HEDGE FUNDS

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Illustration MILES COLE

In the global financial crisis, the hedge fund industry lost about a fifth of its value. Now distressed debt in Europe is seen as the route to renewed wealth, and two law firms look set to dominate, again

DAVID STEVENSON

GET DEBT *GO*

When the dotcom bubble burst at the start of the Noughties and the fantastic bull market of the previous decade shuddered to a halt, two little-known American firms in London cleaned up, big style. Cadwalader, Wickersham & Taft and Bingham McCutchen made hay a decade ago acting for bondholders on a wave of contentious restructurings that pitted American hedge funds against European senior debt holders. Ten years on, and some serious personnel changes later, they're doing the same again.

After Lehman Brothers sank in 2008 and the European sovereign debt crisis reared its ugly head, a period of unprecedented market uncertainty put hedge funds in the doldrums: an industry worth close to $2trn lost 20% of its value in short order. But hedge funds bounce back, and right now distressed debt funds – or vulture funds, as they hate to be known – are doing some serious bouncing.

In August Preqin, the funds data provider, revealed that hedge funds have amassed an unprecedented €60bn to invest in Europe, in anticipation of the sovereign debt crisis pushing banks into the biggest fire sale of distressed debt in history. A raft of US funds are heading to Europe with big money to spend buying devalued corporate and sovereign loans, and yet there are only two law firms receiving the majority of the calls.

'The creditor-side restructuring advisory space is a very small one, concentrated around a limited number of experienced practitioners. This creates significant barriers to entry for new law firms looking to enter the markets,' says Richard Nevins, senior partner of Cadwalader's London financial restructuring department. 'When I moved to London a decade ago, the only people that did bondholder work were Cadwalader and Bingham. Ten years on and little has changed. Bondholder representation is focused around three or four US firms, all of whom have significant experience in the market.'

One partner at another firm points out: 'If you didn't advise the fund on the last deal, it's highly unlikely you will advise them on the next one.'

That's why of the 24 mandates to advise bondholders on European debt deals that Debtwire has recorded since the start of 2010, Bingham has nabbed one in three; handling no fewer than eight deals. Cadwalader is firmly in second place, having done three, while Ashurst and Milbank, Tweed, Hadley & McCloy have handled two apiece. Vulture funds may be where the action is, but they're looking pretty sewn up.

LEGAL ADVISERS TO BONDHOLDERS ON EUROPEAN DEBT MANDATES, 2010 TO DATE

Firm	Total	H1 2012	2011	2010
Bingham McCutchen	8	2	2	4
Cadwalader, Wickersham & Taft	3		1	2
Ashurst	2		2	
Milbank, Tweed, Hadley & McCloy	2		1	1
Bonelli Erede Pappalardo	1		1	
Cleary Gottlieb Steen & Hamilton	1		1	
Freshfields Bruckhaus Deringer	1		1	
White & Case	1		1	
Orrick, Herrington & Sutcliffe	1		1	
Latham & Watkins	1		1	
SJ Berwin	1			1
Brown Rudnick	1			1
Kirkland & Ellis	1	1		
TOTAL	24	3	12	9

Source: Debtwire and Legal Business

GOING AFTER BONDS

Bingham's London managing partner James Roome points to his firm's work in a deal involving Marconi in 2002 as the real game-changer, with the head of Bingham's London finance group Barry Russell also heavily involved. The company was strong in telecoms and defence, but ran into major debt problems and was forced to sell off the defence arm. Bingham's London office was brought in by a group of hedge funds looking to prevent the banks getting preference as creditors in the messy restructuring: the funds were owed £2bn versus the £3.6bn owed to the banks.

'When the bondholders hired us, we only had 12 lawyers in the London office,' says Roome. 'A key feature – then and now – is that the banks are hugely resourced for leading and managing debt restructurings, while bondholder groups must rely on advisers.'

Even securing the bondholders a seat at the negotiating table was a challenge. 'In the end the hedge funds started buying debt from the banks and this more than anything drove agreement on the final debt structure. Our clients made a lot of money out of the deal,' says Roome. 'Unquestionably, the transaction helped our reputation in the field.'

'Hedge funds is a difficult practice to break into and there is a clear global elite of firms that do this work.'

Simon Thomas, Akin Gump

More recently, Bingham has been advising the private placement noteholders on the Thomson restructuring, which became the test case for the settlement of default swaps for the International Swaps and Derivatives Association.

Roome, along with fellow partners Stephen Peppiatt and New York-based Ron Silverman, also represented the committee of senior secured noteholders on WIND Hellas's €1.8bn restructuring via a pre-packaged administration sale. This work for noteholders in the restructuring of the Greek telecoms operator was one of only two mezzanine debt-for-equity swaps in recent years.

Other major mandates the firm has secured include acting for Strategic Value Master Fund against Ideal Standard International Acquisition, seeking declarations on the correct interpretation of the agreement. The firm also acted for Plexus Fund against ECM Real Estate Investments over a €75m bond issue dispute, taking a test case to the Luxembourg court, which ruled in favour of Plexus though the decision is currently under appeal.

THE BIGGEST BONDHOLDER MANDATES OF THE LAST 18 MONTHS

Firm	Defending company	Value (£m)	Date
Cadwalader, Wickersham & Taft; Cleary Gottlieb Steen & Hamilton; Bonelli Erede Pappalardo; Latham & Watkins	SEAT Pagine Gialle	2,950	7 September 2011
Ashurst	Materis France Construction	2,000	26 June 2012
Bingham McCutchen	Klöckner Pentaplast	1,500	18 November 2011
Bingham McCutchen; Kirkland & Ellis	Petroplus Holdings	1,350	27 January 2012
Bingham McCutchen	Sevan Marine	1,000	2 June 2011

Source: Debtwire

Roome is unable to name the funds he's working with at the moment, but does say they include 'the biggest and the best'.

DISTRESSED DEBT LEAGUE

Cadwalader secured its position in the distressed debt world under the leadership of one-time restructuring head Andrew Wilkinson, who joined the firm back in 1998 from Clifford Chance with a remit to pursue the high-yield bondholders. To say he was a success is to vastly underestimate the way he transformed the practice in Europe (even Roome was a one-time Wilkinson sidekick), but when he left in 2007 to join client Goldman Sachs it was questionable whether the firm could keep its standing. It may not still be the powerhouse it once was, but relationships count for a lot in the hedge funds business, and Nevins and others have kept the firm in the game.

However, Cadwalader might be back in the game in a big way. The firm has recently been bolstered by the arrival of Linklaters' financial restructuring and insolvency partner Yushan Ng in September. Ng was one of the partners who led the distressed debt investment practice at Linklaters and has been involved in some of the major European restructurings, including SEAT Pagine Gialle, Fitness First and Klöckner Pentaplast.

These days others hope to give the top two a run for their money, including Akin Gump Strauss Hauer & Feld, Schulte Roth & Zabel, Kirkland & Ellis and Weil, Gotshal & Manges. Simmons & Simmons and Dechert dominate work for hedge funds when it comes to fund formation and regulatory work.

Breaking into any type of work for funds is tough. Hedge funds didn't really become a feature of the UK financial landscape until the late '90s, and although there are statistics that say the average life of a hedge fund is only three or four years, those figures are skewed by the start-ups that never really get going. The top ten hedge funds have been around for a long time, and they know which lawyers they like.

Simon Thomas, a partner in the investment funds practice of Akin Gump, says there are real difficulties for new firms trying to get in on the hedge fund action. 'Because it's such a personal business and the relationships go very deep, it's a difficult practice to break into and there is a clear global elite of firms that do this work,' he says.

Richard Perry, head of the financial services group at Simmons, says it's worth putting in the effort. 'Hedge funds are great clients because they are expert in what they're doing and they know exactly what they want from their legal providers,' he says. 'We've established very long-term relationships. We have relationships with managers we established up to 15 years ago.'

The role of lawyers is even more important as hedge fund managers struggle with a swathe of new global compliance requirements. In a new world of regulation, their investors want recognisable names on the roster and are taking more of an interest in proper risk and operational controls.

Getting through the door is tough. Richard East, founding London partner at US litigation firm Quinn Emanuel Urquhart & Sullivan, says his firm has fashioned a successful niche in London by representing hedge funds in litigation against major banks. 'There is a very competitive market for hedge fund work as they are driven by the individual and personal relationships between lawyers and principles at hedge funds,' he says.

Most lawyers agree that, as clients, hedge funds are extremely intelligent and as the legal spend can come out of a fund manager's bottom line, want value for money. As major funds have in-house counsel this compounds the desire for value.

'The reality is that in-house legal counsel are very sophisticated, bright individuals who are careful with their legal spend, and they'll judge which counsel to employ or instruct based on whether they are technically able to deal with the job, and whether that legal counsel is one that adds value,' says Stuart Martin, an investment funds partner at Dechert.

But once a client is secured, they tend to be extremely loyal.

VULTURE FUNDS

Distressed debt funds have gained a pretty poor reputation as 'vultures' on the European restructuring circuit. 'There seems to be a stigma, especially in the popular press, surrounding these distressed debt investors,' says Nevins. 'Whereas all they're trying to do is return some sort of efficiency to the market and make money for their investors.'

The fact that hedge funds investing in distressed debt act in a counter-cyclical way to the economy is just the nature of the industry. But the problem in Europe today is that the banks aren't selling the distressed debt; that €60bn, which amounts to €100bn spending money when you add leverage, is struggling to find a home. There are often better opportunities in European bonds, especially secured bonds.

'People view distressed debt too narrowly, if funds are waiting for French or German banks to sell bank loans at a firesale price, they could wait forever,' says Nevins.

Adam Plainer, head of the London restructuring team at Weil Gotshal, has been frustrated by banks' unwillingness to unload their debt. 'We acted for a fund that wanted to buy a big pub chain and we couldn't get the price down. The bank was saying "we're too far apart so we'll hold on to it and take it under our wing",' he says.

US hedge funds have set up in London because the US government pumped trillions into its own economy, resulting in fewer insolvencies and fewer opportunities for distressed debt investors. 'The American market is as flat as a pancake,' explains Plainer. 'Any American hedge funds with real money to spend are looking to Europe as there are not many opportunities to use loan-to-own strategies in the US at present.'

Weil Gotshal is one of the firms trying to nab a piece of the action that Cadwalader and Bingham have historically dominated. ▶

'There will be a flood of work but we're not sure when it's going to be because at the moment there is a very flat economy,' says Plainer. The firm has already worked for venture capital firm Lion Capital in a £850m deal involving the Findus Group.

Plainer is well aware of the challenges facing firms advising distressed debt investors although he is confident that his firm is well placed. 'There's more competition for the same opportunities, now more than ever, but we know a lot of hedge funds and our existing hedge fund clients keep us busy,' he says.

Akin Gump also considers itself well placed to advise hedge funds as Thomas says funds are a core part of its business and his firm advises 50% of the top 20 hedge funds in Europe. It has five hedge fund partners based in London. But the firm distinguishes itself from those who focus on distressed debt hedge funds – rather it sees itself as a global hedge fund player with a more complete offering than Bingham, Cadwalader and Weil Gotshal. The firm aims to get its slice of the action by working for the funds across the piece, from start-up, through regulatory work, M&A, litigation and beyond.

'If you were talking to the core group of hedge funds, they would definitely be aware of those firm's practices – they're good firms. But when the client asks "are you a complete global hedge fund adviser?", I don't think they'd say "yes",' says Thomas.

NOT FOR EVERYONE

Clearly not everyone wants to pursue a hedge fund clientele, and particularly not the vulture funds, which are renowned for their contrary positions against major financial institutions. That presents conflict issues that many of the big firms just can't get comfortable with.

Richard Frase, a financial services partner at Dechert, says: 'If the hedge funds wanted to litigate against a bank, we would almost certainly have a conflict, because somewhere else in Dechert we would be acting for that bank and therefore we wouldn't be able to act.'

It's one of the reasons why the Magic Circle firms don't go out of their way to pursue large hedge fund client bases, coupled with the length of time it takes to develop the relationships with fund managers.

That's where Quinn Emanuel comes in, picking up the conflicts and focusing on advising funds suing the banks. East has no qualms about taking on anybody, and resolving the awkward situations that arise for firms who have litigious hedge funds in their client roster.

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Richard Frase, Dechert

'If hedge funds want to take aggressive positions that bring them into adversity with bigger financial institutions, then some firms won't want them as clients,' he says. 'This is where our firm gets a lot of its work.'

Some of the big-ticket litigation that East has worked on includes acting for hedge fund Strategic Value Partners (SVP) in its aggressive, litigation-driven bid to buy German plastics company Klöckner Pentaplast. SVP proposed a takeover that would repay €850m in senior debt and took control of Klöckner from The Blackstone Group.

Firms like Simmons may not go head-to-head with banking clients on behalf of funds, but the firm does get involved in litigation for their hedge fund clients where there is no conflict of interest. The firm was closely involved in the Lehman Brothers administration on behalf of a number of aggrieved funds, and has also acted for funds affected by the collapse of MF Global, which left funds such as Appaloosa Management a billion dollars short. 'We've been acting for hedge funds establishing their rights in the administration of the estate, if they had been contracted to receive supply-of-money protection but the relevant money wasn't put into the client's account,' says Simmons' Perry.

Litigation for hedge funds is creating big business, with Bingham actively pursuing it through the hire of heavyweight financial services litigator Mark Dawkins from Simmons last year. It is overly simplistic to say that all hedge funds use litigation as an alternative revenue stream, but most aren't afraid to take on adversaries. East says there is a hedge fund for every type of investment strategy and each fund has its own litigation strategy as well. 'There are hedge funds that actively look for situations that involve litigation but equally there are funds that don't necessarily want to get involved in litigation but nevertheless want to know what the alternative to a consensual restructuring is when a company doesn't play ball,' he says.

One area that is getting litigators in a frenzy currently is the expected litigation coming out of the Libor scandal. Marcus Rutherford, a partner at litigation specialist Enyo Law, says he doesn't usually advise hedge funds but the Libor issue has changed the landscape. 'I've been looking at a hedge fund with potential claims against a major financial institution. That's a transaction they were directly involved in so we're looking at the documents now,' he says.

Hedge funds that use litigation as a revenue stream have some interesting methods of pursuing claims. Funds will buy claims from investors at a heavily discounted price and then pursue the banks. Rutherford says: 'Typically an investor might have claims of many hundreds of millions of dollars against a bank but doesn't want to fund litigation, so instead would be willing to unload it to a hedge fund for a small percentage of the nominal claim. The potential upside for the fund is considerable, and we were seeing funds looking to buy up to half a billion dollars' worth of claims for something in the region of five million dollars.'

No wonder litigators are starting to take notice. After a lull, the hedge fund industry is back in full swing, going after distressed European debt and banks. Expect plenty of UK litigation because the documentation is London-based, so there's a payday to be had.

Cracking into the tight gang of hedge fund advisers is no mean feat and not without risk. But in such an uncertain financial services landscape, hedge funds might just seem like as safe a bet as any for some firms. **LB**

david.stevenson@legalease.co.uk