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PEMBERTON
Connecting Capital Across Europe

Pemberton Perspectives

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Discussing some key investment themes in European private debt

Credit Structuring Across European Legal Regimes

On 13th October 2017, we hosted a Breakfast briefing in conjunction with Latham & Watkins LLP to discuss credit structuring across the various European legal regimes, with a focus on optimising deal structures in differing legal environments. The focus of the session was not to concentrate on our existing investments, but the wider market backdrop that we operate in, and to look at legal considerations and structuring issues we consider in lending and assessing credit risk in different jurisdictions. Below are a few key takeaways.

Structuring Principles and Jurisdictions

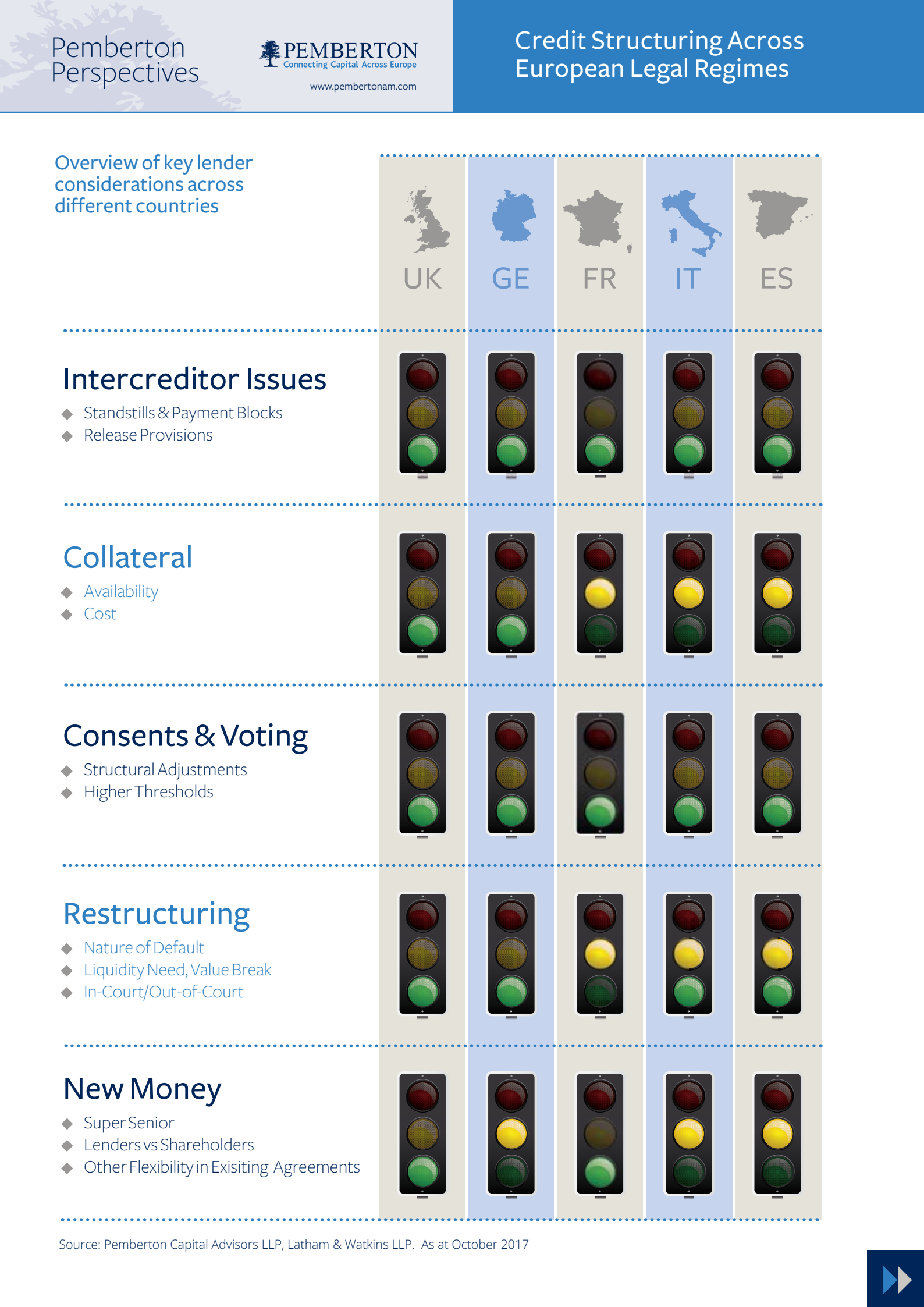
The session covered the following three points:

- Commercial considerations of lending in various jurisdictions
- Recent trends in structuring and restructuring
- Focus on Italy – sometimes thought of as a geography which is difficult to lend in.

The graphic overleaf summarises, from the perspective of a senior cashflow lender, the structuring principles and commercial considerations of lending in the UK, Germany, France, Italy and Spain.

Credit Structuring Across European Legal Regimes

Overview of key lender considerations across different countries



Intercreditor Issues

- Standstills & Payment Blocks
- Release Provisions

Collateral

- Availability
- Cost

Consents & Voting

- Structural Adjustments
- Higher Thresholds

Restructuring

- Nature of Default
- Liquidity Need, Value Break
- In-Court/Out-of-Court

New Money

- Super Senior
- Lenders vs Shareholders
- Other Flexibility in Exisiting Agreements

Source: Pemberton Capital Advisors LLP, Latham & Watkins LLP. As at October 2017

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Recent Trends

- As a general trend across Europe, restructuring regimes have been undergoing reforms which have rendered them, on the whole, significantly more creditor-friendly. The trend of reform is in no small part a response to the turbulence caused by the Financial Crisis, which demonstrated the need for robust, predictable and transparent frameworks.
- Key features of these reforms include an ability to cram-down junior or dissenting creditors, an increased ability to provide "new money" financing to companies in financial distress, and a move towards more speedy out-of-court processes. In some jurisdictions that have been traditionally debtor-friendly (e.g. France and Italy), there has also been a shift towards lender-led processes.
- The UK scheme of arrangement continues to be a tool on which creditors and debtors in the UK and elsewhere seek to rely.

UK

- The UK market is characterised by continuing reliance by creditors, debtors and high-yield bond issuers on schemes of arrangement. The scheme of arrangement is not an insolvency procedure, but a Companies Act mechanism which allows an arrangement to be reached between a company and its classes of creditors which is then sanctioned by the court.
- The voting threshold for a scheme is a majority in number of creditors representing 75% of value within a particular class; one of the great strengths of the scheme of arrangement is that it will bind dissenting creditors within a class and can therefore be used to cram-down junior creditors or dissenting hold-out creditors.
- The flexibility of the UK scheme is shown by the willingness of some debtors to "COMI-shift" (i.e. to move their centre of main interests) to the UK in order to take advantage of a scheme. The scheme can be used as a tool to effect a variety of outcomes, ranging from a simple maturity extension to a full-blown restructuring.
- The UK courts are generally willing to accept jurisdiction for a debtor who is not incorporated in the UK but whose COMI is in the UK. Recent case law shows that the courts are also willing to accept jurisdiction of a scheme for foreign companies even where the COMI is not in the UK, for example where the credit agreement is governed by English law or the foreign company has a UK establishment.
- In addition, courts will generally sanction schemes that have been approved by the required majority of creditors and which are deemed to be reasonable. The involvement of the court is therefore fairly "light-touch", and the decision whether or not to sanction a scheme will generally be made extremely quickly by the court.
- The court judgement sanctioning the scheme is generally recognised by courts in other jurisdictions, meaning the scheme is a powerful tool to effectuate a restructuring of international companies.
- The administration procedure is also widely used by creditors to "pre-pack" companies (enabling a swift sale as a going concern in a manner which preserves value) or to right-size a debtor's balance sheet.

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Germany

- Germany has traditionally been viewed as more creditor-friendly than some of the southern European jurisdictions. For example there is no automatic stay on creditors and the creditors, via an insolvency administrator, can propose a creditor-led plan.
- Cram-down of dissenting creditors is possible in Germany if the majority of creditor classes have voted in favour of a restructuring plan and if dissenting creditors would be better off under the plan than they would be under a liquidation of the debtor.
- Reforms in Germany in 2012 introduced a new kind of preliminary insolvency regime known as Self Administration. Provided the debtor can demonstrate (backed up by external advice) that it is over-indebted or will imminently face a liquidity crisis, and that its restructuring plan does not obviously lack the prospect of success, then the debtor will have up to 3 months to come to an agreement on a restructuring plan while the management of the business remains with the debtor. As the process allows cram-down of dissenting creditors and contemplates the provision of preferential new money financing, it has been increasingly used in Germany to facilitate restructurings in a way that allows a debtor to survive as a going concern.

France

- Prior to 2014, the French restructuring regime gave exclusive rights to the debtor to propose any reorganisation plan. Coupled with the French procedure de sauvegarde (safeguard) (which allows a debtor to seek court protection and automatically stays its creditors from taking enforcement action, with the management of the company remaining with the debtor), the French regime was perceived as being debtor and sponsor-friendly. Prior to 2014, many deals were structured by international investors using a "double Luxco" holding company and security structure to try to ensure that creditors would remain outside a French restructuring and enforcement process, to the extent possible.
- The reforms of 2014 significantly improved creditors' rights by affording creditors a greater degree of control: in the context of a restructuring plan, any creditor may submit a draft restructuring plan which will then be subject to a report by the administrator and a vote by the creditors. Provided voting thresholds are met (66.67% of each of financial creditors, trade creditors and bondholders) and the plan has been approved by the court, dissenting creditors can have their debt rescheduled (but not written off). The reforms also enable forced debt for equity swaps to be imposed on shareholders in certain circumstances; this was not possible at all prior to 2014.
- The 2014 reforms also extended the protection afforded to creditors providing new money financing to a debtor to enable the debtor to continue trading, enabling new money lenders to rank ahead of the vast majority of pre- and post-petition claims. In addition, there has been increased use of "out of court" voluntary mandat ad hoc and conciliation proceedings which are supervised by a mediator or a conciliateur overseen by the court, respectively.
- For these reasons there has been a move away from "double Luxco" structures to all-French structures as international investors become increasingly comfortable with the regime in France.

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Italy

- The restructuring regime in Italy has undergone significant reform and improvement over the last decade, having previously had very minimal reform since the introduction of the Bankruptcy Act in 1942.
- Previously, the regime was debtor-led and did not necessarily provide the correct tools to enable a business to be restructured. This meant that - if creditors did not agree to a debtor's proposals - often one of the only feasible outcomes was a court-led dissolution of insolvent companies, resulting in destruction of value for all stakeholders. In addition, creditors did not wield a credible threat of enforcement due to the fact that enforcement of security must be done in the Italian courts. This could often take many years, with the debtor remaining in control of the management of the business in the meantime.
- The focus of the series of reforms introduced between 2012 and 2016 has therefore been to enable companies to continue as going concerns and to facilitate debt restructurings. In order to enable distressed companies to continue their operations, the reforms have introduced non-judicial procedures including a rescue plan (which binds only those creditors who vote for the plan) and debt restructuring agreement (requiring 60% of creditors to vote in favour with other non-voting creditors needing to be paid out). Both of these procedures are led by the debtor, with the debtor retaining management control of the business. Both procedures require certification by an independent expert prior to implementation.
- There is also a judicial consensual pre-bankruptcy arrangement led by the debtor which allows debt restructuring with creditor consent. The debtor maintains control of management of the business, albeit under judicially-appointed supervision. Crucially, this judicial procedure allows cram-down of minority dissenting creditors in a manner similar to a UK scheme of arrangement; the plan can be approved by a simple majority of voting creditors and a majority of classes of debt. Where previously only a debtor could propose a restructuring plan, the reforms allow creditors to submit an alternative proposal if for example they deem the debtors plan to be unacceptable. This procedure has been increasingly used in Italy in recent years, including by international investors.
- Legal super-priority has also been given for "new money" financing provided to troubled companies, although in practice due to Italian banking regulation it is often only Italian banks who are able to offer such rescue financing.

Spain

- Prior to its reform, the Spanish restructuring regime did not provide many options to debtors or creditors apart from a fomal insolvency, nor were there any particularly viable options to undertake an out-of-court informal process. Reforms of the Spanish regime from 2011 onwards have now produced a restructuring toolkit that is much improved compared to the pre-reform era.
- Debtors now have an increased ability to agree voluntary restructurings by way of a collective agreement with their creditors, for example to extend maturities or make amendments to financing arrangements in order to allow the business to continue to trade in the short to medium term. A collective agreement can be implemented if 60% of a debtor's creditors approve it.

Spain (continued)

- One of the biggest developments in Spain is the introduction of a scheme of arrangement (or homologacion), which is in some respects similar to an English scheme. This is a court-sanctioned collective agreement which requires 51% of creditors to vote in favour and is then approved by the court. Additional voting thresholds may apply depending on the action being taken (for example, for deferrals of debt for more than 5 years, the voting threshold increases to 75%). Importantly, the scheme allows much greater ability to cram-down dissenting creditors and limits the claw-back risk which creditors are exposed to (which was much greater pre-reform). The recent high profile homologacion implemented for the Abengoa restructuring makes it more likely that other debtors and creditors will take advantage of the scheme route in future.
- The restructuring regime in Spain does continue to feature some debtor-friendly concepts: for example, there is a stay of enforcement of up to one year if the debtor can demonstrate to the court that the assets the subject of the enforcement are necessary to continue the debtor's business.

Summary

From a private debt perspective, the positive evolution of creditor rights across Europe is a very welcome development and will, over time, lead to the further opening up of these markets to private debt managers. The trend towards a common pan-European legal framework is evident, however this process will take many years, and therefore a detailed understanding of the different legal regimes is still key to determining creditor protections. This is why we continue to believe that the best and only way to lend in Europe is through local teams who have the time, knowledge and experience to fully understand the nuances of the different legal regimes.

These are just a few of our thoughts based on our experiences in the market.

We'd love to hear your views as we revisit some of these themes over the coming months for our Pemberton Perspectives series. So please feel free to contact our Head Of Investor Relations, Mike Anderson on +44 (0)20 7993 9311 or mike.anderson@pembertonam.com with any questions or comments.