Nexia International

Turnaround Restructuring Insolvency (TRI)

Service newsletter
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Introduction

Welcome to the first Nexia TRI newsletter,

The TRI newsletter is a Nexia publication that gives the readers access to the latest updates from across the globe. The articles are sourced from advisory professionals around the network, both national and international developments.

This edition contains four articles: “out-of-court” restructuring proceedings from Germany, global restructuring opportunities, Caribbean update, and cross service line collaboration

We hope that you enjoy the content. If there are any specific topics you would like us to cover in the future please send details to Greg Palfrey at greg.palfrey@smithandwilliamson.com.

Please click here to read the Nexia TRI brochure and find out more about the Nexia TRI Group.

Greg Palfrey
Nexia TRI Business Group Lead.

Germany - Initiatives on “out-of-court” restructuring proceedings

If a distressed company fails to agree with its creditors on restructuring measures, insolvency is often the only option. In a reform of insolvency law in 2011, the German legislature strengthened the possibilities for restructuring business through various insolvency proceedings.

Insolvency proceedings involve extensive interventions for all parties involved. Even the types of proceedings in which management remain authorized to dispose of company assets (protective shield proceedings, self-administration) are associated with considerable litigation risks. In addition, the “blemish of insolvency” can remain even if not to the same extent as in the past.

In 2017, the EU Commission presented a proposed directive for a so-called “preventive restructuring framework” (COM (2016) 723). One of the aims is to create a uniform legal framework for restructuring companies outside of insolvency proceedings.

In essence, the “preventive restructuring framework” is intended to make it possible to reorganize a company through financial restructuring. The focus is on restructuring the financing structure. For example, by means of debt equity swaps, waivers of all or some receivables, modifications to investments, debt restructuring or new collateral arrangements. The measures required for restructuring are to be recorded in a restructuring plan and put to the creditors for their approval.

Debt waivers, debt equity swaps and other instruments are common practice in corporate restructuring. However, outside insolvency proceedings, these instruments require the consent of all creditors concerned. Firstly, the necessary legal changes can only be brought about by contract. Secondly, the financiers regularly require unanimity (changes are subject to consortium approval). Meeting these requirements is often the biggest challenge in “out-of-court” restructuring. It sometimes requires very complex negotiations, in which individual creditors often use their position to achieve special advantages. This may be the case in particular if specialised investors have bought into the lender position by acquiring distressed debt - usually at a significant discount - and get “paid” for their approval of the restructuring concept. This kind of practice could be countered with a “preventive restructuring framework”.

At the end of the proceedings a restructuring plan is approved by the creditors, by a majority vote and confirmed by the court. This plan contains the legal rules that are deemed necessary for the intended restructuring. Details are yet to be laid down in the directive or in national legislation. The decisive factor is that the restructuring plan adopted with the votes of this (qualified) majority is also binding on non-approving creditors. Their legal positions (claims, securities, etc.) are also changed as defined in the plan. For protection against abuse, a kind of “settlement account” is required, which dissenting creditors may not be placed in a worse position than in the event of liquidation or sale of the company as a whole.

The “preventive restructuring framework” should differ from regular insolvency proceedings as follows:

- The proceedings begin before the insolvency. It is not necessary for the company to be insolvent or overindebted. After all, insolvency should be avoided.
- The procedure should be limited to individual groups of creditors (e.g. financial creditors).
- The procedure is always carried out in “self-administration”. Management of the business is not handed over to an insolvency administrator.

framework" in Germany is to be welcomed. It remains to be seen what provision will ultimately be contained in the directive, which will then have to be transposed into national law. However, according to the basic idea, the planned procedure offers a useful restructuring instrument. Of course, it is not a panacea either. A company in crisis cannot be resolved by itself, and the planned procedures can help to bundle and channel the various restructuring measures.

The final directive is expected to be adopted at the end of 2018 and then it must be transposed into German law.

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Global restructuring opportunities

Even in good economic times, companies around the world need help from experts in TRI. New countries are opening up to investment and new regulations, new technologies and new policies are changing how those policies might develop.

"There are a lot of global opportunities that we are seeing. Our clients are driving us to a lot of places that I never would have dreamed of five years ago," said Frank Longobardi, CEO of accounting firm CohnReznick, headquartered in New York City.

To understand these opportunities, experts from around the world gathered at the Nexia TRI conference, held on 14 May 2018, in New York City. The conference saw over 80 people from 17 countries come together.

Nexia's TRI group was founded in 2012 to bring together financial and legal expertise from across the network to support international businesses and their advisers in times of challenges or distress.

It is now an established global network of TRI specialists, within member firms, who are able to provide advice to clients and support the offering of Nexia members around the world.

The conference topics were wide reaching and included:

Lawmakers fight 'Forum Shopping'

U.S. Senators Elizabeth Warren (D-Mass.) and John Cornyn (R-Texas) have sponsored a bill in Congress that could have a giant effect on where companies can file for bankruptcy.

If passed into law, the Bankruptcy Venue Reform Act would require the parties in a bankruptcy case to file in a jurisdiction that is the principal place of business for the bankrupt company. That's a big change from the current law, under which a bankrupt company can use a small asset like a bank account or the office of a subsidiary to justify filing in a jurisdiction. For example, Enron filed for bankruptcy in New York, even though just 0.5 percent of its assets were located there.

"The system is manipulated when the Dodgers file in Delaware, or Enron files in New York... It looks like a setup," says the Honorable Donald H. Steckroth, member of Cole Schotz, a law firm based in New York City and a retired U.S. bankruptcy judge for the district of New Jersey. For example, creditors may be less to participate in legal proceeding. "The employees in particular are harmed."

London could lose its favored status for bankruptcy

Currently, companies from all over the EU regularly file for bankruptcy in London but that could become less if the UK leaves the EU.

"The flexibility of English law has allowed a string of bankruptcy cases to be filed in England," says Glen Flannery, solicitor and partner for CMS Cameron McKenna Nabarro Olswang, based in London. European law currently recognizes the validity of bankruptcy decisions made in the UK.

That could change if the UK completes its current plan to leave the EU in 2019. Officials in the UK have already submitted a treaty proposal that would allow the current system to continue. But if that treaty is not ratified, bankruptcy proceedings in the UK would become much more complicated, which might motivate many stakeholders to file for bankruptcy in another jurisdiction, such as Holland or France.

"Absent effective replacement measures, Brexit will weaken the UK's stature in European cross-border cases, but it's likely to remain a compelling choice," says Flannery.

New opportunities to turn around companies

Turnaround experts are finding new opportunities to improve companies sometimes in new markets, other times in familiar markets transformed by new technologies.

"We are seeing things from very far away, people are willing to go outside of their region to explore funding sources from here in the U.S.," says Sam Alberts, partner with Dentons US, based in Washington, D.C. Bringing investment from the U.S. to an unfamiliar new market often requires learning. "It is always an investment to get used to a new jurisdiction but it is always worth it. The more complicated the better."

New countries are opening up to investment. "Saudi Arabia is challenging ... we have spent a lot of time in the Arab Gulf fundraising," says Russell Flicker, co-founder and managing partner for AWH Partners, based in New York City.

New technologies are also creating opportunities. For example, real estate is likely to change because of technologies such as ride sharing companies like Uber and self-driving cars. "Not today, but soon there are going to be opportunities in the parking space. Investors are now valuing parking differently than they did before because of the lowered need for parking," says Flicker. "Cap rates are moving today because of the future need from parking."

Opportunities to transform retailers and retail spaces

Turnaround experts are also helping retail real estate companies find new ways stay relevant and improve their business, despite the rise of online shopping. "If you are a retail real estate firm, you have seen your business decimated by e-commerce," says Tama Huang, principal and global real estate advisory services leader for NOI strategies, a division of CohnReznick.

To keep drawing customers, retail real estate firms and retailers are working to provide an experience in their physical stores that shoppers cannot get by shopping online. "A downtown Louis Vuitton show is becoming more of an entertainment center than a shopping center," says Huang. "You go there because of an event, rather than to buy a purse."

Retail property managers are also finding partners like farmer's markets or pop-up stores to bring new experiences and unique vendors to their retail spaces.

Mixed-use development is also helping to create captive audience for some retail spaces. "Every shopping center is now being surrounded by mixed-use," says Huang. "Residential is going hand in hand with retail, so people are living where they shop."

Brexit causes uncertainty for firms that deal with the UK

As the United Kingdom prepares to leave the European Union, many companies now struggle to understand how the change will affect their business. Some may need help from turnaround experts.

"If you are planning, you need certainty and uncertainty is a killer. We need to model various scenarios and be able to adapt quickly" says Greg Palfrey, partner and national head of restructuring and recovery services at Smith & Williamson. He is also chairman of Nexia TRI.

"It is fairly certain that the UK will actually leave the E.U., despite continued speculation that some last minute change could undo the 2016 referendum in which Britain narrowly voted to leave. I think that we are coming out. And I don't see how that is going to change," says Palfrey.

That leaves the details to be worked out on matters ranging from immigration to tariffs on which regulations will govern bankruptcy procedures. So far, British negotiators have not racked up many victories to UK companies. "We have continued to not play our best hand," says Palfrey.

President Trump's policies break with predictability

Since the election of Donald Trump as U.S. p resident in 2016, companies around the world have struggled to understand how changing U.S. policy might affect their business and how they can adapt. President Trump is unlikely to become less confrontational or unpredictable, because that is what many of his core supporters seem to expect of him.

"They voted for someone who said 'I'm going to break some glass, and that's what he's been doing," says Byron Dorgan, senior policy advisor for the law firm of Arent Fox, based in Washington, D.C. Dorgan also served as a U.S. Senator, and was a member of the Senate leadership for 16 years, first as Assistant Democratic Floor Leader and then as Chairman of the Democratic Policy Committee.

However, there are limits on how much a Republican White House has been able to accomplish to change U.S. policy, because the Republic Party only has a thin majority in the houses of Congress. “The Speaker of the House Paul Ryan did not have a great number just a 21 vote majority, and more than that in the Freedom Caucus,” says Dan Renberg, partner with Arent Fox, a former Republican Congressional staffer.

So far, the U.S. economy has weathered uncertainty on issues like trade policy and immigration. “This country has a very strong economy that is growing and it remains so,” says Dorgin.

Skilled nursing homes under pressure

Many of seniors housing properties that provide the most intensive medical services to residents are under a lot of pressure. “Skilled nursing is just now on fire – the pain is so bad,” says David E. Gordon, partner with Polsinelli, a law firm based in Atlanta.

These properties are being hurt by a federal push to save money on seniors care. The Center for Medicaid Services, the federal entity that sets Medicaid reimbursements, is now rewarding hospitals for supplying services at the lower levels of acuity, which have in the past been provided at nursing homes. “That puts skilled nursing under pressure,” says Gordon.

Skilled nursing homes will eventually benefit from a huge demand for housing as the Baby Boom generation grows old enough to need the level of medical care that skilled nursing facilities provide. “There is an opportunity. The question is timing it so that you invest when it is on the upswing,” says Thomas Califano, partner and co-chair of the restructuring practice group for DLA Piper, based in New York City.

Restructuring experts also see an opportunity to help the hospital system in the U.S. provide better care at a lower cost. “There are inefficiencies in our system that need to be changed,” says Califano.

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“People are used to having a hospital in their town that does everything,” says Califano. “Services need to be offered in a place where they do a high volume of the same type of procedure because it is more efficient, it costs less and you have better results.“

Caribbean update

In addition to a long running hedge fund insolvency and other legacy case work, RHSW has recently been appointed to the following cases:

- Provisional liquidators in the Cayman Islands to facilitate the restructuring of a Chinese pulp and paper manufacturer. This is a joint appointment with a Hong Kong practitioner and it is intended that the liquidation will allow for the implementation of a scheme of arrangement that will be binding on stakeholders in the company's Far East markets as well as the Cayman Islands
- Official liquidators to an investment brokerage and agency firm for investors from several countries in South America. The company was based in the Cayman Islands but conducted business in both North and South America. The case is likely to involve asset-tracing, marshalling of client monies and an application for Chapter 15 recognition under the United States Bankruptcy Code.
- Liquidators to a BVI company which owns a luxury villa in St Vincent and the Grenadines. The appointment has been complicated as a result of disputed ownership interests and conflict of laws between the BVI and St Vincent (requiring extensive legal actions in both jurisdictions). Once our appointment has been recognised in St Vincent, we can take possession of the property.
- Trustees to a dissolved Nevis company (this is synonymous with the appointment of a voluntary liquidator) which owns two care facilities in Scotland. The properties are charged to a Bank and liquidators have been appointed over the company's Gibraltarian parent. This obviously has complicated both the appointment and asset realisation process. However with the assistance of Smith & Williamson we are making headway in providing the Bank with the necessary comfort to allow us to proceed with an asset realisation program.

Cayman Islands and BVI markets
The offshore financial centres based in the Caribbean continue to grow despite the increased scrutiny from certain governments and public option. Along with most other developed economies, the islands are faced with ever increasing regulation and compliance requirements but are meeting or, in many cases exceeding, international standards.

The insolvency/restructuring market is relatively quiet although the expectation by practitioners on island and in jurisdictions that tend to use Cayman and BVI structures is that the work opportunities will increase with the expected interest rate rises and tightening of global economies.

Hurricane Irma update from the BVI
The BVI continues to recover from the devastating effects of Hurricane Irma which impacted the islands in September 2017. We are glad to say that through the hard work of the BVI Government, the financial services regulator, industry representative bodies and the industry itself, the effects of Irma on financial services industry have been minimal and it was "business as usual" shortly after the storm.

Much work still needs to, and continues to be done to repair the damage to infrastructure, homes and commercial structures caused by the storms, but the natural beauty of the islands remains.

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Cross service line collaboration

Nexia International's Tax and TRI business groups collaborate to facilitate efficient restructuring driven by U.S. tax reform.

Background

Prior to the enactment of the Tax Cuts and Jobs Act (TCJA) in December 2017, many U.S. businesses that operated as so-called "flow-through entities" (e.g. partnerships, S-Corporations and certain limited liability companies) organized their international operations to take advantage of qualified dividend income (QDI) planning. QDI planning generally involved the formation of one or more holding companies in jurisdictions that have tax treaties in force with the U.S. and utilise a territorial tax system (e.g. The Netherlands, Luxembourg, the UK, Ireland and Malta, among others). Such planning allowed U.S. owners of such businesses to be taxed at lower long term capital gains rates on distributions from non-U.S. subsidiaries.

The global intangible low taxed income (GILTI) provisions in the TJCA have, in many cases, resulted in QDI planning structures no longer providing U.S. tax owners of such businesses with the intended benefits. Many of these U.S. owners are or are considering restructuring their international operations to utilise a U.S. C corporation to hold their non-U.S. subsidiaries or to make a special election to be taxed as a C corporation on GILTI earnings. In these cases, the non-U.S. holding company structures may have become superfluous.

Opportunity

Companies that have or are planning to restructure as a result of the GILTI provisions may have an opportunity to streamline their structures by eliminating holding companies that no longer serve their purpose. Doing so will likely only make sense if such restructuring can be done without current tax cost and the implementation of such restructuring can be accomplished in an efficient manner.

Nexia international's tax and TRI business groups have teamed up to assist clients in implementing restructuring of groups impacted by the TJCA and, in particular, those impacted by the GILTI provisions. Nexia professionals can assist companies in navigating the complex tax and regulatory regimes that may apply to such restructuring opportunities in a cost effective manner.

This process will allow a company or group of companies to be disposed of where they no longer serve a purpose which will save the ongoing costs of compliance ie auditing and being shown as a complex group structure.

For more information about these issues and the assistance Nexia can provide, please contact any of the following Nexia professionals.

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It is now an established global network of TRI specialists, within member firms, who are able to provide advice to clients and support the offering of Nexia members around the world.

The Nexia network consists of over 667 offices in 115 countries and 2,800 partners. TRI specialist's members exist in key jurisdictions and are supported by other members of the network.

Nexia International is a leading worldwide network of independent accounting and consulting firms, providing a comprehensive portfolio of audit, accountancy, tax and advisory services.

Contact us

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