Global Restructuring Review

The Art of the Ad Hoc

Editors
Howard Morris, James M Peck and Sonya Van de Graaff

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Regulation and Structure of an Ad Hoc Committee

Natasha Harrison, Fiona Huntriss and Melissa Kelley[1]

Overview

Ad hoc committees can allow creditors to effectively maximise leverage and pressure against a debtor company to obtain the best outcome for them both individually and as a group. However, it is critical that the structure, decision-making, governance and regulation of ad hoc committees are carefully managed and agreed from the outset, to avoid subsequent disputes among group members that wipe out the value and benefit that creditors can otherwise secure from the ad hoc committee.

The key points to be clearly agreed upfront are: (1) how costs are to be paid (in good times as well as bad); (2) how day-to-day decision-making is delegated (to a steering committee or otherwise); and (3) how the outcome (settlement, consensual restructuring, court process, etc.) is to be decided. Other points that should be agreed include: (1) conflicts of interest; (2) confidentiality; and (3) the creation and maintenance of common interest privilege. The particular circumstances of a case may also require an upfront agreement about the distribution of information (both from advisers to the committee, and among committee members), particularly where material non-public information (MNPI) may be discussed, and any necessary go-private and cleansing periods, or longstop dates.

A commercial and pragmatic adviser can improve the operation of an ad hoc committee, which works to both the committee's and its own advantage. Early consideration and discussion of outcomes and scenarios, understanding the sensitivities that particular members may have, and anticipating future issues and addressing these upfront, should ensure both a smooth-running and successful ad hoc committee, and a remunerated adviser who is able to get clear instructions and understand the limits of those instructions and its power.

1 Natasha Harrison is the managing partner, Fiona Huntriss is a partner and Melissa Kelley is an associate at Boies Schiller Flexner (UK) LLP.

In particular, an adviser can add value to the structuring and regulation of an ad hoc committee by giving thought to the payment of fees. While company coverage may be expected in certain non-contentious restructuring scenarios, this is not always available, and may not be able to be relied upon, even if offered at the outset. Members of an ad hoc committee, particularly original holders in distressed situations, may be uncomfortable or unable to foot significant ongoing adviser costs. Where debt held by the committee continues to be serviced, or there are regular and reliable distributions coming from an insolvent estate or administration, options to 'top-slice' costs may be attractive. Here, costs of the ad hoc committee are paid out (from distributions or coupon payments) as a 'first priority' payment in the waterfall, ensuring that advisers are paid without the member having to 'write a cheque' for those amounts. Even if the creditors are ultimately bearing those costs, this solution has the benefit of both practical ease and preventing 'free rider' creditors either not participating in the ad hoc committee, or non-reporting their holdings to reduce spend, but gaining the benefit of the ad hoc committee's actions.

The agreement between ad hoc committee members (and their advisers) can be custom-drafted or adopted from the LMA Co-ordinating Committee precedents (although, as discussed below, these precedents are designed for different circumstances). In all events, it should be separate from an adviser's engagement letter, and should be put in place at the earliest possible opportunity.

Regulation and structure of an ad hoc committee

Decision-making

Outside of settlement and resolution decisions, the decision-making of an ad hoc committee is generally delegated to a steering committee, comprised of a relatively small number of the largest holders.

Absent the formation of a steering committee – and appropriate delegation to that steering committee – ad hoc committees consisting of numerous holders, some of which are not economically incentivised to invest significant amounts of time in a position, are unwieldy and unmanageable, with slow or near-impossible decision-making proving a major stumbling block.

Clear delegation to the steering committee at the outset reduces the risk of disputes or logjams later in the process. Steering committees generally make all day-to-day decisions, attend company meetings, liaise with advisers, and sign off on non-material documents (and drafts of material documents). In certain cases, a steering committee will have even broader power – such as approving new members to the group, taking more material steps and the right to veto certain decisions – to the extent that the economics of the committee and the practicalities of the matter support that structure.

However, committee agreements should put parameters around the actions of individual members, whether they sit on the steering committee or otherwise. All members will need the comfort that their peers are acting in the group's general interest, and not pursuing individual strategies (or, at the very least, not charging the cost of those individual strategies to the group). It is often incumbent on the legal and financial advisers to manage this dynamic on a day-to-day basis by striking the balance between inclusion of all members and the necessary transparency, with the inevitable power that larger holders will have on the direction of the group.

Settlement or resolution – other material steps

Outside of the day-to-day decision-making, ad hoc committees should reserve some specific matters for approval by the broader constituents, either by unanimity or (more likely) a set majority – two-thirds or three-quarters by holdings. The approval threshold can be set by reference to the relative importance of the decision being taken: settlement or resolution will usually require a relatively high threshold, while less critical decisions (of still significant importance) can be approved by a lower level. While individual holders of a committee may be initially unwilling to delegate any responsibility to the broader group on key areas, allowing for individual hold-outs, irrespective of holding, is the reason why unanimity thresholds prove simply unworkable in anything other than a very small committee.

In specific instances where litigation is afoot or contemplated, it may be the case that only certain of the members of the group are named parties to that litigation (both as a practical matter, and where litigation rights may depend on the original or secondary nature of a member's holdings). This particular situation usually militates to giving a named party specific rights in respect of that litigation, such as the unilateral right to withdraw or discontinue.

From time to time, a member's constitution may provide that it is simply unable to delegate decision-making power to the group, even where a high threshold is set to remove individual interests clouding the voting, and providing the protection of the 'sense of the majority'. These – mercifully rare – instances need to be handled with care, perhaps by the inclusion of a 'get-out' vote for that member, but with significant costs disincentives, or by the inclusion of a resolution mechanism that relies on a third-party view (such as that of a senior barrister or arbitrator) rather than leaving that holder at the behest of its peers.

Costs

While the ad hoc committee may have agreed (or may be able to agree) costs coverage by the debtor company, it is important that the apportionment of costs between members of the ad hoc committee is agreed between themselves in the event that the debtor company breaches that agreement, or the costs are outside of the scope of that agreement.

The most immediate costs to be considered will be those being incurred by the legal, financial and any other advisers to the ad hoc committee. These are generally uncontroversial, agreed to be borne by members of the ad hoc committee on a *pro rata* basis by reference to a member's interests in the relevant debt, and are refreshed on a monthly basis or other frequency. Tripwires of which to be mindful are: (1) ensuring that all interests in the relevant debt are captured (including acquired by sub-participation or other similar structures); and (2) reflecting any lag-time in the settlement of trades, to ensure that active purchasers do not benefit from this, to the detriment of other members of the committee.

Even if litigation is not contemplated at the outset, a committee agreement should also anticipate how any adverse costs arising out of any court proceedings are split between members. Adverse costs risk will vary depending on jurisdiction: English courts follow a general principle that the losing party bears the winning party's fees (usually around 65–70 per cent of those fees in practice, but this principle can be adapted in insolvency or quasi-insolvency proceedings); civil code countries tend to fix any adverse costs by reference to a sliding scale, which can move depending on the value of the dispute and number of litigating parties. In all circumstances, an ad hoc committee involved in litigation should be ready to bear potentially significant adverse costs, to prevent fall-out at a subsequent stage.

Adverse costs are more problematic to divide fairly between committee members, particularly if the matter is long-running, or there is a shifting membership or holdings of those members. Adverse costs are often ordered at a single point in time (usually, the final outcome of any court proceedings) but relate to a long historic period. Ensuring that these are borne by all members for the relevant time period (and avoiding the risk that holders are left 'holding the baby' at the end of the process) is a risk that should be addressed upfront in any committee agreement. Mechanisms that can be used include fixing adverse costs liability at the start of any litigation or court proceeding, or by averaging it based on *pro rata* holdings for the life of that litigation or court proceeding.

Conflicts of interest

Inevitably in any group scenario, conflicts of interest can arise, both between members and between members and certain advisers. It goes without saying that, at all times, prudence and an abundance of caution should be applied to ensure that any potential issues are dealt with as smoothly and as early on as possible to prevent later issues arising.

Particular issues can arise if a large ad hoc committee is made up of holders with varying interests in the debt structure, both inside and outside of the constitution of the committee. While members can enter a matter without any real conflict, changing investment focuses and management decisions can move a member into more difficult territory. A proactive adviser with a global understanding of the matter can manage these sort of issues ahead of time.

Similarly, an adviser (more likely legal than financial) can find itself in difficult positions, as committees fracture or diverge and members fight to retain the adviser with the institutional understanding of the position. Equally, perceptions of conflicts can arise where a member appoints a lawyer that it has used for long-standing engagements as an adviser to the committee. Any perception issues can generally be headed off by clear and transparent agreement from the outset about reporting lines, communications and decision-making structures.

Confidentiality and privilege

These interlinked issues demonstrate the importance of a closed committee, carefully managed to prevent leakage of information and advice, and to preserve confidentiality and privilege.

The constitution agreement of the ad hoc committee should set out clear guidelines and protections on both fronts. First, strict limits around the dissemination of sensitive information, advice and documents should be put in place to prevent broader circulation of that information and documents by a member and controlling the recipients of the information. Where an ad hoc committee is larger and made up of a shifting group of creditors, additional protections should be considered, such as the use of watermarked documents or limited access by password or credentials.

A more straightforward issue to address is the inclusion of a 'common interest privilege' provision in any constitution agreement, confirming the commonality of interest of all of the members of the ad hoc committee, and that the circulation of advice between those members is not deemed to be a waiver of any privileges. While privilege exists as a matter of fact rather than being something that can be agreed between parties, the existence of an explicit agreement on the preservation and non-waiver of privilege can be helpful evidence of the fact of the privilege.

The privilege that applies is generally that of the forum in which any dispute is taking place, so ad hoc committee members should be mindful of the risk that a document that would otherwise be protected by privilege rules of a particular jurisdiction being available in a less protective jurisdiction. A pragmatic lawyer and a risk assessment can deal with these matters; where advice or issues are more sensitive, a more restrictive approach should be taken to protect fully on these matters.

A word on MNPI

Ad hoc committees may consist of all public members, or sometimes a mix of public and private-side members. In all of these scenarios, the receipt and dissemination of MNPI can throw up tricky issues for the members and their advisers.

Each ad hoc committee and each member may have particular stipulations about how MNPI is identified and disseminated. In some cases, the members will want the legal and financial advisers to be the only recipients of MNPI, unless a cleansing period has been pre-agreed. This requires rigorous consideration of the decision-making power of those advisers where they have material information that is not practically available to their constituents. Careful management and communications are also needed, particularly if some, but not all, members (or only some individuals representing a member) are private-side.[2]

Entitlement of members to receive fees and reimbursement of costs

Third-party payment

Committee members will often have or be aiming for the debtor company or other third party (sponsor, acquirer, etc.) to pay or contribute to the costs of the ad hoc committee, if not also the costs of the individual committee members. This can be through a side letter or existing contractual indemnities. Contractual provisions, such as indemnities, can also deal with costs coverage where an ad hoc committee is acting through or liaising with a trustee, security agent or agent.

Some thoughts for advisers

Acting for ad hoc committees presents particular opportunities and challenges for advisers. While the prospect of pooling the combined expertise, power and status of a group of members offers up a platform to be the driving force, be it at the negotiation table or in the courtroom, an adviser must be aware of the danger of the focus of the matter switching to wrangling among group members rather than achieving the combined aim of the committee.

The administrative burden of an ad hoc committee needs careful and efficient management, particularly in instances of large committees with frequent trading and changing of debt positions. An adviser may be concerned about how it ensures that its interests are met – in particular, by the timely payment of its fees – without it expending a disproportionate amount of time on those issues (and away from its 'real' work). Where costs are not being borne by a single third party (such as the debtor company), creative solutions matched to the particular matter can suit both the committee members and the advisers. For example, where a matter relates to live debt that is being serviced, a committee may be able to agree formally

2 See Chapter 11 on the insider/outsider conundrum for more on public and private information.

that its costs are top-sliced from coupon payments. This can usually be achieved by a creditor resolution or instruction, in accordance with the particular terms of the debt. Formalities that would otherwise limit the practical effectiveness of this route – such as the need for in-person meetings, or notice periods – can frequently be waived with sufficient creditor approval. The involvement of other parties, such as paying agents, issuers or lenders, and trustees or agents, should be ascertained from the outset to avoid those becoming a block later in the process.

The same principle can be applied where debt is about to mature, or a restructuring (with cash payment out) is anticipated. This provides the adviser with certainty and a single source of payment, while removing the need for committee members to pay out expenses for adviser costs, and prevents free-riding by holders of debt sitting outside of the committee.

Outside of these circumstances, a committee may agree to pay into a 'fighting fund' to ensure easy payment of its costs, which is particularly useful where the matter may see the incurrence of costs that need satisfaction in short order.

In all instances, ad hoc committees – and their advisers – will appreciate the early and continued consideration of practical matters such as fees, with an understanding that different eventualities should be explored at an early stage. Non-contentious restructurings, with a willing debtor company covering costs, can often become contentious legal proceedings in multiple jurisdictions, or complex insolvencies. The impact of these changing statuses on matters such as the ability to recoup from the debtor company, the power and ranking of a contractual indemnity, and the reliance that can be put on top-slicing costs from debt servicing, will all need to be considered and dealt with at the formation of an ad hoc committee.

Loan Market Association guidelines

The Loan Market Association (LMA) has standard form documents and guidelines, including for the constitution of a steering committee (or, in its parlance, a coordinating committee), and a wider lender group (as opposed to bondholder group). The LMA Co-ordinating Committee documents are designed for workout or restructuring scenarios, where there is a need for a small group of lenders to act as the 'middleman' between the company and its lenders, and look at protecting both the co-ordinating committee and the company. These can be helpful as a base draft when putting in place the terms of the intercommittee decision-making and powers. The standard form documents generally address the realistic options that a potential committee and its advisers will encounter: for example, whether the coordinating committee will have binding authority (the LMA documents generally anticipate not); necessary rules around the appointment of the coordinating committee; and information flow. The LMA guidelines also set out options for director and committee communications, and dealing with fund/CLO situations or scenarios.

Significant deviation from the LMA standard forms is needed is where contentious litigation is anticipated or possible. As to be expected, the LMA documents are designed for and focused on out-of-court consensual restructurings, and while a useful starting point for any group constitution agreement, litigation-specific matters such as adverse costs and named/non-named parties to the litigation must be separately considered, and relevant provisions drafted into the bespoke agreement that will be put in place for that ad hoc committee.

Appendix 1

About the Authors

Natasha Harrison
Boies Schiller Flexner (UK) LLP

Natasha Harrison is the managing partner of the London office of Boies Schiller Flexner, and an experienced English barrister and solicitor.

Acting on behalf of funds, investment banks, corporations and governments, Natasha's practice focuses on high-stakes international litigation and arbitration. She has extensive experience in all types of finance and business disputes, including distressed debt investments, investments in special situations and emerging markets, sovereign debt investments, securitisations and complex finance arrangements, and has litigated many of the most important investor disputes of the last decade. She is regularly retained on behalf of clients to provide strategic litigation advice and to lead and coordinate large international commercial disputes.

Natasha is recognised as a leading banking litigator by *The Legal 500* and *Chambers UK*; and by *Super Lawyers*, *Who's Who Legal* and *Lawdragon* as a leading commercial litigator. She won Best in Litigation at the *Euromoney* Women in Business Law Awards (2015), was named one of *Financial News*'s Rising Stars of Legal Services in 2013 and *The Lawyer*'s Hot 100 2011 for banking litigation. She has been described as 'exceptionally talented', as 'incredibly commercial for a litigator', with an 'unparalleled ability' to turn a client's thoughts into a 'cogent argument'.

Fiona Huntriss
Boies Schiller Flexner (UK) LLP

Fiona Huntriss is a partner at Boies Schiller Flexner and is an experienced litigator who has acted on a range of banking and financial litigation, as well as commercial disputes, restructuring and insolvency litigation, and sovereign disputes. Her core practice involves acting for investors in complex, multi-jurisdictional situations, including bank bail-ins/bail-outs, sovereign or quasi-sovereign disputes and noteholder litigations.

She has acted for and advised parties litigating before the English, European and international courts. As well as active litigation, Fiona advises in respect of litigation and enforcement strategies. Her recent experience includes acting for holders of senior bonds issued by the Canary Wharf group, creditors of the Spanish conglomerate FCC, holders of convertible notes issued by Lloyds Banking Group, an institutional investor in a complex shareholder dispute focusing on valuation, and a leading bank in litigation involving a securitisation. Fiona also represented over 70 holders of notes issued by Landsbanki, Glitnir and Kaupthing in the restructuring and wind-down of the Icelandic banks, which involved litigating constitutional, EEA and banking resolution issues in Iceland and Europe.

Fiona is described as 'absolutely excellent' and '[able to] balance commercial interests with the legal backdrop'. She is ranked as an 'Up-and-Coming Individual' in *Chambers 2017* (Banking Litigation) and was named as a Rising Star (Litigation) at the 2015 *Euromoney* Women in Business Law Awards.

Melissa Kelley
Boies Schiller Flexner (UK) LLP

Melissa Kelley is an associate who primarily focuses her practice on a broad range of banking and financial litigation, and restructuring and insolvency litigation. Among other matters, she has acted for a group of holders of Class A1 Notes issued by Canary Wharf Finance II plc in connection with proceedings seeking declaratory relief about Canary Wharf's Obligation to make a 'Spens payment' following the Class A1 Notes' early redemption, and acting for a group of holders in Fomento de Construcciones y Contratas SA's (FCC) Tranche B debt and notes in connection with FCC's *homologacion* application before the Spanish courts, and related litigation in England. Melissa also has experience of investment treaty arbitration and advises on structuring investments under investment treaties.

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The Art of the Ad Hoc – published by Global Restructuring Review – is a guide on how to work successfully with ad hoc committees. To borrow from Hon. James M Peck in his introduction, 'art' is the right word for a discipline driven as much by 'creativity, improvisation, intuition and occasional inspiration' as by 'dry logic'. *The Art of the Ad Hoc* draws on the collective wisdom and real life experiences of 20 distinguished practitioners from 10 different firms to illuminate this art.

Part I explains an ad hoc committee's formation and organisation; Part II, its activities and powers; and Part III, what trading committee members may undertake. There is an emphasis on the practical throughout.

Published digitally at GlobalRestructuringReview.com and updated annually, the editor and publisher hope that, over time, the guide will codify best practice in this area. *The Art of the Ad Hoc* is the first title in the GRR Guides series.

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