

CORPORATE DEBT RESTRUCTURING



Billy O'Riordan and **Eoghan Linehan** describe some solutions for companies in a distressed marketplace. They explore a number of the formal insolvency procedures available to both banks and corporate entities for restructuring corporate debt.

While a liquidity squeeze, an absence of buyer confidence and uncertainty generally have resulted in depressed market conditions over recent years, there are now some signs of increasing interest from foreign investors in distressed Irish trading businesses. Against this backdrop, the major Irish banks are providing significant capital and allocating internal resources to managing and restructuring their corporate loan books. Banks, and borrowers, are conscious of the need to formally restructure their debts in order to build, equip and sustain viable businesses for future growth. The two main formal insolvency procedures available to companies in restructuring their debts are receivership and examinership. Whilst the basic remedies available through both procedures remain unchanged, variations of

each procedure are emerging in an Irish context with the principal benefit being the preservation of value for stakeholders. Both procedures are governed by the Companies Acts 1963 to 2009, the Rules of the Superior Court and case law.

PRE-PACK RECEIVERSHIP

A receiver is typically appointed by a debenture holder and will take possession of the company assets subject to the debenture holder's charge. Often, the debenture will provide for the receiver to manage the company's business prior to its sale.

A pre-packaged receivership is a sale of all or part of the business and assets of an insolvent company which is negotiated before enforcement, and concluded shortly after the receiver is appointed. A buyer is identified before appointment, valuations are agreed and a contract drafted to enable the

assets to be sold shortly after the appointment of the receiver.

The key goal of any pre-pack receivership is the preservation of goodwill. In sectors where customer confidence is fragile, trading during a traditional receivership, with all the associated uncertainty, has the potential to undermine the business, as both customers and suppliers become reluctant to maintain commercial relationships. When a pre-pack receivership works well, the goodwill of the business tends to remain relatively undamaged.

Advocates of pre-packs claim they avoid protracted insolvency periods and protect employment within companies that are viable but are carrying historic debt they cannot afford. Pre-pack administrations have become relatively commonplace in the UK, where the professional bodies in 2009 issued formal guidance to insolvency practitioners

(Statement of Insolvency Practice number 16 (SIP 16)) to improve the transparency of the process and provide creditors with greater access to information. A pre-pack receivership is, however, likely to give rise to a number of issues:

- there is a perceived lack of transparency to the process;
- unsecured creditors remain unrepresented through the process;
- the process is exposed to the threat of an examinership application;
- there will be a stigma if the existing owner or management team is buying the business.

The receiver has specific statutory duties under section 316A of the 1963 Companies Act, which states that:

- the receiver must achieve the best price reasonably obtainable at the time of sale;
- the receiver must not sell the assets of a company to a person who is, or who, within three years prior to the date of appointment of the receiver, has been, an officer of the company unless the receiver has given 14 days' notice of his intention to do so to all creditors of the company.

It is imperative that the receiver obtains expert legal and valuation advice to comply with his statutory duty to 'obtain the best price reasonably obtainable'. Breach of a receiver's duties in this regard may result in the receiver being held personally liable for any loss incurred. Whilst SIP 16 does not govern the pre-pack receivership process, its provisions act as guidelines for receivers (through the pre-pack process). These guidelines can mitigate the risks in a pre-pack receivership by ensuring that:

- Independent valuations of all assets are performed by third-party professionals;
- Alternative exit and/or sale options are considered prior to concluding a sale;
- Efforts are taken by the receiver and company management to consult with creditors;
- The connection between the insolvent company and the investor/purchaser is clearly understood and assessed.

Each pre-pack receivership requires the identification of an appropriate investor and

involves accelerated due diligence. In an ideal scenario this process will be supported by both the bank(s) and the management of the company, who are likely to have a key role in the future of the company after sale of the assets. The key issues to be considered prior to the closure of any sale include determining the status and obligations of onerous contracts, dealing with critical creditors and the Transfer of Undertakings (Protection of Employee) Regulations. Recent cases in the Irish context highlight the importance of securing the support of company management prior to the appointment of the receiver.

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SALE OF DEBT

The option may also exist for the bank, as the secured creditor, to sell its debt to an investor prior to the appointment of a receiver, thereby removing the secured creditor's requirement to fund the receivership period. The investor will subsequently appoint a receiver to implement the sale of the business.

ACCELERATED EXAMINERSHIP

The 1990 Companies Act introduced the concept of examinership to enable insolvent companies to explore all opportunities for their survival in an inclusive process. Under this legislation, when an examiner is appointed, the company is placed under the protection of the High Court for a maximum period of 100 days whilst the examiner seeks to formulate a scheme of arrangement with the company's creditors.

An examinership has many advantages, including:

1. the transparency of the process;
2. the statutory protection afforded to secured creditors in the process;
3. the automatic stay on collection efforts by other creditors;
4. the binding effect of a scheme of arrangement on all creditors, once sanctioned by the Court.

The examinership mechanism is, however, relatively rarely used by Irish companies. Examinership is not an appropriate relief in many situations, and it is possible that the process is not very popular due to its technical, legal and potentially costly nature. As a corporate restructuring option, however, an accelerated form of the examinership process may emerge as a mechanism to restructure debt and attract equity investment.

With the benefit of detailed planning, the period of High Court protection can be significantly reduced. Heads of terms must be agreed with an investor and a proposed scheme of arrangement must be formulated prior to petitioning the High Court for protection. Detailed planning through this process may reduce the length of the examinership process significantly, with the possibility of the High Court hearing and the scheme of arrangement taking effect within weeks, as opposed to 3 months.

In any examinership the role of the company's bank(s) needs to be carefully considered. In some cases, the bank(s) will actively support an examinership as being the best way for the company to move forward. However, an examinership can also work to the significant disadvantage of the secured creditor because it will:

- have a very limited role in the process of restructuring the company's finances;
- be prevented from taking action to collect the debt and enforcing its security during the protection period; and
- be exposed to all expenses of the examiner having 'super-priority' over the claims of secured creditors.

Banks are likely to take a commercial and pragmatic view as to whether they should support an examinership process. Prior to 2008, the actual market value of the assets

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securing a bank's debt had generally not fallen below the book value of the debt, so there was little need for banks to agree to write off any portion of their debt. However, given the dramatic decline in property values in Ireland, it is likely that, in future examinerships, banks will be forced to accept write downs of their debts to the actual market value of the security held. Such write downs will of course merely reflect commercial reality. While the bank(s) may be obliged to write off a portion of the debt due from the company, any personal guarantees held in respect of the debt so written off will remain in place, and may be called upon by the bank.

In the recent High Court decision of the McNerney Group, the High Court ruled for the first time that proposals for a scheme of arrangement, entailing payment to a secured creditor of a written down sum in full satisfaction of its debt, could be approved. The written down value of the debt must reflect or be in excess of what the Court considers to be the market value of the security held. The main criterion for assessing whether the scheme is unfairly prejudicial to the interests of the secured creditor is whether the secured creditor would do better in the alternative (i.e. receivership) or any other method by which its security could be realised.

Ultimately, an accelerated form of

examinership can only be achieved where the secured creditor(s) supports the process.

OTHER OPTIONS

When new investment for a company cannot be secured, the company's bankers may be agreeable to some form of debt to equity conversion, where the bank converts part of its debt into equity in the company. Until recently this was relatively rare in Ireland but some lenders are now taking a medium-to-long term approach with cash-generating indebted businesses and are engaging in debt-for-equity swaps as a way of dealing with non-performing loans, rather than engaging in a forced sale of business assets.

Debt-for-equity swaps can offer a lifeline to struggling businesses, free up cash-flow, protect employment and allow companies to grow. From a company's perspective, such balance-sheet restructurings can have a significantly positive impact by enabling it to continue to trade and compete more effectively with a reduced debt burden. Furthermore, while the insolvency measures discussed above will realise only partial value for certain creditors, a debt-for-equity swap has the potential to create long-term appreciation in value for all stakeholders.

It will be interesting to monitor future trends in this area of corporate restructuring, as debt-for-equity swaps also have the

potential to present a number of difficult issues for banks. The time and resources which must be invested in a formal procedure-based debt-for-equity restructuring can be considerable and, in practice, it may be difficult to align the competing aims of the company and the secured creditor. The degree of board involvement required by the secured creditor and ongoing shareholder oversight are other factors to be considered by the secured creditor in appraising any debt-for-equity restructuring.

Given that each individual restructuring process will have direct consequences for multiple stakeholders (shareholders, directors, employees, banks and other creditors), it is important for both the secured creditor(s) and the directors of an insolvent company to seek advice from experienced legal, accounting and corporate finance professionals in order to assess all available options. Both parties need to adopt a proactive approach and all strategic options will need to be evaluated early in the process. This should facilitate the selection of an appropriate restructuring process and maximise value for one or all stakeholders. ■

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