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Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

Annual Subscriptions:
Subscription prices 2009 (6 issues)
Print or electronic access:
EUR 695.00 / USD 845.00 / GBP 495.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

EDITORIAL

Developing Extraordinary Restructuring Solutions to Address the Fallout in the Real Economy from the Global Financial Crisis: An Overview of a Project of the International Insolvency Institute

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In response to the global financial crisis, the International Insolvency Institute (the 'III') in Spring 2009 constituted a special high-level committee, the Committee on Extraordinary Restructuring Solutions (the 'Committee'), whose mandate is to develop recommendations for addressing issues of financial distress arising in the real economies of nations. As the Committee's name suggests, the focus is on developing 'extraordinary restructuring solutions', namely innovative solutions that go beyond the conventional restructuring and reorganisation approaches, to address the unique challenges posed by the global financial crisis.

The Committee was the inspiration of III Board member Richard A. Gitlin, who serves as Committee chair, and is comprised of distinguished insolvency professionals from Asia, Europe, Latin America and North America, including individuals from developed economies and emerging markets.[2] The Committee is in the process of reviewing innovative approaches that are currently being embraced by various national governments as a means of restructuring troubled companies and industries in the real economy. The Committee also plans to recommend additional extraordinary restructuring approaches for consideration by governments. In this article, we will briefly review some of the issues that the Committee is currently considering, but this review of issues is not meant to be exhaustive nor is it meant to represent a definitive or official statement of the Committee's views.

A fundamental premise of the Committee's approach is that conventional restructuring and insolvency approaches may prove to be inadequate in addressing the impact of the global financial crisis on the real economies of nations. The global financial and economic crisis makes it much more difficult to achieve successful restructurings in the real economy. Specifically, the lack of liquidity hampers the ability of parties to finance restructurings and reorganisations. Furthermore, depressed global economic activity and the lack of liquidity and timely restructurings could potentially lead to widespread corporate distress or failure.

Such corporate distress or failure may have the potential, particularly in less advanced economies with less well developed insolvency systems, to 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. Certain regions affected by the crisis (e.g., Central and Eastern Europe) may not have recent experience dealing with restructurings in response to financial and economic crises. Moreover, there may be a serious dearth of local restructuring and turnaround expertise and experience in certain affected economies.

Fundamentally, the Committee believes that it is critically important that governments address these restructuring issues related to the real economy, particularly as much of the initial efforts by governments have focused on repairing financial systems. The Committee also believes that if these issues in the real economy are not addressed properly and in a timely manner, there could be further serious stress placed on the global financial system.

Notes

1 Steven T. Kargman is the Rapporteur of the International Insolvency Institute's Committee on Extraordinary Restructuring Solutions, and formerly served as Lead Attorney of the Export-Import Bank of the United States and General Counsel of the New York State Financial Control Board.
The views expressed in this article are solely those of the author and do not necessarily reflect the views of the International Insolvency Institute, its Committee on Extraordinary Restructuring Solutions or any of the Committee's individual members. The author acknowledges his debt to the Committee members for their excellent contributions and insights.

2 The Committee consists of the following individuals: Richard A. Gitlin, Chair (USA); Donald Bernstein (USA); Thomas Felsberg (Brazil); Lucio Ghia (Italy); Stephen Gray (USA); Steven T. Kargman, Rapporteur (USA); Bruce Leonard, III Chair (ex officio) (Canada); Luis Manuel C. Mejan (Mexico): Professor Christoph Paulus (Germany); George Seligman (UK); and Dr. Shinjiro Takagi (Japan).

Despite whatever improvements have taken place in the global financial system since governments began to address the serious breakdown in the financial system in the fall of 2008, there still remains the possibility of knock-on effects to the financial system from widespread financial distress in the real economy. For example, it has been widely reported in the financial press that banks in Western Europe may face further financial difficulties arising from their significant exposures in Central and Eastern Europe, especially in light of the level of corporate distress and non-performing loans that exist now or are expected to develop in Central and Eastern Europe.

Therefore, even though there may be some glimmers of improvement in the state of the global financial system and the global economy, there could nonetheless be a new round of serious pressures placed on the financial system if financial distress in the real economy is not addressed.

Unfortunately, there is a tendency on the part of both banks and borrowers to delay addressing these realities in individual cases. Creditor banks and companies facing unsustainable debt burdens within affected economies do not necessarily have a clear incentive to address these issues in a timely manner. Instead, they may prefer to 'wait out' the crisis in the hopes of rising asset prices and recovering demand. Yet, despite such a reaction from individual lenders and borrowers, it may not be desirable from a macroeconomic standpoint for national economies not to address these issues in a timely manner.

Thus, government action in individual countries may be necessary to address this market failure and jump-start restructuring processes in their respective economies. The Committee has advocated the need for 'extraordinary restructuring solutions' to fill the gap. There is a need to bring to bear a broad array of restructuring resources – including financial resources and restructuring expertise – in a coordinated, timely and efficient manner. There is also a need to supplement existing restructuring processes and institutions or to institute such processes where they are not already present. Furthermore, there is a need to deal in an expeditious manner with the possibility of widespread, possibly economy-wide, corporate distress.

The Committee has identified four core elements that could underlie a program consisting of extraordinary restructuring solutions. First, governments might consider creating some type of quasi-governmental institutional framework for coordinating restructuring expertise, restructuring capital, and expedited restructuring procedures. Yet the Committee recognises a potential pitfall that must be avoided: there is a need to avoid government bureaucracy and the potential for corruption – concerns which may be salient in some of the countries affected by the global financial crisis.

Second, governments, acting on their own or in cooperation with international organisations, should provide a solution for the critical need for interim or bridge financing for restructuring solutions. This would entail developing a mechanism for providing such financing on a broad basis to deal with potential economy-wide or sector-wide situations of financial distress. Such government-led financing may be necessary because private lenders may not be in a position to provide financing on the scale that is required.

Third, governments should be in a position to apply professional restructuring and turnaround expertise on a large scale. Governments must be prepared to deploy experienced professionals, whether such professionals are domestic or foreign, who possess the necessary expertise to handle restructuring situations, especially restructurings arising in the context of a financial crisis. However, governments need to recognise that there may be gaps in local restructuring and turnaround expertise, and there may therefore be a need to bring in foreign experts to fill in whatever gaps exist in local expertise and experience.

Fourth, governments need to recognise the critical importance of having distressed borrowers utilise expedited restructuring procedures. This may involve utilising prepackaged reorganisations or expedited out-of-court restructurings, and in certain cases new laws or amendments to existing laws may need to be put in place to achieve these goals. This emphasis on expedited restructuring procedures recognises that normal restructuring and insolvency procedures may not move quickly enough to address situations of widespread financial distress.

Overall, governments must focus on addressing two overriding objectives. In the first place, they need to ensure that viable companies are fixed – i.e., facilitate restructurings and reorganisations. Second, they also need to ensure that the assets of non-viable companies are recycled – i.e., facilitate liquidations where appropriate.

Governments could further these objectives by taking a number of steps. They could provide critical interim or bridge financing, they could expedite restructuring of viable companies, and they could expedite liquidation of non-viable companies (i.e., recycle assets). They could condition capital solutions for their banks, such as capital infusions to troubled financial institutions, on the cooperation of banks in facilitating restructuring solutions. In other words, banks could be encouraged to deal with corporate distress and non-performing loans among their borrowers rather than trying to postpone the resolution of these problems.

The Committee's current approach is to consider recommending a menu of possible options for governments to consider – i.e., not a 'one size fits all' approach. The specific options that the government in a particular country selects may depend on a number of country-specific factors. Such factors could include the following: the capability of government institutions and the experience of such institutions in dealing with restructuring-related issues; the level of confidence of the public in government institutions; and the lack of bureaucracy and corruption in government institutions. Other factors could include the desired balance between the respective roles of government and the private sector; the level of development and the efficacy of restructuring laws and procedures; and the experience in the society, its courts and among its insolvency and restructuring professionals in restructuring viable companies.

In deciding upon possible alternative modalities for providing restructuring assistance, governments will need to address several issues such as the following: Is it necessary to establish a new government entity to serve as a coordinating body for the broad array of restructuring resources or can existing institutions serve this purpose? Who should provide critical interim or bridge financing to address restructuring situations – national governments, multilateral development banks, regional development banks, commercial lenders, private investors or some combination of these parties?

How can governments catalyse action by lenders to enter into restructuring negotiations with borrowers? Can governments facilitate the restructuring of companies by facilitating the purchase of non-performing assets whether through so-called asset management companies or otherwise? How can governments develop more effective legal frameworks for facilitating reorganisation of viable enterprises, especially with respect to encouraging expedited restructurings?

As noted above, the Committee is currently in the process of considering the merits of innovative restructuring approaches being taken by various governments around the world in the current crisis. But the Committee is also considering whether there have been innovative approaches that were adopted by governments and other key stakeholders in previous crises that may be applicable in the current crisis.

In addition, several Committee members have developed new proposals to address the impact of the financial crisis on the real economy. For example, Dr Shinjiro Takagi has put forth a proposal (described more fully in his article appearing elsewhere in this issue) to establish a new quasi-governmental vehicle based on the model of the Industrial Revitalisation Corporation of Japan that was established by the Japanese government in 2003. Stephen Gray and his colleague Marko Mitrovic have put forth a proposal to establish a regional 'restructuring finance agency' to deal with the problems arising in Central and Eastern Europe.

In the coming months, the Committee will continue to work through the issues discussed in this article with the aim of developing a final set of recommendations. Whatever the specific details and contours of any final recommendations that the Committee develops, the Committee will strive to develop recommendations that will be useful to governments in addressing financial distress in the real economy in a timely and effective manner.

International Corporate Rescue

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