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# New Views in a Post-Recession World

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# Turnaround professionals share business opportunities, cautions

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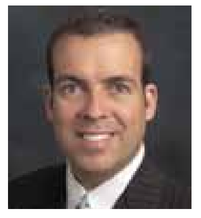

This post-recession period has given rise to a shifting landscape in the business world. We see that transformation firsthand as members of the Turnaround Management Association Chicago/Midwest Chapter. As turnaround professionals—interim managers, financial and operational advisors, attorneys, investment bankers —and as lenders, investors and other professionals in the industry, we believe that the opportunities are tremendous today not only to restructure distressed companies, but also to acquire troubled businesses and assets. But with opportunities come challenges and we explore both in the pages that follow.

This special supplement includes the sharp insight of just some of the nearly 1,100 TMA Chicago/Midwest Chapter members who share common interest in strengthening the economy through the restoration of corporate value. Each year the TMA Chicago/Midwest Chapter host more than 30 events—from educational conferences to our annual golf outing. If you are looking for more information on corporate renewal and turnaround professionals, corporate renewal generally or want to join the chapter, please visit www.tmachicagomidwest.org.

– Carl Lane, president of TMA Chicago/Midwest

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# Changing world for turnarounds

As the turnaround window opens in a post-recession world, it reveals new views from lenders, creditors, and even the debtors themselves. Financial restructurings are happening more frequently outside of bankruptcy. Some lenders are more aggressive, while others remain cautious. Flexibility is the key. Creditors aren't necessarily the same and good buys are possible for strong companies.

"We're not planning to see a significant number of large companies going into some type of bankruptcy protection," says Daniel P. Wikel, a managing director of Huron Consulting Group. "We do anticipate larger companies bolstering their balance sheets and using liquidity to start internal projects that they may have put on hold or to do strategic acquisitions for growth. They may not only use liquidity available in the marketplace, but will also use the cash on their balance sheets," he says.

Wikel says he expects to see more activity like AT&T's recent plans to acquire T-Mobile and some M&A activity buffered by private equity money or high-yield markets. The availability of funding from private equity and other hedge funds type firms may mean fewer financial restructurings for large companies. These types of scenarios are obviously independent of more specific challenges and opportunities in certain industries, or if the company is commodity driven or has a unique product offering.

While large companies may get deals done, middle market companies face a slightly different future, says Wikel, whose Huron Consulting Group works with both middle markets and large cap companies. "Liquidity is not as readily available in the middle market and remains a little more difficult to obtain with traditional pricing. Even the smaller deals are more difficult," he says. "There is private equity and related alternative funding available, but we're still seeing pricing of that type of financing as more expensive than the larger deals."

Kevin Krakora, senior managing director at Mesirow Financial Consulting, says the longer the economy takes to recover, the greater need for companies to restructure debt obligations on the balance sheet. "Companies are not growing fast enough to fit their leverage," he says.

## Banks more flexible

Balance sheet issues at the secured lenders also complicate the lending market because secured lenders previously acted as the restraining wall for troubled companies, says Tom S. O'Donoghue, a managing partner at CRG Partners. Faced with their own challenges, lenders now are more likely to seek alternative arrangements when their clients can't pay, reworking the loan to defer principal payments, for example. "It doesn't benefit them to throw out a business that is paying interest because they don't have a replacement borrower to replace that interest," O'Donoghue says.

Wikel adds that lenders are using that second look at their portfolios as an opportunity to keep ones who might be experiencing early signs of trouble but have the time to address the issues. They also will look at the management team at the helm of the company repaying the debt.

Jonathan A. Carson, co-founder and managing director of Kurtzman Carson Consultants, says last year's improved credit markets and increased amend-and-extend lending activity have significantly reduced the number of companies facing immediate debt maturities; as a result, experts believe there will be less activity in the corporate-restructuring arena for the foreseeable future.

Krakora says, "The corporate restructuring and turnaround market may increase if more lenders begin to require their borrowers to meaningfully deal with defaults or other financial and operational problems rather than amending and extending the credits."

## Restructuring changes

It's no longer bankruptcy as usual in the restructuring sector of the turnaround market, says Michael Traison, a principal at Miller Canfield. "Chapter 11 is a vehicle to

liquidate. Chapter 11 also is used as a principal vehicle in the sale of assets—providing a cleansing order in a bankruptcy sale," he says.

In addition, creditors' roles are changing as well. "We rarely see trade committees—committees made up of actual vendors who know the debtor and would do business with the debtor later. Claims are bought and sold on the open market," Traison says.

People who hold the claims frequently have no relationship with the industry. Their view on the committee is strictly dollars and sense, he says.

## Challenges and opportunities

Carson says today's challenges are more industry specific than macroeconomic. "Companies facing challenges today that require a more formal strategic approach such as Chapter 11 typically confront operational issues or industry-specific obstacles rather than pure balance-sheet difficulties; the latter can be managed via today's more lenient capital markets, whereas the former more likely require the tools contained in the Bankruptcy Code," he says.

Take real estate and related markets. Lenders with significant real estate portfolios are more likely to call out troubled clients, Wikel says, because that sector hasn't completely shaken out of the economic downturn. "Now's the time to go and buy and find deals in the real estate market," he notes.

> ***"Chapter 11 is a vehicle to liquidate."***
>
> ***– Michael Traison, principal Miller Canfield***

Jeff Zappone, senior managing director of Conway MacKenzie, says industries affected by rising commodity costs will experience compound pressure on profit, likely leading to additional restructurings that may not have otherwise occurred. Companies that rely on commodities should look at their contracts to ensure they take into account commodity price increases.

O'Donoghue says unless a company really is running out of money, turnarounds will be viable options. "Now the challenge is we've got to focus on finding ways to not only focus on liquidity but find ways to help companies to become more profitable or grow the business. They still have to find a way to pay their loans," he says.

For Zappone, there's one challenge that has yet to be answered. "The most ominous question remaining from the global financial crisis will likely be pushed to the forefront as many states and municipalities reach a crisis point," he says. ❖


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# Credit availability expands in post-recession market

Availability of commercial and asset-based credit has improved over the last year, experts say, but the size, sector and history of a company affects its individual attractiveness to lenders.

"There are more active lenders in the market, and there is still a limited amount of new loan demand. These two factors have caused rates to drop and loan terms to be more favorable to the prospective borrower," explains John Stewart, executive vice president and regional manager of the Business Credit Division of Wells Fargo Capital Finance.

While credit markets have opened up relative to 2009 levels, a company's ability to obtain credit depends on having a strong track record of performance, says Michael Buenzow, a senior managing director at FTI Consulting and Midwest region leader for FTI Corporate Finance. Companies without that track record need to have the ability to sell their story through a sound third-party-validated business plan to attract new capital.

"Due to losses incurred during the recession, lenders are now much more critical of marginal businesses, furthering the need for a credible business plan that the lenders are confident that the management team can execute," Buenzow says.

## Characteristics considered

Large cap companies (greater than $1 billion in sales and globally diversified) have broader credit options, including access to the high-yield market and, in some cases, the equity market. "In terms of short-term financing, larger businesses tend to have much more ready access to commercial paper," Buenzow says.

Buenzow says he sees credit availability for large, well-diversified companies remaining strong if the economy continues to improve. However, a significant shock to the global economy—inflation in BRIC countries, increased government regulation or further unrest in the Middle East—could offset the credit expansion begun in 2010.

Smaller companies typically are limited to asset-based financings and/or rescue-type capital infusions from the existing equity sponsor. If they are an out-of-favor industry, smaller companies' access to capital is limited even further, Buenzow explains.

Stewart says that in just about every middle and lower middle market loan size, credit availability has increased on terms more favorable to borrowers. "That said," he notes, "businesses looking for asset-based facilities under $5 million will still encounter relatively fewer options and higher interest rates.

"Lenders remain cautious about lending disproportionately on fixed assets, including equipment and real estate," Stewart says.

Companies in favor with creditors include those with good product breadth and geographic diversity, which offers lenders a natural hedge against local economic effects. Companies that own or have strategic access to raw materials also should fare better. In addition, Buenzow says, "industries that are heavy consumers of commodities, such as steel and corn, will be challenged to maintain profit margins because of the upward pressure on commodities from demand growth in BRIC and emerging markets coupled with existing supply constraints and the amount of time required to bring significant incremental capacity on line."

Businesses in agricultural, food and durable goods manufacturing and distribution markets, which have shown the most consistent performance turnarounds, will find more favorable credit pricing and terms, Stewart says. "Businesses in or related to the housing and construction industries are continuing to struggle, and the availability of credit to companies in these industries continues to be limited."

## Diversified v. standalone

AccuVal Associates, which performs industrial appraisals for large banks, private equity firms and hedge funds, among others, can see the changing factors in the credit market, says Rick Schmitt, executive vice president and COO.

"We see what banks are willing to lend and talk to lenders about what they're advancing," he says. "There is an amazing amount of dynamics going on in the marketplace. There are big differences between what large private equity funds can get as compared to what middle market companies can get."

Schmitt says banks are eager to lend to large private equity funds because they command significant dollar investments and represent 50 different companies. To some degree, the bank isn't as quick to say the debtor's proposed financing is overaggressive because they are worried about

not getting the next deal versus a standalone business that may be struggling a bit but not necessarily distressed, he says.

"Most of the major lenders are focused on the revolver piece of a loan … banks are much more interested in loaning against receivables and inventory," Schmitt says, because receivables turn into cash in a 30-, 60- or 90-day cycle. "If the company gets into trouble, the bank is not far away from receiving loan payments."

## Be attractive to ABLs

To be attractive in the asset-based lending market, companies need to articulate a clear business plan based on reasonable/third-party-tested assumptions for the next three to five years, says Michael Buenzow of FTI Consulting.

Wells Fargo's John Stewart concurs, noting that prudent lenders always have and will continue to look for a solid management team first. They also look for a sound business plan, projections based on reasonable assumptions and acceptable liquidity levels and debt to EBITDA multiples.

Buenzow says a business plan should address:

- How the company plans to profitably grow continuing operations,
- How it will minimize cash burn in non-core operations and
- How it will maintain a competitive cost structure.

"Lenders typically want to see a management team that has thought through the issues and conditions, and can articulate the issues and conditions," Buenzow says. "Lenders also find further credibility if a reputable financial adviser was involved with management in developing the business plan."

### Mezzanine, securities return

Schmitt says another player in the lending market has returned to the forefront. "Mezzanine debt lenders have always been out there but are becoming popular again because their purpose is to provide a layer of debt a company needs in order to operate its business but cannot be satisfied by senior secured lenders.

"As far as credit availability, the key is to have some mezzanine lenders out there who are willing to take on that piece of the pie to allow companies the flexibility to move from one bank to the next," Schmitt says. "In the past, the company and bank had to stay as a team. They couldn't get rid of each other because no one else wanted the company."

In addition, high-yield securities that dried up in the recession are reappearing as underwriters are willing to step in and underwrite some companies. "Now we're seeing companies take out what were large loans previously done asset-based and going back to the high-yield market, which don't have a lot of restrictions on how you can run the business," Schmitt says.

### Financial diversification too

Melody Stallings, senior vice president and division manager of the Receivables Funding Group at Wells Fargo Capital Finance, says executives should consider diversifying their debt and credit base to meet their needs both now and in the future.

Diversity of credit, Stallings explains, could include using products offered by diverse financial institutions and trade creditors, as well as capital providers such as angel investors and private equity groups.

"Banks and other financial institutions are beginning to offer or are enhancing their special offerings in order to diversify risk while improving the company's buying experience," she says.

### Lessons learned

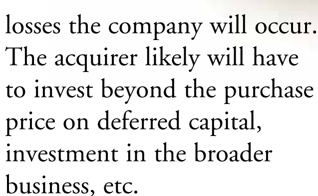
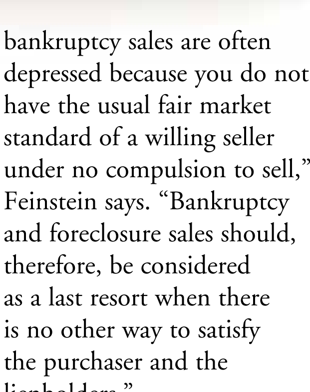
On the positive side, Buenzow says, today's companies were forced to become much smarter in managing their cost structure. "Businesses took out significant costs—both product and overhead—in the last recession and have maintained their operations at these levels to provide additional earnings leverage as the economy improves," he says.

Stewart agrees. "More and more companies that survived the recession are now showing a clear and sustainable turnaround in performance," he says. "This is a distinct improvement from the depths of the recession when revenues and profitability had declined dramatically and turnarounds were often unpredictable and often unsustainable."

Going forward, Stewart expects economic growth will continue in the range of 2 to 3 percent in the next year or two, allowing credit availability on relatively favorable terms to continue. He continues, "Looking out five years, the availability of credit will depend on the health of the overall economy and corresponding trends in non-performing loans and charge-offs within lenders' portfolios."

Businesses also need to recognize the limited credit options and plan strategically. Buenzow says businesses should strive to generate an internally funded business plan so that any funding is obtained ultimately from growth capital. Management should assess regularly all angles, including working capital, employee benefits, corporate overhead, non-core asset sales, to identify sources of liquidity.

"It's important for the lenders or any potential source of credit to see that the company has kicked the tires hard to identify internal initiatives to reduce the lenders' overall exposure," Buenzow says. ❖

# It's a buyers' world for distressed assets

Buyers are coming to the distressed market nowadays for all sorts of reasons—strategic, financial, lenders pursuing credit bid rights and equity holders who want another shot at the business stripped of debt. "The downturn in the market has led to many opportunities for purchasers, and asset sales have enabled many companies to move to another level while retaining jobs, supply chain and customer base," says Faye Feinstein, a partner and head of the Midwest creditors' rights and bankruptcy practice at Quarles & Brady LLP.

Aaron Hammer, bankruptcy partner at Freeborn & Peters, says today's market generally favors buyers. "While many auctions are quite active, the assets of distressed companies are frequently sold for well below their actual value," he says. "In other words, bargains are commonplace. That said, a prospective purchaser must still undergo its due diligence."

## Strategic move

Buyers should appraise the business or asset and understand what they can afford before making an offer. "A potential buyer must understand when a good deal becomes a bad deal," Hammer says. That requires the purchaser to appraise the business or asset and understand what it can afford to pay before making an offer. Asset buyers also must determine how the purchase will affect their existing organization.

"Purchasing an undervalued asset is not a good deal if it exposes the buyer to unnecessary risk," Hammer says. "If the seller is undergoing financial distress, buyers generally should look to purchasing those assets in Chapter 11 to protect themselves."

Ray Anderson, a director in Huron Consulting Group's restructuring and turnaround practice, agrees that distressed companies can represent tremendous opportunities to a sophisticated corporate buyer. "If valued properly, returns can be enormous. Strategic purchasers also have a significant advantage over private equity bidders because they understand the industry well and typically can generate cost savings and other synergies quickly," he says.

## Protecting interest

Of course, a distressed acquisition also poses significant risk with abbreviated due diligence and myriad potential operational and financial issues to address in a short period, Anderson says.

Carl Lane, managing director of Alix Partners, says companies should do the work beforehand to make sure the price being paid is a true reflection of the value. If the acquirer replaces the management team, It may take six months to find the new C-level executives, lengthening the time of the turnaround and increasing the losses the company will occur. The acquirer likely will have to invest beyond the purchase price on deferred capital, investment in the broader business, etc.

Beyond quality due diligence, Feinstein says, purchasers of assets from a troubled company often can dictate the acquisition process that best fits their goals whether it's through assignment for the benefit of creditors, a UCC Article 9 sale or a bankruptcy process, Feinstein says. "In all cases, purchasers will opt for a specific process in order to ensure they do not get saddled with the debts of the seller, in an effort to avoid all claims of fraudulent conveyance or successor liability," she says.

"Further, purchasers should be aware that the lender is really the true seller in interest. To the extent that the seller must transfer assets free and clear of liens, there is generally no effective mechanism to accomplish this outside of bankruptcy without the lienholder's consent," Feinstein says.

The mechanism selected for effecting the sale also has a significant impact on the price, Feinstein says. As the U.S. Supreme Court has instructed, value cannot be judged without taking into consideration the context in which it is determined. "Values in foreclosure and bankruptcy sales are often depressed because you do not have the usual fair market standard of a willing seller under no compulsion to sell," Feinstein says. "Bankruptcy and foreclosure sales should, therefore, be considered as a last resort when there is no other way to satisfy the purchaser and the lienholders."

Buyers may start negotiating sales with the seller, but they should recognize that the real party in interest is the lender. "It's a mistake for purchasers to believe that they will necessarily get a cheap price because the lender would rather sell than take control," Feinstein says.

## Fewer prospects

Hammer says even though more buyers are in the market, most troubled companies still face fewer prospective buyers than they would have in a pre-recession market because of lingering liquidity concerns. "A company looking to sell usually needs to create its own market and rely on its professionals to obtain the highest and best bid," Hammer says. "A Chapter 11 makes for an ideal forum to accomplish this objective, with the debtor generally selecting a stalking horse to compete against other bidders at auction." ❖

# In the courts

Under the former Bankruptcy Act, low valuation in a bankruptcy was inequitable to secured creditors because courts allowed debtors to sell their assets at judicially determined values and pay the deficiency at pennies on the dollar. Debtors would exit bankruptcy and refinance or sell the property at highly beneficial rates, explains Faye Feinstein of Quarles & Brady LLP.

When Congress updated the Bankruptcy Code in 2005, it created provisions to protect that from happening to secured creditors. If the creditor's collateral is valued at less than the full amount of its claim, the creditor can elect to have the entire claim treated as secured and not take payment on its unsecured deficiency claim.

As Feinstein explains, the lender's opting for the secured claim means the debtor must pay the full amount by a payment stream discounted only to the present value of the collateral, and the creditor retains its liens on the assets as security for the full claim. If the debtor sells or refinances the collateral, the creditor is entitled to the full amount of its claim plus interest. Second, a lender generally is afforded the right to "credit bid" at the asset sale and take back its collateral by bidding up to the amount of the claim without paying any cash.

"These sections protect the secured creditor that might otherwise complain that its collateral is being sold at a bargain basement price by allowing it to control the process and take back its collateral if it chooses to do so, in the hope that one day, its value will return," Feinstein says.

However, a couple of recent bankruptcy cases appear to detract from those protections where the debtor has sought to eliminate a secured creditor's right to credit bid in the context of a sale proposed through a plan of reorganization/liquidation. "In the interim, the right that secured creditors believed was inviolate—their right to bid their claim at a sale and recover their collateral—is not assured," Feinstein says.

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# Directors, officers of distressed companies must adapt roles

Directors of healthy companies understand that their role requires a significant investment of time. But that commitment is significantly changed when directors lead a troubled company.

"The amount of time required to properly execute these duties can expand exponentially during distress or a crisis," says Ray Anderson, of Huron Consulting Group and vice president of TMA Chicago/Midwest. "It may be prudent for directors to question whether they want to remain on the board of an underperforming or distressed corporation at all if they cannot devote adequate time."

When directors opt to stay on board, steering the turnaround effort requires a lot of work. Anderson says in companies at an early stage of distress, directors play a key role in setting the tone, evaluating the strategy and monitoring management's results. "Management's plan should contain objective short-term and mid-term goals and milestones," he says. "The tone should be one of urgency.

"Based on my experience as a public and private board member and officer, the most effective board/management response to distress is one in which both embrace the recovery plan and share the same sense of urgency. If the board either senses management denial or a lack of urgency, or if management misses key goals, the board should consider replacing the responsible parties," Anderson says.

In later stages of distress, directors should continue to evaluate management and be actively involved in any restructuring or sales process, he says.

Carl Lane, managing director at AlixPartners LLP, says directors and officers need to be even more thoughtful when dealing with a distressed company. They need to document their decisions as well as the basis for those decisions because a troubled company's board is more likely to be scrutinized than a healthy company's.

"Distressed boards need to be more diligent in making decisions. Usually, the board is much more active in making business decisions and meets more frequently, as often as every couple weeks, and on an ad-hoc basis," he says.

Mark Leipold, a partner & Gould and Ratner, says he encourages boards and management to bring in experienced insolvency counsel who are more experienced with the specific issues than their general corporate counsel may be. Directors and officers insurance also is essential because when insolvency happens and creditors aren't being paid, they'll look for other pockets.

A board of an insolvent company must recognize they now serve a different audience. "The creditors have truly become the equity of that entity," he says. "The creditors now sit in the shoes of a shareholder. So their responsibility is to the creditors."

Lane identifies several questions a board should ask itself when leading a distressed company:

- **Should the board reconstitute itself?** Directors may consider changing the board's makeup so it has fewer insiders and/or more directors with distressed company experience. "You need people who are independent and people who understand the (restructuring) process," he says. Even if the board does revise its director lineup, it needs to be the one ultimately to hire turnaround advisers on behalf of the company. "The advisers are advising the board. They may be working hand in hand with the company, but they're working for the board," Lane explains.

- **Is the management team really capable of leading a turnaround?** Just like a healthy company in which a founding entrepreneur might not be the best person to grow the company in the long term, a company looking to turn itself around may require leadership with turnaround experience. Sometimes the board may decide against changing management but choose to supplement it with a restructuring expert so management can do its day job and the expert can focus on the restructuring.
- **Is the management team incented appropriately?** Management in a healthy company may be rewarded with a high equity stake in the company. If the incentive is the same as when they lead a troubled company, the executives tend to manage with equity as the top goal and thus have nothing to lose by taking risks to create equity. In a turnaround situation, though, leadership needs to manage the business for creditors too.

Finally, Leipold says, directors and officers must remember to make decisions in the best interest of the company and its current situation. "The directors and officers of distressed companies, whether closely held or public, sometimes find it's hard to separate themselves from the corporation's identity. They need to be conscious of that so they're clear on responsibilities and duties. ❖

## Question of liability

In ordinary situations, directors of a U.S. corporation are protected by the business judgment rule—if they make a reasonably informed decision, have no personal interest in the transaction and act in the good faith belief that the transaction is in the corporation's best interest, then they usually are immune from liability, says Ray Anderson of Huron Consulting Group.

Some court decisions, though, have eroded the business judgment rule, potentially expanding directors' duties when the company enters a "zone of insolvency," Anderson says. The fairly technical legal and financial issues involved depend on the level of company distress.

In addition, laws relating to directors' duties and liability vary widely throughout the world and even vary state by state. Directors should seek legal and financial counsel as a company's situation worsens to clarify any potential changes to their duties and/or liability.


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# Restructuring opens up opportunities for troubled companies

More than ever, companies wanting to improve their organization's competitive position now look to debt and corporate restructuring options.

"Companies can explore a broad range of restructuring strategies including Chapter 11, exchange offers or other recapitalizations depending on the capital structure, whereas during the financial crisis, the credit markets were far less amenable to aiding troubled balance sheets of otherwise healthy businesses," says Jonathan A. Carson, co-founder and managing director of Kurtzman Carson Consultants.

Aaron Hammer, a bankruptcy partner at Freeborn & Peters, says corporate restructuring doesn't offer guaranteed solutions. "Even the returns from liquidation can prove disappointing," he says. "As such, the most suitable restructuring option for a troubled company is a fact-intensive inquiry decided on a case-by-case basis.

"In each situation, the company must assess the breadth of their liquidity issues, analyze the available options with their professionals and decide on an identity going forward," Hammer says.

Jeff Zappone, senior managing director at Conway MacKenzie, says a company needs to determine whether the challenging issues it is facing are operational or financial. "Is the root of the problem the income statement, which may be addressed through a turnaround, or is it the balance sheet, which most likely requires a restructuring through the Chapter 11 process.

## Be better prepared for restructuring

How can a company better prepare itself? TMA Chicago/Midwest experts answer:

**Tom O'Donoghue, CRG Partners:**

- **Know where you are making money and where you are not.** Where you're not making money, investigate if you can. If you're a commodity-related company, do you have price increases built into contracts?
- **Identify how much cash you need to make a dollar.** It's not just if I buy $1 and sell for $2, I've made a dollar. If you need to spend $5 today for five units and sell those units for $10 in a couple months, you must account for the time it will take to recover your cost. Ask if you have enough cash to be that "lender" to your customers.

**Jonathan A. Carson, Kurtzman Carson Consultants:**

- **Get experts to help.** When a company finds itself in an insolvent situation, it should seek assistance from outside experts (attorneys, financial advisors or others depending on the nature of the situation) to proactively develop a suitable restructuring strategy.
- **Be organized.** Organize information efficiently. All key information should be clearly accessible and centralized to help expedite the process. Needed data typically includes financial statements, as well as contact information for vendors, employees, contract and lease counterparties, for example.
- **Maintain open dialogue with key constituents.** Develop a strategic communications strategy to disclose forward progress to relevant constituencies, from employees and vendors to financial institutions and the media.

**Jeff Zappone, Conway MacKenzie:**

Restructurings are complex animals and professionals who specialize in this industry exist for a reason. A great restructuring professional and restructuring attorney will pay huge dividends in the long term.

- **Dispel preconceived notions about the business and customers.**
- **Be willing to look under every rock.** Consider almost anything to position the business for success.

"Nobody has a crystal ball, but a defined strategy and goals should be developed to better ensure a successful restructuring," Zappone says.

## Bankruptcy not as popular

Tom S. O'Donoghue, a managing partner at CRG Partners, says more people are recognizing that bankruptcy is an expensive option. The administrative process in bankruptcy, cost of lawyers, notice to creditors, etc. all carry a price tag. As such, a $50 million company could spend between $500,000 to $1 million to go through bankruptcy. When creditors look at that cost of bankruptcy as compared to the company's liabilities, they generally are more inclined to work with debtors out of court.

"Creditors may be tough, but they will work with distressed companies if they're straight-forward," O'Donoghue says.

Jonathan Green, a principal at Miller Canfield, says while out-of-court restructurings are more commonplace, companies with significant real estate interests, such as businesses with many retail

locations, likely will file for Chapter 11 protection because lease negotiations are difficult outside of bankruptcy.

Carson says the likelihood of executing an out-of-court restructuring has increased significantly because lenders are willing to extend debt maturities to give companies time to work through their issues rather than forcing such situations into chapter 11.

Smaller distressed companies or companies with a smaller group of creditors, both secured and unsecured, sometimes find they can negotiate a settlement with their existing creditors according to the priority rule. With larger companies, the certainty of settling with creditors will continue to require a bankruptcy process, O'Donoghue says.

Distressed companies also have greater access to capital today to address balance sheet issues. Carson points to Moody's reporting earlier this year that firms issued more than $200 billion in junk bonds in 2010, up 40 percent from 2009 and 400 percent from 2008. In addition, Moody's found 59 percent of this high-yield issuance was used to refinance debt.

O'Donoghue says state and federal receiverships offer

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## What should creditors know?

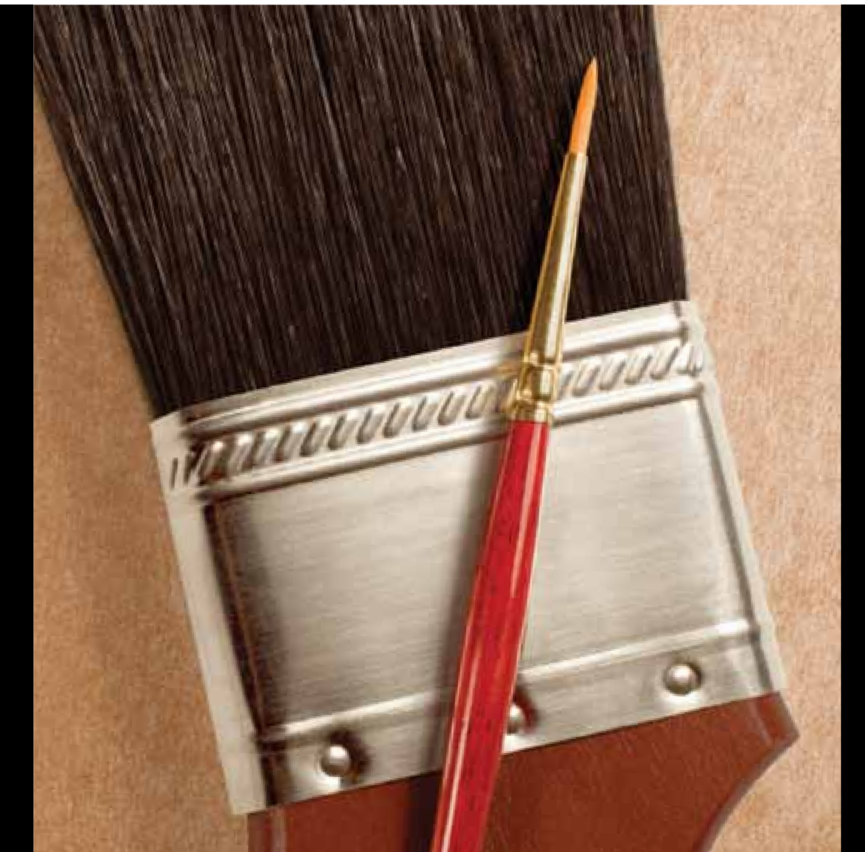
Michael Traison, a principal at Miller Canfield, says his firm frequently is contacted by clients who have an interest in what a debtor is about to do. Creditors need to take an active role in the restructuring, he says.

"It's very important for creditors to know they can turn to a turnaround professional," he says. "We encourage questions all the time because it's good for everybody."

Creditors should be aware that when a debtor files for federal bankruptcy, an injunction automatically goes into effect. Creditors cannot take further action against the company, such as sending demanding letters or litigating in court, unless the bankruptcy court permits it, Traison says.

Be cautious of sales to a debtor in Chapter 11. Debtors may offer to buy in Chapter 11 from an unsecured creditor, placing that creditor's claims just below secured creditors and perhaps other priority creditors and pari passu with yet more on the payment ladder. All that is true, Traison says, but make sure the superior creditor's debt is not so great that the sale offers no real value for the acquiring unsecured creditor.

Join the creditors committee in a Chapter 11. In addition to recouping your administrative expenses, the creditor's representative will learn much more about the debtor's operation. Plus, sitting on a creditor's committee will teach the your representative about the Chapter 11 process so he or she becomes an expert.



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another restructuring option. "They have more flexibility," he says. "Receiverships make sure the process is done right and cut down on court time," O'Donoghue says, noting they also don't have formal creditor committees.

Michael Traison, a principal at Miller Canfield, says he too has seen much more use of out-of-federal-court processes. "That's something I've always done a lot of … relying on state law or something outside the statutory/court system and creating agreements among creditors and debtors on how to deal with the debt," he says.

## Changing picture

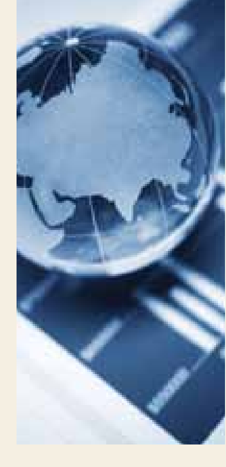
In the last 10 years, Green says, he has seen significant changes both in creditor committees and what kinds of things are accomplished in bankruptcy cases.

"Now debt is sold and traded on a frequent basis," he says. Even creditors committee members change during the restructuring process. Those credit holders have different incentives and want quick returns that result in large returns which makes restructuring cases much more complicated and much more fluid, Green says.

Expect restructurings to be busy the next few years, Zappone says. "The slow economic recovery and significant amount of debt that will need to be addressed in the coming years has the potential to create a great deal of activity in the restructuring space," he says. ❖

## Insolvency goes global

Aaron Hammer, a bankruptcy partner at Freeborn & Peters, says cross-border insolvencies create their own set of challenges. "Disparate insolvency laws have caused considerable headaches for multi-national companies in restructuring," he says. In 1997, the United Nations passed the Model Law on Cross-border Insolvency to harmonize cross-border case administration. The United States adopted a form of that law, which is Chapter 15 of the U.S. Bankruptcy Code.



Once recognized by the U.S. bankruptcy courts, the bankruptcy court has considerable discretion to recognize foreign orders entered by the foreign court, to sell U.S. assets of the foreign debtor or to enjoin enforcement activities against the foreign debtor by U.S. creditors, among many others.

Hammer cautions that each cross-border insolvency matter brings its own particulars, but Chapter 15 has proven effective in assuaging many concerns that U.S. courts would complicate administration of a foreign proceeding, at least with respect to U.S. claims or assets.

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