International Corporate Rescue

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

Annual Subscriptions:
Subscription prices 2011 (6 issues)
Print or electronic access:
EUR 695.00 / USD 845.00 / GBP 495.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

© 2011 Chase Cambria Company (Publishing) Ltd

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without prior permission of the publishers.

Permission to photocopy must be obtained from the copyright owner. Please apply to:
E-mail: permissions@chasecambria.com
Website: www.chasecambria.com

The information and opinions provided on the contents of the journal was prepared by the author/s and not necessarily represent those of the members of the Editorial Board or of Chase Cambria Company (Publishing) Ltd. Any error or omission is exclusively attributable to the author/s. The content provided is for general purposes only and should neither be considered legal, financial and/or economic advice or opinion nor an offer to sell, or a solicitation of an offer to buy the securities or instruments mentioned or described herein. Neither the Editorial Board nor Chase Cambria Company (Publishing) Ltd are responsible for investment decisions made on the basis of any such published information. The Editorial Board and Chase Cambria Company (Publishing) Ltd specifically disclaims any liability as to information contained in the journal.

ARTICLE

Where Are All The Corporate Insolvencies?

Vernon Dennis, Partner and Head of Corporate Recovery & Reconstruction, Howard Kennedy, London, UK

Why is that following a recession as deep as that encountered in the years of Great Depression of the 1930s have we not seen an expediential rise in the rate of corporate insolvencies?

Currently there are many theories being put forward by economist as to why the economy has bounced back into growth following the credit crunch, global banking crisis and global recession. Importantly such theories provide forecasts to the future, with many saying that it was the severity of the fall that has made the bounce back so strong. Like a motorist who has had to slow down, he will pick up speed to 'catch up' on journey time, businesses will react in exactly the same way. However as the American management theorist, Laurence J Peter famously said 'an economist is an expert who will know tomorrow why the things he predicted yesterday didn't happen today.'

Bearing this maxim in mind it is with some trepidation that as a mere lawyer I seek to explore why we have not seen the expected huge rise in corporate insolvencies and speculate on whether with the recession now over we can expect to see continuing falls in insolvency levels.

Perhaps the recession wasn't that bad?

An economic recession is officially identified by a fall in Gross Domestic Product (GDP) over two consecutive quarters. The decline in GDP over six quarters from Q2 2008 to Q3 2009 was more severe than any other recession suffered in the last seventy years. With the generally anticipated time lag between general economic decline and business failures being 12-18 months, it was predicted by many commentators, myself included, that 2010 would see a large rise in the numbers of corporate insolvencies. Instead we have seen in comparative period Q2 2009 and Q2 2010 a fall in liquidations of 19% and of administrations 24%.

While GDP is the accepted economic measure of growth or decline, it does not tell the whole story. Different economic indicators in other earlier recessions have been undoubtedly worse. For example in the 1980s unemployment rates and falls in household income were significantly worse, while in the early 1990s business insolvencies and repossession rates were higher. The has led some, David Cameron included, to question whether GDP is a realistic measure of success (and by implication failure) and that an individuals standard of living should be judged on wider measures, although more intangible such as employment and home security, health and even happiness.

So perhaps one could point to the fact that after the credit crunch and consequent global banking system crisis the recession was nowhere near as bad as feared. Has this inspired consumer and business confidence which in turn has avoided a recessionary spiral and ensured economic growth over the last four quarters (to Q3 2010)?

Unfortunately for the UK the answer does not look this simple. The economic recovery is immensely fragile with GDP growth averaging over the period of recovery a rise of 0.5% per quarter, retail spending is falling, the UK housing market moribund and consumer and business confidence remains resolutely low.

The banks are sitting on the problems?

Undoubtedly the severity of the credit crunch and the near implosion of the Western banking system following the collapse of Lehman Brothers has had a salutary effect upon legislatures and regulators around the world. Swift and massive State intervention into the banking system on an unprecedented scale prevented its collapse. This intervention has however come at a high cost, not least to the Banking industry itself. Now in some areas part State owned, all Banks will now be subject to stricter capital requirements and be more heavily internally and externally regulated. This will means that moves into lucrative (but risky) investment activities will be curtailed; it is no coincidence that the demand for collateralised debt obligations, a major source of credit funding pre-credit crunch, has all but disappeared. It will be naïve to assume that Bankers will not find innovative solutions and invent new forms of credit instruments but in the current climate such innovation is likely to be slower to develop.

In the meantime Banks will be stricter and more selective in their lending practices. On an individual scale the acceptance rate for mortgages applications

is running at historically low levels, while the Business Secretary Vince Cable is exhorting the Banks to once again start lending to businesses. Bank lending is however unlikely to return to normality until their balance sheets are improved and it is those lenders heavily exposed to the property market that seem to have most difficulty.

Clearly reluctant to flood the market with property, as occurred in the 1990s, which in turn created a recessionary spiral, Banks are seeking ways to ensure bad debt is not crystallised. This may include moving assets into SPV, whether wholly owned by the Bank or as part of a joint venture, or agreeing to 'amend and extend' borrowers' facilities that have expired. Many property investors, both wealth individuals and funds, have waited in vain for the banks to release their under performing property portfolios onto the market or by private treaty.

Likewise the insolvency profession while providing advisory work to lenders and borrowers during many of the facility renegotiations have not been flooded with office holder appointment work. Intervention seems to arise only in cases of necessity (such as where the borrower has or will initiates its own insolvency process) or conversely where the asset is easily realisable. With problem cases the Banks instead appear to be prudently waiting to see of the situation will improve.

One further issue on the horizon however is the maturing of credit facilities provided during the days of milk and honey, Standard and Poor's European Leveraged loan index of outstanding loan maturities growing from EUR 5bn in 2011 to EUR 49bn in 2015. This wall of debt requiring repayment is a challenge to both lender and borrower alike.

Companies are able to postpone dealing with problems?

With the lenders willing to amend and extend facilities albeit at the cost of increased spreads, additional fees and improved security, many businesses will be able to avoid facing the issue of over gearing, at least for the time being.

Allied to this are over 370,000 businesses who have entered into time to pay arrangements with HMRC (delaying payment of GBP 6.5bn in tax). Where banks have been unwilling to lend further this has provided some with temporary working capital.

With interest rates remaining at historically low levels those ability to find funding are also able to carry over valued assets on their balance sheets.

Restructuring, both financial and operational comes at a cost but is the long term solution for many companies who are poorly performing and/or over leveraged. Unfortunately buffeted by the unpredictable nature of the credit crunch and the following recession short term survival seems to be only aim of many businesses. Planning for the future is being put on hold and the opportunities to obtain the valuable help of the insolvency profession is not being taken up.

Capital Markets have come to the rescue?

Into the gap left by traditional bank funding, it was anticipated that hedge funds, pension funds and even Sovereign Wealth funds would play an increasing role in refinancing, at least for larger corporates. While some funding has been obtained from these sources the most marked incidence of new lines of debt funding has been the rise in investor appetite for high yield bonds. This non investment grade bond market has a chequered history; arising in the US in the 1970s and often associated with bond holders taking an aggressive stance on any senior debt restructuring. For the corporate the control of the bonds and secondary market was also a cause for concern, with the identity of the stakeholders on any restructuring being unknown at the point of attempted negotiation.

In the current climate however with the withdrawal of traditional bank lending and the wall of debt that will require repayment in the next 4-5 years it is likely that the quality of the investments will improve (and default become less likely). It is noted that 'step up notes' are being provided with the higher rates of interest associated with this market, only arising in later years, furthermore bond holders are seeking to renegotiate the traditional subordination of the high yield bond debt to bank debt. With a greater ability to control any situation of possible default the bond holders maybe more inclined to collaborative solutions with the borrower and other debt providers.

The access to this market is of course limited, but by analogy while smaller companies who may seek lending from asset based lenders, factors and discounters, larger corporates may also find the capital markets an alterative sources of funding but more importantly will fins that the cost of such funding will come at a cost.

We are heading for a double dip recession?

The cost to UK Plc of the bank crisis is the fundamental re-evaluation of public spending. In finding GBP 81bn worth of cuts by 2014 over 490,000 public sector jobs will be lost. Those companies dependant on public sector contracts will undoubtedly suffer and a domino effect could endanger the required growth in the private sector, if recession is to be avoided.

With unemployment set to rise and house prices static it is unsurprising that consumer confidence is low. This is reflected in business confidence with business sales (the driver to successful reconstruction through administrations) drying up. The deflationary pressures

© 2011 Chase Cambria Publishing

of 'why buy now when the price could be lower later' mean that lenders and other stakeholders will not wish to expose distressed assets to a depressed market.

As a result, despite signs of economic recovery, there are clearly huge problems still remaining. These problems have not been solved, merely postponed. Surely this must mean that corporate insolvency numbers are set to rise? My personal opinion; I have no idea. The only thing that has been certain about the economy over the last 3 years has been its uncertainty.

© 2011 Chase Cambria Publishing

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, The US Corner, Economists' Outlook and Case Review section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.

Editor-in-Chief: Mark Fennessy, Orrick, Herrington & Sutcliffe (Europe) LLP, London

Scott Atkins, Henry Davies York, Sydney; John Armour, Oxford University, Oxford; Samantha Bewick, KPMG, London; Geoff Carton-Kelly, Baker Tilly, London; Sandie Corbett, Walkers, British Virgin Islands; Stephen Cork, Cork Gully, London; Ronald DeKoven, 3-4 South Square, London; Simon Davies, The Blackstone Group, London; David Dhanoo, Qatar Financial Centre Regulatory Authority, Qatar; Hon. Robert D. Drain, United States Bankruptcy Court, Southern District of New York; Nigel Feetham, Hassans, Gibraltar; Stephen Harris, Ernst & Young, London; Christopher Jarvinen, Hahn & Hessen LLP, New York; Matthew Kersey, Russell McVeagh, Auckland; Joachim Koolmann, J.P. Morgan, London; Ben Larkin, Berwin Leighton Paisner, London; Alain Le Berre, BTG Mesirow Financial Consulting, London; Guy Locke, Walkers, Cayman Islands; Professor John Lowry, UCL, London; Dr Carlos Mack, White & Case, Munich; Lee Manning, Deloitte, London; David Marks Q.C., 3-4 South Square, London; Ian McDonald, Mayer Brown International LLP, London; Riz Mokal, 3-4 South Square, London; Lyndon Norley, Greenberg Traurig Maher LLP, London; Rodrigo Olivares-Caminal, Centre for Financial and Management Studies (SOAS), University of London; Christian Pilkington, White & Case LLP, London; Susan Prevezer Q.C., Quinn Emanuel Urquhart Oliver & Hedges LLP, London; Sandy Purcell, Houlihan Lokey Howard & Zukin, London; Dr Arad Reisberg, UCL, London; Peter Saville, Zolfo Cooper, London; Daniel Schwarzmann, PricewaterhouseCoopers, London; Richard Snowden Q.C., Erskine Chambers, London; Kathleen Stephansen, AIG Asset Management, New York; Dr Shinjiro Takagi, Nomura, Tokyo; Lloyd Tamlyn, 3-4 South Square, London; Stephen Taylor, Alix Partners, London; William Trower Q.C., 3-4 South Square, London; Professor Edward Tyler, Department of Justice, Hong Kong Special Administrative Region Government, Hong Kong; Mahesh Uttamchandani, The World Bank, Washington, DC; Robert van Galen, NautaDutilh, Amsterdam; Miguel Virgós, Uría & Menéndez, Madrid; Dr Haizheng Zhang, Beijing Foreign Studies University, Beijing.

For more information about *International Corporate Rescue*, please visit www.chasecambria.com