DAVIES

Issue 4

Insolvency Now

International Views: A Canadian Playbook for 2022

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This year, we anticipate that the fiscal protection of the last two years will fall away as government support scales back and businesses face continued cash shortfalls, mounting debt obligations, altered consumer behaviours and rising interest rates. The resulting uptick in restructurings and insolvencies that we expect in the coming months and years will also occur in a changed global regulatory environment.

While the financial and personal losses caused by the pandemic are profoundly tragic, we believe that insolvency and restructuring law and practice have a role to play in building a better world. Our experience has taught us that transformation is a matter of not only loss, but also opportunity.

In this issue of *Insolvency Now*, we examine four key innovations from the United States, the United Kingdom and Australia that will likely help to reshape Canadian insolvency and restructuring in 2022 and beyond:

- Insolvency and restructuring will likely be defined by consistent engagement with environmental, social and governance (ESG) considerations. The risks associated with vulnerable places, systems and assets will become impossible to ignore.

- Old tricks from the pre-pandemic restructuring playbook will likely be used in new ways in debtor-in-possession (DIP) restructurings ("interim financings" in Canada), with equity conversions likely to become more frequent.
- As defaults mount and opportunities present themselves in 2022, debt-default activism and bond-driven refinancings will likely grow in popularity.
- We anticipate that players in the hardest-hit sectors, particularly those in which restructurings are backed by clear legislation, will increasingly turn to efficient courts and empowered administrators to transform and move them out of the pandemic.

Davies Insolvency Now *is a quarterly publication authored by Natasha MacParland, Robin Schwill and Stephanie Ben-Ishai that analyzes key trends and developments in the insolvency and restructuring community.*

ESG Opportunities

As we move into 2022, we expect to see the continued and expanding integration of ESG in distressed credit markets. In particular, we note three global trends that will likely apply to the Canadian context:

1. ESG considerations are intensifying in the distressed credit space. Lenders and sponsors are increasingly incorporating ESG factors into investment decisions and considering sustainability and inclusion in their assessments of business plans and valuations during a restructuring.

2. Industry leaders are turning to improvement on ESG factors as a means to increase valuation and reduce credit spreads. They are also increasingly demanding ESG covenants to address material ESG risks.

3. Executive compensation after exit is also increasingly linked to ESG goals and benchmarks (see, for example, the Pacific Gas & Electric Chapter 11 proceedings).

We expect to see Canadian insolvency and restructuring practitioners playing an important role in guiding the navigation of ESG opportunities in the context of unprecedented uncertainty. Given the breadth of industries – from higher education to bitcoin – that have recently had organizations go through an insolvency process, Canadian insolvency and restructuring professionals have earned the confidence of regulators, stakeholders and the general public to address instability and devise solutions where nothing seems possible.

Select a company name below to read further details.

REAL WORLD EXAMPLE: UNITED STATES

Equity Conversions in DIP Arrangements

While Canada continues to develop creative and novel responses in areas such as third-party releases, the United States also continues to innovate in the restructuring and distressed debt space. The pandemic and the resulting financial hardships experienced by many companies have prompted actors to explore creative techniques in the insolvency space. In addition to the ESG factors noted above, we also saw innovative bond-driven refinancings and lender-side debt-default activism. Some actors have also revisited old techniques, such as equity conversions.

DIP arrangements increasingly include equity conversions, which were previously subject to greater scrutiny and limited mostly to illiquid financial markets. The ability to convert DIP obligations into reorganized equity provides meaningful flexibility for debtors where liquidity may not be readily available on emergence.

Although equity conversions are not new, they are newly popular and have featured prominently in several recent American DIP arrangements in the airline industry, including for foreign-based companies (see, for example, Avianca, Aeroméxico, LATAM and Sanchez).

REAL WORLD EXAMPLES: UNITED STATES

Debt-Default Activism and Bond-Driven Refinancings

In addition to the rise of American bond-driven refinancings (see, for example, Gainesville Hospital District), we have seen an increase in debt-default activism by creditors. Creditors purchase equity on the presumption that a borrower will be, or already is, in default. Creditors then seek to profit from that default through credit default swaps or short positions (see, for example, Windstream).

Debtors have responded to this phenomenon and attempted to pre-empt this threat with their own innovations, including hard voting caps for lenders and provisions designed to preclude unfriendly holders from accumulating large positions.

REAL WORLD EXAMPLES: UNITED STATES

Single-Process Financial and Operational Restructuring

As highlighted in past issues of *Insolvency Now*, there is a negative correlation between the market share of companies referred to as "zombie companies" (companies that are unprofitable and rely on debt to continue) and the state of a country's economy. Simple, clear and efficient insolvency and restructuring frameworks can be effective in minimizing the market share of zombie companies by facilitating successful restructurings or enabling those companies to exit the market.

With these goals in mind, the United Kingdom introduced a key legislative development, the U.K. Restructuring Plan, as part of the U.K. *Corporate Insolvency and Governance Act 2020*. The Restructuring Plan draws much of its substance from the existing scheme-of-arrangement legislation

in the United Kingdom, though it does have several notable differences. Two points of divergence under the Restructuring Plan are (1) the opportunity for companies to deliver a financial and operational restructuring using a single process; and (2) the ability to cram down creditors across one or more dissenting classes.

The following examples of companies using these innovations demonstrate the importance of a simple, single process for financial and/or operational restructuring with significant powers available to the administrators and the courts to impose a complete resolution. The Canadian *Companies' Creditors Arrangements Act* offers similar value in the Canadian context.

The Virgin Atlantic recapitalization involved the first use of the Restructuring Plan (just 18 days after the procedure was enacted) and DeepOcean Group represents the first U.K. cross-class cram down under part 26A of the U.K. *Companies Act 2006*.

REAL WORLD EXAMPLES: UNITED KINGDOM

In Australia, like in the United Kingdom, the financial difficulties of the aviation sector spurred novel approaches to restructuring under Australia's *Corporations Act 2001*. The restructuring and sale of Virgin Australia to Bain Capital used a voluntary administration fully led and overseen by the administrator.

REAL WORLD EXAMPLE: AUSTRALIA

Key Contacts

With extensive experience in applying global innovations and adapting to changing market conditions, Davies draws on the strategic skills of our team to help you navigate the complexities of a restructuring or insolvency. We would be happy to discuss your specific circumstances and answer any questions you may have. Please contact any of the individuals listed below or visit our website at www.dwpv.com.

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