A brief look at a recent development in the European restructuring market

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A significant change in the global leveraged finance market over the past decade has been the virtually wholesale adoption of the "covenant-lite" financing model. And, as lenders and bondholders agreed to relax many of the contractual constraints which used to limit how borrowers could organise their business, over this period companies and their owners have developed novel ways of managing their debt. Originally perceived as aggressive (and risky) manoeuvres by a sponsor to protect a struggling investment, the so-called liability management exercise ("LME") has since become a byword for broad spectrum of legal and financial techniques used to address a range of debt-related issues.

Early examples of LME tended to focus on removing assets from creditors' collateral packages so that these could be redeployed as credit support for new finance. The permissiveness of covenant-lite documents meant that this could often be achieved without the need to consult with, or seek the consent of, existing creditors. Subsequently, the "sponsor- led" LME (or even the threat of one) became a powerful new factor in the dynamics of borrower / creditor relations.

> "debt investors have become more proactive about protecting themselves ..."

As LMEs have changed over time, growing in popularity and complexity, so too have the attitudes of credit investors, many of whom have recognised the LME can also present opportunities to work alongside sponsors. A common feature of LMEs in recent years has been the willingness of creditors to agree to amendments of the terms of the existing debt documentation to facilitate changes to a borrower's debt structure to make way for new capital. This has sometimes proved controversial, particularly in instances where existing creditors have not been offered the opportunity to participate in the new funding and, as a result, find their claims are pushed to the bottom of the pile[1].

In response to these challenges, debt investors have become more proactive about protecting themselves and it has become commonplace in the USA for creditors to agree up front the rules of engagement after a borrower begins to display signs of financial difficulty. Co-operation agreements ("co-ops"), as they are known, operate under the basic premise

1. For an overview on so called "creditor on creditor violence" https://www.alcentra.com/news/articles/creditor-on-creditor-violence-in-europe.pdf.

that investors provide mutual assurances that they will refrain from entering into (or, indeed, negotiating) any transaction with a debtor which does not conform to certain minimum criteria. Key among them is the requirement that all participants in the co-op will be guaranteed equal treatment on their existing claims[1].

As the effect of this is to deprive the borrower and its sponsor of the support that would be required to implement many kinds of LME, the co-op is an effective means of taking options off the negotiating table.

A shield or a sword?

Investors have also found that co-ops can serve ends beyond the merely defensive. The simplest kind of co-op is open to all debtholders and designed to encourage broad participation, but other versions have entered the market. As noted above, investors have become more adept at leveraging LMEs as an investment opportunity. Support for this kind of LME often can be achieved with a simple majority (in value) of the relevant debt instrument. A smaller group commanding just over 50% of the voting rights may therefore be able to deliver a transaction without the need to canvas wider investor support. In several situations, investors wielding a narrow majority have used the co-op to drive a particular outcome at the exclusion of other members of the same syndicate.

First among equals

A third kind of co-op attempts to strike a balance between these two positions. In this version, a group of "Initial Parties" (usually representing a majority of debtholders) establishes the co-op, which is subsequently opened up to the remaining creditors to accede to after the agreement has become effective. Under this structure, the Initial Parties will first agree between themselves how certain economic benefits (usually the share of new money to be provided, along with associated backstop fees) will be allocated in a restructuring transaction. The Initial Parties will also generally control the governance of the co-op such as its duration and the ability to make material changes in the future. The remaining members of the co-op group will be assured of equal (i.e. pro rata) treatment in respect of their claims, though they may not be invited to participate in any of the economic upside and will not be involved in any of the negotiations or decision making.

How are co-ops perceived in Europe?

In the USA, where investors have developed an acute sense of the risks of failing to react quickly, co-ops have come to be accepted as the norm. However, opinion in Europe, where LMEs are less prevalent, is divided.

While co-ops have proved to be effective in a number of high-profile cases (see case study below), a common perception is that insome situations they are being used injudiciously. While becoming more frequent, the LME remains a relatively novel feature of the European market, and many participants are unconvinced that the co-op is a necessary response when a company's performance deteriorates.

> "... but co-ops can serve ends beyond the merely defensive"

Directors duties, which across Europe tend to discourage greater risk taking, are often cited as a check against the more aggressive forms of LME. Moreover, investors in Europe are generally well connected and do not automatically perceive one another as an immediate threat, so that time spent negotiating a co-op to guard against a LME which has not been threatened (and may never happen) can be a distraction. Investor attitudes regarding the pursuit of large fees or exclusive deal structures also remain ambivalent.

As such, a frequently voiced concern amongst investors is that they feel that co-ops are a solution to a problem that does not exist in the same way in Europe as it does in the USA. This is compounded by the fact investors regularly speak to law firms and other advisers who, as well as being an important source of market information, may sometimes be incentivised to promote the co-op as a first move which may help to put them in a better position when formal mandates are being awarded.

An additional concern is that, as co-ops almost always contain significant limitations on transfer, liquidity and prices have been known to suffer, particularly if the co-op does not achieve maximum participation.

How have borrowers reacted?

Unsurprisingly, sponsors and their portfolio companies are not enthusiastic supporters of the co-op. A number of counter-measures have been mooted, although these have yet to gain traction in the market. In particular, it has been suggested that co-ops may fall foul of antitrust law on grounds that they unfairly restrict access to debt markets, though to date this argument has not been litigated before the courts in the USA or elsewhere. In addition (and more concerningly, from an investor perspective) several top-tier sponsors have sought to prohibit co-ops in new financings, though, to date, these provisions have not (yet) cleared the market as a result of investors pushing back.

1. Co-operation agreements were first developed in the US restructuring market, but have become more common in Europe over the last two years.

Case study

Altice France:

The effectiveness of the co-op is neatly illustrated by the case of Altice France (AF), one of Europe's largest debt issuers. In spring 2024 AF took the market by surprise when it announced, in the face of declining performance and a mounting debt pile, that it was looking at ways it could de-leverage its balance sheet. Rumours quickly began to circulate that the AF was planning to achieve this by launching discounted tender offers that would leave non-participating creditors vulnerable to impairment.

In response, investors quickly formed a steering committee to act as a point of contact with AF. In addition, a co-op was entered into which was open to all holders of the company's senior debt. Participation soared past the 50.1% threshold, ultimately settling above 90% of the group's senior secured debt. The effect of this was to (i) shut down AF's ability to push through changes to its credit agreements and (ii) dramatically shrink the pool of potential counterparties with whom the company could discuss alternative capital solutions. With AF's options having been narrowed, the steerco was able to negotiate a restructuring proposal from a position of relative strength. In March 2025 the terms of an agreed transaction structure was announced to the market and a deal is expected to complete in the summer of 2025.

Conclusion

Co-ops are a well-established feature of the restructuring landscape in the USA and are gaining ground in Europe too, where they have been deployed as an effective defensive measure when investors feel the need to react to the threat of a LME. However, in Europe their use as a means of delivering specific outcomes or marshalling creditor benefits has yet to find a consensus.

Many investors are happy to continue working together informally with the matter of economic entitlements being agreed a later stage. That said, once a co-op has entered circulation (for example, because a law firm has volunteered itself to act as draftsman) then, such are the incentives and potential rewards for being an early mover, the risk being left behind may be too great to ignore.

The use of co-ops will therefore continue to attract scrutiny amongst investors who, we believe, should judge each case on its own merits and consider whether it properly serves their interests. And for the time being, at least, it remains to be seen whether they will become the default option.

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