

Global Restructuring Review

The Art of the Ad Hoc

Editors

Howard Morris, Sonya Van de Graaff and James M Peck

Second Edition



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The Role and Purpose of an Ad Hoc Committee from the Debtor's Perspective

Kon Asimacopoulos and Kai Zeng¹

Introduction

In the final quarter of 2019, the European leveraged finance market was in robust health. Total leverage multiples were 5.3 times at the end of 2019,² just a touch lower than the post-2007–2008 financial crisis peak of 5.4 times seen in 2018. High-yield bond pricing had reached five-year lows at 4.5 per cent, with leveraged loan pricing not far behind at 3.9 per cent.³ Although the first signs of distress were beginning to emerge, with distress ratios having climbed over the prior 18 months,⁴ few commentators predicted the unprecedented effect the covid-19 pandemic would have on the European leveraged finance market (and wider society at large) over the course of 2020.

The expansionary period between the great financial crisis of 2007–2008 and the covid-19 pandemic of 2020 witnessed a number of changes to the European credit landscape. Key among those have been:

- participants: prior to the great financial crisis, the majority of financing provided to European corporates was by banks. However, chastened by the crisis, banks were forced by regulators to de-lever their balance sheets and began a decade-long process of retrenchment (which, for some institutions, is ongoing). This retreat accelerated the rise of non-bank lenders, which have now become a key pillar of the European financing landscape. These non-bank lenders come in a number of guises, including divisions of existing hedge funds, private equity funds or standalone private debt providers. Regardless of their

¹ Kon Asimacopoulos is a partner and Kai Zeng is an associate at Kirkland & Ellis.

² S&P Global Leveraged Commentary & Data.

³ Debtwire Par (leveraged loan pricing excludes RCF and amortising term loan pricing).

⁴ Measured by the percentage of securities trading at below 80, which had increased from approximately 1 per cent for Western European loan and European high-yield notes to 1.6 per cent and 2.7 per cent respectively at the end of 2019, with high-yield notes distress ratios having touched 6 per cent over the course of that period (M&G Investments, European Loan Market - Review and Outlook, February 2020).

form, investors have allocated significant amounts to European direct lending, with over €250 billion having been raised by direct lenders since 2015;⁵ and

- credit products: with new participants come new products. With high volumes of invested capital that needed to be deployed, non-bank lenders pioneered the development of unitranche loans that offered blended pricing, removed syndication risk, and came with the speed and administrative convenience of only needing to deal with a single counterparty (rather than satisfy the credit requirements of a number of banks). However, from an ad hoc committee perspective, the biggest development has been the rise of European corporates tapping the corporate bond markets. In the eight years after the great financial crisis, the stock of loans extended to European corporates decreased by €536 million while the stock of long-term debt securities increased by €567 million over the same period.⁶

This fragmentation of the credit space, along both structural and participant lines, can make cooperation among stakeholders more difficult, particularly when the debtor faces financial distress. It has long been well understood that participants in different sections of the capital structure may have different aims and risk appetites (taking an extreme example, providers of super-senior revolving credit facilities compared with mezzanine lenders) but the diversity in creditor type is a decidedly post-crisis development. Providers of alternative credit (whether standalone debt providers, hedge funds or divisions of larger investment management firms) may have very different investment theses compared with each other, let alone traditional bank lenders. When secondary investors are added to this mix, it is easy to see why coordination between a group of stakeholders with such diverging motivations can be challenging.

These issues are made even more difficult when the primary tranche of debt at risk is bonds. Unlike syndicated loans where the debtor, through the facility agent, is able to identify all the lenders of record (albeit some of those participants may be fronting commitments for the beneficial owner), a debtor that has issued bonds has no formal or straightforward way of identifying its major noteholders. In fact, debtors have to cope with two layers of obfuscation in their attempts to uncover the identities of its noteholders. The first are the clearing systems that administer the notes, which have historically refused to divulge the identity of a company's bondholders. The second is that, even if the clearing systems were willing to provide such information, they could only reveal the holders of record, who are usually only intermediaries or prime brokers, leaving the debtor no closer to finding the identity of the real economic beneficiary. Debtors that become distressed have been forced to rely on inaccurate and time-consuming bond identification processes, which generally involve identification firms calling major trading desks to try and piece together who are the most active market participants.

However, for there to be any successful restructuring of a debtor, cooperation between multiple creditors and creditor constituencies remains crucial. The rationales expressed in the International Federation of Insolvency Professionals (INSOL) Principles remain as

⁵ Deloitte, *Alternative Lender Deal Tracker*, Spring 2020.

⁶ European Commission, 'Analytical report supporting the main report from the Commission Expert Group on Corporate Bonds', November 2017.

relevant today as when they were first published at the turn of the century. As the fourth principle notes:

The interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty. Such co-ordination will be facilitated by the selection of one or more representative co-ordination committees and by the appointment of professional advisers.⁷

This need for coordination, despite increasingly fractured creditor constituencies, has resulted in an increasing prevalence of ad hoc committees in workout situations. This is in contrast to coordination committees or steering committees,⁸ which were more common in pre-crisis environments, as being better suited to the prevalence of syndicated loan structures in that market. Coordination and steering committees were appointed by the company, with such appointment being confirmed by the lenders, usually based (with adjustment) on the standard form documents released by the Loan Market Association.⁹ As such, although the roles of such committees varied from situation to situation, these committees would usually be the principal conduit of information and discussion between the creditors and the debtor. In some, albeit limited, circumstances, certain powers of the creditors could even be delegated to the coordination or steering committee.¹⁰

In contrast, the ad hoc committee is far more suited to today's more fragmented financing landscape. Ad hoc committees are self-formed groups of creditors that have managed to identify themselves, either through bilateral contacts between institutions or through the outreach of financial or legal advisers, and that will coordinate among themselves and the debtor on the implementation of the workout. For debtors, particularly those that have issued notes, a proactive ad hoc committee is usually the only available representative of the broader bondholder community with whom the parameters of a restructuring can be negotiated before being more widely disseminated to the market.

The purpose and role of ad hoc committees from a debtor's perspective: the negotiation phase

From a debtor's perspective, the purpose of an ad hoc committee during the initial phase of a restructuring is critical. With no obligation to represent a wider class than their own participants (compared with the coordination and steering committees that were more common

7 INSOL International, 'Statement of Principles for a Global Approach to Multi-Creditor Workouts'.

8 Although there are differences between coordination and steering committees, these are sufficiently minimal that they can be grouped together for the purposes of contrasting them with ad hoc committees. In fact, it has been previously noted that the 'difference between a coordinator and a steering committee . . . is typically one of mere description as opposed to one of any notable substance' (Howard and Hedger, *Restructuring Law & Practice* (LexisNexis: 2014), 2nd edition, p. 213).

9 The LMA's 'Form of Letter to Company governing appointment of Coordinator and Coordinating Committee' and 'Form of Letter to Lenders governing the appointment of Coordinator and Coordinating Committee', respectively.

10 Although rare, this possibility is explicitly contemplated in the LMA's 'Guidance Notes on Role of Co-ordinating Committee' where it differentiates between a coordinating committee 'which is merely a "sounding board" . . . but which has no power or discretion to bind or act for the lenders' and a coordinating committee 'to which certain powers and discretions are delegated by the lenders'.

before the great financial crisis, whose appointment required more formal documentation), ad hoc committees can move quickly and flexibly to meet the specific circumstances of the relevant debtor. In the initial phase of the restructuring of a debtor, where speed is often crucial to ensure the upcoming restructuring is set on the right path, the ad hoc committee can play an invaluable role.

Information sharing

One of the impacts of the greater prevalence of, traditionally covenant-free, bond issuances in Europe has been the proliferation of covenant-lite structures in loans, as well as bonds. This decline has accompanied a gradual erosion of information provision obligations under finance documentation. Creditors generally retain the benefit of quarterly financial reporting but, since these can occur over 90 days after the relevant quarter-end, they are only ever a trailing indicator. Therefore, the initial approach between a debtor and an ad hoc committee invariably focuses on information provision.

Management's natural instinct is to minimise, as much as possible, any public disclosure of the business's financial difficulties, its fear being that such disclosure will increase the debtor's financial distress (e.g., customers and suppliers may impose more onerous terms (such as cash on delivery) or even stop trading with the business altogether). In contrast, creditors will be keen to maximise the amount of information to which they have access. It is during this period that the balance sheet of the debtor needs to be established, the group structure confirmed, ranking of various creditor claims determined, the strategy of the business reassessed, cashflow forecasts performed and discussions with management engaged in, and so on.

However, when engaging with ad hoc committees, two critical issues invariably occur that need to be addressed before any significant information is shared with the ad hoc group: what information is shared and when; and when that information is cleansed. Most acutely encountered with notes (although these issues have also become more prevalent in the loan space), creditors will not want to receive material, non-public information (MNPI) at an overly advanced stage. This is because the receipt of MNPI will restrict the holders of that information from trading their debt for fear of breaching insider trading and market abuse laws (such as the European Union's Market Abuse Regulations). This means that the ad hoc committee's advisers often act as 'gatekeepers' for any MNPI and only disclose MNPI to their clients when the broad parameters of restructuring have been progressed.

The second issue is that MNPI, once shared, must be cleansed. This can be one area of protracted negotiation when dealing with ad hoc committees. Ad hoc committees will want the debtor to commit to a fixed disclosure date to minimise the period during which they hold MNPI and are restricted from trading. In contrast, the debtor will want to ensure that a deal has been struck with the ad hoc committee so that it only has to go through the disclosure process once, and to delineate very clearly what information needs to be released publicly, given that information will likely be closely examined by other stakeholders (suppliers, customers, other creditors in the capital structure and even competitors).

Stability

If a debtor is facing liquidity pressure, one of the most important objectives of approaching the ad hoc group, in the initial phase, is to create stability for the debtor business. The goal is to avoid any stakeholders, particularly creditors, taking precipitous action against the debtor,

which could be value-destructive. This need is particularly important if there are, or will imminently be, events of default that will permit creditors or creditor groups to take action against the debtor.

In European multi-creditor financings, the ability to take enforcement action against a debtor will usually require creditors holding at least a majority by value of the relevant piece of indebtedness to act in concert. In addition, if the capital structure is multi-layered, there is frequently an intercreditor agreement that will regulate when junior layers of debt are permitted to take enforcement action (which may vary depending on the type of event of default that has occurred).

If these existing contractual provisions are in place, a debtor may be able to achieve a standstill of its entire capital structure with the consent of a blocking proportion (potentially not even a majority) of, usually, its most senior creditors.¹¹ The speed at which such an ad hoc group can organise and grant the necessary standstills is important because, at this stage, the taking of any precipitous action by a creditor group could permanently damage the prospects of the debtor. If suppliers, customers and employees become aware that a debtor is in financial distress, they may take defensive actions that could push the debtor even closer to insolvency. In contrast, a debtor that can project stability with the support of an ad hoc group sufficient to block any enforcement action from its financial creditors has a significantly improved chance of implementing a successful restructuring.

Negotiation

Once the information flow has been established and, if necessary, the debtor has been stabilised, the main role of the ad hoc committee from the debtor's perspective is to act as a proxy for the wider creditor group to negotiate the restructuring. The dynamics of any such negotiation will depend heavily on the ad hoc committee's size, constituents and the range of restructuring options that the ad hoc committee is able to implement without the consent of any third party. For instance, if the ad hoc committee controls enough of the debtor's capital structure such that, with its consent (whether or not supplemented through some form of cramdown mechanism), a sufficiently wide-ranging restructuring of the debtor's liabilities could be implemented, negotiating with the ad hoc committee essentially allows the debtor to finalise the terms of a restructuring with a limited group of market participants, with confidence that the restructuring can be successfully implemented.

The purpose and role of ad hoc committees from a debtor's perspective: the implementation phase

Anchor support

Even if an ad hoc committee is insufficient to deliver the necessary restructuring on its own or if the restructuring implementation mechanism envisages some kind of cramdown process, the ad hoc committee is critical in providing the anchor support.

Once a restructuring has been agreed between the debtor and the ad hoc committee, the agreement is frequently evidenced by entry into a lock-up agreement or restructuring

¹¹ One notable exception being the super-senior revolving facility plus bonds structure, where usually the bondholders control the enforcement process, despite being junior to the revolving facility lenders.

support agreement. These agreements are undertakings by the debtor and the ad hoc committee participants to take all reasonable and necessary actions to implement the terms of the agreed restructuring, with the principal terms of the proposal appended to the document in a term sheet. This support is crucial, as when the restructuring proposal is disseminated to the wider creditor syndicate, the debtor can announce that it already has the support of the ad hoc committee. If the ad hoc committee is sizeable, such support can generate enough momentum that the remaining stakeholders will regard the proposed restructuring as a fait accompli. Such support significantly dampens the prospect of any resistance to the restructuring. In contrast, without the anchor support of an ad hoc committee, a debtor would be forced to either negotiate the restructuring with every single creditor whose support it needs (impractical in most multi-creditor financing structures) or be forced to launch a restructuring proposal with a far more uncertain probability of success.

Engagement with the wider creditor group

Although ad hoc committees will resist any implication that they represent any constituency wider than their own members, they can nonetheless be useful to the debtor as a means of communicating with the wider creditor group. In the restructuring of widely held bond issuances, the ad hoc committee can be the primary conduit by which additional members are contacted and persuaded to support the proposed restructuring. This will particularly be the case as, although the debtor may be familiar with its relationship lenders, this may be of limited utility in a distressed situation, given that the original underwriters may have syndicated widely and that the debt is likely to have been traded to distressed investors (being the most likely buyers of such debt). Furthermore, most debtors and their management teams may not have experience of stressed or distressed situations, and, therefore, may not have relationships with common participants in such scenarios (such as the distressed debt investors, law firms and financial advisers that operate in this space). In contrast, ad hoc committees will usually contain participants who are familiar with restructuring processes and other stakeholders, and will be important in communicating and coordinating with the wider creditor group.

In this regard, ad hoc committees can also be useful in encouraging other creditors to engage with the debtor, rather than taking any form of unilateral action. If the ad hoc committee forms a blocking stake (as per the discussion regarding stability above), this can deter other creditors from opposing the committee and the debtor, as they will not be able to effectively take unilateral action. This will be further emphasised if the ad hoc committee constitutes a material proportion of the debtor's financial creditors and such group has commenced discussions with the debtor to support their investment. Instead, it encourages other creditors to engage with the debtor or the ad hoc committee in seeking to have their views on an outcome taken into account.

New money

A key role of an ad hoc committee in distressed and deteriorating businesses is the provision of new money as part of the post-restructuring capital structure. In fact, this is a critical role in most restructurings, and the existence of a functioning committee should make negotiations more efficient. Given their access to additional information, prior engagement with the debtor and existing investment, ad hoc committees are among the most likely providers

of new money financing, particularly given members of ad hoc committees will generally comprise large financial institutions with significant amounts of capital available to deploy.

Even if the members of the ad hoc committee do not end up providing the new money financing as part of a restructuring, their consent will almost certainly be needed to permit the debtor to incur the required financing with a third party. The terms of any new financing will form a critical plank of any restructuring. Therefore, the ad hoc committee, even if not providing that financing, will have significant input into the parameters of the new money.

Fees

A single coordinated committee can assist in reducing fees. It is a market standard that the debtor pays the costs of creditors and their advisers in connection with any restructuring. Obviously, the debtor is keen to minimise these fees, given its financial situation. As such, the debtor can indicate to any small lenders that an ad hoc committee has been formed and is being advised. This obviates the need for the debtor to cover the cost of any additional advisers for smaller creditors, as the company can inform other creditors that any enquiries or requests should be made to the ad hoc committee.

Conclusion

We can see that ad hoc committees have developed in response to a credit landscape that is more fractured, in contrast to the financing market before the great financial crisis. The flexibility of ad hoc committees, both in terms of formation and their role, has meant that they are far more adapted to deal with the range of creditor interests prevalent in multi-creditor distressed situations, particularly those involving bonds where identification of noteholders is not a straightforward process.

The dynamics for debtors in engaging with ad hoc committees is constantly evolving. For instance, one relatively recent consideration that has become more prominent in restructuring situations is the presence of creditors that hold credit default swaps (CDS) on a particular debtor. Holders of a CDS position may be holding them to hedge their exposure to a debtor in the case of a debtor's insolvency, but if the CDS position eclipses a creditor's exposure to a company's debt instruments, the CDS can have significantly different incentives to other creditors in the capital structure and, if that creditor is on the ad hoc committee, other committee members. Given the lack of formality in the composition of an ad hoc committee, there is no way for a debtor to know what the exact economic calculus of the ad hoc committee is. Ad hoc committees, then, are an invaluable (and frequently the only) way by which a debtor can implement a necessary restructuring, but they can come with their own challenges.

Appendix 1

About the Authors

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Kon is a partner in Kirkland's European restructuring group and acts for a range of stakeholders in national and international financial restructuring, insolvency and complex dispute resolution matters. Kon routinely acts for many of the world's leading companies and investment firms in respect of their distressed issues and investments, and the European restructuring group has led many of the marquee restructurings over the past decade. Kon is recognised in *Chambers & Partners*, *The Legal 500*, *IFLR1000*, *The Euromoney Guide to the World's Leading Insolvency and Restructuring Lawyers*, *Who's Who Legal* and other ranking publications as a leading corporate restructuring and insolvency lawyer. In 2016 Kon was admitted to the Financial News Hall of Fame.

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Kai Zeng is a restructuring associate in the London office of Kirkland & Ellis International LLP. Kai has experience in cross-border restructurings advising sponsors, debtors, creditors and strategic investors on restructurings of stressed and distressed businesses. Kai also advises investment banks, hedge funds and private equity houses in their review and diligence of European investment opportunities in par, stressed and distressed transactions.

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With changes in credit markets, traditional steering committees, now seen as too slow and unwieldy, have fallen from favour in restructurings. Enter the ad hoc committee. They take less time to set up, are more flexible and can achieve better results. To quote our introduction, ‘ad hoc committees now rule the restructuring world’.

Understanding the rules that govern such committees and their inner workings is therefore essential. *The Art of the Ad Hoc* has all the answers. In plain English, it provides a comprehensive guide on how to work successfully with these committees, an activity that Judge James M Peck says in the introduction is rightly described as ‘an art’.

The Art of the Ad Hoc draws on the collective wisdom and real-life experiences of 32 distinguished practitioners from 14 different firms to cover every angle and perspective – particularly those of committee members and debtors. It is an essential desktop reference work.

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