Viewpoint

One of a series of opinion columns by bankruptcy professionals

Restructuring International Business: Issues For U.S. Professionals

By Alan Tilley

For a U.S. businessperson familiar with Chapter 11, venturing into the world of international restructuring is more than just entering another world. It is to enter a conceptually different approach to managing debtor interests. While business is international, legislation is local and most jurisdictions vary fundamentally from the U.S. in their approach to balancing debtor and creditor interests. Headline cross-border insolvencies such as Lehman Brothers emphasize different jurisdictional approaches. Without a level of understanding of the jurisdictional differences, U.S. restructuring professionals can miss important early-day tactical issues and important opportunities.

Jurisdictions outside of the U.S. have court-appointed practitioners who replace management in running the business. Goodwill, customers and key employees depart. Equity loses control and is out of the money. Most successful global restructurings of U.S. businesses are achieved by keeping international subsidiaries solvent and outside of formal process. The ability to achieve that while managing escalating issues at home is essential.

Fundamental to that process is an understanding of local insolvency triggers and real and perceived issues of directors' liability. Directors' liabilities are generally more strictly interpreted overseas than in the U.S. and can lead to a dash to the court by local management with little personal interest in equity preservation. Groups with subsidiaries in various jurisdictions are particularly vulnerable as local chief financial officers hoard cash to protect their own interests, unintentionally provoking a liquidity event in another jurisdiction.

The past decade has seen significant changes in both legislation and restructuring practice outside of the U.S. In Western Europe, governments reacted to the damage to enterprise value of businesses in the economic downturns of the early 1990s with new bankruptcy legislation. Between 1999 and 2005 Germany, the U.K., France, Italy and Spain changed their insolvency laws to become more "debtor friendly." The globalization of investment banking saw U.S. professionals move to London where they questioned established local insolvency practice.

The result has been a trend to consensual restructuring, leveraging stakeholder negotiations off the threat of insolvency. Other techniques have crossed the Atlantic too, such as prepacks. But the reality is that U.S. restructuring is still the odd man out. So taking a U.S. mindset to a non-U.S. problem can cause an inappropriate first reaction and lose valuable time in the critical early days as insolvency looms.

An essential element of restructuring is adjusting operations to new activity levels and offloading unnecessary costs and obligations in line with reduced revenue projections. Headcount reductions, pension liabilities and onerous contracts are targets. While the legal framework varies from country to country, little has changed by way of legislation to ease the heavy cost of redundancy programs in the European Union countries.

But with the current recession, economic reality has taken hold and unions and employees have responded by agreeing to salary cuts and short-term working arrangements. German companies in particular have responded to the crisis in this way to keep their cost-base competitive. Similar trends are apparent in the U.K., Ireland and Spain with French unions being the most resistant to change.

In recent settlements the use of prepacks or the threat of one has concentrated the minds of negotiators to mitigate the burden without recourse to filing. Leasehold contracts have also been renegotiated under similar threat. Debt- to-equity swaps and the use of payment-in-kind notes have also evolved in European restructurings. London syndicates are well acquainted with the concept, but outside of the U.K. this is less common.

Accordingly, we have seen a trend to navigate to London to restructure balance sheets. To do this a company must either move its holding company with the debt to the U.K. or prove that its center of main interest (COMI) is in the U.K. In recent years companies such as Schefenacker and Collins & Aikman have used these tactics.

Alternatively, if a company can prove a connection with the U.K. either with a branch or English law loan agreements, it can cram down dissenting creditors under a procedure known as a Scheme of Arrangement. Listed Spanish company La Seda de Barcelona did just that, restructuring its EUR600 million syndicated loan in a

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debt-to-equity swap in May. Mindful of losing restructuring business to London, Germany is amending its legislation to discourage migration. At the same time the U.K. government is considering amendments to remove barriers to consensual pre- insolvency restructuring. There is competitive tension in international restructuring which is a force for good.

While the tsunami of restructuring since the banking crisis has not appeared, the presumption is that international restructuring will continue to grow. It has also become increasingly complex. The driving force is preservation of value and movement away from value-destroying insolvency. Sophisticated schemes such as forum shopping and jurisdiction change are expensive and only appropriate in the largest cases. Challenging accepted local practices has moved international restructuring forward in the past decade, while cross-fertilization of best practice from the U.S. and local legislation continues. Understanding what to challenge and what to manage around is an invaluable tool for the U.S. professional with international clients.

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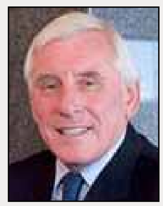

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