

ANNUAL REVIEW

Bankruptcy & restructuring

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UNITED STATES

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Q REFLECTING ON THE LAST 12-18 MONTHS, HOW WOULD YOU CHARACTERISE THE US IN TERMS OF FAILING BUSINESSES AND BANKRUPTCY FILINGS?

TRUST: The US is experiencing near historic lows in the number of Chapter 11 filings of large companies. Many companies that might otherwise need to restructure their balance sheets have been able to refinance their debt out-of-court by accessing the high-yield bond markets and taking advantage of low interest rates. Companies have also benefited from the availability of covenant-lite loans, making it less necessary to even obtain amendments or waivers from lenders. Even those large companies that are unable to restructure out-of-court have sought to minimise their time in Chapter 11 by filing pre-negotiated or pre-packaged Chapter 11 cases. Although there is more in-court activity for middle market companies, those cases are also relatively short as efforts are made to have the company emerge as quickly as possible to avoid the cost and delay of a protracted Chapter 11 case.

Q COULD YOU OUTLINE THE PRIMARY MACROECONOMIC TRENDS CURRENTLY AFFECTING BUSINESSES? ARE ANY PARTICULAR SECTORS DEMONSTRATING STRUCTURAL WEAKNESSES, RESULTING IN DISTRESS?

TRUST: There are several dynamics affecting US businesses from a capital structure perspective. These include low interest rates driven by not only the low Federal Funds interest rate but also by a seeming over-supply of liquidity in the marketplace searching for new investments; relatively easy access to the high yield markets and covenant-lite or other borrower-friendly loans; and an increasingly sophisticated group of stakeholders that are accustomed to restructuring companies in short timeframes. Even in this environment, however, there is distress in the consumer retail sector as brick-and-mortar stores such as RadioShack, JCPenney and Toys R Us lose market share to online shopping businesses and, in the education sector, where small, tuition-dependent private colleges, have rising debt service payments and high overhead expenses.



Q HAVE THERE BEEN ANY NOTABLE BANKRUPTCY/INSOLVENCY CASES IN THE US, WHICH WILL HAVE AN IMPACT ON THE PROCESS GOING FORWARD?

TRUST: The US Supreme Court has recently issued a decision that casts doubt on the well-established expectation of the bankruptcy court system as the single, consolidated venue for adjudication of all matters related to a debtor's bankruptcy case. The Supreme Court ruled that US bankruptcy courts must issue findings of facts and conclusions of law in fraudulent transfer and similar actions that will be reviewed *de novo* by a US district court. Although many bankruptcy courts anticipated this outcome, this decision could have an impact on future Chapter 11 cases because the additional layer of required judicial review could make bankruptcy litigation more cumbersome and potentially delay the emergence of companies from Chapter 11 where the outcome of a fraudulent transfer litigation is central to the company's reorganisation.

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Q TO WHAT EXTENT ARE BANKS SUPPORTING DISTRESSED COMPANIES? HOW EASY IS IT TO RENEGOTIATE EXISTING DEBT IN THE CURRENT MARKET? IS THERE FUNDING AVAILABLE TO FINANCE RESTRUCTURINGS?

TRUST: It appears to be relatively easy for companies to renegotiate the terms of their existing debt in the current US market. The excess supply of liquidity in the capital markets has provided large companies with the ability to refinance their existing debt with their existing lenders or with a new set of lenders or bondholders. To the extent that traditional banks are playing a less central role in those negotiations, many hedge funds and other liquidity providers are assuming a lead role, taking a fresh look at the company's situation and providing any necessary financing. It is a tougher road for middle market and smaller companies experiencing distress to obtain financing or renegotiate the terms of existing debt, but even those dynamics have changed in recent years as distressed hedge funds have become more involved in those situations.

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Q WHAT TRENDS ARE YOU SEEING IN THE MARKET’S APPETITE TO PURCHASE TROUBLED ASSETS? HOW WOULD YOU DESCRIBE RECENT DISTRESSED M&A ACTIVITY?

TRUST: The amount of distressed M&A activity has remained stable in the US. Many buyers still prefer to purchase assets from distressed companies in a Section 363 sale approved by the US bankruptcy court, particularly because Section 363 ‘free and clear’ sales protect buyers from most types of successor liability. However, recent litigation in the Section 363 sale context could affect that approach. In particular, secured creditors considering whether to credit bid their debt in a Section 363 sale of their collateral should pay attention to two separate decisions from the US bankruptcy courts in Delaware and Virginia, where the credit bids were limited to an amount less than the full face amount of the debt. One of the critical facts in those cases was that the secured creditors had acquired their secured claims at heavily discounted prices in order to advance their ‘loan-to-own’ strategies.

Q COULD YOU OUTLINE SOME OF THE PERSONAL RISKS THAT MAY FACE D&OS OF A COMPANY IN THE US THAT NEARS INSOLVENCY OR ENTERS BANKRUPTCY?

TRUST: In general, D&Os owe fiduciary duties of loyalty, care and good faith to the company for which they serve. Unlike in some other jurisdictions, D&Os cannot be personally liable under Delaware law if the company becomes insolvent or enters bankruptcy as long as they have discharged their fiduciary duties. As a company begins to experience financial distress, it is important that the board of directors hire legal and financial advisers to assist them in discharging their various duties. Although those duties do not shift to a particular group of stakeholders when a company is insolvent, the board’s actions will often be scrutinised by creditors concerned about their recoveries. If there is a subsequent bankruptcy, creditors may seek to bring a derivative suit to recover from any available D&O insurance.

**Q HOW DO YOU EXPECT
RESTRUCTURING AND
BANKRUPTCY ACTIVITY IN
THE US TO UNFOLD FOR THE
REMAINDER OF THIS YEAR,
AND BEYOND?**

TRUST: Absent a major event, we do not expect to see any significant changes in the relatively quiet US restructuring market in the near term. The combination of low interest rates and relatively easy access to liquidity provides many companies with an escape valve in the event they find themselves nearing maturities or are confronted with unexpected changes in their fortunes. In the long term, more restructuring activity for larger companies may emanate from higher interest rates and over-leveraged balance sheets arising from some of the current M&A activity. Also, we have observed that non-US professionals are increasingly considering the benefits of either a Chapter 11 case or a Chapter 15 ancillary proceeding to recognise and enforce the terms of a restructuring occurring in their home jurisdiction. We may also see more restructuring activity resulting from the sale by traditional banks, particularly those in Europe, of their loan portfolios to hedge funds. Finally, the American Bankruptcy Institute has formed a commission to consider modifications to the existing US Bankruptcy Code, which could have a significant impact on future restructuring activity in the US.

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Robert Trust is a counsel in Linklaters' US restructuring & insolvency practice. He regularly advises clients in connection with Chapter 11 restructurings, Chapter 15 recognition proceedings, out-of-court workouts, acquisitions of troubled companies and the structuring of corporate and credit transactions. The principal focus of his practice has been the representation of banks and other financial institutions in the restructuring of large syndicated credit facilities extended to borrowers in a wide range of businesses and industries. In addition, Mr Trust represents investors in, and acquirers of, distressed companies in workouts and Chapter 11 cases, as well as financial advisors in connection with retention matters.

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