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Challenges to preserving value in a debt restructuring

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When any industry faces challenging times, thoughts turn to what might happen to those companies which are unable to maintain their solvency and service their existing debt.

The mining industry is no different. If steps such as cutting costs, improving productivity, selling or mothballing unprofitable operations, raising new equity and refinancing existing debt do not yield the hoped-for results, companies may have little choice other than to restructure their existing debt or, in extremis, enter into one or more formal insolvency procedures as a protective step if they are to avoid creditor action.

Debt restructuring and formal insolvency are complicated processes in the best of circumstances, placing significant demands on even the most experienced management teams. However, factors specific to the mining industry may make achieving a debt restructuring particularly challenging.

Formal insolvency procedures in certain jurisdictions, unless part of a carefully planned strategy, may ultimately destroy the value of the underlying business (which may explain why the industry has seen relatively few formal insolvencies to date). This puts pressure on stakeholders (management, banks and other lenders, suppliers and other counterparties, employee unions and, where relevant, governments), where possible, to achieve quickly a consensual debt restructuring which provides the company with a realistic platform for future long-term trading in a world of lower commodity prices.

Whilst traditionally bank debt was prevalent, alternative capital providers are now entering into the market. Many companies have complicated capital structures, including senior bank debt, bond debt and streaming, vendor and royalty finance, as well as hedging arrangements. As between them, the rights of the various lenders will be the subject of inter-creditor arrangements. As any decision on a debt restructuring is likely to require the consent of a high proportion of lenders, with their differing rights and commercial interests, achieving a consensual solution is inevitably challenging.

This problem is not unique to the mining industry and, in other sectors, companies have sought approval from the UK courts for "schemes of arrangement" in order to complete a debt restructuring which had the benefit of significant lender support but which support fell short of the consent thresholds imposed. UK schemes are available to non-UK companies which can establish a "sufficient connection" to the jurisdiction and may therefore be of assistance to mining companies outside the UK, including those with no apparent current link to the UK. In a recent case, a Dutch company successfully established a sufficient connection to the UK by changing the law governing its bond debt from New York law to English law.

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Whilst restructuring negotiations continue, management will need to monitor cash flow and maintain a dialogue with other stakeholders, particularly suppliers, in order to ensure that they do not take action against the company (including arbitration to recover unpaid debts and/or insolvency proceedings) which might jeopardise continued trading pending the completion of negotiations with lenders.

If pressure from unpaid stakeholders is building, management will need to consider whether a protective insolvency filing is appropriate – in many jurisdictions, once a company enters into an insolvency process, it will have the benefit of a moratorium on creditor action. Typically the group structure comprises a series of separate operating companies incorporated in the various countries where the mines are located, together with intermediate holding companies and a parent company incorporated elsewhere, hence multiple filings may be required. If one company has assets in a number of different jurisdictions then ensuring that the moratorium is recognised and enforced by the courts in each such jurisdiction will be key.

The decision to make a protective insolvency filing will be a difficult one for management, given that this may trigger rights to terminate licences and key contracts. Throughout the restructuring process, the directors will need to have regard to their legal duties when making key decisions. These will vary between jurisdictions but they may owe their duties predominantly to the company's creditors, and not its shareholders, if the company is insolvent. They will also need to be aware of any strict obligations upon them, for instance, a requirement to make an insolvency filing if the company is cash flow or balance sheet insolvent. Regular reviews of trading, cash flow, performance against targets, progress of any ongoing asset disposal programmes (together with the progress of the restructuring negotiations themselves) and advice on the options for (and implications of) insolvency filings in relevant jurisdictions will be critical information for management.

Across the industry there is already a broad awareness of other issues which mining companies will face in the context of any restructuring, including untested insolvency procedures in less sophisticated legal jurisdictions, the impact of development finance, the differing outlooks of lenders (for instance par vs. distressed investors), the role of governments and the potential power of employee unions.

One particular issue, the implications of which are worth noting, is that in some jurisdictions, once the company enters into an insolvency process, the business is managed by an insolvency officeholder. It may be very difficult for the officeholder to gain a sufficient understanding of a complex business (including obligations under environmental legislation which, if breached, may lead to personal liability) in order to be able to trade the business for any length of time. Whilst comfort from the courts and discussions with regulators may help, the consequent destruction of value if production ceases will be detrimental to all stakeholders.

Ultimately, if value is to be preserved, a consensual debt restructuring which avoids the need for a formal insolvency filing may be the only option for many mining companies who are unable to maintain solvency and service their existing debt.

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