GLOBAL INSIGHT
News, Views and Analysis from DLA Piper’s Global Restructuring Group
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BANKRUPTCY SALES FOR DISTRESSED HOSPITALS —
FOUR QUESTIONS TO ASK BEFORE YOU BEGIN

Over the last several years, a wide range of healthcare companies, among them hospitals, home health agencies and continuing care facilities, have faced financial distress as a result of declining revenues, high operating costs, reduction in reimbursements rates and increasing competition. Seeking relief, many hospitals and other healthcare companies are commencing chapter 11 cases and selling their assets to third parties in order to shed liabilities and facilitate an orderly transfer of their assets. Fairmont General Hospital, Saint Francis Hospital, Natchez Regional Medical Center and Sound Shore Medical Center are just a few of the hospitals that have recently filed for bankruptcy, selling (or are seeking to sell) all or a portion of their assets to third parties.

In addition to yielding substantial benefits for distressed hospitals, bankruptcy sales also present unique opportunities for third parties to acquire valuable assets at a discount, free from claims arising from their financial distress. In general, the sale of assets in a corporate chapter 11 case is straightforward. Section 363 of the Bankruptcy Code permits companies to sell all or substantially all of their assets free and clear of any interest in such assets to the bidder presenting the highest and best offer. However, when applied in the context of the heavily regulated healthcare industry, several additional considerations come into play. The questions discussed below are just some of the myriad issues that can arise in the sale of hospitals in a bankruptcy proceeding.

DO YOU HAVE A POTENTIAL STRATEGIC PARTNER?

It is advisable for hospitals entering chapter 11 for the purpose of effectuating a sale or other transaction to have a potential strategic partner lined up at the time of filing. This will provide much needed certainty for not only the hospitals, but also patients, residents, physicians, employees and suppliers. While the initial offer from the strategic partner (the “stalking horse”) will be subject to higher and better offers, the relevant constituents will know that there is at least one resolution in hand. In addition, having a “stalking horse” agreement in place will provide a starting point for negotiations with other potential purchasers.

Once they are engaged in the sale process, parties should be made aware that purchase price is not the sole factor taken into consideration in determining what constitutes the highest and best offer for a debtor’s assets. Other factors that should be considered include, but are not limited to, the purchaser’s ability to close the sale transaction in a timely manner, the purchaser’s commitment to preserving jobs and ongoing business relationships with suppliers and vendors post-sale, the purchaser’s ability to obtain required regulatory approvals, licenses, permits, accreditations and certifications needed to operate the business after the sale and, in the case of not-for-profit hospitals, the purchaser’s commitment to continuing the debtor’s charitable mission.

Antitrust concerns were at issue in the bankruptcy case of Saint Francis Hospital, a 333-bed hospital in Poughkeepsie, New York which filed for chapter 11 in December 2013. Saint Francis initially had a proposed deal in place with Health Quest as the stalking horse bidder. Ultimately, however, Saint Francis decided to consummate a sale transaction with an affiliate of Westchester Medical Center, a 643-bed hospital in Valhalla, New York, due to, among other things, regulatory hurdles associated with Health Quest’s bid regarding whether the transaction with Health Quest would violate federal and state antitrust laws, including the Hart-Scott-Rodino Act.

“In general, the sale of assets in a corporate chapter 11 case is straightforward. However, when applied in the context of the heavily regulated healthcare industry, several additional considerations come into play.”
HOW WILL THE SALE AFFECT PATIENTS?

Particularly in the sale of hospitals, courts will consider how the proposed sale will affect patients prior to approving the sale. Both debtors and bankruptcy courts will want assurance from the proposed purchaser that, after the sale, the purchaser will continue to provide quality care and accommodations for patients.

Indeed, the importance of maintaining patient care is highlighted by Congress’ enactment of section 333 of the Bankruptcy Code, which provides for the appointment of a patient care ombudsman for debtors in a healthcare business to monitor the quality of patient care and to represent the interests of patients during the debtor’s bankruptcy case.

ARE YOU MAINTAINING PATIENT MEDICAL RECORD CONFIDENTIALITY?

Parties will also need to maintain the privacy of confidential patient medical records in accordance with applicable law, including the Health Insurance Portability and Accountability Act (HIPAA). In the event that all medical records are not transferred to the purchaser, the seller will need to make sure a protocol is in place for the retention and eventual disposal of such records in accordance with HIPAA.

WHAT ABOUT SUCCESSOR LIABILITY?

Section 363(f) of the Bankruptcy Code generally provides that purchasers acquire assets in a sale free and clear of any “interest” in those assets, thereby forcing parties with pre-petition claims against a debtor to satisfy their claims from sale proceeds and not against the purchaser. The Bankruptcy Code permits “free and clear sales” in order to encourage higher bids for estate assets and to promote an equitable distribution to creditors. Certain post-petition claims may be barred by a section 363 sale order as well. For example, the US Bankruptcy Court for the District of New Jersey recently ruled that certain economic tort and unfair competition claims against the purchaser of Christ Hospital relating to the purchase of the hospital were “interests” under section 363(f) of the Bankruptcy Code and, thus, the sale was free and clear of such claims. In addition, the US Bankruptcy Court for the Southern District of New York recently ruled that the sale of Sound Shore Medical Center’s assets to Montefiore Medical Center was free and clear of the seller’s collective bargaining agreements. Also, post-sale, the bankruptcy court established certain mediation procedures for medical malpractice claims against Sound Shore, which were excluded liabilities under the sale.

Courts have found, however, that certain pre-petition claims against the debtor survive the sale process. In particular, several courts have found that a purchaser that assumes a hospital’s Medicare provider number and related agreements acquires those assets subject to the government’s right to seek recoupment of overpayments made to the debtor prior to the bankruptcy filing. Provider agreements under this line of cases are treated as continuing executory contracts and purchasers are deemed to assume both the benefits and burdens of those agreements. Purchasers may also face successor liability for claims that extend beyond Medicare recoupment, including environmental claims previously asserted against the debtor or claims in favor of holders that were not properly noticed of the sale.
NEW INSOLVENCY LAW IN ROMANIA — A STEP AHEAD

Following a lengthy process which started in 2012 aiming to reform the Romanian insolvency framework as part of a wider judicial reformation program, the New Insolvency Law (Law no. 85/2014 regarding the prevention of insolvency and the insolvency proceedings) entered into force on 28 July 2014. As part of a project coordinated under the aegis of the World Bank and the International Monetary Fund, the New Insolvency Law adopts an integrating vision and illustrates a new approach of saving the business and giving a second chance to the honest and viable debtor, while also ensuring fair treatment of creditors.

GENERAL OVERVIEW

The New Insolvency Law consolidates all pre-insolvency, and the vast majority of the insolvency, provisions under Romanian legislation in relation to companies, groups of companies, credit institutions, insurance and reinsurance companies, as well as cross-border insolvency proceedings. Its applicability is restricted to insolvency proceedings commenced after it entered into force; any ongoing proceedings are regulated by the former insolvency law.

For the first time in Romanian legislation, the New Insolvency Law introduces 13 principles, inspired by the Principles of European Insolvency Law and the UNCITRAL Legislative Guide on Insolvency Law. They shape the ratio legis of the new regulation and give insight into the purpose of the changes and innovations.

The New Law presents numerous amendments to the insolvency regulation, both procedural and substantial, that will significantly affect the way in which insolvency is regarded by the business environment.

IMPORTANT PROCEDURAL CHANGES

Aiming to avoid fraudulent recourse to insolvency proceedings, the New Insolvency Law provides clearer instructions and modifies certain important aspects of its execution, such as:

- The threshold represented by the value of the outstanding debt required for the opening of the insolvency proceeding is reduced from RON 45,000 to RON 40,000 (€9,000). It is now applicable whether the filing to open the insolvency proceeding is made by the debtor, any of its creditors or the liquidator appointed according to the Company Law. Formerly, the threshold only applied to creditors. Moreover, the maturity of the outstanding debt is also reduced from 90 days to 60 days.

- The observation period — this is the first stage following the opening of the insolvency proceedings aimed at assessing whether the debtor’s business is still viable and should be reorganized: it is now expressly limited to 12 months.

“The New Law presents numerous amendments in the insolvency regulation, both procedural and substantial, that will significantly affect the way in which insolvency is regarded by the business environment.”

ABSOLUTE NOVELTIES

Apart from modifying existing provisions in order to mirror the solutions already developed by scholars and case law, the New Insolvency Law also introduces new concepts and solutions:

- A framework for coordinating insolvency proceedings for companies in the same group whether they are connected by control and/or qualified participations (e.g. the appointment of the same special administrator for all the insolvent group companies, the possibility of the judicial administrator appointed with respect to any of the insolvent companies to propose a reorganization plan for any of the other insolvent companies in the group, the duty to cooperate of the judicial administrators of the group companies);
An express provision enabling creditors or the debtor to file for *interim measures* to safeguard the debtor’s assets before the hearing of the application to open insolvency proceedings;

A new provision introducing a private investor test. This was inspired by European Court of Justice case law, where the approval of a reorganisation plan involving a haircut of public debt was not considered per se to amount to unlawful state aid. Public sector creditors are encouraged to negotiate the proposed terms for the recovery of their debt in the same way as private sector creditors, thus supporting the reorganisation of the debtor to avoid its bankruptcy.

**POST-COMMENCEMENT FINANCE**

- Clear provisions for the protection of creditors that finance an insolvent company during the observation and reorganisation periods. Such creditors are now provided with properly regulated securities for the recovery of their loans;
- The duty to notify the competent tax authority prior to filing the claim for the opening of the insolvency proceeding; and
- A dedicated chapter containing all substantial and procedural rules regarding *cross-border insolvency proceedings* which do not fall under the scope of Council Regulation (EC) no. 1346/2000 on insolvency proceedings.

**CONCLUSION**

The New Insolvency Law introduces considerable improvements to Romania. But it is still too early to predict its net effect on the daily difficulties that businesses and practitioners may encounter in the context of insolvency as they will depend on the manner in which the law will actually be applied by the courts.

Nevertheless, the new law is an important step forwards and should at least have the effect of speeding up insolvency procedures and preventing abuse.
MIRABELA NICKEL RESTRUCTURING — AN AUSTRALIAN FIRST

The recent restructuring of Mirabela Nickel Limited is the first time under Australian law that voluntary administrators have completed a debt for equity restructuring of a listed company, using legislative provisions which allow them to sell existing shares in a company without the consent of the shareholders. The outcome should be of significant interest to all stakeholders and investors in the Asia Pacific market.

BACKGROUND

Mirabela is an Australian Stock Exchange-listed nickel mining company, with all of its mining operations based in Brazil. Prior to restructuring, it had US$500 million of indebtedness - mainly debts due to US-based noteholders.

Among the issues facing the board and the lenders were material decreases in the price of nickel, negative operating cash flows, a highly leveraged debt structure, unfunded critical capital works and debt being traded at a steep discount. For Mirabela to be able to continue operating at normal levels, a restructuring was considered to be essential.

THE VOLUNTARY ADMINISTRATION REGIME

The voluntary administration regime in Australia provides a means by which companies in distress can be given breathing space to develop and implement a restructuring plan with their creditors.

The regime involves the company appointing a voluntary administrator to take control of the company’s affairs, with a view to developing a deed of company arrangement (DOCA). A DOCA is a binding agreement that regulates the arrangements between the company and its creditors. There are generally very few restrictions on the types of DOCAs that can be executed, and DOCA proposals can be adapted to meet the particular circumstances of the company and its creditors.

During the period of administration prior to the execution of a DOCA, the company benefits from a moratorium on any action being taken against it by its creditors (save for certain of its secured creditors that act within a certain timescale). Once a DOCA is executed, the voluntary administration ends and a deed administrator is appointed to oversee the operation of the DOCA.

Section 444GA of the Corporations Act permits a deed administrator to sell existing shares in a company without the consent of the shareholders (that is, by compulsory sale), so long as leave of the court is obtained. Until Mirabela, section 444GA has only been used in relation to relatively simple DOCAs involving private companies.

THE APPROACH IN MIRABELA

In Mirabela, the restructuring plan included:

- Certain noteholders entering into an agreement to do everything necessary to achieve the restructure;
- The appointment of voluntary administrators to Mirabela;
- The execution of a DOCA, which provided for the compulsory transfer of 98.2 percent of existing shares in Mirabela to the noteholders for nil consideration, in exchange for the extinguishment of US$435 million of their debts, by using section 444GA; and
- The issuance of US$115 million of convertible notes to fund ongoing operations after the restructure.
The court may only give leave under section 444GA if it is satisfied that “the transfer would not unfairly prejudice the interests of the members of the company”. Among the factors considered by the court in an application for leave are:

- Whether the economic value in the company breaks in the debt or the equity;
- The likely outcome were the company to go into liquidation instead; and
- The effect of the proposed restructuring on the company and its creditors generally.

In Mirabela, the court in granting leave noted in particular that:

- It was difficult to see how the members suffer any prejudice as a result of a proposed compulsory sale under section 444GA, in circumstances where the value breaks in the debt, the existing shares have little to no residual value to the shareholders, the shareholders would be unlikely to receive any distribution in a liquidation and liquidation is the only realistic alternative to the proposal; and
- The proposed plan preserved Mirabela’s business (which would otherwise have inevitably failed), allowed employees to be retained and their entitlements preserved, and allowed payments to be made to trade creditors in full. All of these considerations fell within the objects and intentions of the voluntary administration regime itself.

As well as the approval of the court, the restructuring also required regulatory oversight and approval from the Australian Securities and Investment Commission, the Australian Stock Exchange, and the Foreign Investment Review Board.

**IMPACT ON RESTRUCTURING IN AUSTRALIA**

The Australian Restructuring Insolvency & Turnaround Association has noted that Mirabela has “the potential to change the dynamic of the restructuring sector, overcoming the insolvency stigma of a company going into voluntary administration.”
CHINA CREDIT — RELAXATION OF RESTRICTIONS ON CROSS-BORDER SECURITY

Recent regulatory changes by China’s foreign exchange authority have made it significantly easier for foreign lenders to take security over domestic assets and to obtain guarantees from domestic entities in China.

Borrowers with significant onshore assets in China have until recently been constrained by the regulatory regime limiting a borrower’s ability to obtain onshore security or guarantees (in this article, “onshore” refers to mainland China and “offshore” refers to outside mainland China, including Hong Kong and Macau). The provision of security over onshore assets or guarantees by onshore entities was previously subject to a review by China’s State Administration for Foreign Exchange (SAFE) of whether a set of onerous requirements had been satisfied, including those relating to the principal debtor’s profitability and the security provider’s net assets position, total foreign currency revenues and affiliation with the principal debtor. In many cases, these requirements effectively prohibited outbound security arrangements or at least rendered them impractical.

Offshore creditors were thus effectively subordinated to their onshore counterparts and subject to substantial credit risk in the event of an onshore insolvency. The new Foreign Exchange Administration Rules of Cross-Border Security (the New Regulations) issued by SAFE removes many of these constraints, simplifying finance structures and allowing a more efficient use of borrowers’ assets. The New Regulations became effective on 1 June 2014.

NEW REGULATIONS: A MORE PROCEDURAL APPROACH

As a whole, the New Regulations have fundamentally changed SAFE’s approach to regulating the provision (and acceptance) of cross-border security and guarantees by taking a more procedural, registration-based approach. Furthermore, registration with SAFE is no longer a condition to the validity of the guarantee or security interest.

The New Regulations classify cross-border security and guarantees into three types:

- An onshore entity or individual providing security or guarantees to an offshore creditor to secure the obligations of an offshore principal debtor (“Outbound Security”);
- An offshore entity or individual providing security or guarantees to an onshore financial institution to secure the obligations of an onshore borrower (“Inbound Security”); and
- Other types of cross-border security and guarantees not included above.

Security or guarantees provided in Outbound Security or Inbound Security structures must be registered with SAFE (though, as mentioned above, registration is merely a procedural matter which does not impact the validity of the security or guarantee). All other types of cross-border security and guarantees do not generally need to be registered or filed with SAFE.

OUTBOUND SECURITY

Restrictions on purpose of debt

Despite requiring only registration of Outbound Security arrangements, debts incurred for the following purposes are not permitted under this structure unless specifically approved by SAFE: (i) equity investments in or intercompany loans to onshore entities (including refinancing debt used for this purpose); (ii) acquisitions of offshore entities with more than 50
percent of their assets onshore; or (iii) advance payments to an onshore entity for goods or services if the payment is made more than a year before taking delivery and certain other thresholds regarding the value of the transaction are met.

The New Regulations also contain additional requirements in certain circumstances where the security or guarantee secures a bond issuance, financing of an outbound investment or payment obligations under an offshore derivative transaction.

**OTHER STRUCTURES**

Generally, registration or filing with SAFE is not required for security interests or guarantees that are not provided under either an Outbound Security or an Inbound Security structure. However, parties should ensure that such arrangements are in compliance with other PRC laws and applicable foreign laws.

Foreign-invested enterprises (FIEs), such as Wholly Foreign-Owned Entities and Sino-foreign joint ventures, together with many large-scale companies in China (often state-owned enterprises) can borrow funds offshore with only the requirement to conduct a foreign debt registration with SAFE.

Previously, it had been impractical for such offshore cross-border financings to be secured, requiring SAFE pre-approval before any security interest or guarantee could be provided by the onshore borrower. However, the New Regulations have now abolished these approval requirements, making it easier for onshore borrowers to provide security or guarantees, which enhance the security package for offshore lenders or counterparties, a development that is also likely to benefit structured trade credit transactions.

**POTENTIAL CREDIT ENHANCEMENT STRUCTURES**

Corporates with offshore funding needs will be the main beneficiaries of these developments, as their onshore subsidiaries can now provide credit support in the form of security in onshore assets or guarantees.
REGISTRATION REQUIREMENTS AND ENFORCEMENT

Under the New Regulations, onshore guarantors and security providers must register any Outbound Security with SAFE within 15 business days of execution of the security documents. There is no additional administrative procedure required to enforce a security interest or guarantee provided under the Outbound Security structure. Upon such enforcement, the onshore security provider or guarantor will be subrogated to the rights of the offshore creditor, which in turn gives rise to a cross-border debt obligation. Pursuant to SAFE regulations, such cross-border debt would need to be registered within 15 business days. Furthermore, until such cross-border debt owed by the principal debtor is discharged in full, the onshore security provider or guarantor is not eligible to provide any further cross-border security or guarantees unless prior approval from SAFE is obtained.
WHAT THIS MEANS FOR SPECIAL SITUATION/DISTRESSED-FOCUSED INVESTORS

This ability to take onshore security not previously available to offshore creditors may create new opportunities for both institutional and non-institutional lenders and investors. Not only can their existing facilities be restructured to enhance the credit profile but it may allow investors to issue, acquire or accede to other facilities that were structured before the New Regulations had come into effect and subsequently take new security or restructure existing facilities involving security that would previously have been prohibited. The caveat, however, is that the original debt proceeds from any such facilities must not have been used for purposes that are prohibited under the New Regulations (such as direct or indirect equity investments in onshore entities or intercompany financing of onshore entities).

“This ability to take onshore security not previously available to offshore creditors may create new opportunities for both institutional and non-institutional lenders and investors.”
CROSS-BORDER INSOLVENCIES — RECOGNITION OF FOREIGN LIQUIDATORS IN HONG KONG

A recent decision of the High Court in Hong Kong confirms that foreign liquidators from other common law jurisdictions with similar insolvency laws may obtain recognition and certain types of assistance without the need to commence separate winding up proceedings in Hong Kong.

The ruling in this case will be broadly welcomed by foreign liquidators seeking to obtain information and documents in Hong Kong without having to incur the delay and expense of pursuing separate winding up proceedings.

The case provides clear authority for banks, auditors and other parties in Hong Kong to cooperate with foreign officeholders without any need for a separate winding up order from the Hong Kong courts. Once a request or instruction from a liquidator of a foreign corporation is received, they can act provided the recipient is satisfied that the liquidator has been validly appointed in the place of incorporation.

APPLICATION FOR RECOGNITION AND REQUEST FOR INFORMATION

The case, reported as *The Joint Official Liquidators of A Company v B & Another*, involved a number of applications by the liquidators of a company incorporated in the Cayman Islands which had been wound up by an order of the Grand Court of the Cayman Islands. The applications were made on a confidential basis in the form of a letter of request whereby the Cayman Court requested the following orders from the High Court of Hong Kong:

1. a confidentiality order;
2. recognition of the liquidation in the Cayman Islands and the appointment by the Cayman Court of the liquidators; and
3. an order that the respondents produce certain documents to the liquidators concerning the details of bank accounts into which substantial sums of money were paid by the Company in circumstances which suggested a fraudulent motive.

The third order sought was the type made in Hong Kong under section 221(3) of the Companies (Winding-up and Miscellaneous Provisions) Ordinance (Cap. 32) in a domestic liquidation on the application of a liquidator or provisional liquidator.

‘MODIFIED UNIVERSALISM’ REVISITED

The decision involved an analysis of established principles of private international law applying to foreign companies together with some of the key authorities in recent cross-border insolvency and recognition cases, such as the UK Supreme Court case of *Rubin v Eurofinance* and *Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings plc*.

Since *Rubin*, the extent to which assistance and recognition could be provided by domestic courts to foreign insolvencies and their officeholders has been under debate. The Cayman Court in the case of *Picard and another v Primeo Fund (In Official Liquidation)* confirmed in its decision on 14 January 2013 that, certainly in so far as the Cayman courts were concerned, the Supreme Court ruling in *Rubin* did not expressly reject the underlying common law assistance and recognition proposition set out in *Cambridge Gas*.

“The case provides clear authority for banks, auditors and other parties in Hong Kong to cooperate with foreign officeholders without any need for a separate winding up order from the Hong Kong courts.”
JUDGMENT
The court granted the orders outlined above and in doing so, confirmed the extent to which the common law principles in Hong Kong allow the court to recognise foreign liquidators and provide assistance to them.

The court went on to confirm that the Companies Court may, pursuant to a letter of request from a common law jurisdiction with a similar substantive insolvency law as Hong Kong, make an order of a type which is available to a provisional liquidator or liquidator under Hong Kong’s insolvency regime.

AUTOMATIC ASSISTANCE LIMITED
An important point to note is the distinction highlighted in the judgment between information and assets, whereby the common law principles mean a foreign liquidation has no automatic consequences in relation to the property of a foreign company in a local jurisdiction. Accordingly, an application will still need to be made by a foreign liquidator for an order vesting that liquidator with title to any property situated locally.

MODERNISATION OF HONG KONG’S INSOLVENCY LAW
The judgment concludes with a note of warning to Hong Kong’s legislature. At present, a consultation document has been issued by the Financial Services and the Treasury Bureau, “Improvement of Corporate Insolvency Law Legislative Proposals - April 2013,” which involves a comprehensive review of Hong Kong’s insolvency legislation (see the Q4 2012 edition of Global Insight, - The modernization of Hong Kong corporate insolvency law). However, as Harris J has highlighted, the proposals are silent on the incorporation of statutory provisions providing for the recognition of foreign insolvency proceedings similar to the type found in section 426 of the Insolvency Act 1986 in the UK. Harris J concludes that the failure to make such an obvious amendment would invite the argument that “Hong Kong’s courts should take a more restrictive view of the extent to which they should assist foreign liquidators from other common law jurisdictions”.

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INSOLVENCY IN THE FASHION RETAIL SECTOR — UNDERSTANDING AND MANAGING THE RISKS OF AN INSOLVENT ACQUISITION

In our “Insolvency in the fashion retail sector: the risks and opportunities” article in the Q2 edition of Global Insight, we looked at the challenges the fashion retail industry faces today and the opportunities available for both existing players and new market entrants in the context of insolvent business acquisitions. In this article we comment in more detail on these opportunities and consider some of the factors and risks to be aware of when purchasing an insolvent fashion retail business and its assets.

OPPORTUNITY ARISES OUT OF ADVERSITY

The recent global financial crisis has seen consumers tighten their belts and the retail industry as a whole under ever greater pressure. Even companies with seemingly strong financial reserves and significant brands have found the market challenging - fashion retail has been no different. Profit warnings have peppered the financial pages (e.g. Mulberry), and other fashion retailers, within both the budget and luxury sectors, have been subject to formal insolvency proceedings (e.g. Aquascutum, Barratts and Republic).

For those fortunate enough to be in the position of the buyer, however, the current climate can give rise to considerable opportunities, including:

■ The ability to cherry pick the business’ best assets without having to acquire its liabilities – for example the acquisition of prime retail sites and the ability to leave failing stores behind;
■ Cost-effective market growth;
■ The acquisition of direct competitors and key parts of their supply and distribution networks – for example, the acquisition of JJB Sports by Sports Direct;
■ The consolidation of an existing business in the sector;
■ The diversification of brands; and
■ The development of a multi-channel offering – for example, by acquiring an online or catalogue function.

Understanding your industry, your competitors and their financial position is key to being able to take advantage of any opportunities that present themselves. An appropriately structured offer by a purchaser with an established link to or knowledge of the retail sector and an ability to move swiftly can prove attractive to any insolvency practitioner appointed to deal with the sale of the distressed business.

UNDERSTANDING THE PITFALLS

“For those fortunate enough to be in the position of the buyer... the current climate can give rise to considerable opportunities.”

While the acquisition of a distressed business can present numerous opportunities and the ability to bolster an existing offering at an attractive price, any purchaser should proceed with a certain element of caution and make sure that they understand the nature of a distressed acquisition to avoid any pitfalls.

One of the most common ways of disposing of a distressed but viable business and its various assets is through an administration process. In broad terms, an administrator is an officer of the court with a duty to act on behalf of the creditors of the company over which they are appointed. Any such administrators will have limited knowledge of the business and the various assets. The information available to prospective bidders by way of marketing information is therefore much less comprehensive than in relation to a solvent sale.

Some of the key practical issues which should be considered by any prospective purchaser are set out below:

■ Time is of the essence - Often any potential purchaser will be required to enter into a non-disclosure agreement when commencing negotiations in an acquisition. A distressed acquisition will often be completed in a matter of days.
(typically one to two weeks) from the point when the nondisclosure agreement is signed. While such tight timescales can be difficult to manage, in the fashion retail sector, where brand value and maintaining consumer confidence is key, a swift conclusion to the matter will limit any damage to the business and its brand.

- Cash is king - Administrators will prefer a party that is able to demonstrate ready funds and an ability to pay cash as opposed to reliance on bank or third-party funding.

- Due diligence - In order to structure an offer at the right level, you will need to understand the state of the business and what is on offer. However, the nature of a distressed sale limits the amount of detailed, reliable, current information available, regarding both the assets and the financial status of the business, and it limits the time available for review. The lack of information or ability to value the assets accurately, and, consequently, the increased risk for the purchaser, will typically enable you to negotiate a reduced price.

- Warranty/indemnity protection - A purchaser cannot expect the administrators to provide any warranties or representations (backed by indemnities or otherwise) in relation to the business or assets being sold, nor will an administrator incur any personal liability in relation to the sale. The administrators are under a duty to not knowingly mislead or provide false or inaccurate information. The buyer will, nonetheless, be obliged to pay the full purchase price without deduction or ability to claim for losses should difficulties present themselves post-completion. Again, the price payable for the assets should therefore take account of this.

- Non-transferable assets - Some of the assets of the business – for example, intellectual property and operating licences, leasehold interests or supply and customer contracts – may be non-transferable in their entirety or require the consent of any relevant counterparty. The purchaser should therefore carefully consider the value to the insolvent business of such assets and whether its existing business would be able to operate without them. The need to negotiate with any third parties will inevitably impact timing and could delay completion. In practice, however, there are ways to deal with such issues (see further below).

**KEY STAKEHOLDERS – WHAT IS NEEDED TO RUN THE BUSINESS EFFECTIVELY?**

It is imperative that any purchaser has a clear understanding of the main key assets required to run the business effectively following an acquisition. It may not be possible for the vendor and its administrators to sell and/or grant access to such assets and a purchaser will invariably need to liaise with various stakeholders in this regard.

**TWO OF THE KEY STAKEHOLDERS ARE:**

- Landlords – The premises from which a fashion retailer operates are often key to the business, and any purchaser may wish to retain the ability to operate from well-established, landmark stores. Such premises are not always owned by the insolvent company and are often occupied pursuant to the terms of a lease. Such a right of occupation is invariably non-transferrable without the consent of the landlord. A purchaser is unlikely to have sufficient time available to formally negotiate with a landlord ahead of completion of the acquisition. The administrators may be willing to grant a purchaser a short-term licence to occupy the premises in return for the payment of an appropriate licence fee (usually in a sum equal to the rent and service charge payable under the lease). While a landlord would usually be entitled to object to the occupation of the premises by a purchaser of the business, landlords are often willing not to enforce their strict legal rights on the basis that the rent for any period of occupation is paid, and they are often keen to secure occupation of the premises by a solvent tenant.
Suppliers – Clearly, a company’s suppliers can be critical to the day-to-day functioning of the business. When a company goes into insolvency, suppliers’ terms and conditions of business often permit them to take steps to protect their position – for example, by terminating the supply contract. Suppliers are often in a strong bargaining position vis-à-vis the insolvent company and any potential purchaser and can hold these parties to ransom if a continuing supply of goods or services is required. While the possibility of termination of critical supplies can be a great concern to a prospective purchaser – particularly, for example, if the supplier supplies branded goods critical to the business or an alternative source of supply is unavailable – there are a number of steps a purchaser can take to secure the continuation of supply. Among them:

- A transitional services agreement could be entered into for a short time post-completion of the acquisition. Under this agreement, the vendor and its administrators agree to provide or procure the provision to the purchaser of the service in question (such as stock management systems or electronic point of sale systems). This mechanism gives a purchaser the time to make its own arrangements in respect of the relevant supply or negotiate its own terms with the supplier.

- The purchaser could agree to make settlement payments equal in whole (or in part) to any outstanding sums owed by the insolvent company to a supplier in return for the continuation of supply of goods or services, or the release of goods by the supplier to the purchaser. This may be an attractive proposition to a supplier, as otherwise it would simply rank alongside other creditors of the company and would likely only receive a small “pence in the pound” return from the insolvency process, or

- If time permits prior to completion of the acquisition and a supplier is willing to cooperate, the purchaser could seek to enter into a novation of the relevant supply contract. However, a purchaser will often wish to negotiate its own terms with the supplier so may not feel that this is the most appropriate course.

CONCLUSION

While there are a number of pitfalls for the imprudent purchaser of a distressed business, those who are savvy and well-advised will be able to make the most of the opportunities offered in this arena.
PROPOSED AMENDMENTS TO THE EC INSOLVENCY REGULATION — PROGRESS UPDATE

In the Q1 2014 edition of Global Insight, we discussed the progress already made in respect of the Proposed Amendments to the EC Insolvency Regulation as of April 2014. The European Parliament and the Council of the European Union have now considered the Commission’s proposed amendments.

In this article we will continue to focus on the progress made regarding:

1. Centre of Main Interests (COMI);
2. Coordination of the insolvencies of members of a group of companies; and
3. Recognition of pre-insolvency and hybrid arrangements (and in particular English law schemes of arrangement).

COMI

The European Parliament has proposed the inclusion of a three-month look-back period so that a company would need to have had its COMI within a member state for three months before main proceedings could be opened there.

The Council took a different approach and drew a distinction between the COMI of a company and an individual. For companies it decided not to include any look-back period. For individuals (where it is considered that there is a greater risk of abusive forum shopping) the Council has recommended separate tests for those engaged in business activities and those who are not. For sole traders and partnerships, an individual’s COMI will, in the absence of proof to the contrary, be presumed to be his place of business. However, the COMI of all other individuals will, in the absence of proof to the contrary, continue to be his habitual residence but only if it has not been moved to the member state in the last six months.

COORDINATION OF THE INSOLVENCIES OF MEMBERS OF A GROUP OF COMPANIES

In addition to the proposals for greater communication and cooperation between insolvency office holders, both the Parliament and the Council have put forward suggestions to assist in the better coordination of group insolvencies. The Council’s approach involves the appointment of an independent party to act as coordinator of the proceedings affecting each company within the group. However individual office holders would be able to object to their company being included in the group proceedings.

RECOGNITION OF PRE-INSOLVENCY AND HYBRID ARRANGEMENTS

The Council’s general approach also indicates that it supports member states being able to decide which of their insolvency and rescue regimes should appear in the Annex to the Regulation and thus which will fall within or outside the scope of the Regulation. Consequently, if this approach is adopted, the UK will be assured of its ability to keep debt relief orders and the now very popular, UK Scheme of Arrangement regime (which is used expansively for solvent takeovers as well as to help restructure distressed businesses) out of the scope of the Regulation.

WHAT NEXT?

The Council has continued to work on the detail behind its general approach during the summer months and all parties are now waiting for a date to be fixed for Commission, Parliament and Council to discuss their proposals, in trialogue this autumn.

“In addition to the proposals for greater communication and cooperation between insolvency office holders, the Regulation will provide for the harmonisation of group insolvencies.”

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RESTRICTING IN CROATIA — HARD CHOICES FOR LENDERS

During the 1990s and up to the beginning of the recent financial crisis, the economies of Central and Eastern European countries experienced rapid growth. The privatisation of state-owned industries and the general opening-up of the market attracted foreign investment. Austrian banks invested heavily in the area and as a result, now hold a significant number of non-performing loans, secured on assets located within the CEE. The challenge, for those advising them, is to navigate around the rules and restrictions of each country’s enforcement laws in order to make the best recovery.

This article considers the restructuring of an Austrian law facility secured on assets in Croatia. It provides an example of the difficulties which lenders typically face in this region and highlights the changing appetite for each possible solution. Notable among those solutions is the use of a restructuring trust; an approach that is relatively well-known in Germany, but less familiar to restructuring professionals in other jurisdictions.

“\textit{Austrian banks ... now hold a significant number of non-performing loans, secured on assets located within the CEE. The challenge, for those advising them, is to navigate around the rules and restrictions of each country’s enforcement laws in order to make the best recovery.}”

THE TRANSACTION IN BRIEF

The transaction concerned the financing to develop a holiday resort in Croatia. Facilities were provided to fund the purchase of real estate on the Croatian coastline, which would be developed into a hotel complex and collection of holiday apartments. The apartments would be sold to third party investors and in some cases, leased back to the borrower group.

The borrower group consisted of a Swiss parent company and Croatian SPVs which held the real estate assets. The security package consisted of a Swiss law pledge over the shares in the parent and Croatian law mortgages and pledges over the real estate assets and the shares in each SPV.

The development fared better than some: the hotel was completed and operating and the apartments were being sold, albeit not at a sufficient rate to service the outstanding debt. Restructuring options therefore needed to be considered.

DIFFICULTIES WITH ENFORCEMENT

The prospect of either enforcing the Swiss share pledge or enforcing the bank’s security over the Croatian assets did not appear to present a sufficiently attractive solution for the bank. It was anticipated that any potential purchaser of the Swiss share pledge at the top of the structure would be likely to demand an unpalatably high discount due to: bilateral financing provided to the SPVs by local banks, which would remain following such a purchase; the nature of the assets (not all of which were fully developed); and the manner in which the group had operated. Conversely, any attempt to enforce at the bottom of the structure, by repossessing the assets, would involve enforcement proceedings in Croatia. Only one type of security in Croatia can be enforced out of court (certain title-transfer arrangements). All other enforcement action involves rigid, inflexible and notoriously lengthy court proceedings.
LENDER OWNERSHIP STRATEGIES

In the 1990s European lenders were largely reluctant to be lender and shareholder at the same time, thus favouring traditional enforcement by foreclosure, receivership and liquidation instead. However, in the past five years, particularly as banks started to look to the secondary markets for liquidity and bank debt increasingly started to be held by non-banks, a growing appetite emerged for banks to use debt-for-equity swaps in order to deleverage excessively leveraged borrowers.

Austrian banks have nevertheless, and until very recently, shied away from lender ownership. Where an Austrian bank now finds itself no longer prepared to continue existing arrangements with its borrower, but where there appears to be scope for the borrower, its shareholders and the bank to find a common solution, the bank may consider either an outright acquisition by means of a straightforward debt-for-equity swap into a bank-owned SPV or, less commonly seen in other European countries except perhaps Germany, to establish a restructuring trust over the shares of the borrower.

The trustee would hold the borrower’s shares on trust for both the bank and the company’s original shareholders. They would agree certain key conditions which would govern and guide the trustee’s actions - such as the circumstances under which the shares could be sold - but thereafter the trustee (who would usually be a restructuring expert) would use his own discretion to make decisions.

In this case, the bilateral financing in the group meant that an outright transfer into a bank-owned SPV would not be commercially, or legally, advantageous.

SOLUTION AND CONCLUSION

The most attractive solution in this case therefore, appeared to be a restructuring trust arrangement. Such an arrangement, if drafted and implemented properly, would also have the advantage of surviving an insolvency of one of the beneficiaries (i.e. the bank or the original shareholders).
After years of healthy economic growth, China is currently the world’s second largest economy. GDP growth has averaged 10.2 percent over the past 10 years. But this growth has come with a high cost, as the use of leverage, by both Chinese corporations as well as its citizens has grown at a faster rate than GDP growth. Overall debt now stands at 250 percent of the country’s GDP, up from 234 percent six months prior. According to S&P, Chinese companies have US$14 trillion in outstanding loans, more than any other country in the world.

This growth in borrowing has led to an increase in delinquencies and non-performing loans, a problem which needs to be addressed. However, due to years of support from the local and national governments, as well as state-owned enterprises, we are entering uncharted territory. The shift in political policy is apparent – just ask Huzhou Jintai Science and Technology, which failed to repay principal and interest on 30 million yuan of its debentures when investors tried to sell them back last July, or Zhejiang Walters Polymer Technology Co., which filed an application for bankruptcy last March after the company failed to repay 60 million yuan of the company’s bonds held by investors.

Although these are small companies whose indebtedness lies entirely with the PRC, a growing number of large Chinese corporations, with both PRC (onshore) and non-PRC (offshore) debt have either defaulted or face upcoming maturities. These companies typically utilize both onshore bank debt and offshore high-yield notes, generally issued by a Cayman or Hong Kong holding company.

Two recent high-profile cases involving companies with this exact structure are Suntech Power Holdings Co. Ltd. and LDK Solar CO., Ltd., both of which are currently in the midst of insolvency proceedings in multiple jurisdictions. Suntech and LDK were able to issue high-yield notes through an offshore holding company, despite a lack of meaningful operations outside the PRC. Whilst high-yield indentures typically highlight the risks associated with structural subordination and the difficulties offshore debt holders may have in pursuing recovery actions against onshore assets, these risks do not appear to prevent ‘yield-hungry’ investors from continuing to allocate capital to such onshore/offshore structures. It is essential that investors fully understand the risks and rewards associated with investing in these securities:

- China’s high-yield market totals only US$1 billion and is dominated by smaller companies. Large global companies have to tap into the global high-yield market by issuing notes via a non-PRC holding company.
- These holding companies, generally Cayman or Hong Kong domiciled, commonly have no assets or operation, thus rendering offshore debt structurally subordinated to any onshore debt.
- PRC issuers of high-yield notes typically have substantial onshore debt, lent by the local branch of the so-called “policy banks” and/or local banks which are often partially owned by the Chinese government. The table below examines the amount and implied leverage of onshore indebtedness for 11 PRC based issuers of offshore notes.
- The state-owned banks (fully or partially state-owned) have been reticent to call a default, and will often extend additional credit to troubled or highly leveraged borrowers. However, these banks have been unwilling to assist these same clients with offshore liquidity or maturity issues. Due to recent policy change by the central government to promote a more market-driven economy, the state-owned banks are even less motivated to extend terms to distressed borrowers.
In addition to the structural issues discussed above, holders of offshore notes face numerous uncertainties with respect to their ability to take any enforcement action against issuers.

- High-yield issues are often widely held, requiring a coordinated effort among holders to reach required thresholds.
- Prior to taking any action directed by requisite holders, trustees will generally require an indemnity from holders, possibly even demanding cash escrow.
- This is compounded by the lack of an established protocol for PRC based restructurings.
- Any enforcement action, or even the perceived threat of an enforcement action, could trigger an insolvency proceeding by the debtor within the PRC. Any PRC proceeding faces significant uncertainties compounded by the fact that insolvency procedures are largely dictated by the provincial government.
- Any restructuring within the PRC is as much a politically driven process as it is economic, a fact which greatly favors the domestic debtor.

As cases like Suntech and LDK continue to progress, a protocol for addressing over-leveraged PRC high-yield issuers is likely to develop with respect to those companies willing to engage in restructuring discussions. Regardless, it is imperative for investors to analyze the big picture when considering an investment in any PRC based company.

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Domicile</th>
<th>Industry</th>
<th>PRC On-Shore Debt US$ Millions</th>
<th>Leverage</th>
<th>Total Debt US$ Millions</th>
<th>Leverage</th>
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<tbody>
<tr>
<td>Company A</td>
<td>Hong Kong</td>
<td>Real Estate</td>
<td>$9,837</td>
<td>15.0x</td>
<td>$4,237</td>
<td>16.5x</td>
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<td>Company B</td>
<td>Cayman Islands</td>
<td>Real Estate</td>
<td>$1,557</td>
<td>10.7x</td>
<td>$1,907</td>
<td>13.1x</td>
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<tr>
<td>Company C</td>
<td>Cayman Islands</td>
<td>Real Estate</td>
<td>$2,653</td>
<td>57.0x</td>
<td>$3,409</td>
<td>73.2x</td>
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<tr>
<td>Company D</td>
<td>Cayman Islands</td>
<td>Solar</td>
<td>$550</td>
<td>17.3x</td>
<td>$809</td>
<td>27.5x</td>
</tr>
<tr>
<td>Company E</td>
<td>Cayman Islands</td>
<td>Real Estate</td>
<td>$1,102</td>
<td>13.0x</td>
<td>$1,252</td>
<td>14.7x</td>
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<tr>
<td>Company F</td>
<td>Bermuda</td>
<td>Real Estate</td>
<td>$1,085</td>
<td>12.9x</td>
<td>$1,435</td>
<td>17.1x</td>
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<tr>
<td>Company G</td>
<td>Hong Kong</td>
<td>Real Estate</td>
<td>$5,378</td>
<td>11.5x</td>
<td>$6,678</td>
<td>12.5x</td>
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<td>Company H</td>
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<td>Real Estate</td>
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<td>Company I</td>
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<td>Company J</td>
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<td>Real Estate</td>
<td>$6,190</td>
<td>15.5x</td>
<td>$7,290</td>
<td>18.3x</td>
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<tr>
<td>Company K</td>
<td>Cayman Islands</td>
<td>Solar</td>
<td>$1,769</td>
<td>23.4x</td>
<td>$2,403</td>
<td>31.8x</td>
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Source: Capital IQ. Based on latest public filing.

If you are interested in submitting a guest article to a future issue of Global Insight please email restructuring@dlapiper.com
GLOBAL INSIGHT
News, Views and Analysis from DLA Piper’s Global Restructuring Group

NEWS ROUNDUP

GLOBAL RESTRUCTURING GROUP NEWS ROUND UP

NEWS

■ **Tony Angel**, Global Co-Chairman of DLA Piper, recently visited Bangladesh to see firsthand the valuable child justice work that is being carried out by UNICEF in conjunction with DLA Piper. You can find Tony’s commentary on his experience in Legal Week here.

■ New Sydney office - 10 June: The Sydney office has moved to new offices at 1 Martin Place, Sydney, in a central location in Sydney’s business district, demonstrating our commitment to developing our Australian market.

■ The firm has launched a China Investment Services virtual team. DLA Piper is one of the largest and longest standing International law firms operating in China, with over 26 years of on-the-ground experience. We are now looking to build upon our strengths in China and to capitalize on the enormous opportunity that China presents. As such, a dedicated team of specialists drawn from our Corporate and Tax groups has been assembled to streamline our China offering to clients. **Paul Chen** and **Daniel Chan** are leading the team, comprising 21 partners, and supported by over 120 lawyers operating as one seamless ‘virtual’ team from across Beijing, Shanghai and Hong Kong.

The team will operate at ‘stretch capacity’, utilising resources across different groups and all China offices, with no boundaries. The team is supported by our long established and embedded China Desks in both the U.S. and EMEA, and will also draw upon specialists across Real Estate, Employment, Intellectual Property & Technology, Finance and Projects, and Restructuring, to provide clients with a complete service in China.

For more information on our China Investment Services virtual team, please contact **Paul Chen** or **Daniel Chan**.

AWARDS

Global

■ Legal 500 - Winner of sports law firm of the year.

■ For the second consecutive year, Working Mother magazine recognizes DLA Piper among the 50 best law firms for women.

Asia Pacific

■ DLA Piper Australia honoured to receive the Best International Firm for Pro Bono Work Award at the Euromoney Australasia Women in Business Law Award 2014.


US

■ DLA Piper receives 2014 Beacon of Justice Award for its innovative pro bono work.

■ The Deal ranked DLA Piper sixth by number of cases in the Bankruptcy League Tables for the first half of 2014.
DEDICATED RESTRUCTURING LAWYERS WORKING ACROSS BORDERS

Our Global Restructuring group is one of the largest in the world, with over 200 dedicated restructuring lawyers across the Americas, Asia Pacific, Europe and the Middle East. We have the knowledge, experience and resources to address our clients’ restructuring and insolvency needs on a national and international basis.

We serve a diverse client base encompassing debtors, lenders, government entities, trustees, shareholders, directors, and distressed debt and asset buyers and investors. We advise clients across a wide range of industry sectors and have particular strength in energy, financial services, health care, hospitality and leisure, real estate, retail, sports, technology and transportation.

ADEPT AT ALL LEVELS OF COMPLEXITY

We advise on all matters relating to public and private companies in underperforming and distressed situations. We manage assignments from the mid-market to the largest national and international restructurings and insolvencies. Our experience also extends to any contentious issues arising from restructurings and insolvencies. We have significant experience of advising clients on, investigation, enforcement, litigation and asset recovery on a multijurisdictional basis.

GLOBAL REACH, LOCAL RESTRUCTURING EXPERIENCE

With our global team of dedicated restructuring lawyers we have detailed knowledge of local markets and the associated challenges our clients face. We are passionate about what we do and our clients see this in the quality of work our lawyers provide. Our Global Restructuring group is part of one of the world’s largest law firms with 4,200 lawyers located in more than 30 countries. As a full-service business law firm, we offer clients the benefit of the collective knowledge and experience of all our practice groups.

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