International Comparative Legal Guides

Restructuring & Insolvency 2021

A practical cross-border insight into restructuring and insolvency law

15th Edition

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Preface

Welcome to the 2021 edition of *ICLG – Restructuring & Insolvency*. Macfarlanes is delighted to continue to serve as the Guide's contributing editor.

The detailed content of year's edition is very different from years gone by, primarily as a consequence of the government reactions to the consequences of COVID-19, and I expect that there will be yet more change to reflect in the chapters of this Guide in the years to come. A lot of what we have seen in the past year could be described as 'crisis management'. For example, suspensions of director liability for late insolvency filings and blocks on creditor action to recover unpaid debts in many jurisdictions have helped to ensure that formal insolvencies are much lower than the historic average. However, those types of measures fail to address the massive accrual of liabilities on corporate balance sheets through the deferral of tax payments, the non-payment of rent to landlords and borrowing under government-backed loan schemes. If the post-pandemic economic recovery is not to be drawn out for many years to come, practitioners will need to come up with appropriate solutions – potentially with the assistance of further legal reform. My colleagues Simon Beale and Amy Walker consider this in their Expert Analysis chapter, which I commend to you.

This year's edition contains contributions from many leading practitioners, including an insight into the issues in restructuring and insolvency across 25 jurisdictions. We are very grateful for their support and we trust that you will find it valuable. Please do get in touch with relevant contributors directly, should you need to understand the most recent developments in any particular place.

I hope that you keep well.

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Recent Trends in U.S. Corporate Bankruptcy and Restructuring


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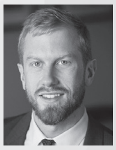
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The COVID-19 pandemic and fears of a global recession roiled financial markets around the world in March and April 2020: U.S. investment-grade risk premiums reached their highest levels since the Great Recession of 2008/9 and commercial paper markets briefly froze; the leveraged loan and high-yield bond markets seized shut; and the amount of U.S. distressed debt (bonds yielding at least 1,000 basis points more than treasuries and loans trading for less than 80 cents on the dollar) ballooned to nearly $1 trillion. Related oil market shocks and economic shutdowns brought a sharp rise in corporate bankruptcies across a wide range of industries in 2020. Some of the companies that filed were distressed or highly leveraged before the pandemic, but others were generally healthy before being broadsided by COVID-19.

The carnage could have been far worse had the financing markets, aided by government intervention, not proven to be resilient, bouncing back far more quickly than the real economy and allowing many impacted companies to stave off default or bankruptcy. Government stimulus programs and central bank activity—including the U.S. Federal Reserve's cut in interest rates to zero and direct intervention in credit markets through purchase of corporate debt—buoyed markets and set the stage for a binge of new borrowings and other financings. Companies moved quickly to stockpile liquidity, first by drawing existing lines of credit and then by exploring more creative options. Some companies, such as Expedia and Gap, undertook major capital structure reconfigurations, strengthening their balance sheets with new sources of capital to ride out the storm. But for many companies, the price has been high: to secure financing, they have had to pledge previously unencumbered assets and take on more debt, leaving them with less flexibility to address future setbacks and uncertainty as to whether, as the pandemic winds down, their businesses will grow into their new capital structures.

Amidst all the challenges of 2020, one silver lining was the smooth working of the U.S. bankruptcy system. Although the loss of in-person hearings and dealmaking has been felt acutely, U.S. bankruptcy courts operated successfully despite the pressure of more and bigger cases, holding multi-day hearings throughout 2020 (and early 2021) by video conference.

We discuss below some trends and developments in the restructuring world over the last 12 months, and expectations for the year ahead.

Mass Tort Bankruptcies

The resurgence in the use of chapter 11 to address mass tort liabilities, which began in 2019, continued through 2020 and into 2021. The U.S. Bankruptcy Code provides companies facing litigation of almost any type with a powerful set of tools, including the ability to halt litigation against both the bankrupt business and, in some situations, related, non-bankrupt parties. For instance, in both the *Purdue Pharma* and *Mallinckrodt* cases, the bankruptcy stay of opioid litigation (including litigation brought by governmental entities) was applied not just to stay proceedings against the bankrupt companies but to litigation against equity holders, officers and employees. The bankruptcy stay is especially useful in mass tort situations where the multitude of parties can be brought to a single forum and litigation across 50 states can be replaced with a centralized process. Bankruptcy can also resolve claims that might arise in the future, providing finality to reorganizing debtors as well as facilitating equality of distribution among claimants. In addition, bankruptcy can be used by non-bankrupt parent companies to manage and resolve tort liabilities relating to a troubled subsidiary or former subsidiary. For example, in the ongoing *Imerys* chapter 11 case—precipitated by a wave of personal injury suits relating to talc—current and former parent companies of the debtor agreed to make contributions to a trust in exchange for broad releases.

An appellate decision in early 2020 reaffirmed the power of bankruptcy to address mass tort claims. The plan of reorganization of asbestos manufacturer Johns Manville, which was confirmed in 1986, "channeled" all asbestos-related claims against the company and certain of its insurers to a trust, which continues to operate today. Decades later, a plaintiff whose injuries manifested long after confirmation of the plan sought to sue one of Johns Manville's insurers. The Second Circuit upheld the channeling of Johns Manville-related asbestos claims to the trust, including claims against the insurer, ruling that appointment of a representative for "future claimants" (*i.e.*, those whose injuries had not yet manifested at the time of the bankruptcy) and a wide publicity campaign during the *Johns Manville* bankruptcy were constitutionally adequate to bind future claimants.

Mass tort situations are invariably complicated, and even successful cases can be expensive and protracted. As an example, the Boy Scouts of America (the "BSA") filed a chapter 11 petition in 2020 to address historical claims of abuse asserted by former Scouts. While the BSA was a defendant in about 275 cases at the time of its filing, a notice campaign during the bankruptcy case resulted in the filing of over 96,000 abuse claims. As another example, Pacific Gas & Electric Corporation ("PG&E") emerged from bankruptcy in the summer of 2020 with a trust in place to pay claims arising out of the wildfires alleged to have been caused by PG&E's equipment. That result followed protracted negotiations among wildfire claimants, governmental entities, holders of insurance subrogation claims, and financial creditors and shareholders. The bankruptcy process took 17 months and the debtors incurred approximately $700 million in professional fees.

Faced with this complexity and cost, companies using chapter 11 to address mass tort liabilities have sought to pre-negotiate settlements and plans to the maximum extent possible. As an example, drug manufacturer Mallinckrodt—which faced wide-scale litigation from individual claimants and government entities relating to its production of opioid painkillers—filed for chapter 11 in October 2020 with a restructuring support agreement signed by unsecured noteholders, 50 attorneys general and an executive steering committee of opioid plaintiffs.

Out-of-Court Deals: The War of Creditor Against Creditor

Thomas Hobbes' famed "*war of all against all*" proved prophetic of intercreditor dynamics in the distressed credit markets in 2020. Various stressed or distressed companies addressed liquidity problems by employing flexibility in their credit documentation to create competition among their lenders. The companies utilized existing covenant carveouts, and sometimes majority-lender amendment provisions, to issue "new money" debt ranking senior in lien priority to their existing debt and/or benefitting from collateral that had previously been part of the package securing the existing debt.

Such priming transactions took various forms. In what is sometimes called a "J. Crew" transaction, borrowers (including, among others, Hornblower and Travelport) took advantage of "basket" capacity to contribute assets to "unrestricted subsidiaries," which then raised new financing secured by such contributed assets. Other transactions involved purchase offers, open only to a subset of existing lenders that agreed to provide a new, super-senior liquidity facility, pursuant to which those lenders sold *existing* claims for new debt ranking senior to the claims of existing lenders that did not participate in the transaction. While challenges to some of these transactions remain pending, at least one court, in the *Serta* case, rejected an attempt to enjoin an out-of-court transaction that allowed lenders providing new financing to also obtain more senior positions for their existing debt.

It remains to be seen whether, as the markets adapt, lenders will seek to address the collective action problems raised by these recent transactions by requiring more restrictive credit documentation (*e.g.*, requiring unanimous as opposed to majority consent to subordinate the liens of the existing debt). In the meantime, we expect well-advised companies facing headwinds to continue to take advantage of intercreditor dynamics to raise liquidity.

Rejection of Midstream Contracts in Oil and Gas Bankruptcies

2020 saw the largest volume of oil and gas bankruptcies since 2016. One notable legal development in these cases relates to "midstream contracts" between exploration and development ("E&P") businesses and pipeline companies, which provide for the storage, processing and transportation of petroleum products. These are generally long-term contracts, often providing for minimum commitments and other terms that were rendered uneconomic by the sharp decline in oil and gas prices.

In the past, pipeline companies have successfully argued that these contracts create "covenants running with the land" and thus are not capable of rejection under the U.S. Bankruptcy Code. But in 2020, in the *Chesapeake Energy* bankruptcy in Texas, and the *Extraction* and *Southland* cases in Delaware, bankruptcy courts concluded that the midstream contracts did not contain covenants running with the land and were susceptible to rejection. Further, in each case, the courts suggested that even the existence of such a covenant would not necessarily bar rejection.

The receptivity of bankruptcy courts in both Delaware and Texas to the need for bankrupt E&P companies to shed the burden of uneconomic midstream contracts will undoubtedly prompt more E&P companies to seek relief from such arrangements in chapter 11. The change in expectations regarding the inviolability of midstream contracts could also impact financing for new pipeline projects, which is often predicated on the revenue projected to be generated from the projects under long-term contracts with E&P companies.

A Shift in Negotiating Leverage in Retail Bankruptcies

The retail bankruptcy surge of the past several years accelerated further in 2020, as the pandemic forced store closures and foot traffic drastically declined nationwide. In the early months of the pandemic, decisions in the *Modells* and *Pier 1* chapter 11 cases permitted debtors to delay rent payments, despite the U.S. Bankruptcy Code's requirement of timely payment for non-residential leases. Even without those rulings, however, market conditions have strengthened debtors' hands in their negotiations with landlords. Faced with the loss of retail and other tenants, and the prospect of large amounts of unoccupied space, landlords have faced pressure to provide rent reductions and other concessions. For example, while a Texas bankruptcy court refused in December 2020 to grant debtor Chuck E. Cheese relief from making timely rent payments—ruling that the U.S. Bankruptcy Code requirement of current payments could not be excused, and that the *force majeure* clause did not cover the situation—by the time the ruling was issued, Chuck E. Cheese had already reached accommodations with landlords at most of the 141 locations where it had sought to delay rent payments. Similarly, Ascena Retail Group achieved considerable savings through negotiations with its landlords, facilitating a successful sale process under section 363 of the U.S. Bankruptcy Code for certain of its assets and maximizing recovery for its creditors.

Debt Default Activism

Windstream exited bankruptcy in 2020, ending a saga that unfolded after a court ruling, at the behest of a creditor widely believed to have sold short Windstream debt, that the company had defaulted on that debt years prior. The Windstream case brought attention to the phenomenon we have called "Debt Default Activism," in which investors purchase debt on the thesis that a borrower may already be in default, and then seek to profit from the alleged default, including through credit default swaps (or "CDS") or short positions in the capital structure.

Borrowers have in recent years increasingly sought to preempt the threat of debt default activism by including in debt agreements provisions that undermine activist strategies, including strategies based on profiting from short positions. But the technology continues to evolve, with strong capital markets enabling companies to obtain previously unheard-of protections from default assertions. Recent deals have included hard voting caps for lenders, whether or not short, limiting any one large lender's ability to dictate voting outcomes, as well as provisions designed to preclude unfriendly holders from accumulating large positions in the first place.

Other Restructuring Developments

In a busy year for restructuring, we saw other notable developments both in and out of court, including:

- *New Competition for Debtor-in-Possession ("DIP") Financing.* 2020 saw various examples of asset managers, including private equity firms, providing DIP (*i.e.*, bankruptcy) financing to companies of which they were not major creditors. In *LATAM Airlines*, Oaktree provided a large third-party DIP loan, which was combined with a junior tranche provided by shareholders and bondholders, to fund the case. Apollo stepped up in *Aeroméxico* to provide the same, again with bondholder participation. Both DIPs reflect continuing evolution in asset manager and private equity strategy, with such investors competing for opportunities in direct lending and hybrid investments.

- *U.S. Bankruptcy Courts Still the Forum of Choice for Many International Debtors.* In a time of crisis, debtors facing complicated international restructurings continued to turn to the U.S. bankruptcy system, with foreign-based airlines LATAM, Aeroméxico and Avianca, among others, all seeking to restructure their liabilities through chapter 11 cases filed in New York. This is a testament to the resiliency and depth of the U.S. bankruptcy system.
- *Strict Foreclosure Remains a Useful Tool.* While U.S. bankruptcy courts have continued to function, bankruptcy remains expensive and time-consuming. When there is sufficient consensus among creditor classes and/or relatively simple capital structures, out-of-court "strict foreclosure" transactions can be a nearly equivalent alternative from a legal perspective, saving months and millions. Critically, like a plan under the U.S. Bankruptcy Code, a foreclosure under the Uniform Commercial Code can bind holdouts in classes of secured debt and effectively discharge unsecured financial debt. In 2020, secured lenders to Phillips Pet Food & Supplies deployed this tool to equitize their claims. While recent decisions in New York could render strict foreclosure more challenging for capital structures with secured bonds qualified under (or incorporating the terms of) the Trust Indenture Act of 1939, the process remains viable in many situations.

Joshua A. Feltman focuses both on acquisitions of leveraged entities in connection with in-court and out-of-court workouts and on the financing aspects of leveraged acquisitions generally, including negotiation, implementation and issuance of credit facilities and debt securities. Prior to joining Wachtell Lipton, Mr. Feltman worked as a consultant and economist on regulatory and antitrust matters for Price Waterhouse and National Economic Research Associates.
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