KIRKLAND & ELLIS

Latest UK Restructuring Technology for Stressed / Distressed Groups

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At a Glance

Against the backdrop of increasing macro-economic pressures, this deck provides a high-level overview of restructuring solutions available to stressed or distressed European groups.

This includes the very latest technology for implementing financial and operational restructurings.

This deck focusses primarily on contractual and English law restructuring solutions, touching briefly on other European restructuring processes.

3 Key distressed inflection points — illustrative timeline

4 Out-of-court solutions

Including: opportunities within existing debt documents; amendments, waivers and forbearance; consensual restructurings; liability management transactions

5 "Capturing the discount"

The possibility of companies "capturing the discount" where their debt trades below par, via debt buy-backs

6 Restructuring plans and schemes of arrangement

7 Company voluntary arrangements

8 Staying creditors' claims

Administration and stand-alone moratorium

9 Other European restructuring processes

10 Kirkland's distressed, special situations and specialty lending senior team

Key distressed inflection points — illustrative timeline

Against the backdrop of huge macro-economic pressures, many businesses are under-performing against previous expectation and may become financially distressed. This chart shows typical distressed indicators and how to mitigate risks in this environment.

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For more information about mitigating risk in periods of distress, please contact us.

Distress indicators across phases

1 – Normal operations
- Trading meeting financial expectations

2 – Under-performance
- Trading downturn
- Tightening covenant headroom
- Failure to deliver on business plan

3 – Distress
- Liquidity squeeze
- Maturities in <12 months with no refinancing certainty
- Contingency planning exercises ongoing
- Possible covenant breaches

4 – Crisis
- Severe liquidity squeeze / burning platform
- Maturities in <3 months with no transaction certainty
- Insolvency practitioners engaged?

5 – Crisis management
- 'Lock up' / support agreement with key creditors prioritising stable platform to effect implementation
- Management supported / reincentivised

6 – Stabilisation & recovery
- Recapitalisation / refinancing completes
- New money infusion
- Potential deleveraging
- Trading meeting revised expectations

Risk mitigation across phases

2 – Under-performance
- Implement best practices
- Situational analysis
- Options assessment

3 – Distress
- Stakeholder engagement re options
- Liquidity solution implemented, if possible

4 – Crisis
- Implementation of preferred solution, if required / is possible
- Typically in tandem with programmed operational turnaround

5 – Crisis management
- Implementation of fallback solution, if earlier preferred solution not possible

6 – Stabilisation & recovery
- Implementation of operational turnaround
- Continued stakeholder engagement

Out-of-court solutions

Opportunities within existing debt documents

- We regularly assist companies in identifying potential opportunities in their existing debt documents, if any, such as available baskets, “off balance sheet” transactions, transactions with unrestricted subsidiaries or asset sales to enhance liquidity or extend runway.

Amendments, waivers and forbearance

- Companies may seek amendments to, or waivers of, existing debt documents where necessary e.g. covenant, reporting and/or other obligations.
- Companies may also seek forbearance agreements from financial creditors not to take enforcement action based on an impending default or event of default.

Consensual restructurings

- We regularly assist companies in negotiating fully-consensual restructurings, avoiding the need for formal proceedings. This generally requires unanimous consent of lenders or 75/90% consent of bondholders, if payment terms are being amended.
- The prospect of formal proceedings as a ‘Plan B’ often helps forge agreement to a fully-consensual solution.

Liability management transactions

- Increasingly, companies are pursuing out-of-court liability management transactions to address their capital structure goals.
- These transactions tend to be bespoke and require detailed legal and financial diligence to address the company’s goals while adhering to restrictions in applicable debt documents. In all scenarios, compliance with governing debt documents is key to mitigating risk while deploying strategies and pursuing transactions.
- Potential forms of liability management transactions include:
  - **“uptier” exchanges** – the most common form of which involves a company offering to exchange unsecured bonds for a lower principal amount of secured bonds that are either pari passu with or subordinated to the company’s existing secured debt (i.e., “1.5 lien” or second lien)
  - **“drop-down” exchanges** in which a company places certain assets into an Unrestricted Subsidiary or designates a Restricted Subsidiary as unrestricted, and then uses such assets as negotiating leverage, or collateral for new financing or new debt securities which are offered in an exchange
  - **“amend & extends”** which provide companies with a maturity extension in exchange for certain credit enhancements; a variety of “carrots” and “sticks” can be used to incentivise creditors to participate and reduce the risk of holdouts
  - **discounted debt buybacks** which involve the company (or a related party) repurchasing existing debt at discounted prices; see further next page

LEARN MORE

Kirkland has led the design of some of the most complex and novel liability management transactions completed in recent years. For more information about potential liability management transactions, please contact us.

“Capturing the discount”

Increasingly, bonds and loans of non-distressed companies are trading at a discount to par.

Companies and their sponsors/shareholders are able to take advantage of these discounted trading prices by carrying out buybacks and acquisitions by affiliates to achieve a variety of objectives.

Available options vary according to whether or not the company and/or its sponsor/shareholder have available cash, or an SPV that is able to raise new debt.

There are also important differences as between bonds and loans when considering capturing discounts, including:

- transfer restrictions;
- available buyback mechanics;
- whether a buyback offer must be made to all bondholders/lenders; and
- publicity considerations.

POTENTIAL CAPITAL STRUCTURE OBJECTIVES FOR CAPTURING THE DISCOUNT

- Reduce cash debt service requirements, i.e., interest, amortisation
- Delever
- Alleviate / remove financial covenant and/or audit pressure
- Prepare for a future liability management transaction or restructuring
- Efficient use of excess cash

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For more information about how companies and sponsors can potentially “capture the discount” where their debt trades below par, please contact us.

Restructuring plans and schemes of arrangement

- Restructuring plans and schemes of arrangement are procedures under the Companies Act by which companies can bind dissenting minority creditors and/or shareholders to a restructuring.
- Both procedures can facilitate a wide range of potential restructurings, including e.g. "amend & extend" transactions, debt for equity swaps, standstills, other compromises of contractual liabilities, etc.
- Critically, a restructuring plan can bind dissenting classes. This facilitates the option to include a broader range of stakeholders within the restructuring, e.g. operational creditors, tax authorities, landlords etc.
- Once the court sanctions the scheme/plan, it will be binding on all affected creditors and/or shareholders, including those that voted against it or did not vote.

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Kirkland lead the market on restructuring plans, pioneering innovative uses for this new tool. For more information on restructuring plans and schemes of arrangement, please contact us.

FEATURE	SCHEME OF ARRANGEMENT	RESTRUCTURING PLAN
Eligibility	No need to prove insolvency, but will require analysis of the alternate comparator if the scheme is not to go ahead, which will often be insolvency but may be e.g. an accelerated M&A process	No need to demonstrate insolvency, but does require evidence of actual or likely financial difficulties that are affecting (or will or may affect) the company's ability to carry on business as a going concern
	Open to (a) domestic companies and (b) foreign companies which can demonstrate sufficient connection with England (e.g., English law governed debt or with their centre of main interests in England). If a non-English company uses a scheme or plan, obtaining recognition of the proceedings in home jurisdiction will be key	
Process and control	Two court hearings required – convening hearing and sanction hearing Proposal may be launched by the company or any creditor or shareholder (among others) — but in practice, invariably launched by the company itself. Directors remain in control Court exercises a discretionary power to approve the terms of the scheme/plan — not a "rubber stamp"	
Scope and requisite approvals	Allows company to compromise creditors (both secured and unsecured) and shareholders Stakeholders segregated into classes for voting purposes, based on their current rights and potential outcomes for them post-restructuring	
	Each class must vote in favour of the scheme — at least 75% in value and a majority in number, of those voting, in **every** class	▸ For a class of stakeholders to approve the plan, at least 75% in value, of those voting, must vote in favour ▸ The plan may be confirmed by the court even where there are one or more dissenting classes, provided: – at least one class that is "in-the-money" in the relevant alternative to the plan has approved it; and – no member of a dissenting class would be any worse off under the plan than they would be in the event of the relevant alternative to the plan ▸ It is also possible to exclude "out-of-the-money" classes from voting on the plan altogether – as Kirkland recently pioneered in the case of Smile Telecom

Company voluntary arrangements

What is a CVA?

- A CVA is an insolvency process under the Insolvency Act by which a company and its creditors agree to compromise its debts.
- It is a powerful, tried-and-tested restructuring tool in the UK market, especially to restructure leasehold obligations to landlords (particularly in the retail, hospitality and leisure sectors). It can also assist with downsizing certain stores and changing the structure of rent payments.
- A CVA is a debtor-in-possession process with minimal court involvement; directors remain in control, though the CVA is subject to oversight from a licensed insolvency practitioner.

Who is eligible for a CVA?

- There is no requirement that the company be insolvent.
- Need to show that an insolvency is the most likely alternative if the CVA does not proceed. Valuation evidence needed to show that insolvency option is worse for creditors.
- Available to foreign companies in certain circumstances.

What claims can be compromised in a CVA?

- A CVA will bind all unsecured creditors, even if they did not vote in favour of the compromise.
- The company can select which of its unsecured liabilities it wishes to compromise under the CVA – including, for example, rent and other leasehold liabilities (including future rent – with the possibility of implementing turnover rents e.g. to manage seasonal variations in trading), business rates, contractual liabilities and intra-group claims.
- A CVA **cannot** be used to compromise the claims of secured or preferential creditors without their consent, but may be used in conjunction with another procedure (e.g. a scheme of arrangement or restructuring plan) to bind secured or preferential creditors.
- Note that HMRC now ranks as a preferential creditor in respect of VAT and certain other taxes; accordingly, those claims will not be capable of compromise in a CVA without HMRC's consent.

What are the voting requirements?

- All unsecured creditors vote on the proposal, whether or not their claims are compromised. They vote as a single class, unlike in a scheme of arrangement or restructuring plan.
- The CVA requires approval of at least 75% of unsecured creditors (by value, of those voting) and at least 50% (by value, of those voting) of unconnected unsecured creditors; connected party claims can vote and are included for the purposes of the first test. Secured creditors can vote for any portion of their claim that is under-secured.
- CVAs also require a shareholder vote (with members approving the CVA if more than 50% by value vote in favour), but the creditors' decision prevails.

LEARN MORE

Kirkland lead the market in advising debtors on company voluntary arrangements, continually developing use in response to evolving market conditions and the needs of companies and their landlords.

Kirkland partner Elaine Nolan recently co-edited the first practitioners' book on CVAs – 'Company Voluntary Arrangements: Law and Practice'.

For more information on company voluntary arrangements, please contact us; see also here on developing CVA technology.

Staying creditors’ claims: administration and stand-alone moratorium

- The procedures previously explored in this deck do not provide a standstill on creditors’ claims.
  - However, the English court has discretion as part of its case management powers to stay a hearing of e.g. a winding-up petition, and may be willing to do so where a company is in the process of restructuring – as recently successfully used by Virgin Active and Travelodge.
- Alternatively, a more formal stay can be obtained through use of administration or the new stand-alone moratorium — see right.
  - Use of the stand-alone moratorium has so far been limited to the SME market, in part owing to significant eligibility constraints.
- Additionally, companies can explore “time to pay” arrangements with tax authorities.

FEATURE	ADMINISTRATION	STAND-ALONE MORATORIUM
Eligibility	▸ Directors/company can voluntarily file for administration if the company is, or is likely to become, unable to pay its debts ▸ Available to foreign companies in certain circumstances	▸ Available to companies that are, or are likely to become, unable to pay their debts – but only where it is (and remains) likely that the moratorium will result in the rescue of the company as a going concern ▸ Broad capital markets exclusions render most bond issuers / guarantors ineligible for the moratorium ▸ Available to foreign companies with a “sufficient connection” to England (upon court application)
Control	▸ Administrators (who are licensed insolvency practitioners) take control of running the company ▸ Directors cannot exercise any management functions without the administrators’ consent ▸ Often, administrators seek to sell the business swiftly following their appointment to minimise loss of value – a so-called “pre-pack” administration sale	▸ A licensed insolvency practitioner must serve as “monitor” during the moratorium to protect creditors’ interests. The monitor has a duty to terminate the moratorium in certain circumstances and their consent is required for certain transactions ▸ The directors otherwise continue to run the business
Scope of stay	▸ Automatic, broad moratorium – though secured creditors may enforce their security in certain limited circumstances	▸ Automatic, broad moratorium – though secured creditors may enforce their security in certain limited circumstances ▸ However, the company does not get a “payment holiday” for various categories of debts – critically, this includes bank debt, debt for goods/services supplied during the moratorium and rent during the moratorium (i.e. the company is effectively required to pay these)
Duration	▸ Administration lasts a year unless extended or terminated earlier	▸ Initial duration of the moratorium is 20 business days — extremely tight, if not impossibly short, to negotiate a substantive restructuring in that time. Various possibilities for extension, depending on circumstances

Other European restructuring processes

- Each jurisdiction has its own restructuring tools; a detailed analysis lies beyond the scope of this deck.
- Most European jurisdictions have recently reformed their restructuring frameworks to include “pre-insolvency”, “pro-rescue” restructuring proceedings. These reforms represent major improvements in many jurisdictions, such as Germany and the Netherlands, which did not previously facilitate restructurings outside formal insolvency proceedings unless all stakeholders consented.
- The various new European restructuring measures are broadly similar to the English restructuring plan (see page 6), though specific details vary by jurisdiction, e.g.:
  - relevant financial threshold to eligibility;
  - degree of court involvement;
  - approval threshold;
  - timeline;
  - conditions to binding dissenting classes; and
  - scope of stakeholders who can be bound by the process.

… SO WHICH IS THE BEST RESTRUCTURING TOOL?

The most appropriate implementation tool for any restructuring depends on a variety of factors, including:

- the desired goals of the restructuring;
- the degree of stakeholder support for the restructuring, and how far the group is seeking to bind dissenting stakeholders;
- eligibility for the relevant procedure – including the prospect of creating jurisdiction specifically for the purposes of the restructuring;
- the likelihood of recognition of the procedure in other relevant jurisdictions – including the jurisdiction(s) of incorporation of the main debtor, guarantors and other important group companies, and the jurisdiction(s) governing the law of the group’s debt;
- the availability/scope of a stay on creditor action; and
- various other factors, including costs, timing, certainty and degree of publicity.

We would be delighted to discuss options with interested clients, free of charge.

Distressed, Special Situations and Specialty Lending Senior Team

RESTRUCTURING (LONDON)

Kon Asimacopoulos
Tel: +44 20 7469 2230
kon.asimacopoulos@kirkland.com

Partha Kar
Tel: +44 20 7469 2350
partha.kar@kirkland.com

Sean Lacey
Tel: +44 20 7469 2410
sean.lacey@kirkland.com

Elaine Nolan
Tel: +44 20 7469 2130
elaine.nolan@kirkland.com

Kate Stephenson
Tel: +44 20 7469 2301
kate.stephenson@kirkland.com

Thomas Jemmett
Tel: +44 20 7953 2597
thomas.jemmett@kirkland.com

Ian Clarke
Tel: +44 20 7469 2464
ian.clarke@kirkland.com

Hannah Crawford
Tel: +44 20 7469 2079
hannah.crawford@kirkland.com

RESTRUCTURING (MUNICH)

Leo Plank
Tel: +49 89 2030 6070
leo.plank@kirkland.com

Sacha Lürken
Tel: +49 89 2030 6114
sacha.luerken@kirkland.com

Wolfgang Nardi
Tel: +49 89 2030 6188
wnardi@kirkland.com

Bernd Meyer-Löwy
Tel: +49 89 2030 6160
bmeyer-loewy@kirkland.com

Josef Parzinger
Tel: +49 89 2030 6057
josef.parzinger@kirkland.com

DEBT FINANCE

Michael Steele
Tel: +44 20 7469 2340
michael.steele@kirkland.com

Jonny Birks
Tel: +44 20 7469 2070
jonathan.birks@kirkland.com

TAX

Jonathan Kandel
Tel: +44 20 7469 2460
jonathan.kandel@kirkland.com

REGULATORY

Lisa Cawley
Tel: +44 20 7469 2140
lisa.cawley@kirkland.com

CORPORATE

Aprajita Dhundia
Tel: +44 20 7469 2290
aprajita.dhundia@kirkland.com

CAPITAL MARKETS

Bill Burke
Tel: +44 20 7469 2395
william.burke@kirkland.com

Tim Volkheimer
Tel: +44 20 7469 2456
tim.volkheimer@kirkland.com

ANTITRUST

Paula Riedel
Tel: +44 20 7469 2470
paula.riedel@kirkland.com

LITIGATION

Richard Boynton
Tel: +44 20 7469 2180
richard.boynton@kirkland.com

Stuart Doxford
Tel: +44 20 7469 2046
stuart.doxford@kirkland.com

International Reach

Austin
Bay Area
Beijing
Boston
Brussels
Chicago
Dallas
Hong Kong
Houston
London
Los Angeles
Munich
New York
Paris
Salt Lake City
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