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LBO STRUCTURES – LESSONS LEARNT FROM RECENT RESTRUCTURINGS - PART II OF III

By Neil Caddy

This article continues to look at how the experiences of recent restructurings of leveraged credits will impact and inform new leveraged deals.

Complex capital structures Complex financing structures are inevitably harder to unwind. It is more difficult to find acceptable restructuring solutions where the rights and interests of many divergent creditor groups need to converge. Even relatively small deals can include senior, 2nd lien, mezz and pik tranches. Will there be a push to “keep it simple stupid”?

Amendment provisions A balance will need to be struck on amendment provisions. Flexibility to make changes without unanimous consent can avoid hold-outs scuppering restructuring efforts. Facility change or structural adjustment provisions have also proven useful in plugging liquidity gaps, however it is still likely that unanimous senior consent will be required to put new money in on a super senior basis.

CLOs and CDOs? Restructurings have highlighted that CLOs, CDOs and other funds are not able to grant indemnities due to limitations in their constitution. Even if they are able to, their worth is questionable. In deals where the security agent requires an additional indemnity from the syndicate to carry out an enforcement this has been an issue. Thus far either non-CLO/CDO entities and/or the company have been prepared to

fill the void or the security agent has taken a view. This could become a greater issue in the future if the work-arounds are found wanting or if some non-CLOs/CDOs/security agents get burnt.

Intercreditor foibles (i) Lawyers have been grappling with the prospect of contractual restrictions continuing post restructuring therefore binding the company and senior creditors. This seems perverse if it benefits out of the money creditors and could limit restructuring options. The outcome will most likely turn on the intricacies of the drafting in a particular case or the reliance on a broader construction argument. It may therefore be sensible to address this point specifically in future intercreditor agreements. (ii) Mezzanine payment stop events should include non-compliance with the senior financial covenants. They often do not include non-delivery of accounts on which the financial covenants are tested however.

Subordination provisions Some guarantees include very broadly drafted subordination clauses. This could be to the detriment of a guarantor’s creditors and to the benefit of unsecured trade creditors. We may therefore see negative pledge clauses being broadened to deal with this so that only narrowly drafted subordination clauses can be executed.

Early warning systems We have seen that financial covenants have not always flagged



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performance issues at an early stage. Financial covenant breaches have often been swiftly followed by payment defaults and liquidity crises. This may just be down to the suddenness and severity of the recent downturn, but we may see a greater focus on the scope and quality of information being provided and a quest for other more effective early warning provisions/covenants.

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