



INSOL International

Assessing the Effectiveness of and Challenges Facing Chief Restructuring Officers

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Acknowledgement

INSOL International is very pleased to present a special report titled "Assessing the Effectiveness of and Challenges Facing Chief Restructuring Officers (CROs) by Ann-Marie Laing and Alastair Beveridge of AlixPartners, UK.

In the event a corporate entity is faced with financial distress most often the preferred option is to pursue pre-insolvency reorganisation. In such circumstances, there may be a perception that the debtor company's management is unable to command the respect and confidence of key stake holders - lenders or creditors, shareholders, and employees to carry out the restructuring effectively. In some jurisdictions the appropriate statutory provisions that are conducive to restructuring may not be available or there may be significant cultural issues that have to be taken into account in the restructuring process. In such situations, the company may be better served by highly skilled Chief Restructuring officers (CRO's or Quasi CRO's) together with their supporting teams.

This special report highlights practical issues that CROs have to deal with before and after their appointment. The report was prepared with the information gathered from an on-line survey as well as from interviews with practitioners from many jurisdictions. The report highlights the findings on six key areas that are of great practical importance namely:

- the origination of work;
- skills required by a CRO;
- pre-appointment issues;
- delivery of the role;
- completion of the CRO role and
- views about the future of the CRO role.

INSOL International sincerely thanks Anne-Marie Laing and Alastair Beveridge for carrying out the initial on-line survey, conducting the interviews and preparing this excellent report that has a wealth of practical information that all insolvency practitioners would value and appreciate.

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Assessing the Effectiveness of and Challenges Facing Chief Restructuring Officers (CRO's)

By Anne-Marie Laing and Alastair Beveridge*
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Introduction and background

Over the past decade there has been a growing trend in the use of restructuring professionals to guide companies and groups through financial distress. This role is probably best understood in the US and is commonly known as the CRO, 'Chief Restructuring Officer', and from the research we have undertaken the role is gaining ground in Europe as well as Asia.

Perhaps oddly, the role does not have a specific legal definition. It can be very wide ranging in terms of scope, the level of personal exposure which it will place on practitioners and the extent to which implementation (as opposed to providing advice) is needed. In fact the broad scope of the role leaves practitioners facing a number of challenges not least where the stakeholders do not understand what the role is, which can result in mixed expectations of what can and should be achieved.

In a world that is perpetually dealing with changing legislation, more complex corporate and financial structures and funding which now routinely travels beyond geographical boundaries, The Technical Research Committee of INSOL International felt that it would be worth undertaking a piece of research on the "CRO" phenomenon.

An on-line survey on this topic was carried out for members in late 2014. Unfortunately the results were not substantial enough to draw any significant conclusions. It did however suggest that, particularly outside of North America, the number of situations where an actual CRO was used was relatively modest and therefore many members were not in a position to provide responses based on experience. A different approach therefore was required.

As a result during the latter part of 2015, eleven respected practitioners from around the globe were invited to participate in a series of interviews which typically lasted approximately an hour. The interviews were broad in nature but ultimately structured around the 6 topics listed below:

- **Origination of work:** where was work sourced from, who were the influencers in the appointment of CROs, was there any legal regulation driving the market, and were there any barriers to entry to professionals providing CRO services?
- **Skills required by a CRO:** what were the typical qualities required to be successful as a CRO, were there any skills which were a hindrance to providing the services, did participants think that there would be a need to have different skills to be successful in the future.
- **Pre-appointment:** what processes were undertaken prior to and during acceptance of a role, typically how long did it take to finalise the engagement process, what is the general perception of the role.
- **Delivery of the role:** is there a need to be an executive to successfully deliver the role and implement change or can it be achieved as an advisor, does regulation support delivery of the scope of work and how is a CRO remunerated (success fees, day rates or other mechanics).
- **Completion of the role:** how does the role conclude, is it easy to define when the 'job is done', what is the perception of the extent of the responsibility of the CRO, is it a fair perception and does it match the perception at the start of an assignment.
- **Future:** what is the market sentiment on the future of the CRO role, is the role needed and valuable, is there likely to be more roles and is the scope of the role likely to stay the same or change.

* The views expressed in this article are the views of the author and not of INSOL International, London.

The participants were drawn from the European, US and Asian markets, although many have dealt with global enterprises. Perhaps unsurprisingly, a significant proportion of the observations cite local culture as influential in most aspects of such roles.

This short paper considers these interviews and seeks to identify common threads but also highlight differences across the geographies in respect of each of the topic areas.

The role and title of CRO – some observations

One consistent theme from the discussions related to the CRO title and role, suggests it could take on many different guises and forms. The very fact that the role tended to be defined by the specifics of the situation was a consistent observation. Another related to the number of areas of responsibility (and the extent of these) which brings its own challenges which means that CROs need to be particularly flexible in approach. There was a fair amount of debate in the interviews about whether the CRO ought to be a purely financial role (which most likely would lead to a restructuring of the balance sheet) or whether there was also a need to be operationally focused as well (which would address performance and profitability).

The general consensus was that the CRO had to have a primary financial focus. It was likely however, that as part of the role whether through other advisors, the team of the client, or themselves, there would be a need to have some involvement in operational improvement. For the long term success it was simply not enough for the corporate to improve the balance sheet or simply generate profit for a CRO to be successful in providing a stable platform from which a corporate could grow, it was important that both operational as well as financial areas are dealt with.

Another issue was whether the title was always effective or whether, as in some cases, the title was seen as suggesting that a company was suffering a significant degree of distress and therefore it may be seen as an indication of weakness in the corporate; which could potentially lead to a loss of value.

Interestingly whilst the CRO role is utilised in Asia, the title rarely is. The reason for this is that the perception that such a role indicated financial distress in a corporate, along with the stigma that the management was required to hand over (or appearing to -) control of the corporate to a third party were considered the major reasons as to why the use of title was not common in the region.

Some of the US practitioners reported that there were situations where the appointment of a CRO was categorised as a covenant breach and a default under financing documents.

The conclusion that can be drawn from this is that a CRO is a role with global application and one which is needed and valued in certain corporate stressed situations. It is however, not a prescribed function and needs to be shaped to fit the specific circumstances.

Origination of work

The key question on this topic was 'where does the work for CRO's come from? A universal response was that work for financial restructuring roles (i.e. where it is just the balance sheet which needs attention) rarely comes from the company itself. It is much more likely that it would be key creditors or their advisors who would identify that the company would benefit from having a restructuring professional in a senior role. This notably differs from operational restructuring roles (where the business needs to be turned around and profitability restored or improved), where typically the company itself would seek professional support in order to achieve the necessary changes. A consistent theme that was seen was that whilst the role may start out with either an operational or financial focus it would quickly become clear that the company needed to look at both areas to varying degrees.

Unsurprisingly creditors and lenders in their widest sense feature heavily in the origination of work globally. Often however it is important that there is also an advocate or supporting referral / recommendation from the legal and / or finance professions.

Interestingly in the UK it was observed that for certain situations, in which a failure of the corporate would result in a significant impact on the public, such as the healthcare sector, the regulator of that sector and other finance providers would have foreseen the potential of future difficulties in the sector (possibly due to concerns about the level of debt taken on by some businesses). In such cases the finance / regulatory documents require that the company in financial difficulty should appoint a CRO in

through the pitch' through to many months of research prior to meeting the company and winning the role. There were also differing views on whether pitching was really necessary, and it was seen more of the norm in the US and the UK and less common or relevant elsewhere.

When thinking about whether or not to accept a role the discussion centred on three main areas.

1. *The identity of the “real” client*

There was agreement that the company that was the contracting party, often may not be the entity with the most influence on the project. For example the key stakeholder may be the shareholders or potentially a creditor and whilst the obligations and duties of the CRO would clearly be to the company it would also be critically important to understand, prior to accepting the appointment, the positions of all of the key stakeholders.

2. *How the practitioner felt (at this initial stage) that the assignment would be successful?*

This centred round the difficulty of setting clear achievable goals early in the process, which could be agreed by all stakeholders. It was readily accepted that the goals were likely to change during the course of the assignment. Having however, the first set of objectives clearly defined was imperative to the success of the assignment and therefore a key element to the decision making process of whether to accept an assignment.

It was felt that often the exercise of setting the goals would lead to an extensive debate between stakeholders which would highlight early on possible areas of disagreement or non-alignment, which might hamper the CRO's efforts to design and deliver a solution. A good knowledge of these issues was important to any potential CRO as if the expectations between stakeholders differed too significantly, then the role of the CRO would, by definition, be more difficult to achieve or potentially impossible to achieve.

3. *Level of protection provided by the engagement letter*

This topic brought a wide range of opinions. The UK and US practitioners placed significant value on the robustness of the engagement letter and specifically the clarity of scope in defining the, agreed terms and an indemnity. However one Asian practitioner went as far as stating “there is no point in negotiating indemnities or even worrying about directors and officers insurance as it can't be relied upon”. It was felt that even negotiating an engagement letter could be a hindrance to commencing a role in Asia as it could be considered counter-cultural in a hierarchical society. Some of the larger practices that required this sort of protection may not be as successful in the region as smaller more flexible operators.

Delivery of the role

The general view was that it was easier to deliver the role as an executive than as an advisor. However it was felt that to be an executive in the Asian market, due to the culture and also legal position of directors was extremely challenging. For example, the legal governance structure for Chinese companies requires that one person, the ‘legal representative’, is responsible for all actions of the company. These responsibilities are very extensive and non-compliance can result in penalties up to and including execution in some cases (e.g. the baby milk scandal). Culturally it is the person who is the legal representative who then makes all the decisions. Whilst other management team members hold titles such as CEO, CFO, their impact is limited to the actions which the legal representative supports.

The level of responsibility typically placed upon board members in Asia is partially mirrored in certain European jurisdictions where it was felt that a CRO needed to be an executive to demonstrate to the existing board and management the understanding of their position.

The need to understand the local rules and cultural differences was considered by all participants to be a barrier to CROs working outside of their home jurisdictions. The consensus was that cultural awareness was more important than a good understanding of the specific sector in which the client operated.

It was also accepted that during the course of an assignment, roles often change from advisor (which tends to be more palatable to existing management at the beginning) to being an executive but in

making this transition a practitioner may be taking on more risk than first envisaged. It was important therefore to continually consider whether the role had implicitly changed and consequently whether the engagement terms needed to be formally updated to reflect the current risks and responsibilities being borne by the CRO.

Most roles were remunerated on day rates with a few exceptions working on success fees. Although success fees were generally thought to be a good idea, most participants did not necessarily think that they always drove the right behaviours and were often too difficult to police and monitor.

Many of the roles commence through necessity, and without a clear exit strategy agreed upon therefore require the CRO to remain flexible and open minded during their tenure.

Completion of the role

This area was, bizarrely, the one with the most diverse views. Although the heading may appear to be clear, from the discussions held, the definition of exactly when the role had completed varied significantly.

There were some practitioners who were clear that the role finished upon a transaction being completed and 'you should never go back again even if you have made friends' and there were others who spoke about never actually being able to leave and effectively becoming a crutch for the company for too long.

What was agreed across the jurisdictions was that almost always the perception of what the CRO is able to do and is responsible for was much more extensive than that which in reality could be achieved or delivered.

Sometimes this was because the role was never fully defined at the beginning or simply evolved during the course of the assignment. What was clear was that maintaining frequent and open communications with all stakeholders was critical so as to ensure there was limited risk of the perception of under delivery by the CRO.

Also sometimes adopting the pragmatic approach of 'you can't please all of the people all the time' may become necessary.

The risk for CROs and the restructuring industry is potentially one of perception and this is an area where the profession could do better at supporting practitioners. Perhaps it is an area where having some best practice guidelines as a framework would help educate stakeholders about what is realistic.

Future

The US felt that the CRO role was at risk of becoming a commoditised product for the less complex and more modest sized mid-market space but remained very relevant and a highly skilled and necessary role for the complex global corporations and quasi-government situations.

The UK practitioners saw the volume of major roles as maturing but perhaps resulting in some spreading of the underlying skills into the upper midmarket.

France's practitioners thought that the speed of change for them was glacial; not least because the volume of restructurings which are actually delivered successfully in France is very low (less than 4% of all companies) they would need a legislative overhaul to become more effective and currently it (rather like the reform of the Chapter 11 legislation in the US) is not a political priority now.

The German practitioners thought that with the increase of US funds and global money they would see more CRO appointments in particular given the German ability to cram down public bonds.

The Asian practitioners were expecting an increase but did not envisage a flood due to the cultural challenges of those markets.

Conclusions

The CRO role was seen as a useful tool across the countries that participated in the discussions however the local cultural challenges were a common theme in all of the interviews. Assignment set

up and the initial scope and fee arrangements were key to the success of each role and often required significant investment of time and effort.

Whilst the use of the role was growing, in particular in Asia, it was not perceived as a role which would be overly common and that the number of practitioners operating in this sphere worldwide would probably remain in the low hundreds rather than expanding significantly.

There was a desire to increase the understanding and benefits of the role outside of specific client situations and an acknowledgement that public communication about the role could and should be, improved.



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