International Insolvency Institute (III) Committee on Extraordinary Restructuring Solutions

Addressing the Impact of the Current Global Financial Crisis on Debt Restructuring Issues Arising in the Real Economy

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I. Need for Extraordinary Government Action

- Need for Government to Step in to Jump-Start Restructurings
  - Global financial crisis has already led to corporate debt restructuring issues in certain regions and may lead to such issues in other regions in the future
  - But creditor banks and companies facing unsustainable debt burdens within affected economies do not necessarily have clear incentive to address issues in timely manner—may prefer to “wait out” the crisis in hopes of rising asset prices, recovering demand, etc.
  - Yet not desirable from macroeconomic standpoint for economies not to address these issues in timely manner
  - Government action in individual countries may be needed to address this market failure and jump-start restructuring processes in their respective economies
I. Need for Extraordinary Government Action (cont’d)

- Lack of Government Focus on Restructurings in Real Economy

  - So far considerable focus by governments on addressing problems arising in financial sectors of countries—i.e., fixing banking systems
  - But lack of concentrated focus on addressing fallout from global crisis in real economies, especially from restructuring standpoint
  - Key concern: how to deal with many companies economy-wide that may be facing financial distress all at the same time
  - Existing approaches and institutions may prove to be insufficient in addressing issues in real economies
  - Thus need to develop and implement new approaches to deal with debt restructuring issues arising in real economy
I. Need for Extraordinary Government Action (cont’d)

- Why this global financial and economic crisis poses unique challenges for restructurings in real economy
  - Lack of liquidity hampers ability to finance restructurings and reorganizations
  - Depressed economic activity and lack of liquidity and timely restructurings could eventually lead to widespread corporate distress/failure
I. Need for Extraordinary Government Action (cont’d)

- Why Existing Institutions and Procedures May be Inadequate for Current Crisis
  - Economic distress could be widespread within national economies and therefore might potentially overwhelm existing restructuring/insolvency institutions and processes
  - Economic distress may be particularly acute in certain emerging markets which do not have well developed restructuring institutions and supporting legal frameworks
I. Need for Extraordinary Government Action (cont’d)

- Certain regions affected by crisis (e.g., Central and Eastern Europe) may not have recent experience dealing with restructurings in response to financial and economic crises
- There may be serious lack of local restructuring expertise and experience in affected economies
I. Need for Extraordinary Government Action (cont’d)

- Why Extraordinary Government Action is Necessary
  - Need to bring a broad array of restructuring resources—financial resources, restructuring expertise, etc.—to bear in coordinated, timely and efficient manner
  - Need to supplement existing restructuring processes and institutions (or institute such processes where not already present)
  - Need to deal with possibility of widespread corporate distress in expeditious and efficient manner
I. Need for Extraordinary Government Action (cont’d)

- Potential Knock-On Consequences for Financial Sector of Failure to Address Issues in Real Economy
  - Demand for goods has decreased significantly globally which has created or will create a significant and painful adjustment in many economies around the world
  - Unless this adjustment is handled effectively, there will be a significant risk of another banking crisis due to new problem loans emerging for the financial sector
II. Core Elements of Extraordinary Restructuring Solutions

- Creating a special purpose institutional framework for coordinating restructuring expertise, restructuring capital, and restructuring procedures
  - But need to avoid government bureaucracy and potential for corruption

- Providing a solution for the critical need for interim financing for restructuring solutions
  - Developing a mechanism for providing such financing on broad basis to deal with potential economy or sector-wide situations of financial distress
II. Core Elements of Extraordinary Restructuring Solutions (cont’d)

- Applying professional restructuring and turnaround expertise on large scale
  - Deploying experienced professionals (whether domestic or foreign) with such expertise to handle restructuring situations
    - Recognize in particular that may need to bring in foreign experts to fill gap in local expertise

- Utilizing expedited restructuring procedures
  - Recognizing that normal restructuring and insolvency procedures may not be fast enough to address situations of widespread financial distress
III. What Governments Must Do to Address Restructuring Issues and How Governments Can Do So

- What Governments Must Do to Address Restructuring Issues
  - Fix viable companies—i.e., facilitate restructurings and reorganizations
  - Recycle assets of non-viable companies—i.e., facilitate liquidations
III. What Governments Must Do to Address Restructuring Issues and How Governments Can Do So (cont’d)

How Governments Can Do So

- Provide critical interim or bridge financing
- Expedite restructuring of viable companies
- Expedite liquidation of non-viable companies (i.e., recycle assets)
- Condition capital solutions for the banks on their cooperation for the above
IV. Possible Alternative Modalities for Governments to Provide Restructuring Assistance

The current approach of our project is to recommend a menu of possible options for governments to consider—i.e., not “one size fits all” approach.

The particular option(s) governments in a particular country select will depend on a number of factors, such as:

- Capability of government institutions in a particular country, and experience of such institutions in dealing with restructuring-related issues
- Confidence of public in government institutions
- Lack of bureaucracy and corruption in government institutions
- Desired balance between the respective roles of government and private sector
- Status of restructuring laws and procedures
- Experience in the society, courts and professionals in restructuring viable companies
IV. Possible Alternative Modalities for Governments to Provide Restructuring Assistance (cont’d)

- **Issue 1**: Is a new government entity necessary or can existing institutions or resources serve the purpose?
  - **Option I**: Rely on existing government resources
    - Obama Administration’s model for dealing with US automotive industry—i.e., creation of industry-specific government task force drawing heavily on existing government resources
    - Work through existing institutions such as government-owned Development Banks
  - **Option II**: Rely on creation of new special purpose government vehicle
    - Precedent in Japan in early 2000s with the creation of Industrial Revitalization Corporation of Japan (IRCJ)
    - Dr. Takagi’s proposal for new institution
IV. Possible Alternative Modalities for Providing Restructuring Assistance (cont’d)

- Option III: Rely on creation of new quasi-governmental coordinating body but with fairly limited government involvement
  - Create new “restructuring finance agency” (Stephen Gray proposal)
IV. Possible Alternative Modalities for Providing Restructuring Assistance (cont’d)

Issue 2: Who should provide critical interim or bridge financing to address restructuring situations?

- Option I: Government through existing institution (e.g., Development Bank) or through new special purpose vehicle (e.g., Japan’s earlier use of IRCJ)
- Option II: Government to tap external official sources of financing (e.g., IMF, World Bank, EBRD, EIB, ADB, IDB, etc.)
- Option III: Government to use external sources of finance to leverage private capital (whether debt or equity) and attract private investors
IV. Possible Alternative Modalities for Providing Restructuring Assistance (cont’d)

- Issue 3: How can governments catalyze action by private banks to enter into restructuring negotiations with borrowers?
  - Option I: Use government’s central bank or other similar institution to serve as convening forum for debt restructuring negotiations and apply moral suasion to extent necessary
  - Option II: Use government’s provision of rescue funds to banks as leverage to encourage banks to enter into restructuring negotiations with borrowers
IV. Possible Alternative Modalities for Providing Restructuring Assistance (cont’d)

- Option III: Predicate government’s provision of interim financing to borrowers on negotiations taking place between creditors and borrowers

- Option IV: Consider establishing other government-sponsored mediation-oriented institutions
  - i.e., types of institutions established in the wake of Asian financial crisis such as Jakarta Initiative, CDRAC, etc.—but need to carefully consider in practice what worked and what did not work
IV. Possible Alternative Modalities for Providing Restructuring Assistance (cont’d)

- Issue 4: How can governments help restructure companies by facilitating purchase of non-performing assets?
  - Option I: Rely on Asset Management Company model but with broadened powers
    - Model of proposed Korean Restructuring Fund which will be empowered to purchase assets from distressed companies as well as distressed debts from banks
  - Option II: Rely on government to force restructuring of companies and thereby facilitate related asset sales
    - Model being pursued by the Obama Administration in the automotive sector
IV. Possible Alternative Modalities for Providing Restructuring Assistance (cont’d)

- Issue 5: How can governments develop meaningful legal frameworks for facilitating reorganization of viable enterprises?
  - Option I: Enact fundamental insolvency law reforms and other supporting legal or regulatory changes (e.g., tax changes to permit debt for equity swaps, etc.)
    - UNCITRAL Legislative Guide on Insolvency Law, for example, provides a detailed roadmap for such legislative reform
  - Option II: Where such reforms already in place but where bottlenecks in process still exist, enact further targeted legislative and regulatory reforms to facilitate meaningful restructuring (e.g., prepackaged restructuring)
V. Alternative Triggers for Governments to Use in Providing Restructuring Assistance

- Based solely on potential long-term viability of specific enterprise in question
- Based on assessment of criticality of specific enterprise and/or industry to overall economy
- Based on determination of which enterprises/industries shall survive and which shall fail, including rationalization of existing industries especially those with many players
  - i.e., an “industrial policy” conception (recognizing that this may be controversial in certain quarters)
V. Alternative Triggers for Providing Restructuring Assistance (cont’d)

- Focus on SMEs, large corporations, both or neither
Appendix A—Process for Providing Restructuring Assistance

Dr. Takagi’s proposal

1. Application made by ailing companies
2. After preliminary due diligence, select target ailing companies which are important to the national economy
3. Issue notice of standstill or stay to financial creditors
4. Facilitate provision of finance by financial institutions under the guarantee of Governmental agencies
5. Conduct financial and business due diligence under the direction of professional experts
6. Develop business and financial restructuring plans for the companies assisted by professional experts
7. Solicit and persuade creditors and other affected parties to accept proposed restructuring plans
8. Execute accepted plans
9. In some cases purchase troubled company’s debts and infuse capital into troubled company
Appendix A—Process for Providing Restructuring Assistance (cont’d)

- S. Gray’s proposal
  1. After a company’s application, a Selection Committee will provide initial decision to support the company and define restructuring program
  2. Restructuring team prepares operational and financial plan
  3. Selection Committee reviews plan and, if satisfactory, approves
  4. Management implements operational restructuring with Restructuring Agency assistance
Appendix A—Process for Providing Restructuring Assistance (cont’d)

- S. Gray’s proposal (cont’d)

5. Equity and debt holders negotiate balance sheet restructuring based on the restructuring plan and Selection Committee criteria and mediation

6. Plan is implemented over the following months or bankruptcy proceeding initiated if agreement cannot be reached with Restructuring Agency

7. Investment exit within 12-36 months depending on the company’s status and the state of the capital markets
Appendix B—Development of New Expedited Restructuring Approaches

- Review of existing approaches and consider whether can be enhanced and/or reactivated to deal with current crisis
  - Bank of England’s “London Approach”
    - Issue: Can it be reactivated in a world where banks (under supervision of central authority) are no longer only players?
      - See discussion infra at pp. 30-31
  - INSOL Lenders Group Statement of Principles for a Global Approach to Multi-Creditor Workouts
  - Prepackaged bankruptcies (providing for streamlined reorganization process)
    - US model under US Bankruptcy Code
    - UNCITRAL Legislative Guide on Insolvency Law provisions
Appendix B—Development of New Expedited Restructuring Approaches (cont’d)

- Consider whether new approaches necessary for facilitating out-of-court restructurings—i.e., something beyond INSOL Principles
  - Can new protocols be designed to achieve expedited out-of-court restructurings

- Consider whether any features of institutions established in prior crises such as in Asian financial crisis (e.g., mediation-oriented institutions such as Jakarta Initiative, CDRAC, etc.) are relevant and can be adapted and/or updated to deal with current crisis
Appendix B—Development of New Expedited Restructuring Approaches (cont’d)

- Case Study: Possible Enhancement of “London Approach”
  - Mediation by independent third party could still be useful
  - Mediator will need:
    - confidence of all debt providers
    - means or authority to persuade debt providers that rescue should be implemented
  - Bank of England has indicated willing to be approached
  - Similar bodies in other jurisdictions which are independent and authoritative could play mediation role
Appendix B—Development of New Expedited Restructuring Approaches (cont’d)

- Case Study: Possible Enhancement of “London Approach” (cont’d)
  - Fully consensual restructuring may still be difficult to achieve
  - However:
    - restructuring plan could be agreed by majority prior to entry into formal rescue procedure requiring a plan
    - majority consensus may assist in reducing time company spends in a formal rescue procedure
Appendix C—Focusing on Targeted Legislative and Regulatory Reforms to Eliminate Barriers to Reorganization

- Case Study: Brazil
  - Enacted major insolvency law reform in 2005 providing for more effective reorganization mechanism, but additional improvements in reorganization process still necessary
- Additional necessary reforms (T. Felsberg article)
  - Consider whether applicable tax rules and banking regulations need to be modernized in order to enhance restructuring prospects
  - Improving superpriority rules applicable to DIP financing
  - Imposing a majority rule on credits which are outside of reorganization proceedings
  - Eliminating unnecessary costs and delays in insolvency proceedings