Debtwire
An Acuris company

Distressed investors ready to pour dry powder into Europe as crossborder harmonisation set to improve patchy framework - Conference Coverage

02 December 2019 | 12:09 GMT

"In Europe, and in France in particular, bankruptcy is still a bad word for investors. The challenge for foreign investors, when looking at investment opportunities in the European Union, is the complexity of an ununiform system," said Christian A. Saxenhammer, managing director at Saxenhammer & Co, describing investors' reserves vis-à-vis the French distressed debt market's regulatory framework, at the 15th International Insolvency & Restructuring Symposium held on 14 and 15 November by the American Bankruptcy Institute in Paris.

Attended by lawyers, judges and buysiders from both sides of the pond to discuss the future of the European distressed debt and restructuring market, the conference kicked off with a panel focusing on French insolvency law.

Throughout the first day of the event, participants agreed that the French distressed debt market is not mature yet, with not enough investors for the plentiful opportunities available. Alban Meteyer, vice president at Chiron Financial SAS, pointed out that France is still far away from being considered a restructuring hub at the European level. Answering a question on whether investors are changing their strategy and approach vis-à-vis the country, he noted that many investors only set up offices in France but continue to structure and manage their deals from their London offices. "At the middle market level, we see American groups testing the European waters mainly through their UK presence. Some foreign groups [though] are starting to develop dedicated teams for each local jurisdiction," he said.

Anker Sorenson, partner at De Gaule Fleurance & Associes in Paris, listed several industries that are experiencing distress in France at the moment: retail was of course the obvious candidate, with Orchestra-Premaman being the latest victim and falling into sauvegarde a couple of months ago. Inevitably, commercial real estate has also suffered as a result of retail's difficulties. The automotive industry, steel, media and tourism – as well as airlines, with recent liquidations of Thomas Cook, and French companies Aigle Azur, XL Airways – were also mentioned.

Navigating European distressed opportunities

The automotive sector is indeed under the spotlight globally. Over the past few months, the automotive giants have been increasingly warning that the industry is facing difficult times because of a downturn in demand for cars driven by China, as well as changes in technology battery-operated car, autonomous driving or the evolving habits of young people. In sharing his colourful thoughts on the impact of decreasing car production in Germany and China, Saxenhammer said that this will soon impact iron prices, hence creating opportunities for distressed investments in the sector in the coming months.

PROPRIETARY
Europe

Consumer: Retail
France

Issuer
Market Report

Other
Aigle Azur SA

Other
Lehman Brothers

Other
Orchestra Premaman SA

Other
Thomas Cook Group Plc

Other
XL Airways France S.A.

Federica Pietrogrande, managing director at Gordon Brothers in London, also earmarked the automotive industry as well as the construction and retail sectors. She, however, noted that rather than an all-out recession, investors should “monitor disruptions in various sectors or jurisdictions in Europe”. Pietrogrande cited “some European countries have never really recovered from 10+ years of recession”. She added that some countries are disadvantaged by “regulatory framework issues” e.g. in Italy, Austria and France where lending activity is highly regulated. However she highlighted that there is scope for “the right legal reforms to unlock opportunities. And many European countries are waiting for that".

On the rumours of retail apocalypse, Pietrogrande went on to clarify “there is no apocalypse, only transformation” and suggested that in the new fast-evolving retail market, those with dynamic and innovative solutions were more likely to perform. Saxenhammer’s view of the situation was more dramatic. “There will be a big transformation, but it will be bloody,” he commented. “You know how it happened in the United States with store closures and rent cuts. In Europe things are different; In Italy, people still go to stores, and internet coverage is not as widespread.”

With more than USD 80bn of cash - or “dry powder” – waiting impatiently to be deployed by distressed investors, according to Teresa Kohl, managing Director at SSG Capital Advisors, the big question is when will be the right time to pull the trigger.

Pietrogrande also noted that taking a generalist view on potential distressed sectors could be misleading, adding that investors should have a local and case by case approach.

Extending a hand to creditors

Focusing on the French market, Fabienne Beuzit, partner at Jones day’s Paris office, said that traditionally French companies used the so-called preventive proceedings available in the domestic workout toolbox, i.e. the mandat ad hoc and conciliation. However, those processes require unanimity and features no cram down mechanism. As for other tools available, she noted that even the sauvegarde, a “collective” proceeding, is not sufficiently well-equipped to force the hands of the dissenting stakeholders.

Panellists touched upon recent legal reforms in “the Hexagon” that have expanded debt for equity swaps as well as an element of cram-down. The French regime, however, largely remains debtor-friendly, the panellists cautioned, pointing out that, for instance, the administrator is appointed by the debtor, not the creditors.

The new EU harmonisation directive was thoroughly discussed to understand how it could help pave the way for new cross-border opportunities, making France a more attractive restructuring hub. “Our government has fully understood the need to align with international best practice to attract foreign investors,” argued Beuzit, adding that the Directive aims to facilitate loan-to-own transactions, which are popular in the United States, “but quite difficult to implement” in France.

The EU directive on insolvency, restructuring and second chance, sometimes referred to as “the European Chapter 11”, was adopted in June 2019 and will be implemented by the end of 2020.

"In France, the EU directive should be used to provide a more consensual preventive phase. Its objective is to save viable enterprises in the country that need to be released from part of their financial liabilities while keeping value for creditors", said Beuzit. She highlighted that the Directive does have several game-changing features: the debtor will remain in control of day-to-day management; creditors will vote in classes; and only the parties affected by a workout plan will be invited to vote on it.

This, she continued, is a major shift vis-à-vis sauvegarde in which other stakeholders such as suppliers and shareholders get to vote in their distinct classes. And the Directive also provides for cross-class cram down in a scenario where at least one class (excluding shareholders or out-of-the-money classes) has voted in favour of the plan. She argued that this is a significant improvement compared to the existing regime under which, for instance, a mezzanine or other subordinate creditor might be able to block a plan even if bank lenders have approved it.

But panellists broadly agreed that even with new opportunities provided by the Directive, strong French labour laws, which prioritise job protection, might still deter distressed investors from getting involved, and push them to look at alternatives in Europe, such as Germany or the Netherlands.

Broader harmonisation around the globe

Last year, the United Nations Commission on International Trade Law (UNCITRAL) Working Group V revealed a new Model Law on the Recognition and Enforcement of Insolvency-Related Judgments. This has been referred to as "UNCITRAL 2" or "UNCITRAL lite" and establishes a framework for recognition and enforcement of foreign insolvency judgments.

While the EU harmonisation directive is expected to influence the internal dynamics of the EU insolvency space, the new Model Law targets broader harmonisation and mutual recognition across the globe.

The new Model Law provides a definition of what an insolvency judgment is and lists several requirements for recognition of judgments. Robert van Galen, partner at NautaDutilh and the Dutch representative to UNCITRAL Working Group V, said that one requirement of recognition is for a judgment to be effective in its state of origin. He explained that the judgment doesn't have to be issued by the authorities of the country where insolvency proceedings have been opened.

Van Galen, however, warned that recognition cannot be assumed in every case, adding that it can be refused when and where it interferes with the administration of the debtor's insolvency, has an adverse impact on the general body of creditors, or if the interests of creditors are not adequately protected in the proceedings in which it was issued.

Kathlene Burke, associate at American law firm Skadden, argued that the new Model Law was expected to have a significant impact on the recognition of foreign insolvency proceedings in the UK, eventually replacing the controversial rule in Gibbs, the longstanding English law principle – which dates back to 1890 – based on which claims governed by English law cannot be discharged by the courts of another country unless the relevant creditor(s) submit to those courts' jurisdiction. She added that stipulations of the new Model Law on recognition are formulated in way that make the courts of signatory countries more likely to grant recognition.

In the United States, a foreign judgment can already be recognised quite swiftly thanks to the mechanism devised under Chapter 15 of the Bankruptcy Code. But Burke noted that even in the U.S., there are sometimes differing views between different courts as to what relief should be granted pursuant to Chapter 15.

In discussing the model law on Enterprise groups, she noted that coordination between the relevant courts was key in large multi-jurisdictional cases such as Wall Street giant Lehman Brothers' bankruptcy. Recalling her experience on the case, she said: "Judge Peck encouraged for coordination [between the courts involved]. Many of the courts and lawyers cooperated, but not all of them."

Burke also pointed out that while the new EU Directive addresses many of the concerns addressed by the Model Law, it doesn't eliminate the need for such an international framework, simply because the Directive only applies to EU, and not beyond.

Businesses dealing with trade wars

The recent tariffs wars around the globe and geopolitical instabilities, notably fuelled by the revival of nationalist feelings, were also touched upon as source of additional uncertainties for businesses and distressed investors.

Drawing on the US Chamber of Commerce forecasts, one panellist listed the agricultural, automotive and iron and steel sectors as specific industries hit by US-China trade war. "Agriculture exports drastically fell this year and farm bankruptcies in the US jumped to highest level since 2011 as Trump's tariffs bite", noted Amy Edgy, partner at Linklaters in Washington. According to the American Farm Bureau Federation, Chapter 12 farm or fishery bankruptcies totalled 580 filings between January and September 2019, a 24% increase compared to the same period last year.

For some of the panelists, US companies are struggling dealing with tariffs forecasts and their potential impacts on earnings. "At the moment, it is all about the cost impact. The first phases of tariffs have not yet hit the consumers directly, but they have impacted the companies' cost", noted Carrianne Basler, managing director at AlixPartners in Chicago.

If both vertical and horizontal diversifications were deemed as a potential strategy to seek protection from tariffs, some panellists concurred that it could also represent a risky attempt for companies as tariffs led by Trump administration were described as unpredictable.

"While tariff wars were historically more about economic policy, they are increasingly being used to drive foreign policies and can now lead to more financial restructurings", said Basler. In addition, some panellists noted that companies dealing with operations and shipping goods will be increasingly exposed to the risk of bankruptcy.

by Claudia Cohen and Hossein Dabiri