GRR Global Restructuring Review

Heads-Up: Stephen Lerner at Squire Patton Boggs in Cincinnati

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Stephen Lerner (Credit: Squire Patton Boggs)

Stephen Lerner, global chair of Squire Patton Boggs' restructuring group, tells GRR it will be a "big day" when the Second Circuit hands down its decision in Purdue Pharma on whether third party releases are permitted or not – an issue, he says, many lawyers thought was "dead and buried at this point".

Lerner also discusses how the perception of bankruptcy lawyers and bankruptcy practice has changed in the US since the late 1970s – "we are doctors not undertakers" – and explains why restructuring is extremely rewarding and challenging because you can be a deal lawyer and a litigator at the same time.

There used to be "a lot less financial engineering that was required to help clients manage through distress, fewer moving parts," Lerner says. "Back in the old days, lenders simply wanted to be repaid their principal and make a return with their interest rate and some other fees. Now, it's not all about repaying the debt, but about using the debt in a "loan to own" strategy to acquire companies or achieve other goals."

Lerner started his career at Weil Gotshal & Manges' New York office in 1985. Five years later he joined Taft Stettinius & Hollister in Cincinnati, where he made partner in 1994, before opening the Squire Patton Boggs Cincinnati office in 1999.

Can you tell me a little bit about your career to date? How did you end up in restructuring?

I started my career at Weil Gotshal & Manges in New York in the 1980s and I never intended to be a restructuring lawyer. In fact, when my father, who was also a lawyer, first learned that I was going to do bankruptcy work, he wanted to disown me because back in the day bankruptcy lawyers were not viewed very positively. That was because most of the bankruptcy cases until the 1980s, where Weil Gotshal pioneered "mega cases," were mom and pop businesses and the work was not glamorous.

I learned rather quickly that restructurings are very complicated and interesting engagements, and I was fortunate to train under **Harvey Miller**, who is the godfather of modern restructuring law and started the Weil Gotshal team in the 1970s. We had a new bankruptcy code in 1978, which began the era that we still are in now with mega cases.

I was fortunate to work on cases like Texaco, Eastern Airlines, Drexel Burnham and others of the first mega cases. But what I found interesting and why I wanted to be a restructuring and bankruptcy lawyer was because every single day I can be a deal lawyer and a litigator, which I think is unique, and every day is different. We're across every industry and we work with

colleagues in virtually every other practice group.

We are doctors not undertakers. Our goal is to try to help resuscitate companies that are in distress, or to work with our creditor or other stakeholder clients to maximise their outcomes. There is a lot of problem solving and complex challenges that I find interesting and worthwhile.

How has the restructuring field changed since you started out?

I would say that a lot has changed. One change from when I first started is that capital structures were a lot less complicated. In many cases, you had a single commercial bank as a lender, not a fund, a distressed debt fund, a hedge fund or alternative lender, but a commercial bank that was down the street from the company. You may have had a few banks in the bank group, but not a large consortium and you didn't have mezzanine debt, second lien debt, third lien debt, etc. Overall, you had a very simple capital structure. There was a lot less financial engineering that was required to help clients manage through distress, fewer moving parts. When there was litigation, it was generally debtor versus creditor litigation.

Roll forward now 30 plus years and commercial bank lenders are, relatively speaking, few and far between by the time we get to a distressed situation. When companies are healthy, they're able to bank with a traditional lender, but once there's distress, there's a huge amount of trading. The whole notion of debt trading is something that didn't exist when I started. Now we see debt changing hands daily.

There is an enormous increase in the lender community and the different flavours of lender that are involved in restructuring – we have behemoth hedge funds, small hedge funds, distressed debt funds, family office investors etc. We have a much larger array of capital providers, many of whom have very different agendas.

Back in the old days, lenders simply wanted to be repaid their principal and make a return with their interest rate and some other fees. Now, it's not necessarily about repaying the debt, but about using the debt to acquire companies or achieve other goals.

We also see that a substantial portion of the litigation that arises in a restructuring context is not debtor versus creditor, but creditor versus creditor. An enormous amount of litigation between first and second lien lenders. We have crossover holders, which is not new, but certainly didn't exist when I was starting out my career.

You also have investors in a variety of places in the capital structure that have different strategies for either maximising their recoveries and returns or employing a loan to own or similar strategy. People end up on the secondary market acquiring debt at all the different levels within the company secured, unsecured, first and second lien – the variety of types of debt that is in the capital structure. With these more complicated capital structures, the financial engineering is way more complicated.

Another change that I think came about in the last significant financial crisis of 2008 to 2009, which we saw for the first time and maybe only time in my career, was where lenders and funds themselves were distressed. We had not only distress among borrowers and users of capital, but in providers of capital. What that meant was that there was paralysis. Where lenders and other investors who previously were very comfortable providing debtor-in-possession financing, to allow a company the liquidity it needs to go through a formal restructuring, suddenly refused or were unable to provide additional financial support.

Prior to the financial crisis, there were many more freefall bankruptcies, where the exit strategy was not baked yet. These were companies who had some significant reason for contemplating bankruptcy – loss of liquidity, adverse judgement, or loss of a huge customer. They would file and we'd figure out after the filing how best to restructure.

But suddenly, those with the money, who were in many ways the most important player in this scenario, were no longer willing to provide financing to give some rope to their borrowers and customers to restructure – that changed the game. We are still in this era, where in most Chapter 11 filings we see the exit already determined. The whole notion of restructuring support agreements, plan support agreements, agreements among the parties in advance of a Chapter 11 filing and using the Chapter 11 filing simply to implement a deal that's already been cut. That's the way most of our restructurings are done because you no longer had the investors in distressed companies willing to roll the dice, have a freefall bankruptcy and figure it out later.

The other thing that's changed dramatically is the increase in cross-border restructurings. I'm relatively certain early in the careers of my peers that have been doing this as long as I have, didn't have much international work several decades ago. There may have been some international element to our daily regimes but now it's an everyday occurrence. Most larger enterprises have some element of multi-jurisdictional issues, whether it's a large conglomerate with companies that are organised under the laws of different jurisdictions, or there are customers and investors across the globe. That forms a large part of the more complex restructuring playing field and will continue to do so.

I personally find the cross-border world to be among the most interesting things that we do. In the last seven-eight years I've had opportunities to restructure companies in the United Arab Emirates and India, in Japan and China, throughout much of Europe, certainly the UK, in South America – and those present interesting challenges. Our firm is uniquely suited to handling

those cases, because of our large global footprint. We have capabilities in almost 20 countries where we offer restructuring services.

What kind of kind of work is keeping you busy at Squire Patton Boggs at the moment?

The major engagements I'm working on are at the moment not public. In the last year or so, restructuring work was dramatically down largely because of the vast amount of stimulus dollars that governments around the world have put into their economies in order to deal with the covid-19 pandemic.

We are all anticipating a major increase in restructuring and cross border restructuring work as we get through the fourth quarter and into next year and the tea leaves suggest that there will be an increase in work. But in part because of the state of the economy and the stimulus dollars, a lot of the work I have been doing is out-of-court recently.

I've been working with a large Hong Kong based private equity fund, who is a majority owner in a global manufacturing business. We had very significant corporate governance issues, which come into play a lot, and I would say I have honed a real specialty in corporate governance issues, disputes and litigation. We have been working with this company, who's the majority investor in the manufacturing company to change management and manage through the governance issues. We successfully reached a sale that will provide significant recoveries.

I am also representing a significant top-10 Japanese company that is both a minority investor as well as a supplier of product to another global manufacturing business, which is experiencing significant distress. This one is more at the outset of it, but again, we have significant governance issues. Our client is the minority owner and it is not getting along with the majority owner, who is also the CEO of the business.

One of the more recent examples of what I've been doing that is both sort of big, complicated and related to corporate governance, but not cross border is **Purdue Pharma**. I was named the examiner in that in that case last year. It was a limited assignment but extremely interesting. Late in the case, there were allegations made regarding a concern that perhaps the Sackler family, who owns Purdue Pharma, had interfered with the independence of the independent directors that were managing the company and the court ordered the appointment of an examiner. I was named by the US Trustee to serve in that capacity and issued my report later last year, finding there was no interference by the Sackler family.

Did you experience a decreased workload because of the covid pandemic?

For 2020 through almost the first half of 2021, we were drinking out of a firehose in the early part of the pandemic, before stimulus dollars were injected into the global economy and even after that, because there's always a lag in the effect that stimulus money has – it doesn't immediately cure problems.

Similarly, when you go into a recession, it's not like potentially distressed companies are immediately going to dive into a restructuring. It's true our world slowed down significantly mid-2021. But we were already extraordinarily busy in 2018 and 2019. I've never pulled more all-nighters than I did in 2020. It was incredibly, incredibly busy at the outset.

With the expected increase in work, is Squire Patton Boggs actively looking to bolster its capabilities?

We're always looking to take on top talent. My experience has been that the best lawyers are good at generating work, even when times are slow. We are always looking to improve our team and to expand the team and recently added top talent in London, Paris and New York.

I am very interested in growing our Asia Pacific presence, so we are actively looking there. We did bring on two associates in New York recently, because we wanted to bulk up the US team. We our US lawyers as a as a national team. A lot of firms in our space have their lawyers principally in New York, Chicago or in LA. We have cross-country coverage – east coast, west coast, Midwest, southeast and southwest – and we view ourselves as a national team. Which in many ways, makes us very well rounded and able to cover lots of geographies.

The US dollar has been in a very strong position recently as compared to the British pound and the Euro. Has this state of affairs had an impact on your restructuring work – whether creating new work or affecting existing deals?

We have seen an uptick in work in the UK already. I can't tell you personally whether its because of the strength of the dollar versus the pound, but we saw the pound hit its historic low against the dollar, which is not good for businesses in the UK. Stating the obvious, it's a factor that will make it more likely that there is distress.

Another big factor is the ongoing war in Ukraine and rising energy prices, as we're about to get into winter. Energy prices are likely going to increase, and we saw NATO determine that the Nord Stream pipeline was sabotaged. Our view is, and this led to our desire to accelerate hiring in **London** and in **Paris**, that this confluence of events, to which we add inflation and supply chain

disruptions, all means that we're going to see an uptick in work and a greater level of distress. We are definitely seeing the hurt that these factors have caused and expect it to continue for some time.

What challenges are US restructuring practices likely to face in the near – and distant – future?

I think the challenges are for our clients not so much for us. We are well equipped as a US team to handle anything and everything that comes at us. We are in some senses lean and mean. There are firms that traditionally bulk up and then reduce as we see ebbs and flows. We have chosen to bulk up, because we found an extremely qualified team of lawyers in London led by **Charlotte Møller** and **Monika Lorenzo-Perez**, and **Arnaud Moussatoff** in Paris (who joined from Brown Rudnick in September). I don't think we are going to face challenges because enough of us have worked across enough industries that there really isn't an industry where we don't have experience. We understand oil and gas, coal and mining, retail, real estate. We also developed expertise in crypto – the new industry de jure to suffer – and we have significant crypto capabilities.

In recent years, we have seen an increased number of major bankruptcy filings in Texas. Why is that, do you think?

The move to file more complex cases in Texas predated covid. It's a combination of things, and it's not just Texas but the Southern District of Texas. They developed industry leading complex case rules that enable parties to fully understand how cases would be managed. In the Southern District of Texas, they also assigned two judges to handle all the complex cases.

One of the jobs of restructuring professionals, if you're representing debtors, is to identify the most beneficial jurisdictions to your client and to the restructuring issues that your client is going to face. Knowing with certainty that if you filed in Houston you would have one of two judges created a lot more certainty. In practice, you also saw the Texas courts managed through complex cases effectively. Not everybody's happy with the outcomes in these cases, but I think you found a lot of the professionals involved feel as though Texas was providing a very fair shake and a good process.

What are your thoughts on companies using the bankruptcy process to deal with mass torts filed against them, especially applying divisive mergers such as Johnson & Johnson did with the Texas two-step?

Divisive mergers have existed for some time. They are only recently being used in the context of restructurings to kind of create what we'll loosely call Goodco and Badco. But they are not limited to Texas law – other states permit divisive mergers, including Delaware, although I'm not aware of a Delaware company that has yet sought to employ the so-called Texas two-step in a Chapter 11 case.

Just generically speaking, I don't think there's anything wrong with utilising applicable state law as an approach to addressing the issues that you've got. There is a lot of confusion about what the Texas two-step means. The major concern is over whether engaging in a divisive merger results in a fraudulent transfer, where you've got Badco creditors, who are impaired and prejudiced by the divisive merger.

But to my understanding, the divisive merger statutes don't permit a fraudulent transfer. If there is a fraudulent transfer associated with a divisive merger, then you're going to have issues with your Texas two-step transaction. We have a long way to go before we see how it shakes out.

One of the hallmarks of our practice is enormous creativity and looking for ways to solve problems. The Texas two-step may, in fact, be successfully employed and we'll have to see how courts ultimately determine the outcome. But my view is it's going to be based more on the facts, which are going to be different in every single case, than on the law.

We work with the tools that were given. But sometimes we don't even realise until someone figures out that there are tools. This is not a new tool, it's been there, but it just was never used to fix this problem.

Outside the mass torts arena, are there any particularly interesting court decisions expected from US bankruptcy or appeals courts at the moment? What should we be looking out for?

The one I'm most interested in is the Second Circuit **decision** in Purdue Pharma on third-party releases. The key issue here is whether the Second Circuit will recognise them at all. A lot of bankruptcy lawyers in the US had accepted that third party releases are permitted, under the right, limited circumstances, in accordance with a number of decisions in the different circuits that have been issued. I personally thought that the issue of whether they're permitted or not permitted, and under what circumstances, should have been dead and buried at this point.

The district court in Purdue found that the Bankruptcy Code doesn't permit them black and white, end of story. There's a lot of disagreement within our community on this. If you are a lawyer who represents debtors, you likely view third party releases as critical to being able to reorganise companies in Chapter 11. But if you are a creditor lawyer, who isn't in support of the outcome that a debtor is seeking to obtain court approval for in a plan, you look at attacking third party releases as providing negotiating leverage.

This is an enormous issue. It's one that dramatically can change the playing field in restructuring negotiations. Of all the cases that are pending, this is the one that I think will have the most impact because the Second Circuit is extremely important, as it governs New York.

When you talk about cases being filed in different venues, if the Second Circuit determines that third party releases are impermissible under any circumstances, I will predict that you will see fewer cases filed in New York, in favour of other jurisdictions where either it's an open question or it's resolved that they're permitted, with appropriate limitations. Not sure when we'll find out, but it'll be a big day when that decision comes down.

What are your thoughts on the recent spate of cryptocurrency related bankruptcies? Is crypto here to stay and what can we learn from them?

In some sense, I'm surprised it hasn't happened sooner. But we have seen the floor come out from under people in the crypto world. This is an example of a financial instrument in which the law is way behind compared to the market and regulation. What you're seeing is a scramble for the stakeholders in the crypto cases, trying to figure out how best to protect their interests with a legal system that doesn't have all the answers yet.

We are seeing tremendous fights here across different creditor classes; a lot of people who believed when they got involved with a crypto platform that's now in Chapter 11, be it **Voyager**, **Celsius** or **others**, that they actually owned the cryptocurrency and that it was not property of the estate. I think a lot of people woke up to a surprise that the fine print in the agreements they signed often do not provide they are the owner of the crypto, but rather, they're simply an unsecured creditor, which has caused a lot of people to not only lose a lot of money, but to lose faith in the currency and in the system.

We are in the early stages of the crypto winter and it will be interesting to see how things develop and whether or not there will be any changes to the regulatory environment. In the meantime, that will impact how these restructurings play out.

Which emerging jurisdictions do you see value in, in the coming years?

From our firm's perspective, we see opportunity in Asia Pacific, some of which is emerging and some of which is not. It's just not been an area where we have added significant resources to our team yet. We have an excellent team in Australia and in a number of jurisdictions, but I think that's an area of significant focus for us.

I also see the Middle East and the Gulf Cooperation Council countries as providing opportunities. We do have meaningful capabilities in Dubai, Abu Dhabi and Riyadh and I'd like to expand on those. Those are the two emerging markets for our team to look to the future.

What do you do to wind down outside of the office?

Usually a workout, although I tend to be working out early in the morning these days. I wind down before I wind up. I'm having a good time burning calories on my Peloton, which was a Covid purchase. I would also say that oftentimes I take long walks to clear my head.

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