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Insolvency and Infrastructure Projects

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Insolvency and Infrastructure Projects

1. Introduction
2. Syndicate Issues
3. Appointing Investigating Accountant
4. Restructure/Standstill
5. DOCA Restructure
6. Receivership Restructure

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Early Warning Signs

- Default.
- Request for covenant waiver / relaxation.
- Request to reschedule repayments / provide additional funding.
- ASX Announcements / press release.
- Rating agency action (down-grade).
- Adverse audit comment.
- Creditor action / litigation.
- Declining share price.
- Deterioration in financial performance.
- Adverse industry / market / economic conditions.
- Regulatory action / change in tariffs.
- Increase in off-balance sheet financing.

Dealing with syndicate members

Some observations.

- Banks move at different speeds (and some banks don't move at all!)
- Banks have different levels of resources.
- Some banks have dedicated workout and restructuring teams (e.g. the Australian trading banks)
- Some banks with smaller local representation run workouts through their local credit executive roles.
- Some banks leave the issue with the person who wrote the deal.
- Some banks deal with the issue entirely offshore which gives rise to time zone issues.

How do Syndicates deal with the problem?

- What is the role of the agent bank.
- Is there a need for a lead bank? If so which bank?
- Should the agent bank lead or should it be an Australian trading bank with the largest exposure?
- Formation of the steering committee/representative bank group.
- Which banks should join?
- What are the rules for committee members?

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Protocol of the Steering Committee

- Legal Counsel
- Indemnity for steering committee
 - From lenders and the company
- Release from any conflict of interest
- Use of confidential information
 - Stays within workout group
 - Information barriers created
 - Share with wider syndicate, when reasonably able to do so
- No trading of a bank's debt, until all information public

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Steering Committee

Role of the Steering Committee

- Dialogue with debtor
- Liaison with Syndicate

Initial Considerations by Steering Committee

- Quality and level of reporting;
- Transparency and credibility of information;
- Competency of management;
- Lender concerns, need for earlier involvement or intervention
- Need for an investigating accountant (IA)... Who to appoint?

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The Investigating Accountant

The Triggers

- Events of default – potential or actual
- Separate class of triggers?
- Debtor concerns, rule 3.1 issues
- Automatic acceleration?

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The Investigating Accountant

Terms of reference would typically cover:

- Historical and projected project performance
- Project model and key sensitivities
- Integrity of model and key inputs
- Future cash flow, debt service capabilities, lender covenant sensitivities
- Enterprise valuation
- Key project risks
- Assessment of management
- Financing alternatives and workout solutions
- Structuring solutions

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The Investigating Accountant

The IA is expected to play a key role in communication:

- Managing debt expectations
- Managing equity expectations
- Assisting management to communicate effectively with key stakeholders, particularly lenders
- Providing an "unbiased" opinion
- Reducing confrontation / tension between parties by acting as a sensible conduit / mediator / interpreter
- Setting clear priorities and agreed milestones to measure and report progress towards ultimate solution

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The Investigating Accountant

Who appoints the IA:

- Lenders
- Company
- Jointly
- Jointly with a default to Lenders

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Epic Energy

- 28 Lenders, debt \$1.85 billion
- Took 22 months from initial appointment of IA to finalisation
- Agreed strategy post IA report was a refinance via sale by the company
- Standstill agreement put in place and sale strategy agreed
- IA represented Lenders on a Sale Steering Committee with equity
- Protocols established for co-operation and open dialogue between Epic Board, Lenders Steering Group and Equity
- Sales process timetable agreed and milestones monitored and reported upon by IA to Lenders
- The number of lenders and potential conflicts meant IA had a key role to play in managing / massaging information flow
- IA formed a view sales process was unsatisfactory and not capable of being concluded. IA took control as Receiver appointed by Lenders
- Sale concluded and Lenders paid in full

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CrossCity Motorway

- 16 Lenders, debt \$600 million
- Equity appointed "advisers" to negotiate with lenders
- Equity wanted lenders to "take a haircut"
- Inability to pay interest, slower ramp up profile
- Standstill solution not capable of being put in place
- Sale via receivership
- Political issues had to be diffused
- In process of completion; Lenders to be paid in full
- Substantial return to equity

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Adelaide – Darwin Railway

- Equity sale unsuccessful
- Inability to pay interest
- Maintain reserves, slower ramp up profile
- IA appointed and standstill effected
- Standstill designed to give maximum flexibility to achieve ramp up (capex specifically addressed)
- Equity / debt / company contributed to the solution resulting in a debt restructure and additional equity to meet the terms of the restructured facilities

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Three different solutions

	Standstill	Formal Solvency	Sale
CrossCity Motorway		✓	✓
Adelaide – Darwin Railway	✓		
Epic Energy	✓	✓	✓




Don't Spook The Debtor

Although not an infrastructure project the HWE example is also interesting:

- IA appointed
- Weekly standstill arrangements initially
- Longer standstill (6 months) to allow IA to complete his work and develop a solution with management
- Board got nervous after a downturn in results and called in Administrators without discussions with Lenders / IA
- Value destructive – equity wiped out
- Legal Perspective
- Lenders' Perspective

Time for Action

- Need to bring negotiations to a head
- Lenders concerned
- Subsisting Event of Default?
 - Need for clarity
 - MAC clauses useful?
 - Timing of measurement for ratios and covenants
 - Importance of not accelerating
 - Rendering facilities "on demand"








Standstill

Key Considerations in Strategy Development

- Current and future project value
- Likelihood of loss to Lenders
- Upside for Lenders
- Financier appetite for risk
 - Different Lenders
 - Different jurisdiction
- Relationship with management and equity
 - Competence
 - Confrontational or co-operative
 - Trust
 - Other project relationships

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Standstill

Key Considerations in Strategy Development

- Nature of facilities
 - Impact of credit derivative products
 - Term of facilities
 - Security, current and potential
- What is being requested
 - Can interest be paid?
 - Can any amortisation be made?
 - Are equity's demand reasonable?

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Standstill

Fundamental Pre-requisite to a Restructure / Standstill

1. Key drivers
 - Equity wants to retain ownership
 - Lenders want to be kept whole
2. No deterioration in a Lender's position i.e. a "standstill" not a "step back"
3. No new risks i.e. exposure to market risk where it previously did not exist
 - No "haircut" (CrossCity)
 - Increased risk = increased return
4. Identity of lender... extent of derivative and hedge exposure?
5. Can each lender's risk exposure be addressed?

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Standstill

Highlights of a Restructure / Standstill

- Objective
 - Allow sufficient time for ramp up
 - Preservation of rights
 - End of standstill-sale or refinance / restructure
- No Action
 - No enforcement action
 - Waiver of existing defaults
- Liquidity
 - Need for new money?
 - Priority issues
- Principal Payments
 - Deferred, reduced, rescheduled

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Standstill

Highlights of a Restructure / Standstill (continued)

- Interest
 - Paid in full, part paid, pk?
- Consents Required
 - Enforcement
 - General waivers
 - Payment waivers
 - New money priority
 - Different percentages in a default scenario?
- Reporting
 - IA / monitoring accountant
- Restrictions
 - Expenditure / capex
 - Business in ordinary course

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Standstill

Highlights of a Restructure / Standstill (continued)

- Sale Process / Refinance
 - Restrictions
 - Reporting
- Role of IA
 - Involvement in sale / refinance
 - Involvement in business plan
 - Attendance of critical meetings
- Fees / Costs
 - Fixed
 - Upside sharing
 - Equity participation

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DOCA Scenario

€m	
Tangible Assets	1,000
Intangible Assets	500
Total Assets	1,500

Financed by:		
Senior Debt	800	(first fixed and floating)
Junior Debt 1	200	(second fixed and floating)
Junior Debt 2	100	(third fixed and floating)
Shareholder Loans	200	(unsecured)
Total Liabilities	1,300	
Net Assets / Shareholder Equity	200	

■ EBITDA sufficient to cover Senior Debt and part of Junior 1 Debt, but not Junior 2 Debt

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DOCA Scenario

- Intangibles have impairment test and need to be written down to \$100m
- Junior debt 1 – trading in marketplace at 60 cents. Some hedge funds have recently entered
- Junior debt 2 – not trading
- Senior debt – nervous with respect to write down / its exit strategy but comfortable interest is being paid. Increasingly nervous with respect to hedge fund involvement

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DOCA Proposal

Balance Sheet Restructuring

Before		After	
€m		€m	
Tangible Assets	1,000	Tangible Assets	1,000
Intangible Assets	500	Intangible Assets	100
Total Assets	1,500	Total Assets	1,100

Financed by:		Financed by:	
Senior Debt	800	Senior Debt	800
Junior Debt 1	200	Junior Debt 1	200
Junior Debt 2	100	Junior Debt 2	100
Shareholder Loans	200	Preference Shares	100
Total Liabilities	1,300	Shareholder Equity	400
Net Assets / Shareholder Equity	200	Losses (write-down)	(400)
		Net Assets	100

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DOCA Proposal

Assets writedown by \$400m but net impact only \$100m i.e. net assets reduced by \$100m due to:

	\$m
Reduction of Junior Debt 2	100
Conversion of Shareholder Loans	200
Writedown of Intangibles	(400)
Net Reduction	(100)

Existing shareholders to acquire Junior Debt 1 and a second charge at a significant discount (60 cents)



DOCA Proposal

Restructure Proposal

- Junior Debt 2 convert to preference shares
- Shareholder loans convert to pure equity
- Junior Debt 1 - offer of 60 cents by existing shareholders

Legal Parameters

- Need for 50% in value and number to vote in favour (if votes not consistent Chairman normally "casts" with value)
- Secured creditors who do not vote in favour can still realise and otherwise deal with security







DOCA Arrangement

- Shareholders obtain agreement of Junior Debt 1 to sell but only \$150m (for \$90m). Hedge funds refuse to sell
- Junior Debt 2 asked to convert to participating preference shares ranking above existing equity. Interest coupon increased but only payable out of profits (cumulative)

BUT




- DOCA issues:
 - Shareholders insist they want all of Junior Debt 1. Don't trust hedge funds
 - Hedge funds refuse not bound by DOCA?
 - Junior Debt 2 refuse to convert not bound are they a secured creditor for DOCA purposes?

DOCA Issues

- Section 444(D) – a secured creditor can realise or otherwise deal with security, unless
 - DOCA provides otherwise and secured creditor voted in favour, or
 - Court orders.

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DOCA Issues

Who is the secured creditor?

- Separate security for each of Senior Debt, Junior Debt 1 and Junior Debt 2
- Same security for all debt

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DOCA Issues

Inter-creditor/priority arrangements

- Are lower ranking secured creditors really subordinated?
 - Can they enforce upon an insolvency event/administration/scheme of arrangement?
 - Do priority arrangements continue to subsist upon an insolvency event?
 - Is security trustee/senior agent obliged to follow instructions of senior debt for DOCA voting purposes?
- **Protection for the junior creditors?**
 - Unfairly prejudiced?

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Receivership

Indemnity to receivers

- Risk assessment
- For New Money and Liabilities Incurred
- Co-ordinating syndicate to give indemnity.
 - ↳ Several
 - ↳ Given by all lenders

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Receivership Sale

- Trade and Operational Creditors
- Market Value under Corporations Act
- Sale Advisors
- Political Considerations
- Tax and Stamp Duty Issues
- Interaction with administration
 - ↳ Epic – administration ends
 - ↳ CrossCity
 - ↳ Vendor DOCA
 - ↳ Sale Entity DOCA

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Receivership Sale


Consents required from financiers

```

graph TD
    subgraph Vendor_Entities
        HT[HOLDING TRUST]
    end
    subgraph Shareholders
        HC[HOLDING COMPANY]
    end
    subgraph Sale_Entities
        PT[PROPERTY TRUST]
        FC[FINANCE CO]
        OC[OPERATOR CO]
    end
    HT -- units --> PT
    HC -- shares --> FC
    HC -- shares --> OC
    UH[Unit Holders] <--> SH[Shareholders]
  
```

G: Guarantor
B: Borrower
Borrowing and Guarantees secured
*Need for extinguishment of debt at Sale Entity level
*Need for release of Sale Entities from security

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Receivership Sale
Consents required from financiers

Alternative Structures?

- Less than 100% consent for debt extinguishment on enforcement?
- Security over ultimate equity/units?... Tax consolidation issues
- Equity agreements automatically come to an end

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Receivership Restructure

The 85¢ in the \$ Scenario

- Differing Lender Agendas
 - Exit and Sell?
 - Increase and Buy?
 - Retain?
 - Equity upside?
- Role of the Steering Committee
 - Dissemination of information
 - Formulating solutions

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