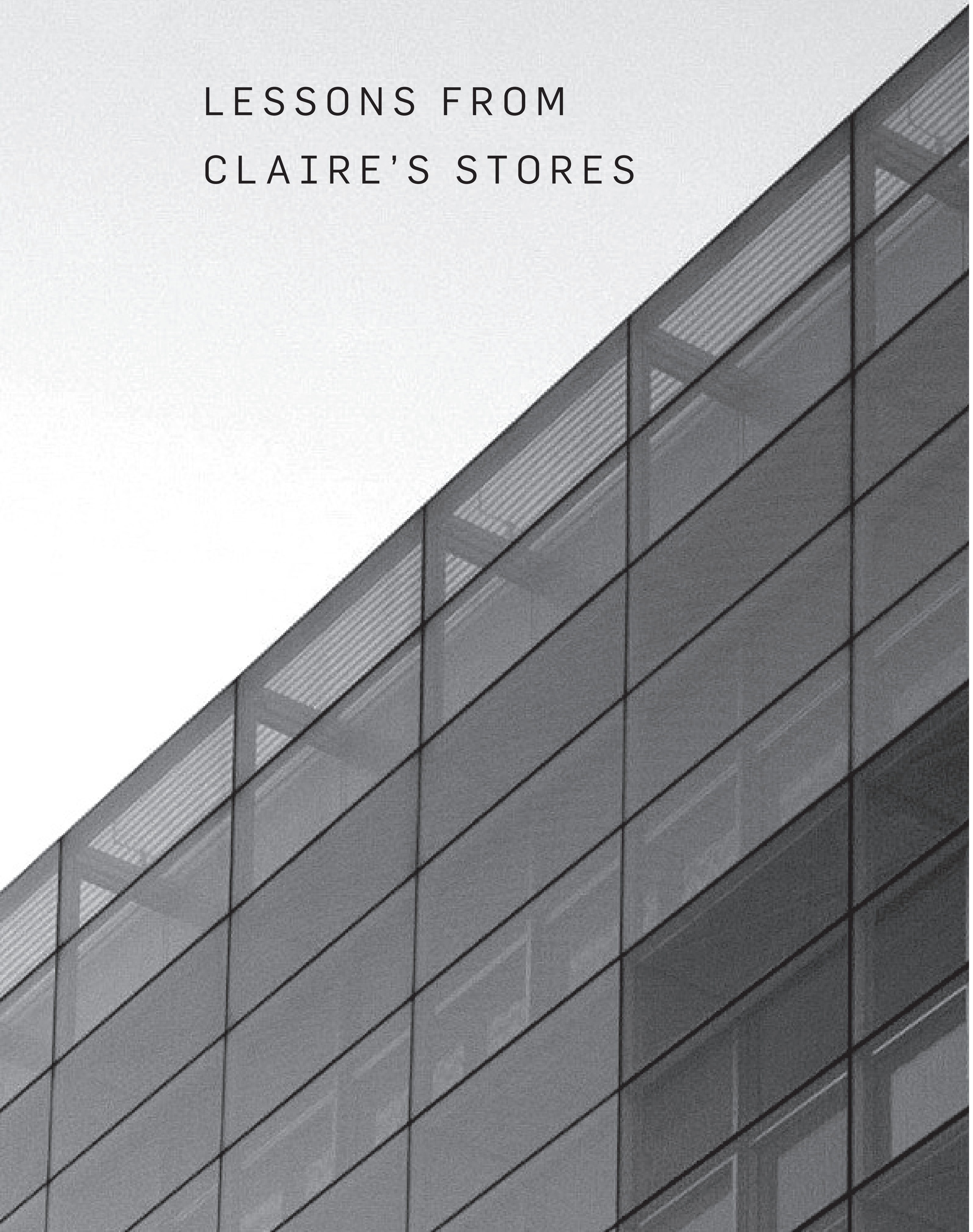
Although a provision that has recently received attention from the LMA to remedy some historic ambiguities, older Intercreditor Agreements often include option to purchase provisions which suffer from drafting issues that render them almost impossible to implement, for example:

i whether the right is granted to junior creditors collectively or individually;

ii the call option exercise notice period being longer than the period of any junior creditor consultation / notice of enforcement,

iii being drafted such that compliance with the senior facility's transfer provisions (including, e.g. the requirement where applicable for borrower consent) is required making them inoperable post-default

LESSONS FROM CLAIRE'S STORES



Claire's is a leading mall-based retailer with approximately 7,500 worldwide locations and more than 17,000 employees. By late 2017, Claire's was facing liquidity issues and a potential "going concern" default in connection with its more than $2bn of debt. At the time Claire's was held by a private equity sponsor who also held more than $50m in debt following a liability management exercise. In March 2018, Claire's filed for Chapter 11.

THE CHALLENGE

- Dissenting Creditors seeking to de-rail the Chapter 11 process sought to claim that the decision-makers at the debtor were not independent and were essentially acting in the interests of their sponsor not their company or the company's creditors

- Challenges raised were not simply around the substance of decisions but also attacked the process by which decisions were made

- Underpinning the challenge was NY jurisprudence that bankruptcy proceedings should not only be conducted correctly but must be seen to be conducted correctly

- In the UK there has been increased focus on governance and recent case law has considered claims of shadow directorship and self-dealing / fair-dealing when junior creditors sought to attack senior driven governance reform as a proxy for attacking the proposed restructuring

CLAIRE'S RESPONSE

- Recognising the distressed state of the business would likely lead to the making of difficult decisions, the board formed a committee consisting of the CEO and the most senior independent director

- The committee was tasked with evaluating, developing and ultimately recommending restructuring matters

- A junior creditor sought to claim that the committee was acting in the interests of the equity sponsor

- To ensure the integrity of its restructuring process, Claire's added a further independent director to the committee and delegated full decision-making authority to the committee

LESSONS

TIMING
- Be proactive. Independent governance should be established as early in the process as possible

LOCATION
- In a distressed situation identifying key boards (which may not be the usual management board) will be critical

- Director duties across jurisdictions are not identical and understanding these differences is critical to developing proper procedures

SCOPE
- The extent to which authority is delegated to a committee or board will need to be carefully judged in each situation

- The scope of appropriate authority may need to evolve over time – governance should not be viewed as being static

EXPERIENCE
- Board duties in the context of a restructuring can often escalate beyond normal director responsibilities

- Appointing independent directors with specific restructuring or financial experience can often provide substantial value

PRECEDENT
- A "one size fits all" approach to corporate governance will not be successful

- A proactive but nuanced strategy can facilitate outcomes for stakeholders

GOVERNANCE – THE SPECTRUM OF OPTIONS

GOVERNANCE ISSUES

– Sponsors and incumbent directors may seek to use their control / visibility over a business to direct or hinder a much-needed financial restructuring

– Creditors of a distressed business are focused on enhanced information flows and may wish to frustrate disruptive sponsors' control

– Other stakeholders, such as regulators and supervising courts, may be focused on ensuring information integrity and good stewardship

KEY FACTORS FOR OPTIMAL GOVERNANCE

VISIBILITY / CONTROL Information flow, quality / integrity of information, identity of recipients, public vs. private side considerations

LIABILITY Mitigate director liability or shadow directorship risks alongside other lender / sponsor liability issues (including reputational issues)

IMPLEMENTATION Ensure management attention is focused on operational issues and that the restructuring is managed by people with appropriate expertise and enhances confidence / trust of other stakeholders in the restructuring process. Governance changes can be consensual as part of a negotiation or can be achieved by creditors exercising security rights to change boards and vote pledged shares.

	ENHANCED INFORMATION COVENANTS	BOARD OBSERVER / ADVISORY COMMITTEE	NON-EXECUTIVE DIRECTOR / RESTRUCTURING COMMITTEE	CHIEF RESTRUCTURING OFFICER	SELF-APPOINTMENT	APPOINT INSOLVENCY PRACTITIONER
SUMMARY	13 week cash flows; litigation reports; regulatory and other stakeholder communications	One or more non-director, stakeholder-appointed advisors whom the board is obliged to consult	One or more directors appointed, often as part of a committee, which lead restructuring discussions with stakeholders	Stakeholders nominate professional chief restructuring officer	Stakeholder personnel appointed as directors	Stakeholders appoint insolvency practitioner
DISRUPTION	Least disruptive	Low disruption	Moderate to high disruption	High impact; likely to be disruptive; more likely to attract concern / publicity	High impact – may result in change of control and publicity	Typically terminal for board / sponsor control
VISIBILITY AND CONTROL	Greater visibility but not control	Greater visibility and 'soft control'	Enhanced visibility typical; often used to oust sponsor appointees	Enhanced visibility typical; often used to oust sponsor appointees	Maximum visibility and control	May not provide visibility or control, but insolvency practitioner typically owes duties to creditors
OTHER		Typically creditors provide slate of candidates and Company chooses	Typically creditors provide slate of candidates and Company chooses	Nature of role dictated by business need, eg operational, financial creditor interaction; appointment and tenure can be imposed	Management of conflicts may be challenging Director and shadow director liability issues	Senior creditors may have some input into the choice of insolvency practitioner

CHAPTER 11 FOR THE UK? BREXIT AND UK INSOLVENCY REFORM

NO DEAL BREXIT

As things currently stand on the date of publication, a no deal Brexit remains a real risk. The potential loss of UK participation in the EU Insolvency Regulation, whether in a no deal Brexit, or expiry of the transition period, is a real threat to the UK debt restructuring regime, particularly for EU high yield issuers.

WEIL VIEW

UK insolvency proceedings and schemes (including obtaining US Chapter 15 recognition) will become more difficult, COMI shifting may no longer be attractive. There is a real risk of parallel insolvency proceedings in EU jurisdictions and interference by foreign officeholders in assets held abroad. However, recognition for schemes of arrangement for restructuring of EU companies should be available based on comity and reciprocity, as was the case pre-EU regulation. Attention is likely to focus on the use of other EU jurisdictions where recognition measures are designed to facilitate restructuring of EU debtors, such as Ireland.

UK INSOLVENCY REFORM

In 2018, the UK government also put forward its own proposals for insolvency reform, introducing the following concepts:

A NEW RESTRUCTURING PLAN PROCESS WITH A CROSS-CLASS CRAM DOWN MECHANISM

- A new type of restructuring plan providing a way to cram-down classes of non-consenting creditors (not possible under a CVA or scheme)
- Will not replace the CVA or scheme but will be an alternative / additional restructuring route
- Similar to a scheme (i.e. 75% by value), but instead of the scheme's further voting threshold of 'a majority in number', a majority in value of unconnected creditors test (similar to the CVA rules) will apply
- In terms of a comparator, approach is similar to the approach taken in US Chapter 11 (e.g. is based on the 'next best test'), rather than the traditional approach in English schemes of using a liquidation comparator which may give rise to disputes on the often controversial question of valuation
- Different to Chapter 11, it is not intended to be available for capital markets companies, limiting the value of the reform. Also has yet to be decided whether process available to companies with no COMI in England

SELLING A DISTRESSED BUSINESS

- Insolvency Service to get new powers to investigate directors of dissolved companies and to disqualify directors "who unreasonably sell insolvent companies"

MORATORIUM

- Establish a standalone moratorium for pre-insolvent companies (i.e. not yet insolvent but will become insolvent if action is not taken)
- Criteria to include a requirement that the company is able to carry on its business, meet its current obligations as they fall due during the moratorium and new obligations that are incurred in the moratorium; and prospect of rescue more likely than not
- Not available if company has been in an insolvency process within 12 months Moratorium duration 28 days, extendable to 56 days
- Will require a court application. An insolvency practitioner and officer of the court will be appointed as 'monitor'. Such monitor will not be able to act as administrator or liquidator in any subsequent insolvency process (but can act as a CVA supervisor or advisor in relation to a Restructuring Plan)

INSOLVENCY EVENT TERMINATION CLAUSES (IPSO FACTO CLAUSES)

- A prohibition on the enforcement of insolvency event termination clauses in contracts for the supply of goods and services and contractual licenses when a company enters a formal insolvency proceeding, the Restructuring Plan process or a pre-insolvency moratorium
- In any subsequent administration or liquidation, counterparties will be entitled to super priority (including pre-insolvency moratorium costs) for post-insolvency claims and, in cases of hardship, may seek the court's permission to terminate a contract
- This will not prevent counterparties' from exercising other termination rights

EU INSOLVENCY REFORM: A CHANGING LANDSCAPE

EU INSOLVENCY REFORM

It is anticipated that the EU will formally adopt a new Insolvency Directive which will bring about changes to the EU restructuring landscape in 2019. Member states will have three years to implement, but it is widely expected that this will happen sooner. Key changes include:

NEW CHAPTER 11-STYLE PROCESS

– Based on Chapter 11. It is intended to enable proceedings to be opened for the benefit of solvent debtors who find themselves in financial difficulties. The debtors will remain in possession. Appointment of restructuring practitioners will be optional. The company to benefit from a moratorium preventing creditor action for a period of 4 months, which (provided certain conditions apply) can be renewed twice up to a maximum of 12 months

CRAM-DOWN MECHANISM

– The Directive introduces or confirms (for countries where similar provisions are already in place) the concept of creditor classes. Cross-class cram-down will be possible if certain conditions are met

NEW MONEY PROTECTION

– The directive mirrors the safe harbour model to encourage new financing already adopted in France, Spain, Italy and Germany, such that those creditors who provide new money in order for the debtor to implement the restructuring plan or to preserve value during the moratorium will not be adversely effected by any subsequent opening of insolvency proceedings. Member states will also be able to elect to provide for a priority ranking for such creditors in their implementing legislation

INDEPENDENT RECOGNITION

COMMENDED FOR RESTRUCTURING AND INSOLVENCY
THE TIMES
BEST LAW FIRMS 2019

FINALIST LEGAL EXPERTISE – INNOVATION IN MANAGING COMPLEXITY AND SCALE
FT
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