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The Americanisation of European LMEs Part 3 — What happens next? (9fin)

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Whatever your feelings on LMEs, there is no denying they are here to stay. In the UK, following the recent ruling in Petrofac and that in Waldorf Production, we are likely to see more companies veer away from formal restructuring plans given the new level of uncertainty. Such a change is likely to lead to a rise in consensual out-of-court restructurings, including LMEs.

As Duane Loft, partner at **Pallas Partners**, observes, such a movement seemed inevitable anyway "given the presence of US sponsors and US advisors in the European capital markets".

This is the third and final part of our series on the Americanisation of European LMEs. Part 1 looked at the origins of LMEs in Europe and part 2 took a deep dive into some of the European cases to have tapped into the more aggressive style transactions. This last instalment looks to the future of LMEs and considers where the market goes from here.

Fair judgment

As set out in Part 1, the pattern of movement in the US — at least in the first half of 2025 — is towards more pro rata, inclusive transactions that are more akin to amend and extends than anything else. Such structures are, as one *9fin* source suggests, slightly more innovative than a simple A&E, but the sole purpose still appears to be an extension of the company's runway.

Everything about European LMEs to date suggests they follow the pace set in the US, so the simple assumption is European deals will eventually align with this approach. That would make the current spike in aggressive transactions only a temporary phase.

"It's almost like [European] sponsors and their advisors were asleep during [the US trend] and have gone back to the much harsher forms of less inclusive LMEs," says Loft, adding that he "expects that trend to take hold in Europe" with the "European market [evolving] to more inclusive deals".

This is not what we have been seeing in the out-of-court restructurings in Europe, as discussed in Part 2, but is in line with what we are seeing in court, especially in the UK. In both Petrofac and Waldorf, the court refused to sanction the plan on the grounds of fairness. In both cases, the plan company failed to treat the out-of-the-money creditors fairly when considering the application of the restructuring surplus (i.e. the benefits of the restructuring).

These judgments will no doubt influence the restructuring sphere as a whole in the UK, even out-of-court processes. For one thing, in instances where a restructuring includes a combination of court and consensual features (see for example Ardagh's latest restructuring) the company must take into account the court's appetite for fairness.

On the other hand, the court's disposition could help dissenting creditors to challenge non-pro rata LMEs. Current judicial sentiment is against non-pro rata dealing, so excluded creditors may be able to challenge such transactions, or even use the threat of a challenge, knowing that, should it go to court, judges are likely to be sympathetic to their claims.

Of course, for such an angle to work, there must be grounds of complaint — something that, as discussed in Part 2, is not always readily available.

Continuing with the judicial angle, it is easy to grumble about the lack of judicial guidance from the European courts on LMEs but this ambiguity could in fact be key in keeping non-pro rata transactions at bay.

If the financial markets have emphasised anything over the last few years, it's that investors don't like uncertainty. The LME landscape is no different. As long as it lasts, uncertainty around how European courts might treat particularly violent LMEs may deter investors and sponsors alike from using such forums. Why risk it, when there is a chance that the transaction may be all-but unwound following lengthy and costly litigation?

Naturally, and as discussed below, this lack of clarity can also be argued in the alternative. Still, considering the fewer aggressive LMEs in Europe (though their number is increasing), the absence of judicial guidance probably serves as a big deterrent against such transactions. How long such ambiguity can last remains to be seen as the courts come under increasing pressure to provide guidance, with some European courts already providing rulings (the Dutch court has indicated its approval of up-tiers and the German court has recently sanctioned a double dip in Wirecard).

No authority

The latest wave of LME transactions (Altice France, Hunkemoller, Selecta and Victoria) has established a new precedent for European LMEs by introducing more aggressive transaction styles than previously seen. A compelling reason why these aggressive tactics may become the new norm is simply that sponsors face few disincentives to avoid them.

In the absence of any judgment saying otherwise, it appears sponsors have little to fear and can continue to exercise non-pro rata deals if such a transactions benefits them and their runway. Indeed, as a *9fin* source suggests, all sponsors and creditors are interested in creating value and it is irrelevant if such value is obtained from other creditors in the picture.

Litigation is live for two out of the four deals, but success on these fronts is far from assured. As discussed in Part 2, we consider it unlikely we will have a hard and fast ruling on Hunkemoller, expecting the parties to move towards a mutually beneficial settlement (although of course we would not be sad if this turns out to be incorrect and we are provided with some clarity from the court). On Selecta, **Deltroit Asset Management** has an uphill battle given the Dutch court has already approved the distressed disposal, which is the subject of its challenge.

As discussed above, the absence of clear judicial guidance from predominantly fairness-oriented courts could ultimately lead to more inclusive transactions. But the opposite is also true. As we are witnessing, companies appear to be testing the boundaries of what is possible. Without anything seemingly holding them back, there is nothing causing them to adopt a cautious approach.

Accordingly, until we receive a court ruling prohibiting such dealing we expect sponsors will keep taking advantage of this lawlessness.

Better blockers

As set out in Part 1, there are a number of tools creditors can use to prevent non-pro rata transactions — blockers and co-op agreements. We expect their use and influence to rise further in response to the expansion of LMEs.

As discussed previously, co-op agreements appear the better option out of the two as they can be used in the here and now. That said, the influence of blockers should not be overlooked. One of the complaints levied against the practical impact of blockers is they do not impact debt issued before the rise of LMEs.

LMEs are still quite new, but they are no longer *that* new. If debt subject to current restructuring was negotiated in the pre-LME era, or when the company was in a healthier position, and therefore doesn't contain adequate protections, that can only be the case for a short while more. Eventually, debt containing all the bells and whistles will form part of the next wave of restructuring. At that point, it is possible that sponsors will be prohibited from undertaking some transactions due to the protections contained in the documents.

It is also possible the blockers themselves will become more refined. The efficacy of LME blockers is questionable (see Part 1), but as the market becomes more attuned to the risks, we expect to see these sharpen.

Ultimately, it is hard to tell how much blockers will really help. The goalposts are constantly moving and the documents are, in reality, just playing catch up. Accordingly, blockers may get better but we don't think they, alone, will be enough to banish non-pro rata dealing in its entirety.

The sponsor's toolkit

There is no denying sponsors are also getting savvier on ways to use the traditional toolkit with — as Loft puts it — growing sophistication about the "the options in the debt documentation to pursue various forms of LMEs and then the litigation challenge that will follow".

As discussed above, the rise of LME blockers is not sufficient to prohibit the company from entering into non-pro rata deals.

Instead, sponsors can manipulate the various [baskets] at their disposal and use nebulous calculations to achieve their goals. Even when a LME blocker is present, such as a Serta blocker, it may prove ineffective if it still allows some debt to be incurred under one or more baskets.

The fact of the matter is that sponsors still hold the drafting power — the market remains competitive and the continued rise of private credit threatens to eat into the broadly syndicated market's fair share.

We tend to see less LMEs in the private credit market. The reason for this is multifaceted, but at its core the reasons private credit became popular in the first instance were similar to the reason LMEs are unlikely to take hold; namely that the documents are subject to a high degree of negotiation and are, on the whole, more bespoke than syndicated counterparts.

Relatedly, dialogue between the lenders and borrower is much more open in the private markets, allowing for waivers and adjustments throughout the life cycle of the debt. This means a lot of companies' liability management occurs behind the scenes, where all creditors come to the table to discuss options, thereby limiting the opportunity for creditor-on-creditor violence.

These are reasons why LMEs might not work in private lending, but they are also reasons sponsors may actually prefer to transact with such lenders. Given the healthy amount of competition, it is hardly a surprise the broadly syndicated markets still need to bend to the sponsors' will for a seat at the table.

Although sponsors have thus far been unable to get anti co-op provisions into the market, there are other tools they can use to prohibit communication between lenders. For example, in the US sponsors have been known to encourage creditors to sign NDAs preventing them from contacting other lenders. This was the approach Ardagh undertook and resulted in litigation issued by **Canyon** and **Arini** to allow communication between the SUNs and the SSNs, as *9fin* reported. But as the *9fin* source suggests, this is quite an outdated process and becoming harder to implement.

Even if a sponsor is able to implement an LME under the terms of its debt documents, usually we would expect there to be tripwires in the intercreditor agreement preventing further action. However, as the recent uptier in Victoria demonstrated, the ICA is no longer the hurdle it once was. Instead, sponsors are able to manipulate the payment waterfall through either amending the ICA itself or, more likely, entering into a subordination and turnover deed that sets out fresh payment obligations.

This manoeuvre gets around the high (often unanimous) voting thresholds required to amend the terms of the ICA, as was the case in Victoria. This is another example of the flexibility afforded to sponsors enabling them to manipulate waterfalls to implement non-pro rata transactions.

Directors' duties — not as threatening as first thought

Directors' duties are often lauded as one of the main prohibitors of particularly violent LMEs in Europe. But their effectiveness in deterring such transactions is questionable in most scenarios.

It is true that when a company is insolvent, or facing insolvency in some jurisdictions, directors must take into account the creditors' interests. But, in the absence of financial distress, directors have fairly limited obligations in this area.

In some circumstances, if the company later files for insolvency, courts can retrospectively examine and potentially challenge some transactions. The scope of these reviewable transactions varies by jurisdiction. The provisions may carry weight in specific scenarios, but in practical terms, multiple things must go wrong before a company's transactions are unwound.

For one thing the company has to become insolvent, something we imagine the participating creditors would be keen to avoid given the risk this might pose to their position. For another, there is no certainty an LME would be unwound — it depends on how these were structured at the time, the rationale behind the transaction and the appetite of any liquidator to bring a claim.

That is not to say the directors' duties do not carry any threat — certainly the rules in a number of jurisdictions (e.g. Germany) are strict enough to deter aggressive behaviour. Moreover, there may be specific restrictions outside of insolvency that prohibit directors from partaking in LMEs, but these can be hard to evidence in some cases and, again, may lead to nothing.

Where do we go from here

To a large extent, whether violent LMEs become part and parcel of European transactions hangs on the outcome of the Hunkemoller and Selecta litigation. They may set the tone for the future of LMEs in Europe.

We cannot predict the outcome of the litigation, but we can assess what these transactions will mean for the market. Regardless of how the court rules, the landscape has clearly shifted — non-pro rata LMEs will continue to be a feature. The controversial transactions we've examined throughout this series have likely permanently moved the goalposts, creating space for more aggressive terms.

Predicting whether this will become a trend remains difficult. The cultural norms around these types of LMEs are evolving, but this alone may not be enough to completely transform the zeitgeist. What is certain is that European LMEs have fundamentally changed. Whether or not non-pro rata transactions become the norm, the market has demonstrated its appetite for aggressive tactics and we expect to see more of them.

Pandora's box has been opened.