

Business Finance and Restructuring

What will 2018 hold?

Horizon scanning for 2018

Legal Outlook

Legislative changes

Reform of English corporate insolvency framework

The Insolvency Service has yet to react to responses to its consultation in mid-2016 on significant reforms designed to improve the restructuring tools available to companies.¹ We had expected the government to push this forward in 2017, but the reforms appear to have stalled and the issue was sadly missing from the Queen's Speech. Presumably, this is owing to the focus on Brexit and a desire to see how the draft European directive on preventive restructuring frameworks will evolve (see next page). The reforms will be key to helping the UK to remain competitive in the global restructuring market – even more important post-Brexit. The UK should not rest on its laurels and should refresh this initiative in 2018.

We also expect a renewed focus on pre-pack sales in administration: the Insolvency Service will undertake an assessment of the impact of the voluntary industry measures that were introduced in 2015 to improve the transparency of connected party pre-pack sales in administration (following the Graham Review).² Any substantive reform would likely occur beyond 2018.

Airline insolvency arrangements

The government has pledged to launch a review into consumer protection in the event of an airline or travel company failure (in the Autumn Budget). This will draw on lessons from the collapse of Monarch Airlines, in which the government stepped in to repatriate c.110,000 stranded passengers. The review will include full consideration of options to allow airlines to wind down in an orderly fashion. The Transport Secretary has cited the lessons to be learned from the collapse of Air Berlin and Alitalia, which were both allowed to continue flying to assist an orderly wind-down – and of course many distressed US airlines have restructured via Chapter 11 proceedings without interruption to operations.

The Recast EU Insolvency Regulation in practice

The updated and extended European Insolvency Regulation entered into force on 26 June 2017; there have been only a few cases on it to date. We look forward to a growing body of practice in 2018 and, in particular, to seeing whether concerns over the efficacy of group co-ordination proceedings will be overcome in practice.

UNCITRAL Model Law

UNCITRAL's insolvency section is working towards a new model law for the recognition and enforcement of insolvency-related judgments. They met at the end of 2017; we hope for a final model law this year. We understand the group's other projects – on facilitating the cross-border insolvency of multinational enterprise groups, and issues relevant to the insolvency of SMEs – have further to go.

Reforms to the European Bank Recovery and Resolution Directive

The draft [European Insolvency Hierarchy Directive](#) requires Member States to create a new class of “non-preferred” senior debt. The reform aims to facilitate the application of EU bail-in rules and provide legal certainty for banks and investors. This fast-tracked measure has just been formally adopted; Member States must introduce national legislation to comply with the directive by 1 January 2019³ – but query whether the UK will do so, given the timing of Brexit.

Less straightforward are the proposed reforms in the draft “BRRD II” Directive⁴, expected to face an especially rough ride through the European Council and Parliament next year. Particularly controversial is the proposal to extend the close-out stay on derivative contracts to up to five working days. This goes against the international consensus of swap stays lasting no more than two days and could trigger opt-out rights for entities that have adhered to ISDA's Universal Resolution Stay Protocol. ISDA, AFME and, reportedly, the Bank of England oppose this element of the reforms. The Commission has called for political agreement on the “BRRD II” Directive by mid-2018 at the latest.

¹ The proposed reforms included a new flexible restructuring plan, with a cram-down mechanism, a new pre-insolvency temporary moratorium, and options for rescue financing. We broadly welcomed the proposals – although the devil is of course in the detail, and the consultation paper offered little detail.

² Insolvency Service [announcement](#), 12 December 2017.

³ Or 12 months from the day after its publication in the Official Journal of the EU, whichever is the earlier.

⁴ The draft “BRRD II Directive”, published in November 2016, includes two new moratoria powers: a new “early intervention” moratorium tool to be employed in the pre-resolution phase, and the power to suspend payments if necessary for the effective application of other resolution tools. Other draft European legislation provides for further reforms of the BRRD, but is beyond the scope of this note.

Horizon scanning for 2018

Legal Outlook

Brexit

We hope difficult questions of cross-border recognition of insolvency proceedings will get sufficient attention in the Brexit negotiations. For example: should the UK recognise European insolvency processes unilaterally post-Brexit, or only do so upon reciprocal recognition of UK insolvency processes? This is up for negotiation, but we fear it is not high on the Government's agenda. Absent proper resolution of such issues, we risk procedures becoming less predictable and thus more risky than at present. More "parallel" proceedings may be necessary, no doubt resulting in higher costs and lower efficiency. This has the potential to dramatically impact the UK's and Europe's restructuring and insolvency landscape.

Reform of European restructuring frameworks

The [draft](#) European directive "harmonising" restructuring proceedings⁵ continues to progress through the European legislative process. It does so at a moderate pace, notwithstanding the institutions' pre-occupation with Brexit, reflecting the importance of this initiative to the European Commission's stated priority of achieving a "true Capital Markets Union". We anticipate a revised draft shortly.

The European Commission recently [consulted](#) on the possibility of a new out-of-court enforcement mechanism. This aims to better protect secured creditors from defaults and, in particular, to reduce the accumulation of NPLs (which the Commission partly attributes to inefficient or ineffective enforcement procedures). We may see a proposal for a new so-called "accelerated loan security" this year – an EU collateral instrument to facilitate the effective foreclosure of collateral, perhaps somewhat akin to receivership but with built-in safeguards. This project is at a very early stage.

Case law developments

Schemes of arrangement

We expect the 2016-17 trend of heightened judicial scrutiny to continue this year – generally and particularly as regards restructuring fees. Watch out for close analysis of any advantages available to certain key creditors (e.g. right to subscribe for equity upon different terms to other creditors; director appointment rights; beneficial commercial terms for funding new money; payment of professional advisers' fees). Such benefits should be made available to anyone who holds a sufficient share of the debt. The court will enquire whether the scheme vote would have succeeded even absent the votes of those creditors receiving the additional benefits.

Cross-border recognition

The extent of assistance available under the Cross-Border Insolvency Regulations (which implement the UNCITRAL Model Law on Cross-Border Insolvency in the UK) and common law principles of comity for e.g. Chapter 11 proceedings is a recurring theme in Weil's practice. Watch out for cases testing the extent of "any additional relief" available in this regard.

NPLs

2018 will no doubt herald further developments in the push to rid the Eurozone of its persistent problem with non-performing loans. This follows the recent ECB initiative⁶ proposing to force banks to post collateral against any loan that becomes non-performing after January 2018. The ECB has pledged to present, by end March, fresh policies to deal with NPLs left over from the crisis years.

⁵ This is the draft directive on "preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU", dated 22 November 2016. The Commission's proposals focussed on three key elements: (1) common principles on the use of early restructuring frameworks, designed to help companies continue their activity and preserve jobs; (2) rules to allow entrepreneurs to benefit from a second chance, as they will be fully discharged of their debt after a maximum period of three years; and (3) targeted measures for Member States to increase the efficiency of insolvency, restructuring and discharge procedures.

⁶ Announced October 2017, followed by criticism from the European Parliament and Commission as to the proper scope of the ECB's powers.

Horizon scanning for 2018

Market Outlook

Against the backdrop of a significant supply of capital, the **hunt for yield** has driven appetite for lower credit quality and long-dated debt, amid an asset-price boom. **Covenant erosion** remains a growing concern; investor push-back in Europe appears to have been less effective than in the US. A correction appears overdue – so what will happen when investors' "risk-on" temperament reverses, refinancing activity becomes more challenging and defaults finally begin to transpire? The light-touch covenant package (now adopted "cookie-cutter" style) means the **removal of early warning signs** – in particular, the absence of financial maintenance covenants, looser restricted payments and dividend restrictions. Together, this means creditors risk being left on the side-lines in collective dismay as debtors' financial positions worsen, enterprise value continues to drain and options narrow pending a **true payment default**.

With the **lack of significant credit protections**, the market will have to rely on management and financial sponsors to be sensible in identifying situations where they need to engage with their creditors to preserve economic value (and bearing in mind variances in directors' duties across different jurisdictions). We are already starting to see such transaction activity with management teams engaging with their core stakeholders pre-emptively in advance of an immediate credit catalyst.

To date, **interest rate rises** have had relatively little impact on restructurings and the availability of cheap money in practice. However, further interest rate rises are widely anticipated this year, perhaps signalling the "beginning of the end" for cheap credit. A \$1tn wave of

fixed-income debt is set to mature in EMEA in 2018.⁷ Despite the current abundance of liquidity in the high yield bond and Term Loan B markets, no doubt weaker issuers will experience difficulty in refinancing, especially amid the early stages of the "great unwind" of global monetary stimulus.⁸

We expect political uncertainty and especially **Brexit speculation** to continue to dominate this year: with the "divorce deal" now agreed (in outline), focus shifts to the post-Brexit trading relationship. We hope for greater insight as to the potential post-Brexit R&I legislative landscape – especially as regards the Insolvency Regulation and Judgments Regulation.

Over the course of this year, we view key focus areas for restructuring activity within the following segments: consumer / retail (driven by changes in consumers' buying patterns and pressure on discretionary spending); UK-specific situations (various economic headwinds including inflation and market uncertainty driven by Brexit); oil and gas ("Phase II" restructurings); and other idiosyncratic situations driven by challenged business models.

We also believe restructuring activity will continue in emerging markets where we saw a considerable uptick in activity during 2017. Finally, it will be relevant to keep an eye on other nascent markets including cryptocurrencies for their impact on credit directly (via clearing houses, margin loans etc.⁹) and indirectly via their impact on market sentiment / risk-tolerance with potential contagion impact across the capital markets.

⁷ According to research by MUFG, published December 2017.

⁸ ECB bond purchases will drop from January to a monthly pace of €30bn (from the current €60bn). The US Federal Reserve's QE unwind, which started in October 2017 at \$10bn/month, will continue this year.

⁹ See the FIA's open letter regarding the listing of cryptocurrency derivatives, [here](#).

In 2017

Weil's London team...

advised the Ad Hoc Committee of noteholders in relation to **Dana Gas**' high-profile *sukuk* restructuring

welcomed the judgments of the Supreme Court in the "**Waterfall I**" proceedings and the Court of Appeal in the "**Waterfall II**" proceedings in relation to long-time client **Lehman**, in a dispute relating to the distribution of £8bn surplus assets in Lehman's main operating company in Europe

advised Lehman Brothers Holdings Inc. on the back-stop deal which settled the "**Waterfall III**" proceedings and various intercompany positions, unlocking over £1bn of distributions out of four Lehman estates

advised Lehman Brothers Holdings Inc. on plans to **resolve litigation and entitlements** to the surplus assets in Lehman's main operating company in Europe potentially via a scheme of arrangement

continued to advise the Special Administrators of **MF Global UK** on the ground-breaking **CVA** to facilitate the winding-up of the estate, giving creditors the option of exiting the special administration early in return for 99.75p/£

was called on by **Westinghouse Electric Company**, a subsidiary of Toshiba Corp, in relation to its \$9.8bn Chapter 11 proceedings, together with our US and European colleagues

advised offshore drilling provider **Paragon Offshore plc** in relation to its parallel Chapter 11 and English administration proceedings, together with our US colleagues

advised on the implementation of **Algeco Scotsman's** \$750m PIK loan restructuring via a scheme of arrangement, together with our US colleagues

acted for **CHC Helicopter Group** on its \$1.6bn Chapter 11 proceedings and Cayman provisional liquidation, together with our US colleagues and Cayman local counsel

played a leading role in the complex restructuring of **Edcon**, the South African retailer, in one of the **largest EMEA leveraged deals of the year**

advised Stemcor, the UK steel trading company, on its **consensual refinancing and equity raise**

celebrated Adam Plainer's **appointment** as President of the Insolvency Lawyers' Association

Paul Bromfield

We continue to mourn the loss of our colleague and partner, Paul Bromfield, who passed away on 4 July 2017 after a courageous battle with cancer. Paul was an extremely popular member of our team and the wider restructuring community. We were very touched that so many of our restructuring community attended his memorial service.

Who we are

Contacts – London Business Finance and Restructuring



Adam Plainer

Partner – London

Tel: +44 (20) 79031030

adam.plainer@weil.com



Andrew Wilkinson

Partner – London

Tel: +44 (20) 79031068

andrew.wilkinson@weil.com



Alexander Wood

Partner – London

Tel: +44 (20) 79031206

alexander.wood@weil.com



Mark Lawford

Partner – London

Tel: +44 (20) 79031050

mark.lawford@weil.com



Kate Stephenson

Consultant – London

Tel: +44 (20) 79031245

kate.stephenson@weil.com