

Restructuring & Insolvency

QUICK REFERENCE GUIDE FOR DETECTING AND ADDRESSING DISTRESS SITUATIONS | June 2020

Restructuring & Insolvency: Quick Reference Guide for Detecting and Addressing Distress Situations

The world has been experiencing a massive downturn over the recent months because of the COVID-19 pandemic. Locally, the Philippine government has reactively imposed community quarantine measures of varying degrees. The actions taken have resulted in disruptions in the operations of businesses, which, in turn, have caused significant adverse consequences to economic activity and growth. Understandably, the uncertainty and pitfalls brought about by the COVID-19 pandemic and the corresponding governmental response, including the ongoing Community Quarantine measures and the issuance of rapidly evolving regulations, make enterprises highly vulnerable to financial distress.



The Warning Signs

In order to implement appropriate pre-emptive or remedial measures in a timely manner, companies should recognize and be mindful of the early warning signs of distress. They typically include the following:

For underperforming companies

- ✓ Lower stock performance relative to peers
- ✓ Market share loss
- ✓ Slow sales growth
- ✓ Margin deterioration
- ✓ Workforce reduction
- ✓ Delivery and quality issues
- ✓ High customer concentration

For troubled companies

- ✓ Tighter working capital
- ✓ Lower capital spending
- ✓ Debt restructuring or debt covenant default
- ✓ Continued workforce reductions
- ✓ Operational reorganization
- ✓ Lack of innovation in product or process technologies

For technically insolvent companies

- ✓ Limited access to new debt
- ✓ Requests for price increases or accelerated payment terms
- ✓ Inability to gain new business from customers
- ✓ Stock devaluation
- ✓ Debt downgrade
- ✓ Financial restatements
- ✓ Parts of the business liquidated



Corporate Check-Up

A distressed company should understand its responsibilities to its stakeholders, including the fiduciary duties of its officers and directors. Ideally, a "corporate check-up" should follow, which would entail asking the following questions:

- ✓ Are there issues or potential issues from a governance perspective (both intercompany and with equity holders), and, is the company meeting its obligations to its stakeholders?

- ✓ What are the company's liquidity options, taking into account existing credit facilities? (Remember that "cash is king" when a company is experiencing challenges.)
- ✓ What are the potential stress points in relationships with key customers and vendors, as well as other key contract counterparties?
- ✓ What critical dates are the company facing (e.g., maturity dates, collateral redeterminations, financial reporting, contract expirations or renewals, litigation deadlines, and termination dates under default notices)?
- ✓ Are there burdensome contracts? If so, what are the exit options? Is the company meeting obligations under key contracts?
- ✓ "If you could wave a magic wand and change things, what would be different?"

A company that understands these challenges is better equipped to prepare a clear path forward with options. It is vital that the actions that the company will take are proactive, not reactive, and tailored to the company's bespoke and industry-specific challenges. They must also comply with relevant requirements under Philippine laws, rules, and regulations.



Addressing a Distress Situation

Depending on the challenges identified and the industry in which the distressed entity operates, among the possible strategies or measures that a company may consider are the following:



Financial Restructuring

For creditors, whether original lenders or secondary purchasers, the restructuring process involves analyzing value, managing uncertainty, and ultimately seeking to maximize the recovery of loans and other extensions of credit made to financially troubled companies.

On the other hand, borrowers may initially take advantage of government-mandated debt moratorium. For instance, certain measures were recently enacted pursuant to Republic Act No. 11469, otherwise known as the Bayanihan to Heal As One Act. For borrowers, the restructuring process involves evaluating existing loan agreements and entering into negotiations with creditors to arrive at a form of concession to ultimately allow the borrower more flexibility to better manage its liabilities in view of revenues or cash flow issues, among others.



Distressed Mergers and Acquisitions



Divesting distressed businesses

Divestment is a strategy frequently resorted to for distressed non-core businesses of industrial groups. Potential purchasers are financial and strategic investors. The divestment provides the seller with financial and operational relief. Cash burn and losses are reduced, painful operational restructuring can be avoided, and the seller's management can focus on the seller's core business.



Acquiring distressed businesses

Companies in financial or operational distress may be attractive targets for financial and strategic investors. Investors may pursue various acquisition strategies (e.g., a share or asset deal outside of formal court proceedings, an acquisition in restructuring or insolvency proceedings, or even an acquisition of debt to be converted for equity). The appropriate strategy will depend on the situation of the relevant target company and will be influenced heavily by the applicable restructuring or insolvency law, and regulatory requirements. There would also be relevant requirements under the Philippine Competition Act.



Corporate Restructuring

Restructuring the affairs of the business can be an effective strategy to enhance the value of entities that are in actual or anticipated financial difficulty. Some of the usual reasons for restructuring a business are to reduce costs, improve competitive advantage, concentrate on key products or accounts, or simply to enable the organization to invest in or extract itself from a business. The appropriate restructuring strategy would normally be driven by the circumstances surrounding the entities involved, as well as by various regulatory, tax, and even employment law considerations. In certain cases, there could also be requirements under the Philippine Competition Act.



Loan Portfolio Disposals

During times of economic and regulatory challenges, banks and other institutions may look to divesting assets such as performing loans, non-performing loans, and entire lines of business. This divestment is an opportunity for institutional investors, such as private equity funds, insurance companies and other financial institutions, to strategically expand their portfolios. A clear divestment strategy on the part of the banks, other institutions looking to divest, and other investors, should be able to maximize the opportunities for the profit after divestment. However, regulated institutional investors, such as banks and insurance companies, should be mindful of applicable requirements under issuances of regulators such as the Bangko Sentral ng Pilipinas and the Insurance Commission.



Distressed Debt and Loan-to-Own Strategies

Investors can seek to obtain control of companies by acquiring distressed debt and then converting it for equity (loan-to-own strategies). Such strategies can provide significant returns but also bear significant economic risk. One of the ways to minimize significant risk is to gain a complete knowledge and understanding of a company's capital structure, outstanding liabilities and security package granted to secure the obligations.



Assessment of Creditor Rights

When a company is facing a crisis, corresponding problems may arise for creditors and other stakeholders. They may wish to continue with the business relationship but are exposed to increased risk. One of the options that creditors may wish to undertake in assessing their rights is to evaluate potential issues in the enforcement of security for their borrower's secured liabilities. The sooner creditors prepare for possible insolvency of their borrowers, by assessing their rights, the more options they will have.



Assessment of Management Risk

In any financial crisis, there may come a time when the interests of management and shareholders diverge. It is critical for management and boards of directors to be aware of their fiduciary duties to shareholders and other stakeholders and personal liability risks during periods of financial uncertainty. The Financial Restructuring and Insolvency Act, for instance, contains provisions that deal with these matters. Principles under the Revised Corporation Code may also be applicable, under certain circumstances.



Rehabilitation or Insolvency Proceedings and Litigation

It is critical for debtors, stakeholders and their professional advisors to identify the most appropriate formal insolvency or restructuring process under the circumstances, in order to effectively manage insolvent businesses, maximize the chances of recovering assets, unwind unlawful transactions, and hold officers of businesses accountable for their actions. Rehabilitation and liquidation remedies under Philippine law are found in the Financial Liquidation and Suspension of Payments Rules of Procedure for Insolvent Debtors and in the Financial Rehabilitation Rules of Procedure.



Conclusion

It bears emphasizing that once a company starts to experience distress, issues pile up at an accelerated pace. However, the management and the board of a company that is facing headwinds likely do not have the same level of experience in addressing all the types of problems that might arise. This places them at a disadvantage in dealing with other stakeholders; other stakeholders are singularly focused on their concerns, while the company must deal with all concerns of all stakeholders.

Many stakeholders, especially financial creditors and distressed debt investors, likely have prior experience in dealing with a company that is facing difficulties. Borrowers need to review and have a full understanding of existing loan agreements with a view to possible restructuring of the same. Any existing security arrangements for loans must also be assessed to determine potential impact on the business in case of lender's enforcement on the security in case of default.

It is therefore advisable for a distressed company to seek professional advice from experienced restructuring and insolvency (R&I) practitioners to level the playing field, and to help them navigate the myriad considerations under relevant Philippine laws, rules, and regulations. Besides, a company's management and the board should focus on what they do best: run the company and not run around putting out fires.

Amidst the COVID-19 pandemic where lockdown restrictions and Community Quarantine regulations are forcing businesses to shut their doors or severely limit their operations, Quisumbing Torres (**QT**) continues to work with clients to deconstruct and address R&I-related issues and problems. We provide timely and valuable advice and services that ensure tailored and practical solutions. We also provide guidance on multiple legal aspects of emergency responses. As a member firm of Baker & McKenzie International (**Baker McKenzie**), QT's global reach makes us well-equipped and uniquely qualified to provide the most well-rounded advice, derived from the extensive range and number of company-side mandates Baker McKenzie firms and members firms have collectively handled.

Please participate in our survey on Restructuring & Insolvency

We invite you to participate in our survey to identify matters of interest to you in relation to R&I. This will allow us to assess how we can be of assistance to you during these unprecedented times. We would appreciate receiving your response by or before 25 June 2020.

[Click to participate in the Survey](#)

Pre-register to our webinar on Restructuring & Insolvency

QT will be hosting a webinar to be held on 15 July 2020 at 2:00 pm. Select matters of interest in Restructuring & Insolvency will be discussed by some of our key R&I practitioners. Please click on the button below to register.

[Click to register](#)

Baker McKenzie Global Restructuring & Insolvency Guide 2020

You may download a copy of the Baker McKenzie Global Restructuring & Insolvency Guide 2020 by clicking the button below. The guide has been compiled by lawyers from Baker McKenzie member firms, including lawyers from QT, who are experienced in the practical aspects of R&I. It is a helpful reference in understanding the numerous R&I regimes that may affect your business.

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