Turnarounds & Workouts

JANUARY 2024

VOLUME 38, NUMBER 1

News for People Tracking Distressed Businesses

www.TurnaroundsWorkouts.com

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Another Busy Year

By Christopher Patalinghug

In December, we looked back at the events that moved the restructuring industry in 2023. We now look ahead. What's in store for the industry in 2024? How will this year's restructuring activity compare to prior years? Which sectors will see the most activity? What will be the greatest challenges? *Turnarounds & Workouts* asked these restructuring experts for their insights on the upcoming year: **Shana Elberg** and **Evan Hill**, partners at Skadden, Arps, Slate, Meagher & Flom LLP's Corporate Restructuring group; Hopkins & Carley shareholder and Financial Institutions and Creditors Rights practice chair **Monique Jewett-Brewster**; **Jonathan Lazarow**, founding member and co-chair of the Corporate Group at Ambrose, Mills & Lazarow, a boutique law firm in Virginia; **Randy Klein**, principal at Goldberg Kohn and Co-Chair of the firm's Bankruptcy & Creditors' Rights Group; **Doug Mintz**, partner and co-chair of Schulte Roth & Zabel LLP's Business Reorganization Group

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SC Split, Purdue Win Seen

By Christopher Patalinghug

The U.S. Supreme Court held oral argument in *Harrington v. Purdue Pharma* L.P. back in December. The controversy revolves around the legal permissibility of non-debtor releases, specifically the release of the Sackler family from civil liability amid the opioid crisis. The Supreme Court took on the case after the Court of Appeals for the Second Circuit reversed a district court decision that vacated the bankruptcy court's order confirming Purdue's Chapter 11 exit plan and held nonconsensual third-party releases provided in that plan were not permitted under the Bankruptcy Code. The Second Circuit concluded in May last year that the releases are permissible. All eyes are now on *Purdue* as a landmark Supreme Court decision, which is expected by June 30, 2024, will have the potential to reshape corporate accountability and significantly impact victims' ability to seek redress.

Monique Jewett-Brewster, a shareholder and chair of Hopkins & Carley's

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and Special Situations Group; and **Michael J. Cohen**, partner at Gibson, Dunn & Crutcher LLP's Business Restructuring & Reorganization practice in New York.

What are your firm's preparations for 2024?

Shana Elberg and Evan Hill, Skadden: One of the major steps that Skadden has taken to prepare for what we anticipate will be another busy year is recruit the Hon. Robert D. Drain to join our New York office following his retirement from the Bankruptcy Court for the Southern District of New York. Judge Drain is among the most high-profile and respected judges to have ever served on the bankruptcy bench, having handled many of the most complex and high profile bankruptcy cases over the past two decades. We anticipate that Judge Drain's insight and experience will be highly beneficial to Skadden's clients going forward, and further augment Skadden's position as a market leader in the restructuring space.

Doug Mintz, Schulte Roth: We are always adapting to changes in the market. In late 2023 we introduced our special situations team. With this team we build on our broad approach to restructuring to face the market, early on, with the wide array of talent clients need to handle the accelerating restructuring process — a process that requires earlier and more strategic consideration of potential distressed debts.

Monique Jewett-Brewster, Hopkins & Carley: We are looking to increase our bandwidth by bringing on a junior associate to support our growing insolvency practice in 2024. We also are collaborating with our lender clients to provide education and support as they expand and train their internal special assets groups in [2024].

Jonathan Lazarow, Ambrose Mills: We have prepared our team for a brisk 2024. We have also developed proprietary processes to help independent sponsors.

Morgan Stanley reported in November that about $73 billion in junk bonds are set to mature in the next 18 months, and this number is expected to rise to $125 billion over the next six months. This will definitely drive restructuring activity in 2024. Which industries continue to be vulnerable and may see heightened activity this year?

Jewett-Brewster: The commercial real estate industry, in particular, office properties, very likely will continue to experience distress in 2024. Some factors for heightened risk of distress include the age of the property and anticipated tenant improvement costs required to increase vacancy rates.

Elberg and Hill: Rates-based refinancing pressures tend to be industry agnostic, and we anticipate that the primary driver of restructuring activity in the new year will continue to be heightened borrowing costs. Commercial real estate is one example of a specific sector that is particularly vulnerable, with increased interest rates having a direct impact on asset values.

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Lazarow: I don't think any one industry is plagued more than another. Retail and consumer goods will have to adjust so they can manage their own changing rates while acknowledging that their customers are also being directly affected with higher interest rates and other systemic costs which

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will likely reduce their dollar spend. However, I think any business will have to confront the costs of capital and how it limits their ability to grow their businesses. Much of this maturing debt is acceptable if the company can maintain growth plans. Depending on industry and business cycles we will likely see more restructuring this year.

Describe the opportunities, if any, for distressed debt investing.

Randy Klein, Goldberg Kohn: Someone is going to figure out a way to take on busted downtown office real estate off the books of the regional and national banks. There probably hasn't been an "opportunity" like that since the RTC days. However, it is more challenging now to figure out when/how those properties will start to cash flow, so it will take a long-term investor (maybe large family offices) to want to hold those properties for the long term.

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Michael Cohen, Gibson Dunn: Noting that the [Morgan Stanley] projection is based on high-yield bonds, which are largely fixed-rate instruments. Noting that there is obviously also a large amount of leveraged loans outstanding, which are by definition floating rate and thus more susceptible to stress and sooner. So the opportunity set for maturity and liquidity issues is likely material larger than the quoted projection.

Mintz: Mike Eisenband of FTI in December wrote a very thoughtful article on the fact that there is no such thing as a "maturity wall." I tend to agree with Mike. Either there is liquidity, in which case, people will push decent companies past their maturity. Or there is no liquidity, in which case, of course, companies (even good ones) will struggle to find capital. Right now, there is increased liquidity in the market. It is more expensive than a few years ago. But rates are up a few hundred basis points. This is not currently 1980 — with 20+% interest rates. Credit will cost more but it is currently available. Borrowers will likely avail themselves of that paper if they can.

Lazarow: I expect an increase [in] distressed debt investing. In fact, I think sponsors and independent sponsors will find potential home runs this year. A number of good businesses with maturing debt and an uncertain political environment will need new investment. We think it's a great time to be opportunistic.

Fitch's Global Economic Outlook report released in December declared that the U.S. just avoided a recession, noting a "surprising U.S. growth resilience." Fitch expected one more hike in the Federal Funds Rate in January before the Fed keeps rates on hold until July and then cuts by 100bp by year-end to 4.75% (upper range). Please share your thoughts on this. ***(Editor's note - The Federal Open Markets Committee on Dec. 13 unanimously voted to keep the target Federal Funds Rate unchanged and forecast at least three rate cuts in 2024. The Fed will hold its first meeting of 2024 on Jan. 31)***

Cohen: There will always be a tier of companies that were not built for rising rates and will not have a long enough window before a liquidity or maturity issue arises to course-correct before rates moderate to a sustainable level. The corollary of that premise means that there will be some moderately stressed companies that have more tools today that may be able to avoid a restructuring catalyst due to potential rate moderation. How this plays out might be a key driver

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of the pure quantum of restructuring situations we will see in [2024].

Lazarow: In many regards this is already priced into the market. We did miss a recession and I believe we will continue to be resilient. The cost capital will continue to affect sponsors and even lead to more restructuring activities.

Jewett-Brewster: Even if Fitch's conclusion that the U.S. "just avoided a recession" is on the mark, commercial debt defaults are expected to continue as margins continue to decline. Financing conditions likely will remain tight in 2024, forcing many borrowers with loan maturities [in 2024] or in 2025 to refinance at much higher interest rates than they may have anticipated would be the case when their term loans or lines of credit originated. In addition, borrowers with maturity defaults may seek bankruptcy relief to stop secured creditors' foreclosure of lien rights in real or personal property collateral. However, with financing conditions likely to remain tight across industries, not all debtors seeking such relief will be able to obtain debtor-in-possession financing sufficient to sustain their postpetition operations on favorable (or at least tolerable) terms. Debtors in such cases may find themselves defending against motions to dismiss or convert their cases to chapter 7.

Elberg and Hill: If rates continue to hold steady — or even increase — through Q2 2024, then the companies that may feel this pressure most acutely are those that need to refinance funded debt obligations in the short term. We anticipate that many such companies, across a range of industries, will find their options for liquidity increasingly limited, and would therefore not be surprised to see an uptick in Chapter 11 filings in 2024.

What do you consider as your greatest challenge going into 2024?

Lazarow: Uncertainty in interest rates coupled with a rapidly adjusting market and unknown political environment.

Elberg and Hill: There are a number of important macroeconomic uncertainties (for instance, with respect to interest rates) that make advising clients with significant upcoming maturities difficult, as we anticipate the market's appetite for restructuring transactions (particularly out of court restructuring transactions) will continue to remain volatile. Additionally, there are several key bankruptcy issues currently working their way through the courts of appeal, particularly in the mass torts context. Depending on how those issues are resolved, there may be significant additional challenges facing companies seeking to reorganize under chapter 11.

Klein: Trying to budget what a middle market Chapter 11 should cost. For lending clients, Chapter 11 has gotten substantially more expensive over the years, based primarily on increased billing rates but also the practice has gotten much more intensive. It is difficult to run a "quick" Chapter 11 for a reasonable, controlled cost structure. Creditors' committees (for unsecured creditors that are completely out of money) continue to be an external drain on efficiency that rarely benefits anyone other than the committee professionals.

Mintz: The biggest challenge facing restructuring advisors is the ever-accelerating nature of the restructuring process. Nowadays, advisors (and clients) are reviewing loans that could mature more than year in advance to consider all options. Earlier in my career, we would have more likely gotten calls a few weeks before a company was ready to file for bankruptcy requesting help. This acceleration creates the opportunity for more creative and thoughtful deal-making. But certainly comes with its own set of challenges. ¤

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