How do I deleverage and restructure my business

David A. Agay | Monday, March 23, 2020

Until now, I could be accused of writing about more straightforward topics and avoiding really difficult issues. Ok, then, let's discuss restructuring a business.

In our company-side engagements prior to COVID-19, often we would focus on overleveraged balance sheets in the sense that payment requirements under funded debt obligations (e.g., bank loans, bonds, and swap and hedge obligations) did not align with the timing and frequency of cash flows into the enterprise. In other words, the basic strategy involved renegotiating with institutional stakeholders (both debt and equity) a highly engineered capital structure that no longer worked (often because of demand or supply shocks or other changes in the business compared with projections). As part of the process, we may have sought concessions from landlords, equipment financiers, or other similarly situated parties with long-term arrangements. We would rarely impair trade vendors or customers with whom we had less leverage, because they could refuse to do business or reduce their exposure to the company without suffering much detriment to their own operations. These restructurings would very rarely impact employees, other than directors or senior management who may be asked to adjust their employment contracts or other compensation arrangements. COVID-19 may change that playbook and may make achieving out-of-court restructurings more difficult.

In general, outside of court (i.e., outside of a chapter 11 bankruptcy), a lender or other stakeholder either must consent to less than par value or some other impairment, or the relevant debt, equity, or operating documents must provide a contractual or corporate law means of compelling a stakeholder to accept less favorable treatment or dilution of their position. However, in the coming round of restructurings, it may be that to resuscitate the enterprise: (a) institutional and other longer-term stakeholders have to accept more pain; and (b) customers, trade vendors, employees, and other parties not usually impacted have to share in the sacrifice. This has several implications.

First, discussions with debt and equity holders may turn even more rancorous and harder to manage. On the other hand, the company's dire condition may cause stakeholders to more quickly come to the table.

Second, the company and its professionals may have to undertake logistically difficult negotiations with numerous and widely-dispersed trade vendors, customers, landlords, and other parties around price and other concessions, all while these parties grapple with their own survival. Again, it's possible that the crisis lends itself to greater receptivity and flexibility. It is also possible that trade groups and ad hoc committees emerge, which could facilitate negotiated out-of-court resolutions.

Third, to the extent an out-of-court restructuring cannot be achieved to align the company's debt and expenses with its cash flows, the company and its lenders may have to show greater receptivity to quick chapter 11 processes through bankruptcy court-supervised sale transactions (a/k/a "363 sales") or "prepackaged" chapter 11 reorganization plans. Prior to COVID-19, many companies and their lenders treated chapter 11 as untenable because of the commercial stigma and other business impacts, and because frothy debt markets provided solutions. That may change as business distress spreads. Of course, lenders and other creditors would have to support chapter 11 processes by funding businesses through "debtor in possession" (a/k/a "DIP") loans and extending trade credit terms. If the parties refuse to support bankruptcy processes, then they could quickly lose a business partner to liquidation, with the attendant impacts on their own businesses.

Finally, in recent years, we have guided clients through alternative state-law processes, such as assignments for the benefit of creditors (a/k/a "ABCs"), receiverships, and Article 9 sales, which typically cost less than a federal bankruptcy court process. However, while solving certain situations, these alternative insolvency processes can have limited effectiveness in the current environment for various reasons, including a potential lack of finality on account of, among other things, interstate enforcement issues and post-transaction litigation from creditors and other parties.

As we navigate the perils and unknowns of COVID-19 and its effects, we restructuring professionals–like everybody else–likely will find ourselves in a new world. While we can try to predict consequences and outcomes, the future likely holds much more uncertainty than any of us have experienced in our lifetimes. We will have to use our skills and experience as crisis managers to react quickly and with as much prescience as possible. Working with all constituents, the task will fall on us to craft creative and effective solutions under constantly changing circumstances.

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