

# Restore 05

The turnaround magazine

ADVISORY

## **Still under construction**

High levels of debt mean times are still tough for the commercial property sector

## **Rapid rescue service**

A look at the benefits of implementing the Special Resolution Regime

## **The relocation option**

Why UK insolvency laws are attracting foreign businesses to Britain

# Welcome



News that US gross domestic product grew by 5.7 percent in the final quarter of 2009 is a sign that one of the longest and deepest recessions in living memory is over. Although growth in the major European economies has been slower, they are heading in the right direction. Meanwhile, Asia's already buoyant economies are expected to power ahead.

But the hangover from the recession will be with us for some time. Spending on stimulus measures, lower tax revenues and the cost of support for an expanded pool of unemployed has taken its toll on public finances in many countries. In the private sector, trading conditions are likely to remain tough for a while yet, and we expect to see a lot of restructuring activity.

Some sectors will be affected more than others. In this issue, we look at the commercial real estate sector in terms of restructuring projects, and also assess the outlook for the automotive and hotel sectors. Elsewhere, we consider why a number of German companies have sought to restructure under foreign jurisdictions and examine the new UK laws governing bank insolvencies.

I've handed over the reins to my colleague Philip Davidson, who is interviewed on this page about the trends that will dominate the year ahead. So it's goodbye and good luck from me, and welcome to the latest issue of *Restore*.

## Mick McLoughlin

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## In with the new

### As he starts to take over as KPMG's new Global Head of Restructuring, Philip Davidson talks to *Restore*.

Over the past few months, KPMG's current Global Head of Restructuring, Philip Davidson, and his predecessor, Mick McLoughlin, have held meetings in each of KPMG's three global regions. These have allowed Davidson to set out how he sees KPMG's Global Restructuring practice developing over the coming years. As a 24-year veteran of KPMG's Restructuring practice, Davidson is well known to colleagues around the world and, with McLoughlin's retirement in March, he has now become firmly established as the man at the helm.

Davidson is taking over the reins at a crucial time for the world's economy. The US has bounced back from recession with an unexpectedly high rate of growth in the final quarter of 2009, while Europe's major industrialised nations are also expanding again. But behind the headline figures, the downturn has left the world with a huge hangover, and many businesses will face extremely challenging conditions in the months and years ahead.

In this climate, demand for KPMG firms range of restructuring services is likely to grow. As a result, a key element of

Davidson's role is to ensure that, nationally and internationally, the resources are in place to deliver the services demanded by clients. "One of the most important parts of my job is to help our network of member firms develop a range of restructuring services," he says.

#### Setting global standards

The goal is to create and maintain an international operation whereby clients receive the same standard and range of services wherever their business is located. As Davidson points out, when a major business undertakes a restructuring operation, often it will need professional help, not just in its home country, but also in the territories where it has a presence. He cites the example of the Royal Bank of Scotland. "It has a big presence internationally, so it needs to know that when it talks to a local restructuring professional, it will have access to exactly the same service and experience that it would in, say, the UK," explains Davidson.

However, he stresses that providing services around the world is not just about building services at a local level. It's also vital to have advisors on the ground who



Picture and cover image: Getty Images

## SOVEREIGN WEALTH FUNDS

As KPMG's new Global Head of Restructuring, Philip Davidson sees sovereign wealth funds playing an important role in restructuring activity over the next few years. "A lot of these funds have a huge amount of liquidity," he says. "They will want to deploy their capital, and many of them will be looking for opportunities to buy into distressed companies at the bottom."

However, many funds themselves require restructuring. There have been winners and losers through the downturn, and some are seeking help to improve the performance of their portfolios. "There is particular demand for advice on operational restructuring and on governance issues," says Davidson.

understand the issues facing multi-national companies. "We need to ensure they have a global focus – that they possess international experience," he says.

KPMG's commitment to building on its global restructuring presence is not simply a response to the financial crisis. As Davidson explains, there is demand for 'stressed/distressed' services at all points of the business cycle. This becomes more apparent when there are practitioners on the ground who can readily provide

on the restructuring of Gerald Ronson's Heron and the turnaround of Federation Brewery. "That was particularly satisfying as it was a company from the North East of England, where I come from," he says.

### Economic outlook

As the industrialised economies of Europe and North America return to growth, Davidson believes that a huge amount of financial restructuring work will be needed over the next few years. "The main issue is leverage," he says. "Every sector is



**"Many companies borrowed heavily to fund acquisitions, and now there is too much debt on the balance sheet"**

**Philip Davidson**, Global Head of Restructuring, KPMG in the UK

restructuring skills: "Once a restructuring practice acquires critical mass in a country, then it tends to experience consistent demand for the services it offers."

Davidson has a long history in restructuring. Joining KPMG in the UK in 1986, he became part of the corporate rescue team in 1989, in time for the UK's early 1990s recession. After being seconded to Midland Bank, he joined KPMG's turnaround team, and since then he has mostly been involved in non-insolvency restructuring work. Davidson's career highlights include work

different, but over-leverage is common. Many companies borrowed heavily to fund acquisitions, and now there is too much debt on the balance sheet. That will have to be dealt with."

As Davidson observes, the relatively low number of insolvencies that we've seen in the current recession potentially disguise a deep debt problem. "A lot of companies have got through the downturn on a 'pretend or extend' basis. However, now that the recession is over there are a lot of problems that need to be fixed," he says. Davidson is keen to point out

that the future of the global economy remains uncertain. In the financial sector, banks and other institutions are preparing themselves for a wave of regulation. Meanwhile, higher taxes and lower public spending will affect jobs and spending power, as well as placing a counterweight on the economic recovery. Davidson predicts that the winners in this climate will be those businesses that are able to repair their balance sheets, while also restructuring operationally.

Challenging times then, making it all the more important for restructuring professionals to have the skills and resources to help their clients deal with the problems that lie ahead. ■

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## Still under construction

The emergency refinancing of the commercial property sector is more or less over, but with indebtedness running at high levels, restructuring is likely to continue for some time.

The Heron Tower in London's Bishopsgate shows that, despite the recession, developers are still capable of making a mark on London's skyline. When completed, the 46-storey building will stand 202 metres high, more than matching the existing towers in the City of London financial district, and dwarfing most of the surrounding buildings. While economists debate whether the UK is set for modest recovery or double-dip downturn, the construction cranes are hard at work.

But even as the Heron Tower continues to rise, the UK commercial real estate market is facing some difficult times ahead. In the latest Stability Report, the Bank of England warns that the sector is steaming through troubled waters. As the bank notes, commercial property in the UK has gone through two distinct phases. The first saw capital values falling 45 percent by July 2009 from a June 2007 peak. That drop directly triggered a number of loans-to-value covenant breaches in the real estate sector.

Since then, there has been a limited and patchy upturn in valuations, with

prime properties in major cities being the main beneficiaries, and non-prime sites remaining depressed. However, the sector has been hit by a second wave of problems in the form of declining revenues, caused by a double whammy of falling occupancy rates and lower rentals. According to Bank of England figures, vacancy rates rose from 9 percent to 12.6 percent between October 2008 and October 2009, with the lower demand putting downward pressure on revenues from rents.

The gloomy picture is one Ian Durant, Group Finance Director of Liberty International, recognises. Liberty is the UK's largest owner of shopping malls, and Durant confirms that 2009 was a tough year. "We lost about 10 percent of our revenues to tenant administrations," he says. "We also saw the fastest fall in valuations in living memory."

It was a similar story in the industrial property market. David Sleath, Group Finance Director of industrial space provider Segro, says 2009 was a difficult year for the company's customers. Demand for industrial space fell as companies began to retrench. "Companies were seeking to hunker down and cut costs," he recalls. "Those that had leases about to expire, or with break options, took advantage of this and cut back on their spending. At the same time, there were few opportunities for us to rent to new customers."

However, the situation has stabilised. The wave of tenant administrations affecting Liberty peaked in the period from December 2008 to March 2009 and has now abated. While revenues are down, occupancy rates have held up, with Liberty responding to the market by offering more

short-term rental agreements. Meanwhile, the number of tenants on Liberty International's administration 'watch list' has fallen. Furthermore, as confidence returns, Sleath has seen demand for industrial property recover a little as confidence returns to the wider economy.

### The legacy of indebtedness

The problems facing the commercial property sector should start to dissipate when the recovery strengthens. As KPMG partner Jonathan Thompson points out: "The commercial real estate sector is underpinned by demand from businesses, so the upturn is likely to be good news."

But even when growth returns, pushing up occupancy rates and revenues, the commercial real estate sector is by no means out of the woods. The problem



## "The US economy is starting to show signs of a strong recovery"

Jonathan Thompson, Partner, KPMG in the UK

is the legacy of indebtedness from the boom years ahead of the financial crisis. "Debt is the fly in the ointment," says Thompson. "Many banks are over exposed to the commercial property sector and they are reluctant to increase their exposure."

As the Bank of England report reveals, the major UK banks have reason to be wary. In the 18 months to the end of June 2009, they posted impairment charges of £1 billion due to exposure to the property market, and that figure could rise. Those holding commercial mortgage-backed securities also face the possibility that falling values will translate into more charges on their trading books.

All this could mean property companies will have problems when it becomes necessary to refinance. The Bank of England quotes research from De Montfort University suggesting that, between 2009 and 2013, scheduled loan refinancing will be around £160 billion. Banks have already reduced the loan-to-value ratios at which they are prepared to lend, and may well be reluctant to provide property

companies with the necessary debt finance. That could mean developers having to make up the shortfall through additional equity. "What we should see over the next few years is a lot of deleveraging," says Thompson.

### The international picture

The US commercial property market also saw a sharp fall in valuations and demand in 2009. However, there are some significant differences to the situation in the UK. "The US economy is starting to show signs of a strong recovery," says Thompson. And although, like in the UK, the level of indebtedness is high, the deleveraging process is likely to be much quicker. That will affect valuations in the short term, but the problems are likely to be sorted out far more quickly than in Europe.

There are also signs that investment is starting to flow into the US property market. Some is coming from overseas banks. For instance, in January 2010, *The Financial Times* of London reported on statistics from real estate consultancy CB Richard Ellis showing that the Bank of China had emerged as a major investor in US property, with a particular focus on so-called 'trophy' developments in major cities. Overall, overseas banks accounted for 60 percent of investment in the US market. The same edition of *The Financial Times* also reported an influx of private equity money.

On the European mainland – although there have been national variations – the problems of the property sector have not been as acute as in the UK and US. “Retail footfall has been holding up and residential values have been stable,” says Thompson. “One reason for that is jobs have not been hit in this recession on the scale we saw in previous downturns.”

The preservation of jobs has partly been down to employers negotiating salary freezes, wage cuts and short-time working, but government spending has also played a major role, while pushing up public sector deficits. “No one really knows what long-term economic effects this will have,” says Thompson.

From a UK perspective, Durant agrees the economic policies pursued by the new Conservative/Liberal coalition will have a profound impact on the outlook for commercial property. “They will be key in areas such as employment and tax,” he says.

In Asia and the Far East, many countries – including the new global powerhouses of China and India – have continued to grow, and this expansion is reflected in the commercial property market. “Values in China have been particularly strong,” says Thompson. “The Australian market is also looking robust.” There are exceptions, however. Japan’s property market, for example, has been weaker than those of its Asian neighbours.

### Restructuring potential

In terms of restructuring activity, most of the emergency refinancing work that took place in the wake of the financial crisis has been completed. In the UK, highly leveraged players struck deals with banks, often in the form of debt-for-equity swaps. However, as the market picks up, the banks will have more options. “They will have a choice of refinancing or simply pulling the plugs and selling the debt,” says Thompson.

**“As the market improves and banks assess their options, weaker companies are likely to lose out and the stronger ones will win”**

Jonathan Thompson, Partner, KPMG in the UK



Image: iStock images

Refinancing is certainly not impossible, as Liberty International has proven. In January, it secured a £525 million loan facility to refinance the Lakeside Shopping Centre in Thurrock, in a deal that (in tandem with Liberty’s own cash) redeemed previous outstanding loans totalling £545.8 million. Prior to that, the company also refinanced the Cardiff Shopping Centre.

Segro has also refinanced. “In 2009, we renegotiated our covenants to give us more flexibility in the face of falling values,” says Sleath. “We also took out new debt to finance the acquisition of Brixton, negotiated new credit lines and raised £300 million on the bond markets.”

But he accepts that not every property company will be able to do this. “We benefited from an excellent relationship with a group of banks. Refinancing may not be so easy for others,” he says.

Finance for new developments is also in short supply. “In the retail sector in the near term they are virtually impossible to fund through debt,” says Durant. “New projects in the pipeline are thin on the ground.”

### Strength and weakness

In Thompson’s view, there will be winners and losers in the refinancing stakes. “A year ago, when the whole property sector was suffering, banks had little choice but to work with the situation,” he says. “As the market improves and banks assess their options, weaker companies are likely to lose out and the stronger ones will win.”

To some extent, that assessment of strength and weakness will depend on the nature of the property portfolio. For instance, in a UK context the impact of the recession on the retail sector has been mixed. “Out-of-town shopping malls have continued to do well,” says Thompson. “But the High Street has suffered.” Meanwhile, in the office market, a revival in valuations has been focused on prime sites in major cities. Government policy will also have an impact on the commercial real estate portfolios, with expected cutbacks in civil service and public sector headcount affecting demand for office space.

As 2010 unfolds, Thompson expects to see a rise in portfolio transactions, as bid offer spreads become more acceptable, and an influx of new players to the market take advantage of investment opportunities. The restructuring of the commercial property sector has really just begun. ■

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Image: Getty Images

## Sector report

Growth has returned to major western economies, but the legacy of the recession remains. We assess the outlook for three key sectors.

### Hotel and leisure

The collapse of Lehman Brothers was a watershed for the hotel and leisure sector. Travel from the US to the rest of the world fell sharply. Hotel operators in Europe and the Middle East were the hardest hit, but bookings also declined in the relatively recession-free Asia region. Many chains had to lower prices, leading to a drop in revenue per available room (RevPAR). This is unlikely to return quickly to pre-crisis levels as RevPAR tends to lag gross domestic product by about 12 months. There are also structural problems in the sector. Despite the recession, new hotels have been built in cities such as London, so more capacity is coming into the market, which will serve to depress revenues.

However, banks appear willing to support the sector and there have been reductions in debt repayments agreed. As the economy improves, hotel chains that have managed costs to cope with falling revenues will be best placed to take advantage of the upturn. To date, budget hotels have fared better than their premium counterparts.

### Automotive

The problems facing the automotive sector were thrown into sharp relief by

the financial crisis. US manufacturers in particular were already struggling in the face of high labour and production costs. Growing markets (notably Brazil, Russia and China) had clear implications for the geography of car production, whilst tougher emissions laws meant higher spending on green research and development. The industry faced the prospect of significant operational restructuring even before the downturn.

Peaking oil prices combined with the loss of credit and consumer confidence created a steep drop in volumes. The first priority for manufacturers and suppliers was survival - managing cash and restructuring balance sheets as required. Governments then stimulated demand with scrappage, short time working schemes, and other financial support.

With Government help and some markets showing increased demand, that emergency phase is now largely over. However, there is still much operational restructuring to do. Cutting costs and improving margin per unit are absolute priorities. In the future, demand for greener cars will create both opportunities and threats, while the rise of the emerging economies points to a very different looking industry.

### Commercial property and construction

Downsizing during the recession has reduced demand for commercial property. Projects already underway tend to be completed. However, with only a limited amount of debt and equity available, new projects could be limited.

Government-backed construction works have been, to some extent, insulated from the impact of the recession, and infrastructure projects, in particular, have been ploughing ahead. However, countries with high deficits will have to cut spending, which could impact on the future of infrastructure projects.

In 2007 and 2008, the bulk of restructuring work in the property sector was in the residential market, but by 2009 the focus had shifted to the commercial sector. We expect to see a continuation of pressure being felt by players in this sector, together with a related impact on the construction supply chain. **R**

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**“Budget hotels have fared better than their premium counterparts”**

**David Crawshaw,** Partner, KPMG in the UK



## Rapid rescue service



## The transfer of Dunfermline Building Society assets and liabilities to Nationwide took place recently. The ground-breaking operation was among the first of its kind to be carried out under the UK Government's new Special Resolution Regime. *Restore* investigates.

In the early hours of Monday morning on 30 March 2009, Scotland's Dunfermline Building Society was placed into administration. Later that day, news bulletins reported that key assets and liabilities – including buildings, staff, loans and deposits – had been transferred from Dunfermline to Nationwide Building Society. The financial sector was still in the grip of a profound crisis. So, perhaps the most surprising aspect of this event was the absence of any sense of shock or trauma in the media or among the general public, as had greeted other financial failures. A few months earlier, concern about the health of Northern Rock sparked the first run on a UK bank in living memory. Dunfermline's problems, by contrast, were dealt with discreetly and quickly.

"It was a sensible, orderly process," recalls Richard Heis, a partner at KPMG in the UK's Restructuring practice. The transfer of much of Dunfermline's assets and liabilities was the first (and as things currently stand, the only) transaction to take place under the Special Resolution Regime (SRR), introduced by the UK Government as part of the 2009 Banking Act. With the run on Northern Rock and its subsequent nationalisation still raw, the SRR was intended to provide a means to rescue troubled 'deposit takers' – banks and building societies – while maintaining the stability of the banking system. SRR gives the Bank of England three so-called stabilising options:

- transfer to a private sector purchaser;
- transfer to a bridge bank; and
- transfer to temporary public ownership

The speed of these procedures allow the transfers to happen prior to any problems becoming public knowledge.

In the case of the Dunfermline/Nationwide deal, the result was a transition that had no effect on most customers. It was, as they say, business as usual when the news broke. But if all was tranquil on the surface, there was lots of activity taking place below the waterline. As Heis explains, the SRR allows for a "good bank, bad bank split". In other words, while the viable part of the business is taken by another deposit taker, the remainder is left in the hands of an administrator – in this case, KPMG in the UK.

"The SRR makes a big change to the role of the administrator," says



**"A transfer under the Special Resolution Regime is a much faster process, so there is a lot of work to do afterwards"**

**Richard Heis**, Partner, Restructuring, KPMG in the UK

Heis. "In a normal insolvency, the administrator takes control of all the business and either restructures it, sells it as a going concern or – if that's not possible – breaks it up and sells the assets to pay creditors. In the case of a SRR operation, the administrator takes control of the rump of the business and his primary obligation is to facilitate the transfer of the 'good' part of the bank, which has occurred immediately before appointment."

So rather than simply acting on behalf of creditors, the administrator has the major role of ensuring that the transfer of one bank's assets and liabilities to another is successfully concluded. As Blair Nimmo, a partner at KPMG in the UK's Restructuring practice who worked on the project, recalls, the new

procedures meant new challenges.

"This was an unusual case in that you were dealing with a new legislative process and a business of which you had virtually no prior knowledge. As a result, the learning curve was very steep for all involved!" he says.

The SRR marks a dramatic change from previous notions of property and insolvency. It allows the authorities to expropriate assets from private companies and instantly transfer them out by decree. If this process were not tightly controlled, it would be a source of instability, rather than stability. For that reason, the Banking Act

mechanism ensures that the process can only be used for the right reasons and pursuant to very clear objectives.

### **SRR mechanisms**

The execution of a transfer under the SRR involves a number of agencies, including the Bank of England, the Financial Services Authority (FSA) and the Treasury. The Financial Services Compensation Scheme (FSCS) would generally be required to pick up the bill for protecting the depositors. The FSA holds the starting gun. Part of its role is to monitor the health of banks and building societies, and take action under its mandate, if necessary. Once the FSA's concerns had been expressed, the Bank of England began to draw up contingency plans for administration and the special resolution process.

Those plans were put into effect when the FSA triggered the SRR on the weekend of March 28. Within two days, the sale to Nationwide of the bulk of Dunfermline's business had been agreed, with the Treasury providing funds to the buyer covering the cost of the net liabilities. At the same time, Dunfermline's portfolio of social housing assets and liabilities were transferred to a bridge bank owned by the Bank of England. That left a portfolio of commercial loans, bought-in residential mortgages and short to medium-term bonds, with a combined face value of some £1.1 billion. These were placed in the hands of KPMG.

Officially, the administrator is not appointed until the SRR process is underway. So, in contrast to the usual process, the insolvency team


– for the asset portfolio under the control of KPMG in the UK. "We have been doing a major separation exercise on that front," says Heis, "and have transferred the commercial loans and bought-in mortgages to a third-party servicer."

As this focus on servicing implies, KPMG in the UK is continuing to run commercial loans and bought-in mortgages, and this task is set to continue until the market improves. "We have more than £1 billion in assets, but there is a difference between what we think the assets are actually worth and the current market value. If we dumped them on the market now, we wouldn't get full value," says Heis.

Obtaining the best outcome for creditors is a key objective. "The management of the commercial

Carrying out a SRR creates challenges for administrators, and the main obligation to prioritise a smooth transfer is new territory for practitioners. But the Dunfermline case shows SRR provides a way to achieve stability, shore up public confidence and protect depositors, while ensuring that creditors' rights are respected – all of which are key priorities.

There are questions still to be answered. Although Dunfermline was a major entity, effecting a similar transfer on a bigger institution would be more difficult. However, under new 'living wills' rules, banks will be obliged to plan for this by effectively laying out a road map for an orderly resolution. As a halfway house between a disorderly collapse and a bail out through nationalisation, SRR provides a way to rescue troubled institutions without placing an undue burden on the taxpayer, or allowing failures that would destabilise the system. "We see it as a very positive development," says Heis.

Nimmo agrees, saying: "Our experience with Dunfermline has proved the process works. I am sure it could be replicated effectively in other situations." 



**"Each effort is made to handle each position sensitively, but with a view to maximising value in the medium term"**

**Blair Nimmo**, Partner, Restructuring, KPMG in the UK

has little input regarding the transfer of the troubled business to a third party, although it needs to quickly understand the deal. However, once the transfer has been implemented, the administrators must take immediate action to make the deal work. As Heis explains, that's partly due to the speed at which the SRR operates. "It's not the same as a sale," he says. "In a normal M&A situation you do the due diligence ahead of the transfer. A transfer under the SRR is a much faster process, so most of the work is done afterwards."

#### Ongoing co-operation

In the case of the Dunfermline transfer, there has also been a substantial overlap between the work of the administrators and Nationwide, and co-operation between the two parties has been ongoing. For instance, Nationwide didn't acquire Dunfermline's IT, so KPMG in the UK was required to facilitate Nationwide's access to the system. The administrator's obligations in this respect were set out in a Transitional Services Agreement. Equally important, Nationwide is providing the servicing – essentially processing loan transactions

loans and bought-in mortgages has been a particularly interesting and challenging part of this assignment, especially during this difficult economic climate," says Nimmo. "Every effort is being made to handle each position sensitively, but at the same time with a view to maximising value in the medium term."

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Debt buybacks have become relatively common in refinancing packages agreed between corporate borrowers and banks, but companies should be aware that they can trigger an unwelcome tax charge in the UK.

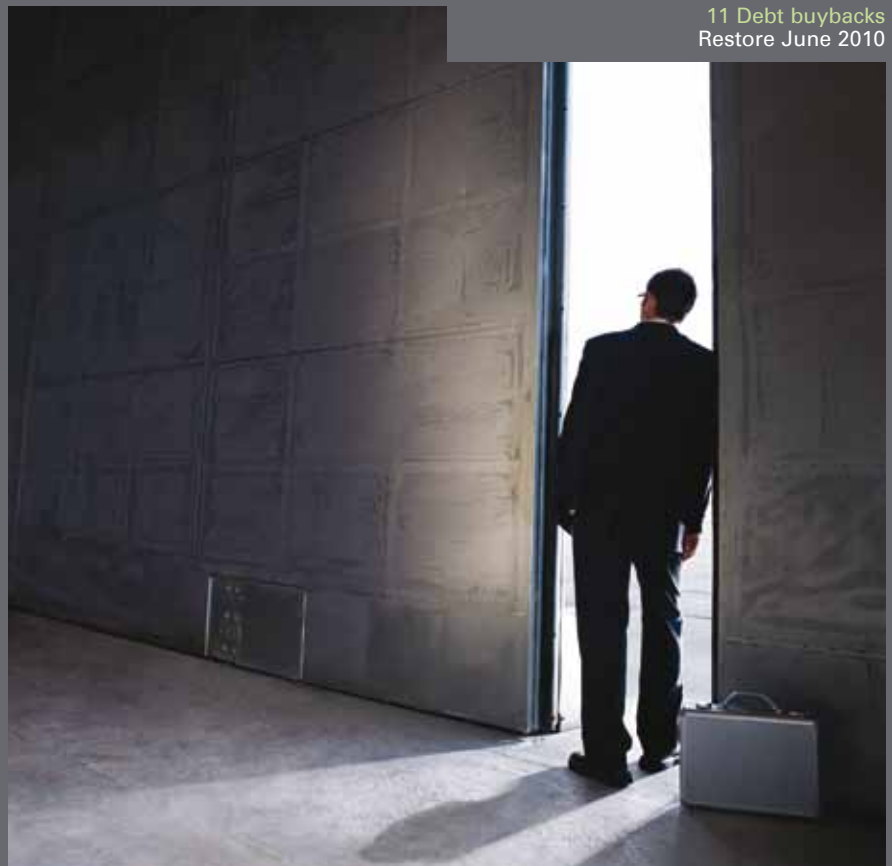


Image: Corbis Images

## Look before you leap

In 2008, Danish Telecoms company TDC caused a stir in banking circles when it bought back around €500 million in loans. The transaction was controversial, because the company was not in financial difficulty. Indeed, it carried out the buyback using its own excess cash. Commenting on the arrangement, *The Financial Times* asked: "Will debt buybacks become the next big thing?"

In fact, buybacks have become relatively common. But as Anneli Collins, Head of M&A Tax at KPMG in the UK, explains, most buyback activity is focused on financially troubled companies, rather than healthy businesses taking advantage of market conditions to deleverage. "Often you'll find a debt buyback as part of a wider agreement when a stressed or distressed company is refinancing," she says. And just as the recession has pushed up the incidence of companies requiring refinancing, buyback numbers have also risen.

However, the incidence of a few large buybacks by healthy companies has not escaped the attention of the UK Government. In October 2009, the Financial Secretary to the Treasury, Stephen Timms, announced that the rules governing the taxation of buybacks were to be tightened. The changes mean that when a company buys back debt, the difference between the face value of

the loan and the discounted amount paid by the borrower will be treated as profit, triggering a corporation tax charge.

"There are exceptions," says Collins. "Distressed businesses can avoid the tax, but only if there is a change of company control and the business can show that it would have ended up in liquidation within 12 months, if the switch hadn't happened. A business that is negotiating a refinancing in the face of



### "Not enough thought has been given to the tax implications of debt buyback"

Anneli Collins, Head of M&A Tax, KPMG in the UK

potential covenant breaches to avoid insolvency, will not necessarily wish to indicate that it is in imminent danger of going into administration. What's more, even if tax is avoided on the buyback, steps taken after this – such as to waive the debt – could trigger the charge."

The upshot is that a troubled company may successfully negotiate a refinancing package only to find its financial health undermined by a tax charge, perhaps running to millions of pounds. Collins believes this is a trap that many businesses are unaware of. "To date, the focus has been on the commercial benefits of carrying out buybacks," she

says. "Not enough thought has been given to the tax implications."

One misapprehension is that the charge will be offset by tax losses. But, companies with a group structure could find the tax losses are in the wrong place to enable them to avoid the charges from the buyback. Thus, thinking about tax ahead of the operation could be vitally important. "It may be necessary to move the debt around," says Collins.

Ironically, the tightening of the rules comes when buybacks are proving to be a useful restructuring tool. "The government focus is on tax avoidance not the restructuring issues," says Collins. "That's not true elsewhere – in the US, for example, the rules have been relaxed." But regardless of the rights and wrongs of the UK rules, businesses will have to understand and adjust to them, so it's vital that refinancing companies consider the tax implications before going ahead with a buyback. **R**

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## The relocation option

UK insolvency laws have prompted some European companies to relocate to England. *Restore* looks at the reasons why, and examines the German Government's efforts to make its jurisdiction more attractive.

There are many reasons why businesses choose to relocate. Sometimes the motive is to save tax through the transfer of a holding company from one jurisdiction to another. Cost is another common factor, as businesses move to another country to take advantage of cheaper staff and facilities. But given the expense and complexity of the process, it's perhaps surprising that relocation is also seen as an option for companies on the brink of bankruptcy. Yet that's what is happening in the European Union (EU), where businesses are coming to the UK, attracted by an insolvency regime seen as more conducive to a positive outcome than those of other EU nations.

Migrants include German car parts business Schefenacker, who set up headquarters in the UK and went into administration under the English system. According to Lars Westpfahl, Head of Restructuring at law firm Freshfields in Germany, 'insolvency tourism' is not common, but is certainly on the radar of troubled companies. "It's the exception rather than the rule," he says, "but it's fair to say that a number of companies have looked at this."

From a German perspective, the English insolvency system offers certain advantages, not least because there is more flexibility as to when directors

must declare a business insolvent. "In Germany, there is a very rigid time factor," says Westpfahl. "There is an obligation placed on directors to file for insolvency within three weeks of an insolvency event."

The UK also offers a range of tools not available in Germany. These include the Company Voluntary Arrangement (CVA) and Scheme of Arrangement, which enable companies to strike binding deals with creditors and shareholders, even if a minority object. In Germany, however, a minority of stakeholders can block a restructuring plan out of court. Furthermore, there is a greater degree of planning possible under English law.

Tammo Andersch, Head of Restructuring at KPMG in Germany, agrees that the UK system offers more scope for planning the insolvency process. "The main advantage is the possibility for creditors to put the most appropriate insolvency practitioner in place, which is not possible in Germany. Hence, the creditors have more influence in formal restructurings," he says.

In Germany, the court appoints an administrator and companies don't know who they will get until the proceedings have begun. In effect, this means it's not possible for German firms to work with

insolvency practitioners on the carefully planned 'pre-pack' administrations that have allowed many UK companies to emerge from the insolvency process as trading entities.

### Risk factors

If the circumstances are right then, there can be a case for relocating to the UK. For instance, when Schefenacker and its advisors formulated a restructuring plan that involved renegotiating terms with its customers, restructuring the balance sheet, separating the loss-making and profitable parts of the business and a debt-for-equity swap, it seemed unlikely the plan would succeed under German law. The fear was that the debt-for-equity plan would not have worked out of court, because consent from all stakeholders would have been needed. Under English law, the company was able to hammer out a deal under a single CVA procedure.

But relocations of this kind are subject to tests in both the English and German courts. If a company is seeking to restructure under a Scheme of Arrangement, it will be necessary to show that, following the relocation, it has "substance" in its new base country. The potential problem here is that the meaning of the word "substance" has not yet been clearly defined.



Image: Getty Images

In the case of CVAs, the position is a little more straightforward. EU law requires that a foreign company seeking to undertake a CVA in England must convince the courts that it has moved its “centre of main interest” to the UK prior to the restructuring taking place. However, there is still some debate about what this means. The European Court of Justice (ECJ) has ruled that companies must move not just the “mind” (the senior management) of their business, but also some of their operations. However, there are no clear guidelines.



## “The main advantage is putting the most appropriate insolvency practitioner in place”

**Tammo Andersch**, Head of Restructuring, KPMG in Germany

In practice, any court decision on the validity of relocation is likely to be based on the nature and size of the business in question. “Very often relocation is about moving a holding entity,” says Westpfahl. “However, if you’re talking about a big manufacturing business, the courts may struggle to accept that a relocation has occurred just because the management has moved from one country to another.”

We have already seen examples of relocation being rejected by the courts. For instance, an attempt by Germany’s Hans Brochier to undertake restructuring under an English CVA was rejected as an abuse of the system, because the

company failed to prove it had genuinely relocated. So the message is simple. In order to take advantage of English restructuring laws, it’s vital that companies and their advisors take the utmost care to ensure that the requirements of the courts in both countries are fully addressed.

### The future

England is not the only destination favoured by insolvency migrants. France has recently introduced a modern restructuring regime, which is being aggressively marketed by French insolvency professionals. Meanwhile,

for companies with US stakeholders, Chapter 11 can also prove attractive.

But the situation is changing, and in this competitive landscape Andersch predicts amendments to the German system. “I expect that we will see some changes made by the German Government to tackle the issues,” he says. “For example, there are some discussions of a formal pre-insolvency process, which could be an analogy of the French regime. Moreover, we may see more influence of creditors in the adequate preparation of the formal insolvency process. We may also witness more pre-packed insolvencies over the next two years.”

The coalition agreement of the new German Government has promised reforms. These include new instruments to provide a means for the early restructuring of financial institutions, and measures aimed at facilitating the rescue of viable companies as going concerns, with greater scope for out-of-court proceedings.

According to Ursula Schlegel, solicitor in insolvency specialist law firm Kebekus et Zimmermann, the global financial crisis and recession have served to focus minds. “People were aware of potential shortcomings of the German system, and the problem has been looked at during recent years in designated expert commissions set up by the German Ministry of Justice,” she says. “But we have just come through the greatest crisis that any of us have seen, and that has created a real urgency for change.”

The new laws are expected to take effect within the life span of the current German Government and should remove the need for migration. In the meantime, the likelihood is that troubled companies and their advisors will continue to look at relocation as an option as they formulate restructuring plans. No one expects a rush of companies from Germany to elsewhere in Europe or beyond, but migration certainly is part of the restructuring toolkit. [□](#)

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Image: Getty images

## The refinancing mountain

KPMG is expecting considerable demand for refinancing in the coming year. But companies that have restructured in the recent past may face challenging times when looking to refinance again in such a competitive marketplace.

The extreme panic in the debt markets has now subsided. Thanks to a global effort by governments and the financial services industry itself, the banking sector has stabilised. So while the Lehman Brothers collapse is still fresh in everyone's memory, things have moved a long way from the near catastrophe of 2008.

But in terms of corporate refinancing, the coming year and half could be challenging. This is partly down to the high volume of loan refinancing activity that is predicted to take place. Coming up in the near future is a confluence of company refinancing, as five-year loans arranged in 2007/08 and three-year loans from 2008/09 must be refinanced ahead of maturity. Meanwhile, the banks themselves will be under pressure to refinance their own balance sheets. The result is likely to be a squeeze on the capital available to support loan renewals.

According to Neill Thomas, European Head of Debt Advisory at KPMG, liquidity



## “Like the bread queue, don’t stand in the middle or at the end, and trust to luck that there’s still something left on the shelf”

**Neill Thomas**, European Head of Debt Advisory, KPMG in the UK

in the financial markets will be affected by a range of local and international factors. “The liquidity windows available under quantitative easing will gradually close,” he says. “Banks will also be competing in the capital markets against European sovereign issuance.”

### Double whammy

As Thomas sees it, with bank capital potentially constrained and corporate loan facilities maturing, the scales will again be heavily tipped towards the demand side. “With everyone heading in the same direction, companies should aim to be at the front of the queue, and not seek to second guess the markets,” he advises.

Life could be particularly difficult for those companies seeking to refinance that have already restructured in the recent past due to the recession. “They will be competing with quality investment grade names,” says Thomas.

There’s potentially something of a double whammy here. In a competitive debt

market, weaker companies will have the biggest mountain to climb in terms of obtaining finance. At the same time, they are likely to be more dependent on debt than their healthier counterparts.

“Many of the quality investment grade names have taken advantage of the capital markets to refinance,” says Thomas.


“Weaker companies have missed out on that. They haven’t been able to diversify, so are still heavily reliant on bank debt.”

Tighter liquidity in the loan markets may also reduce the exit options for banks. “Typically when a company refinances, it is an opportunity for some lenders to get out and new ones to come in,” says Thomas. “This time there could be fewer willing lenders, so existing ones may well find that they have reduced opportunities to exit.”

Thomas is not expecting a sharp rise in insolvencies in 2010 and 2011, not least because multiple-lender groups have found the process to be expensive and,

ultimately, destructive of value. However, he does expect lenders to take steps to ensure they get value in the future. “There has been a trend towards putting in instruments that provide the banks with an equity-type return,” he says.

### Go now or wait

With loan margins reducing, corporates have a choice of whether to refinance early or wait to see if the costs fall further. “It’s a very difficult judgement to make,” says Thomas. “Conditions may continue to improve and spreads/margins could contract further, but, as many have discovered to their detriment, it is liquidity not price that matters most. My advice is companies may want to consider taking what is available now. Like the bread queue, don’t stand in the middle or at the end, and trust to luck that there’s still something left on the shelf.” 

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