

# The lessons of Schefenacker

German auto parts maker Schefenacker has migrated to the UK in order to take advantage of more user-friendly English insolvency laws for its restructuring. The deal has recently completed. Rick Mitchell, an American lawyer working in McDermott Will & Emery's London office, advised the original owner Dr Alfred Schefenacker throughout the controversial process. Mitchell believes valuable lessons have been learned.

**D**r Alfred Schefenacker, grandson of the group's founder and 100 per cent shareholder until the restructuring, wanted to migrate the company to London in order to use a Corporate Voluntary Arrangement (CVA).

This process would allow the owner to retain a small equity stake in the newly reorganised group. Similar European restructurings usually wipe out old equity or leave it with just one or two per cent.

McDermott Will & Emery is Dr Alfred's legal advisor. Rick Mitchell, the lead restructuring partner in McDermott's London office advised him on the restructuring. Mitchell says: "There is no analogue to the CVA in Germany at all."

Mitchell adds that attempting to organise the bondholders, many of them private individuals, was "like trying to herd cats. It was frustrating for the lawyers advising the bondholder committee as well as for us."

The English CVA allows the company to compromise the debt of subordinated creditors. If they could win 75 per cent of the vote, for instance, they would be able to modify the rights of a whole class of creditors.

Dr Schefenacker also had over 100 million euro in private loans to the company.

Mitchell, who has many years of restructuring behind him at firms like Milbank



Richard Mitchell, McDermott Will & Emery

Tweed and Paul Weiss, declares: "The Schefenacker deal represents the success of consensus and common sense."

## Advising Dr Alfred Schefenacker

As an experienced American restructuring lawyer with a central role in the Schefenacker case, Mitchell has some important points to make about German insolvency law and the European migration debate generally.

The restructuring had to surmount a number of obstacles. Auto parts suppliers like Schefenacker are being squeezed between cost cutting by the OEMs like Ford, GM and Daimler Chrysler, and rising raw material costs.

As the world's third-largest manufacturer of rear-view mirrors, Schefenacker was over-leveraged, and there are other auto suppliers with high yield bonds and too much debt who will have to go through similar restructurings.

Another problem was the sharp differences between creditors on how to carve up the pie. Originally the debtor had offered the bondholders a deal worth significantly more than the five per cent they ended up with, but couldn't clinch the deal.

"It is one of my regrets that we couldn't get that deal done," says Mitchell.

Instead the debtor had to negotiate with the senior lenders, who were refinanced, while the bondholders got 5 per cent of the equity plus cash, warrants and other inducements.

There is a uniquely German phenomenon of retail bondholder action groups, which act rather like class action groups in the US and in this case caused a lot of disruption.

A large number of retail investors had bought over 200 million euro of Schefenacker bonds in 2004, and when they discovered last year that the bonds were effectively worthless "it came as a shock," says Mitchell.

Some of the bondholders were represented by Rotter, a German law firm specialising in group actions. They tried to oppose the migration to the UK, but were unsuccessful - just. The CVA vote which required a majority of 75 per cent of bondholders squeezed past with 75.9 per cent.

The overwhelming majority of other stakeholders were happy to support migration, transferring the centre of main interest (COMI) of Schefenacker to the UK in

order to use the English CVA.

Mitchell notes: "Without shareholder approval, migration is not possible."

## They rejected Chapter 15

Schefenacker's advisors had pondered filing for Chapter 15 in the US, but this plan was rejected. The mechanics of running a restructuring straddling the US and UK are well understood. Trying to run a restructuring between the US and Germany was new and unpromising territory. "It was a no-brainer," concludes Mitchell.

## Why the OEMs supported migration

It might be asked why the OEMs were happy to support Schefenacker's migration to the UK and the retention by Dr Alfred Schefenacker of a significant stake post-restructuring.

"The OEMs were receptive to migration to the UK because their experiences of German insolvencies were not good, and they were looking for a different way of doing things," says Mitchell.

Collins & Aikman had angered many OEMs when it entered a pan-European insolvency two year ago which they felt favoured local creditors over the US. And Peguform's restructuring had been very expensive because the business had been kept up purely by funding, with all the counterparties demanding cash up front.

Thirdly, the OEMs tend to prefer to deal with family shareholders rather than purely financial investors, says Mitchell.

## The future of migration

Mitchell says there is a lot of debate in the German popular press on how to stop migrations, such as changing the law to make them impossible, or making insolvency laws more user friendly. But the American fears entrenched interests will stymie reform.

On the other hand, the EU Merger Directive will probably make migrations easier.

This debate will run and run.