

KEY POINTS

- Roust Corporation successfully completed its \$1.1bn restructuring in February 2017.
- The Roust restructuring is especially noteworthy for the contribution of significant new value in kind, through the merger of a distinct business entity owned by Roust's controlling shareholder, into the reorganised Roust Corporation.
- In the right circumstances, pre-packaged Chapter 11 plans provide an efficient process by which primarily foreign entities can restructure their debt in the United States with minimal disruption to their business operations.

Feature

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Pre-packing European debt in American courts: the Roust Corporation restructuring

This article examines the successful \$1.1bn reorganisation of Roust Corporation in the United States Bankruptcy Court for the Southern District of New York.

RUSSIA IN CRISIS

Roust Corporation, along with its immediate subsidiaries and affiliates, comprises not only one of the largest vodka producers in the world but also operates one of the largest integrated alcohol importation and distribution networks in Europe. With products exported to more than 80 countries, yearly revenue in the hundreds of millions and a plethora of highly successful premium brands, Roust is a goliath in the global spirit beverages industry with a reach that extends far beyond its primary operating bases in Russia and Poland.

Despite this range of successful products and expansive global distribution network, Roust Corporation has previously been forced to restructure. Faced with mounting debt and internal accounting issues in 2013, the predecessor of Roust Corporation effectuated a successful pre-packaged Chapter 11 in which nearly \$800m of Senior Secured Notes and Senior Convertible PIK Notes, both due 2018, were issued in settlement of existing claims. In addition to these notes, the restructuring process involved Roustam Tariko (the entrepreneur who controls the Russian Standard Group, of which Roust Corporation is a part), investing significant cash into the business and forgiving material debts.

Roust Corporation emerged from its 2013 restructuring primed for success. Despite its international scope, however, Roust remained significantly reliant on the Russian domestic market. When Russia, incidentally the world's largest vodka consumer, entered a sustained economic crisis in 2014, Roust Corporation suffered. Currency volatility, dramatic runaway inflation, unprecedented depreciation

of local currencies (which made imported spirits significantly more expensive for local consumers) and a ban on Russian products entering Ukraine dramatically reduced Roust earnings and made repaying debts, particularly US dollar denominated debt, burdensome.

Amid this perfect storm battering Roust, Russia legislated a higher excise tax on spirits. This ultimately led to an explosion in black market vodka production and a resultant erosion in market share for the mainstream legal producers. Faced with these inimitable macroeconomic pressures, Roust became overleveraged and hampered by liquidity constraints and high borrowing costs.

To address this crisis, in mid-2016, Roust management launched negotiations with the largest holders of its Senior Secured Notes and Senior Convertible Notes to negotiate a restructuring deal. With nearly \$800m of notes outstanding, the noteholders formed the primary stakeholders in the restructuring and their blessing of any eventual plan was essential to Roust's survival.

NEGOTIATING THE PLAN

Through the summer and autumn of 2016, Roust and its affiliates negotiated with the committees which had formed to represent the largest holders of Senior Secured Notes and the largest holders of Senior Convertible Notes. Differing interests emerged and had to be addressed not only between Roust, its controlling shareholder Mr Tariko and its noteholders but also between the two creditor committees.

These competing interests meant the negotiations were oftentimes fraught, as a fine balance had to be achieved that was

representative of all interests. Despite these challenges, Roust entered into a restructuring support agreement and term sheet in November 2016. Both groups of noteholders achieved high levels of support for the plan: 90% in principal amount of the Senior Secured Notes and nearly 67% in principal amount of the Senior Convertible Notes supported the proposition.

The Chapter 11 plan of reorganisation had two key components:

- (1) the contribution of significant new value to reorganised Roust, by means of the merger of the Russian Standard Vodka business; and
- (2) an infusion of cash, primarily by holders of the Senior Convertible Notes, which was made possible through a share placement offered to all outstanding noteholders.

NEW VALUE AND NEW MONEY

In exchange for 57% of the equity in the reorganised Roust, certain corporation affiliates controlled by Mr Tariko, contributed a strategic and highly valuable asset – Russian Standard Vodka, or RSV as it is better known, and all related intellectual property into reorganised Roust.

RSV, one of the most recognised vodka brands in the world and the largest domestic distiller and distributor of vodka in Russia, generates tens of millions of dollars a year in revenue and is expected to experience strong global growth as it expands into new markets.

Despite this significant value creation that would further its long term business growth, the RSV contribution alone could not resolve Roust's immediate liquidity crisis. With significant Russian excise tax payments due in early 2017, Roust needed cash. To resolve this need, the plan provided for an infusion of \$55m into reorganised Roust, to be completed through a share placement.

Feature

Biog box

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The share placement made an estimated 19% of the total equity of reorganised Roust available to all existing noteholders through a detailed and heavily negotiated waterfall priority scheme. As \$50m of the share placement was backstopped by certain members of the Senior Convertible Notes committee, these members were provided with priority in access to the new equity.

MINORITY PROTECTIONS

Upon confirmation of the restructuring, the noteholders became significant minority shareholders in the reorganised corporation. This minority participation resulted from:

- the right of all noteholders to participate in the share placement;
- the holders of the Senior Secured Notes receiving just over 12% of the equity in exchange for a portion of their existing bond claim; and
- the holders of the Senior Convertible Notes receiving nearly 12% of the equity in exchange for all of their existing bond claim.

As Mr Tariko, the incumbent sole shareholder, maintained majority control in return for the substantial strategic contribution of RSV, minority shareholder rights became a central theme in the restructuring. To protect their minority stake in Roust Corporation, the noteholders required robust protections to be built into the corporation's governing documents.

This entailed negotiating an entirely new governance system for the reorganised Roust Corporation. The minority shareholders required independent oversight, not least because of Roust's extensive operations in foreign jurisdictions with only minimal regulatory protections.

These protections focused on the right of the minority shareholders to appoint two of the five members of the board of directors, with one to be appointed by the holders of the Senior Secured Notes and the other to be appointed by the holders of the Senior Convertible Notes.

These minority directors were in turn granted significant powers to protect the rights of their respective shareholders, including the exclusive right to approve certain reserved matters. A unanimity requirement over the

reserved matters was designed to protect company liquidity by limiting the issuance of additional securities, preventing incurrence of certain debt, and supervising most affiliate transactions.

As the plan of reorganisation contemplates the completion of an initial public offering (IPO) or a sale of shares acquired in the share placement to occur by 30 June 2019, it was critical that the minority directors have the power to drive this process. Incidentally, the enhanced liquidity of holdings that will result from an IPO or sale of shares provided a further impetus for the minority shareholders to build robust minority protections in the Roust governance documents. The minority is interested in not only the preservation of Roust's value but also its enhancement. The minority directors thus have significant power to direct the process towards June 2019 and ensure optimal value maximisation.

Chapter 11

Noteholders voted overwhelmingly to support the plan. The final vote tabulation showed that 100% of those who voted, voted to accept the plan. Participation was also high with approximately 90% of Senior Secured Notes and 93% of Senior Convertible Notes voting.

Despite the positive end result, at first glance, it was not an intuitive decision for a Delaware holding company with 3,500 employees working across multiple operational facilities in Poland and Russia and with only a limited operational and executive connection to the United States to launch a Chapter 11 process in the Southern District of New York Bankruptcy Courts. However, this decision proved key to Roust's success and indeed survival as it not only maximised foreign creditor participation but also ensured that Roust subsidiaries in Poland, Russia, Ukraine and Hungary remained unaffected, and customers, suppliers, employees, trade creditors and third party lending banks would not be impacted by bankruptcy claims.

Most significantly, a key foreign creditor and member of the larger Russian Standard Group of companies agreed to exchange receivables owed to it by Roust and its subsidiaries for equity in reorganised Roust. However, the strong preference to hold equity

in a New York corporation meant Roust had to be reincorporated from Delaware. This was achieved during the restructuring process.

Chapter 11 not only served to enhance Roust's value by maximising the participation of certain foreign creditors affected by the restructuring, but it also permitted uninterrupted trading of integral operating subsidiaries in its key Eastern and Central European jurisdictions.

A pre-packaged Chapter 11 plan enabled speed, in this instance nearly an unprecedented seven days, between the filing of the bankruptcy petition and the confirmation of the plan. Concerns existed that local credit support providers in foreign jurisdictions, primarily Russia, Poland, Ukraine and Hungary, would view bankruptcy in a negative light and that these local credit support providers had the potential to act in a way that would damage the broader group. Minimising this unpredictability required Roust to complete its restructuring in a hyper-condensed timeline, which was only possible through a Chapter 11.

It must be noted that minimal disruption to the broader Roust business was essential in every aspect of the process as the restructuring coincided with the winter holidays – the busiest and most profitable period for the alcoholic beverages industry.

CONCLUDING REMARKS

As a result of the restructuring, Roust's capitalisation was strengthened by more than \$500m, its balance sheet deleveraged by at least \$462m and its equity was enhanced by \$55m. Roust is now positioned for faster revenue and expanded global growth opportunities in the coming years as well as a successful IPO. ■

Further Reading:

- The dash for debt: Russian issuers return to the market [2017] 2 JIBFL 82.
- Restructuring reform in Europe: the European Commission's draft Directive [2017] 3 JIBFL 149.
- LexisNexis RANDI blog: Skadden comment on Chapter 11 reforms proposed by the ABI.