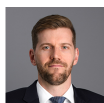
CADWALADER

How to Prepare for a Real Estate Enforcement in Europe, Part 3 – Implementation (or Getting the Deal Done!)

By **Bevis Metcalfe**
Partner | Financial Restructuring


By **William Sugden**
Associate | Financial Restructuring

By **Sophie Parker**
Paralegal | Financial Restructuring

Having covered how to prepare for an enforcement in Part 1 and stressed the importance of valuation evidence in enforcements in Part 2, the focus of our mini-series now turns to implementing the enforcement.

Let's imagine the following scenario:

There is a continuing event of default under the finance documents, negotiations between the lenders and the company have stalled, and the lenders no longer believe that the borrower can repay the loan. At this juncture, the logical next step is that lenders will be asking how they can enforce their security and how long it will take to get their money back. A headline point to stress in this situation is that implementing a real estate enforcement is not something which can be done at the drop of a hat. The planning and execution of an enforcement will always take longer than expected. Indeed, considering enforcement options for the first time when liquidity is "drying up" may disadvantage lenders. A well-planned enforcement should not be rushed.

What Do You Need to Get the Deal Done?

Each enforcement will look different. However, there are three key things that must be done in every lender-led enforcement:

1. Firstly, creditors need to agree what enforcement action will be taken. If there is a divergence of views between creditors, steps will need to be taken to bind in those dissenting creditors to the enforcement plan.

2. Next, the secured asset will need to be sold.

3. And lastly, to provide a "clean" sale, the claims of junior creditors (typically intercompany and shareholder loans) will need to be released.

We will now look at each of these in turn.

Step 1: Bind Dissenting Creditors

A key factor to iron out in the early stages of enforcement planning is working out what creditors want to do. While each creditor will want to have their debt repaid, it is not uncommon to see a divergence in opinion between creditors in how best to achieve this. The more complex the capital structure, the harder it will be to get all creditors on board with the proposed enforcement strategy, and this can have a negative impact on the ultimate recovery.

In simpler capital structures – for example, a lender club deal – getting consensus amongst all creditors to the enforcement strategy may be relatively straightforward. To minimise execution risk, best practice is for the creditors to document their agreement by way of a restructuring term sheet and a lock-up agreement. A lock-up agreement seeks to bind creditors into an agreed method of enforcement. It can be seen as something of an *agreement to agree*. The lock-up agreement and restructuring term sheet will typically address the following matters: (1) when default/acceleration notices will be issued; (2) whether, and what type of, insolvency procedure will be used to implement the enforcement; (3) funding; (4) how the asset will be sold – for example, marketing periods and the engagement of advisors; and (5) signing of key documents – for example, to release security interests.

In complex capital structures – for example, involving numerous and disparate bondholders – getting consensus will not be as easy and may not always be possible. In these situations, a way forward can be through utilising a statutory in-court restructuring procedure. In England, the two key court procedures in the restructuring "toolkit" are the Scheme of Arrangement and the Restructuring Plan. Both of these can be used to bind minority creditors who do not agree with the terms of a proposed restructuring. The Restructuring Plan can be particularly useful as it permits "cross-class cram-down." This allows a restructuring to be imposed on an entire class of dissenting creditors, providing that: (1) the court is satisfied that if the Restructuring Plan is implemented, none of the dissenting class would be "any worse off" than they would be in the "relevant alternative" (typically, the "relevant alternative" to the Restructuring Plan being implemented will be an insolvent liquidation); and (2) at least 75% in value of a class of creditors, with a genuine economic interest in the restructuring, vote in favour of the plan.

Until recently, the English courts were the main (and really, *only*) option in Europe if companies and creditors needed to bind-in dissenting creditors to a proposed restructuring. However, similar court-driven processes have recently been implemented across Europe, and "cross-class cram-down" is now available in several jurisdictions, including in the Netherlands with the WHOA Scheme, the German StaRug, the Spanish Restructuring Plan and the French Accelerated Safeguard procedures. Indeed, we are starting to see these regimes be put to the test – for example, in Spain through the *Celsa* restructuring, France with the ongoing *Orpea* matter and *Leoni AG* in Germany.

Step 2: Sell the Asset

Assuming enough creditors are on board with the enforcement strategy, the next step is to sell the secured asset. The typical path to recovery for real estate lenders is to exercise their rights under the security package they hold to sell the secured real estate asset. Typically, in a real estate enforcement, the creditors will hold a legal charge or mortgage over an asset which can be enforced to recover value. This sounds simple, but of course there's always plenty that needs to be considered.

Under English law there are three key remedies for lenders wanting to sell a secured real estate asset:

1. by the lender exercising power of sale; or
2. an administration sale; or
3. a receivership sale.

The appeal in each of these methods is that lenders can enforce without any (or, in the case of administration, minimal) court involvement, theoretically facilitating a more efficient path of recovery. Deciding which remedy is most appropriate will depend upon a number of factors and is something that will need to be considered by a lender's lawyers and financial advisors. One key factor is that a seller is under a legal duty to act in good faith and take reasonable care to achieve the best sale price reasonably obtainable at the time. Due to these duties, lenders are understandably very reluctant to be the selling party and in practice lenders will usually exercise their rights under the security documents to appoint an administrator or receiver (who are subject to a similar duty). The administrator or receiver will then be tasked with marketing the asset, negotiating the key transaction documents, completing the sale, and then applying the proceeds of sale to pay down the debt.

For lenders, appointing a receiver or administrator to sell the asset can be seen as something of a "protective buffer." It allows lenders to exercise a degree of control over the process while maintaining a safe distance from the risks and duties associated with the sale of the asset. There are certain advantages and disadvantages to the receivership and administration remedies. The receivership method is more of a private remedy, as the receiver is appointed by the secured lender and owes its duties primarily to its appointor. As such, receivership can be an efficacious enforcement option if lenders are seeking to sell a specific site or building. Administration is more public as it is considered a "rescue procedure." The administrator owes its duties to all of the company's creditors and is also required to prepare reports on the conduct of the directors, and whether the company has engaged in transactions that have breached applicable insolvency laws (whereas a receiver has no such duties).

As a final point, at the outset of the deal it is important that lenders understand what their "exit route" looks like and what enforcement options are available to sell the secured asset. These may differ considerably across jurisdictions, and lenders should always seek local legal advice to understand their options.

Step 3: Release the Claims of Junior Creditors

Lastly, when the asset is sold, it needs to be sold free of claims. This means that security granted by the company, and claims against the company, need to be released. The senior secured lenders will often be driving the enforcement bus.

However, junior and unsecured creditors (often mere passengers on the bus) may be reluctant to release their claims to facilitate a sale, particularly if they feel they are being "short-changed." It may be possible for a consensual deal to be struck between junior creditors to release their claims for less than the full amount of their debt. If this kind of deal is not possible then recourse can be sought through an appropriately drafted intercreditor agreement. In any secured financing, the intercreditor agreement is a critically important document. An intercreditor agreement will set out the powers and duties of the various lenders involved in the financing, as well as the role of the security agent and its relationship with the lenders and the borrowers and the guarantors.

A key feature of an intercreditor agreement is the distressed disposal provisions, which set out the powers granted to the security agent by the parties to facilitate an enforcement. A well-drafted distressed disposal provision will empower the security agent to release the claims of junior creditors. Certain conditions will need to be met before the security agent can effect the release. These requirements will differ from deal to deal, but often the security agent is required to show evidence of value, for example by conducting a sale process or obtaining a valuation (for more information, see Part 2 of our mini-series here). There may also be requirements set out regarding the treatment of non-cash consideration.

What's Next?

If you have followed the series to date, you should now have an insight into: (1) how to prepare for a restructuring; (2) the importance of robust valuation evidence; and (3) key implementation considerations. However – we're not yet done! In our next (and final) article, we will cover challenges to enforcement and what lenders can do to protect themselves in these situations. And for those readers that make it to the end, we will even include an "Enforcement Checklist," summarising the *dos and don'ts*!