Restructuring and Insolvency

Carrying on with the subject of Restructuring and Insolvency, *Lawyer Monthly* speaks to Chad Griffin, Senior Managing Director and Simon Kirkhope, Managing Director at FTI Consulting.

The restructuring and insolvency market has evolved radically over the last few years. How have you seen the market change recently in your jurisdiction?

- Looking back to the start of the global financial crisis, an extension of existing facilities was a common restructuring solution.
- In our view this option is now becoming less attractive for both banks and their borrowers. Banks are under pressure to de-leverage and capital constraints mean that they often need to consider a debt sale alongside the restructuring options available. Furthermore, as the economy turns, borrowers are increasingly looking for capital structures which provide new money and sufficient flexibility to fund growth and investment.
- The high yield bond market continues to remain active and companies are seeking to take advantage of this where they can as an alternative to traditional bank financing.
- Continuing balance sheet pressures often mean that traditional lenders no longer have the risk appetite to finance companies which are stressed or distressed – instead hedge funds and alternative investors are an increasing source of capital in restructuring situations. With fresh capital to deploy to fund restructurings this can often be to the ultimate benefit of the company – simplifying existing capital structures, de-levering and providing new money to fund working capital, cost reduction and investment.

What do you think are the advantages and disadvantages of a restructuring as opposed to insolvency?

- In distressed situations in Europe, out of court restructurings tend to be the default choice as opposed to insolvency whenever possible. This is driven by a number of factors, not least the challenges presented by differing insolvency laws across European jurisdictions when dealing with large cross border situations. Despite a number of recent improvements to insolvency legislation in jurisdictions such as Germany and Spain cross border insolvencies still lack certainty and speed.
- Moreover, restructurings are seen as a better tool for preserving value, with insolvencies being value destructive and costly. The stigma of insolvency makes it extremely difficult to continue to trade on businesses post filing. Restructuring out of court helps maintain a 'business as normal' message in a bid to retain customers, suppliers and staff. Restructurings are far less likely to trigger default clauses in finance and commercial documentation. Crucially, they afford greater control of the process to the company rather than ceding control to an insolvency practitioner.
- However, out of court restructurings are certainly not the panacea for all situations. Due to the need for compromise by a wide range of stakeholders, they can take far longer than management expect, lasting many months and in some cases years. This can lead to deal fatigue, just at the very time when management should be focused on turning around the underlying business. Restructurings can often be expensive and costs of a prolonged restructuring process can significantly dilute overall stakeholder value.
- In our view insolvency has a key role to play. It is vital in any restructuring to have a robust insolvency plan, both as a fall back should requisite support not be obtained for the restructuring, and as the 'stick' to obtain the support needed.
- Insolvencies continue to be used frequently in real estate situations where concerns over the insolvency impact on trading are far less pronounced. Insolvencies can also be advantageous in certain cases including delivery of a more sustainable financial and operational restructuring than would be achievable consensually; to maximise value in exit situations and leaving behind onerous liabilities; liquidate unviable businesses; and as a mechanism to deal with hold-out financial creditors.

What challenges and complexities arise when dealing with insolvency and restructuring? How can you assist clients in navigating/solving these challenges and complexities?

- Every restructuring presents a unique set of issues and challenges to solve, from complex tax structuring, director's duties, defined benefit pension schemes, out of the money interest rate swaps to name but a few.
- In recent restructurings, intercreditor issues have probably presented the greatest challenges. Restructurings have always required the coalescing of views of a wide variety of stakeholders. We have seen increasing intercreditor disputes as lenders take fundamentally different positions over key topics such as debt levels, new funding and exit strategy. This is more often than not caused by internal lender institutional factors rather than differing views on the underlying borrower.
- Debt trading has become far more prevalent in large restructurings as bank lenders look to sell out due to continuing balance sheet pressures. Debt trading throws up complexities and potential areas of conflict around information provision, new funding, level of control, debt terms and advisors. Views can also be fundamentally different on the restructuring strategy itself with bank lenders targeting preservation and recovery of debt and sub-par lenders focussing on control, debt for equity conversions and exits.
- The role of both financial and legal advisors in such situations has become critical. With extensive situational experience, advisors can act as impartial, credible ringmasters in stakeholder negotiations and drive the restructuring to its conclusion.

How do you see this practice area progressing over the next 12 months and beyond?

- In Europe, we expect an overall decline in restructuring cases in the coming months on the back of an improvement in the wider economy. Although those businesses which have been capital constrained or those with greater working capital and investment requirements could face difficulties as they try to fund growth as the economy turns.
- We expect hedge funds and distressed investors to continue to target Europe, taking advantage of investment opportunities created by European banks as they continue to pursue deleveraging actions such as non-performing loan portfolio or single name debt sales. These investment opportunities are likely to involve either buying debt on the secondary market and pursing loan to own strategies, the purchase of loan portfolios or underwriting single name rescue refinancings. We expect these transactions to act as a catalyst for change and drive restructuring activity over the coming months. **LM**

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