In recent years, the emerging markets in Asia, Latin America, and elsewhere have witnessed a number of high-profile defaults and restructurings. Some of these defaults have involved outstanding indebtedness on the part of the debtor companies of hundreds of millions of dollars, and in some cases well over a billion dollars. In many cases, for various reasons, including particularly the possible weaknesses of the relevant local insolvency system, the creditors involved in such defaults have attempted to negotiate an out-of-court, “consensual” restructuring with the debtor to resolve the debtor's financial difficulties.

Nonetheless, emerging market out-of-court restructurings can pose unique and daunting challenges for creditors, especially foreign creditors. Among other difficulties, it has not been unusual for a number of these restructurings to drag on for several years without a definitive conclusion. From the creditors’ standpoint, a protracted restructuring process can be particularly costly since there is often a debt service moratorium in place during this process, which may have been unilaterally imposed by the debtor following the original defaults. Therefore, under such circumstances, the majority of the creditors during the period of the restructuring may not be receiving any debt service payments.

In addition, restructurings can involve very significant transaction costs for the creditor institutions involved in the process. First, restructurings may require a substantial investment of staff time for the respective creditor institutions. These transactions can be very labor-intensive given, among other factors, their complexity and the array of legal and business/financial issues raised by such transactions, the difficulties of negotiating with debtors, and, if and when a deal appears to have been reached, the often voluminous deal documentation involved. Second, restructurings can require the creditors to incur substantial fees and expenses for professional legal and financial advisers for those fees and expenses that are not otherwise covered by the debtor.

Foreign creditors in particular—even certain creditor institutions that would generally be considered to have extensive and sophisticated international experience—may not be fully prepared for some of the obstacles that they may encounter in some emerging market debt restructurings. Such creditors may well understand in the abstract that such restructurings may not proceed in the same manner (or with the same results) as restructurings in their domestic markets in the developed economies. However, even so, they may not fully appreciate in concrete terms many of the handicaps that they may face as they attempt to negotiate certain restructurings in the emerging markets.
FUNDAMENTAL STRUCTURAL CHALLENGES IN EMERGING MARKET RESTRUCTURINGS

In the first place, creditors in general and foreign creditors in particular may be seriously disadvantaged by the nature of the local laws of the debtor’s home jurisdiction, particularly the local insolvency system, as well as the functioning of the local courts. Although the creditors and the debtor may be negotiating an out-of-court restructuring, the local insolvency system can play a critical role in determining whether the creditors and debtor are negotiating on anything resembling a level playing field. The World Bank addressed this matter in a 2000 draft consultation report on insolvency law. This report stated in relevant part as follows: “With little or no creditor protections and weak enforcement rights, management for financially distressed or willfully defaulting enterprises have no credible threat to compel them to negotiate on commercially reasonable terms.”

As is sometimes observed, out-of-court restructurings essentially take place in the so-called “shadow of the insolvency law.” This means that, as counterintuitive as it may seem at first blush, the likelihood of success of an out-of-court restructuring may depend heavily on the framework and substance of the local insolvency law, including not unimportantly how the local insolvency law is applied in practice. If the local insolvency law is not well developed or is otherwise disadvantageous to creditors, the incentives for the debtor to negotiate a fair, reasonable, and timely out-of-court restructuring may be minimal at best. As the International Monetary Fund (IMF) has observed more generally, “…out-of-court negotiations are likely to be limited or even nonexistent if there is no clear and predictable in-court insolvency system to provide a backdrop for these negotiations.”

(It should be noted that, in light of the deficiencies of insolvency laws in many jurisdictions, there are major and important international efforts currently underway to improve domestic insolvency systems around the world. These efforts are led by, among others, the United Nations Commission on International Trade Law (UNCITRAL), which through one of its working groups has been developing a draft legislative guide in the area of insolvency law for possible use by individual countries, and the World Bank, which has been developing a set of core principles for domestic insolvency systems.)

The weaknesses of the relevant local insolvency system may be compounded in certain jurisdictions by the functioning of the local courts. Specifically, foreign creditors may encounter certain jurisdictions where they have significant concerns with respect to the independence, integrity, and/or fairness of the local courts. Therefore, to the extent that creditors attempt to exercise remedies in the local courts in certain jurisdictions or even to defend themselves against legal actions by the debtor in such courts, they may find themselves at a significant disadvantage.

Creditors may not receive a fair or impartial hearing that they might hope for or expect. Creditors may as a consequence find themselves in certain situations facing judicial rulings that they find difficult to fathom. Such rulings may not comport with the creditors’ understanding of normal commercial law principles or may otherwise appear in the creditors’ view (as well as in view of certain outside observers) to be somewhat arbitrary and capricious and/or not necessarily well grounded in the applicable law.

In some emerging market jurisdictions, it is not just the foreign creditors that may be concerned by the nature and functioning of the local insolvency system and the local judicial system. Rather, in certain emerging market jurisdictions, some of the domestic creditors may have similar concerns. For example, it is possible that in certain large-scale restructurings, some of the leading domestic commercial banks may also find the local insolvency system and the local court system to be highly frustrating for pursuing creditor rights and remedies and/or otherwise achieving acceptable restructuring results. In such cases, it is possible, but certainly not guaranteed, that these local creditors may be inclined or willing to work with some of the foreign creditors in seeking a solution.

Nonetheless, in some emerging market restructurings, it is not unheard of for some of the local creditors to end up receiving preferential treatment from the debtor. Notwithstanding any debt service moratorium or debt standstill that may generally be in place, certain local creditors may continue to receive some or all of their debt service payments in the wake of a debtor’s default on its outstanding debt. Yet, at the same time, other creditors, including foreign creditors, may be subject to a debt service moratorium or debt standstill and therefore may not be receiving any debt service payments during the course of the restructuring process.

In addition to the potential substantial handicaps imposed on creditors by the local insolvency systems and the local legal systems, the creditors involved in an emerging market restructuring may also face difficulties posed by the role of the so-called “controlling shareholders” of the relevant debtor company. The controlling shareholders consist of the individuals who hold a controlling equity stake in the debtor company. They may
also control the board of directors of the debtor company and/or of any holding company of the debtor company. In addition, such controlling shareholder’s individual family members may also occupy some of the key management positions of the debtor and its affiliates.

Furthermore, and very importantly, the controlling shareholders may represent influential family interests in the host country. By virtue of their position in the host country, certain controlling shareholders may feel that they are not under any particular pressure to reach a prompt or fair restructuring with their creditors, particularly where the creditor body consists of a large number of foreign creditors.

The Asian Development Bank, in a report in 1999 reviewing a number of Asian insolvency systems, noted that one of the principal factors underlying the conduct of owners of a troubled corporation is their “fear of loss of control” of the relevant business enterprise. Accordingly, certain controlling shareholders may view much of the restructuring process through this prism, and thus the calculus of such controlling shareholders may be considerably different from that of the creditors. It is conceivable, therefore, that the controlling shareholders of certain debtors may be focused on whether the restructuring process in general and any specific proposed restructuring plans in particular pose a threat or challenge to their continued control over the debtor company and all that such control represents.

DECIDING WHETHER RESTRUCTURING NEGOTIATIONS AFFORD THE PROMISE OF A TIMELY AND ACCEPTABLE RESTRUCTURING SOLUTION

In the face of these potentially significant structural challenges that may be present in certain emerging market restructurings, creditors may wonder about the efficacy of the out-of-court restructuring process. In any given case, the creditors may wish to consider the issue of whether the out-of-court restructuring process will afford the eventual promise of a restructuring solution or whether it is likely or possible that the debtor and its controlling shareholders will ultimately block such an outcome.

The creditors will essentially be faced with the following fundamental issues: First, is the restructuring process likely to proceed in a relatively timely fashion? Second, is such a process likely to result ultimately in a restructuring plan that is commercially fair and reasonable? In other words, ideally, even before embarking on an out-of-court restructuring, the creditors may wish to have certain reasonable expectations concerning the possible and/or likely procedural and substantive aspects and outcomes of the restructuring process.

Unfortunately and perhaps not surprisingly, the answers to these questions may be hard to know ex ante. Such answers may depend in large part on the conduct and course of dealing of the debtor and its controlling shareholders during the restructuring process itself—i.e., matters that are effectively outside of the control of the creditors. Even in some of those restructurings where the debtor and its controlling shareholders are later shown to be obstructionist and non-cooperative, that may not necessarily be the case or otherwise readily apparent at the outset of such restructurings. Moreover, certain debtors and controlling shareholders may, perhaps deliberately, send mixed signals. Thus, at certain times, such debtors and their controlling shareholders may appear obstructionist, while at other times they may appear cooperative. Some debtors may even send such mixed signals at the same time.

But that it is why it is so important for the creditors to continually monitor the conduct of the debtor and its controlling shareholders. In effect, the creditors need to perform a “reality check” of the debtor and its controlling shareholders on an ongoing basis. The creditors should be trying to assess whether the actions and conduct of the debtor and its controlling shareholders are generally contributing to—or, in fact, impeding—the progress of the restructuring process as well as whether such actions and conduct are likely to result in a satisfactory restructuring solution.

Obviously, some emerging market debtors may in the final analysis not warrant as much concern as other emerging market debtors warrant. There are certain emerging market debtors that may be genuinely interested in seeking a mutually acceptable restructuring solution with their creditors. These debtors may, for example, attempt to close a restructuring deal in a reasonable time frame, such as perhaps in 1-2 years or less (although, obviously, the specific length of time obviously depends on the complexity of the given transaction and other relevant factors). Such debtors may realize that the manner in which they handle the then pending restructuring process could very well affect their ability to access the capital and credit markets in the future, which could in turn have a major effect on their future business plans and overall viability. Such debtors may therefore decide that it is in their long-term interest to help facilitate a restructuring solution by working in a cooperative manner with their creditors.
(Throughout this article, it should be borne in mind that although the focus of the article is on those debtors in the emerging markets that may use various tactics to delay and obstruct restructurings, certainly not all debtors fall into that camp. Obviously, there are debtors in the emerging markets that are willing to work cooperatively with their creditors in seeking a mutually acceptable restructuring solution in a reasonable period of time. Such creditors would likely not present the problems and concerns that are discussed in detail in this article.)

But for those emerging market debtors that are less interested in their reputational interests, the creditors may wish to be attentive to warning signs indicating that they are dealing with what might generically (or charitably) be described as a non-cooperative debtor. With such debtors, restructuring negotiations may lack some of those elements that may be considered among the basic prerequisites of any successful commercial negotiation. Based on the debtor’s conduct during the restructuring process, creditors may form the opinion that such debtors are not engaging in good-faith negotiations. Creditors may also believe that the conduct of such debtors is not necessarily designed to advance the negotiations on a relatively straightforward or linear path towards a conclusion, particularly in a timely manner. Instead, in the view of the creditors, such conduct may be calculated to obstruct any genuine progress with the result that negotiations may proceed at best in fits and starts and/or meander along a zigzag path without any clear end point in sight.

**WARNING SIGNS OF THE NON-COOPERATIVE DEBTOR**

The following discussion sets forth a non-exhaustive listing of some of the major warning signs for creditors indicating that they may well be dealing with a non-cooperative debtor. Creditors might be well advised to pay careful attention to recognizing such warning signs if and when they first become evident. Non-cooperative debtors may exhibit some of these warning signs, but not necessarily all of them. As discussed more fully in the conclusion of this article, where such warning signs are present in a critical mass, the creditors may have to consider the issue of whether it will in fact be possible to achieve an acceptable out-of-court restructuring in a timely fashion with the debtor in question or whether alternative courses of action should possibly be considered and explored.

**Delays in Finalizing Preliminary Arrangements**

In virtually all emerging market restructurings, there are certain preliminary matters that need to be addressed before the parties can enter into substantive restructuring discussions in earnest. Among other matters, the creditors and the debtor will need to enter into confidentiality agreements that will permit the creditors, usually acting through a Steering Committee, to have their designated financial adviser conduct a due diligence investigation of the debtor. In addition, the creditors and/or their financial advisers and outside counsel may enter into engagement letters or similar agreements with the debtor that will establish the “scope of work” and responsibilities as well as any fee arrangements for such advisers.

In the normal course of events, these would be considered fairly routine agreements that should not be overly difficult to negotiate and finalize. However, in certain emerging market restructurings, these agreements can become a flash point between the creditors and debtors and may end up taking, at least from the creditors’ perspective, an inordinate amount of time to finalize. To be sure, there may be legitimate areas for honest disagreement and tough negotiation between the parties with respect to these agreements. For example, the debtor may have a bona fide interest in ensuring that a confidentiality agreement is drafted carefully so that, under the terms of the agreement, the debtor’s proprietary business information is adequately protected and is not exposed to the risk of becoming available to its business competitors.

Nevertheless, in other cases, debtors may use the negotiation of these preliminary documents as a means to forestall progress with regard to the overall restructuring process. Without these documents being in place, the creditors will be hampered in their ability to move forward with important tasks related to the restructuring process. The creditors may be unable to launch their due diligence investigation of the debtor and otherwise may be prevented from giving the go-ahead to Steering Committee advisers to become fully engaged with their work on behalf of the creditors. For instance, Steering Committee advisers may not be willing to become fully engaged if fee arrangements with the debtor are not firmly engaged if fee arrangements with the debtor are not firmly and clearly established and set forth in writing.

In short, certain debtors may attempt to prolong the negotiation of these preliminary documents. Even though such documents could in a normal commercial negotiation be finalized in a matter of several weeks at most, such negotiations in certain emerging market restructurings may drag on for a much longer period without good reason.
(at least as seen from the vantage point of the creditors). Since the negotiation of these preliminary documents occurs by definition at the very outset of the restructuring process, creditors should be especially sensitive to the use of delaying and obstructionist tactics by the debtor at this juncture. If the debtor sees fit to make the negotiation of these fairly straightforward preliminary documents a difficult and tortuous process, this could be an important early warning sign to the creditors of the difficulties that may lie ahead in the restructuring process.

**Obstructing Due Diligence Investigations**

A thorough due diligence investigation of the debtor’s business operations and financial condition is generally viewed by creditors as a necessary prerequisite to the development of a sound restructuring plan. In effect, the creditors want to have as comprehensive an understanding as possible of the debtor’s business and finances so that, among other things, reliable cash flow projections and so-called “sustainable debt” figures can be generated. Such projections and figures may be among the key elements underpinning any restructuring plan that is ultimately developed. Typically, the Steering Committee or the principal creditors involved in a complex restructuring will retain an outside financial adviser to conduct the due diligence investigation. Depending on the size and complexity of the specific debtor’s business operations and organization, the financial adviser may potentially deploy a large team of individuals to conduct the due diligence investigation.

However, for the creditors’ financial adviser to be able to conduct an effective due diligence investigation, it will generally require meaningful cooperation from the debtor. The financial adviser will need to have access to a broad range of company records as well as company personnel. The financial adviser may know the specific types or categories of information that it is seeking, but it cannot produce such information on its own since much of this information will be contained in the company’s records.

The financial adviser may be seeking information on such diverse matters as sales figures, production levels, pricing of sales, cost of inputs, cash flow, and so forth. With respect to each of these matters, the financial adviser may be interested in historical, current, and projected information. In addition to reviewing company records, the financial adviser may also wish to speak to company personnel who may be in a position to shed further light on some of these issues. Accordingly, the creditors and their financial advisers in restructurings may speak of the goal of having relatively “full and unfettered access” to company records and personnel without undue interference or “micro-management” by the debtor. Although the creditors will thus be seeking transparency in the due diligence process, the debtor may not necessarily share the same goal.

Specifically, in certain cases, the debtor may not want the creditors’ financial adviser to conduct too broad, extensive, or thorough a due diligence investigation. For instance, the debtor in such cases may be concerned that the financial adviser will unearth embarrassing information, such as related party transactions among the debtor and its affiliates that may not have been entered into on arm’s-length terms. Or, more fundamentally, the debtor may not want the financial adviser—and the creditors—to have too accurate a picture of its current and projected financial situation or of its business prospects more generally. Instead, the debtor and/or the debtor’s financial adviser may want the creditors to accept more or less at face value what it claims to be the magnitude of its financial distress, including for example its estimates regarding the level of “sustainable debt” which as noted above is a fundamental parameter in most restructuring plans. (In some instances, however, the debtor may simply be concerned about the cost or time it will take to complete an overly comprehensive or extensive due diligence investigation, or at least that is how certain debtors may frame their concerns.)

Furthermore, certain debtors may realize that if they throw up roadblocks to the creditors’ due diligence investigation, such actions may help forestall the development of any restructuring plan, which could be certain debtors’ objective in the first place. Such debtors may calculate that the creditors will not want to move forward with restructuring discussions until the due diligence process is completed, and therefore such debtors may view it to be in their interest to create as many delays and obstacles as possible in the due diligence process.

For all of these reasons, the creditors should be alert to this warning sign. Otherwise, a creditors’ due diligence investigation that is subject to repeated delays and interruptions caused by the debtor could easily become the “tail that wags the dog.” As discussed above, if there are substantial delays in the due diligence process, the creditors may be very reluctant to enter into serious restructuring discussions and negotiations until the due diligence process is completed. However, this could have the effect of working against the interests of the creditors if they are anxious and eager to conclude a restructuring deal in a reasonable time frame.
Late Payment and/or Non-Payment of Professional Advisers’ Fees

In many restructurings, the debtor may agree at the outset of the process to pay for the fees and expenses of the principal creditors’ advisers, including outside counsel and an outside financial adviser. The Steering Committee and/or its outside advisers in a given restructuring may have a written agreement to that effect with the debtor, and certain other individual creditors or creditor groupings, such as for example a bondholder committee, may also have similar agreements. In certain cases, the creditors may arrange for the debtor to establish an escrow account that will cover a month or more of anticipated Steering Committee expenses in case the debtor does not pay the fees of the Steering Committee’s professional advisers on a timely basis. However, even if there is such an escrow account, the Steering Committee and its advisers often depend on a process whereby on a regular basis they submit to the debtor invoices from the Steering Committee’s advisers. The debtor in turn is supposed to pay the Steering Committee’s advisers for such fees and expenses a certain number of days (e.g., 30–60 days) after such bills are submitted to the debtor.

But certain debtors may use this process of reviewing invoices to significantly delay the payment of the Steering Committee’s advisers. In some cases, the debtor may claim that the creditors’ professional adviser has devoted too much manpower to a particular assignment or task, or the debtor may assert that the professional adviser has deviated in a material respect from the agreed upon “scope of work” for such adviser. In other cases, the debtor may simply be slow or delinquent in processing invoices, with the result that there can be significant delays in payments of the fees for the creditors’ professional advisers.

Of course, where debtors use the review of invoices as an opportunity to challenge the invoices that have been submitted by the advisers, this could be an effort on the part of the debtor to frustrate or delegitimize the work of the professional adviser. For example, such challenges may be just a thinly veiled way for the debtor to “second-guess” the work of the creditors’ financial adviser, whose work the debtor may not be overly interested in seeing completed successfully in any event.

The original engagement letters or other similar agreements relating to the retention of the professional advisers may set forth agreed upon dispute resolution mechanisms for addressing disagreements on these matters between the creditors/professional advisers on the one hand and the debtor on the other hand. But the creditors and their professional advisers may lose their patience if they have to repeatedly resort to the dispute mechanism procedures for resolving contested invoices, particularly if the process involves arguing further with the debtor and its representatives. Moreover, the creditors and their professional advisers may view such a dispute resolution process as a distracting and potentially time-consuming sideshow to the more serious and central substantive issues in the restructuring process.

From the creditors’ standpoint, if there are significant delays by the debtor in paying the creditors’ professional advisers and/or challenges to statements submitted by the advisers, this could potentially have serious consequences for the restructuring process. It may mean that ultimately the outside professional advisers will decide to suspend or scale back their work—or at least discuss or weigh the possibility of doing so—until and unless they are brought current on their outstanding invoices. Some advisers may even permanently terminate their engagement if they have not been paid for a long period of time and/or if a large amount of their fees remain unpaid.

If the professional advisers feel compelled to take any of these actions and this happens at a critical juncture in the restructuring process, it may make it difficult for the Steering Committee to proceed with discussions with the debtor since the Steering Committee may be very dependent on the technical and detailed analysis and recommendations of its advisers. Or it may mean that an important creditor constituency that relies heavily on outside advisers, such as a bondholders’ committee, may lose its focus and organization if its outside advisers stop work once they are no longer being paid by the debtor on a timely basis for their fees and expenses.

In short, even though this debtor tactic of not paying advisers’ fees on a timely basis may seem like a mere bookkeeping or ministerial issue, it can potentially have broader consequences for the overall restructuring process. Even if the professional advisers do not stop their work in those circumstances where they are not paid by the debtor on a timely basis, the advisers may become very frustrated by late payments or by the fact that the debtor is raising questions about their invoices. The professional advisers may feel that they are not able to devote their full energies to addressing substantive restructuring matters on behalf of the creditors and instead may have the sense that they are getting bogged down in dealing with billing disputes with the debtor or otherwise chasing after the debtor for late payments.

Furthermore, certain debtors may use billing disputes in the hopes of possibly driving a wedge between
the creditors and their advisers. This may happen if the debtor uses a billing dispute as an avenue to raise questions and/or doubts about the methodology of a professional adviser. The debtor may perhaps implicitly, or even explicitly, be trying to raise doubts about the competence or expertise of the professional adviser.

In sum, from the creditors’ standpoint, none of the foregoing are positive developments in the restructuring process, since the professional advisers are likely to constitute an integral part of the creditors’ team. Fee payment issues may interfere with the advisers’ ability to perform the work requested by the creditors, which could ultimately impede the creditors’ development and analysis, as well as closing, of any proposed restructuring plans.

Lack of Follow-Through on Stated Commitments

During the course of the restructuring process, the creditors and debtor may agree to move forward in specified ways. They may agree on specific timelines for completing the many specific restructuring milestones and tasks involved in a restructuring, including drafting certain restructuring documents, preparing security documents, filing registration statements for any potential bond exchange, or taking any of a number of other actions such as engaging their respective financial advisers in detailed discussions regarding the relevant financial model(s). Or, on various discrete or more limited items, the debtor may pledge to follow up on certain issues or make certain decisions by a fixed date. Some of these mutual agreements between the parties may be in writing, whereas others may simply be oral agreements reached in the context of ongoing face-to-face meetings between the Steering Committee and the debtor. Whether set forth in writing or agreed orally, the creditors may be relying on such commitments as the basis for moving forward with the process of seeking an out-of-court, “consensual” restructuring with the debtor.

In certain cases, however, the creditors may find that the debtor does not follow through on the commitments that it has made to the creditors. If there is a fixed timeline that the parties have agreed upon, the debtor’s failure to follow through on commitments can be fairly easy to establish by the creditors. The debtor may simply not produce drafts of the relevant documents by the dates that it has agreed to. Or, for instance, the debtor may not have conducted discussions with necessary third parties, such as regulatory authorities, whether in the host country or in foreign jurisdictions, which it has promised to under-take by a given date. In some circumstances, the debtor may offer what may seem like valid reasons for the delays, such as the fact that a particular task is taking longer than expected due to its inherent complexity or difficulty. However, in other cases, the debtor’s failure to meet a deadline or deadlines may appear to the creditors to be part of an overall strategy of delay on the part of the debtor.

Certain debtors may be fairly cavalier with respect to honoring commitments that they have made and even perhaps somewhat brazen in how they try to justify their conduct. For example, the principals of a debtor may make unequivocal assurances in person to the members of a Steering Committee that, by a date certain in the following month, it will pay, say, the outstanding fees of an indenture trustee for an issuance of U.S. dollar-denominated bonds. The overdue fees may be quite substantial, and the indenture trustee may not have been paid for its services in a long period of time. Needless to say, the date certain may come and go without the trustee being paid its overdue fees. The debtor may claim that it did not receive expected payments from certain customers and therefore could not make the payment to the indenture trustee. But the indenture trustee may be forced to remind the debtor that it made an unqualified and unconditional commitment in front of the full Steering Committee to pay these fees, and such a commitment was not dependent on the business performance of the debtor.

In short, where the debtor fails to follow through on commitments, this can be detrimental to the interests of the creditors in several respects. First, since the lapsing of time is generally viewed as the enemy of creditors, the debtor’s failure to follow through on its commitments in a timely manner, including those set forth in agreed upon timetables, can harm the interests of the creditors by serving to prolong the restructuring process. Second, more generally, where the debtor makes pledges and commitments to the creditors that it does not follow through on, the creditors may stay invested in the restructuring process based on such pledges and commitments, only to be ultimately disappointed by what may be the debtor’s broken promises.

Raising of New Deal Issues or Revisiting Old Issues

At some point in most restructurings (unless, for example, the prospects for a successful restructuring are seemingly hopeless), often following extensive and possibly prolonged discussions and negotiations, the parties may agree on a term sheet outlining the principal terms and conditions of the contemplated restructuring plan.
Although the term sheet is not necessarily designed to cover every single last issue in a restructuring transaction, it is generally viewed as providing an overall road map for the detailed legal documentation that will follow. While certain major issues may be specifically reserved for further discussion, the term sheet will typically reflect the parties’ resolution of the key substantive issues.

However, in the hands of a debtor that is more interested in delay and obstruction than in actually closing a restructuring, the fact that there is a term sheet may not prevent the debtor from raising new issues or revisiting old issues that the creditors thought were previously resolved. (Indeed, it should be noted that even before there is a term sheet, the debtor may use similar tactics in its ongoing discussions and negotiations with the creditors. The result may be that such discussions and negotiations do not make steady progress, and it may even be difficult to finalize a term sheet under such circumstances.)

Sometimes in those cases where the debtor revisits old issues or raises new issues, some of the issues raised may relate to key elements of the overall restructuring (e.g., issues related to the overall structure of the deal, such as matters possibly dealing with payment terms, default mechanics, or corporate governance provisions). In other words, the debtor may be raising or revisiting issues that implicate fundamental deal terms as opposed to issues related to mere details.

The debtor may argue that the term sheet was silent or ambiguous on certain matters that it is then introducing into the discussions. But it may also be the case in certain situations that the debtor is deliberately re-opening issues that were previously resolved or otherwise putting new issues on the table. In some cases, therefore, the debtor may view the post-term sheet documentation process as an opportunity to take a “second bite at the apple.”

If the non-cooperative debtor employs this tactic of revisiting old issues or raising new issues, it may serve what may be such debtor’s overall goal of delaying the restructuring process. The creditors may be moving forward with documentation and related matters on the basis of an agreed upon term sheet, only to find that the debtor is introducing new issues (or re-introducing old issues) into the equation. The documentation process then may have to stop as the parties argue about whether the issues raised by the debtor fall within the scope of their original understanding as reflected in the term sheet.

The debtor may in effect even threaten to hold up the restructuring process unless its concerns are addressed. The debtor may be testing its creditors’ resolve to see whether the creditors are willing to make additional concessions to the debtor in the interest of keeping the restructuring process moving forward or whether they are willing to risk delaying the process in order to fight the debtor on these new issues (or on the old issues that have been revisited). Indeed, the debtor may be counting on the creditors to lose some of their resolve the longer the process drags on. In these circumstances, the creditors should be aware of the dynamic of “negotiating against themselves.”

**Predisposing Public Opinion Against the Creditors**

It has not been uncommon in contentious restructurings for the debtor and its controlling shareholders to attempt to “poison the well” for the creditors in the arena of host country public opinion. The debtor may, for instance, try to blame the creditors for the financial difficulties that the debtor company is facing, including any actual or potential layoffs of employees that may be a possible element of a company’s austerity program following a default. Of course, in certain cases, it is possible that any such retrenchment may have been necessitated to a certain extent by the earlier financial and/or business mismanagement of the debtor company by the incumbent management. Yet the debtor and its controlling shareholders may calculate that it is advantageous for them to make any actual or potential layoffs a prominent public issue. They may very well want to have the local work force and the local community on their side if and when the restructuring becomes a major political issue in the host country, whether it becomes a political issue at the local level or at the national level.

In effect, the debtor may be trying to portray itself as the champion of the local work force and the local community, even though as noted above it is possible that the incumbent management’s prior mismanagement of the debtor company may have contributed to need for the very layoffs that it is then decrying. In this effort at aligning itself with the work force, the debtor’s management and its controlling shareholders may be aided by what may be their very close ties to the leadership of the relevant labor unions.

In addition, certain debtors and their controlling shareholders may claim that the creditors are trying to take over a company that is vital to the host country’s economy at either the national or regional level. (Foreign creditors may become a particular target of such criticism.) Some restructuring plans may contain debt-for-equity swaps that will provide the creditors with an equity stake in the debtor company in exchange for retiring a certain percentage of the outstanding principal amount of their loans. In addition, certain restructuring plans may...
contain “change of control” provisions that would give the creditors effective control of the debtor company upon the occurrence of certain major events of default, notably payment defaults.

The debtor and its controlling shareholders may try to characterize such restructuring provisions or terms as an alleged challenge to continued local control over the company in question. However, through such provisions, the creditors may argue that they are merely trying to protect their economic and financial interests in the restructured company and may not be seeking control of a local company for the sake of control. If the creditors agree, for example, to accept a reduction of the amount of their outstanding principal as an element of the restructuring plan, they will often seek some economic consideration in return, such as being given a certain amount of equity in the restructured company. Moreover, if the creditors were to be faced with a new payment default following the closing of the restructuring, the creditors may believe that the current owners of the company (i.e., the company’s controlling shareholders) should lose any further right to control the company. Obviously, the debtor and its controlling shareholders may view these matters, or at least will frame the issues, quite differently. (It should be noted that in certain cases, rather than focusing strictly on the details of particular restructuring provisions, the debtor and its controlling shareholders may make relatively broad-based claims that the creditors are trying to take control of a local company.)

Nevertheless, attacks by the debtor and its controlling shareholders on the motives of the creditors, whether focused for example on local employment or local control issues, may find some resonance in public opinion in the host country. The debtor and the controlling shareholders may well enjoy a significant “home court advantage” over the creditors in the realm of local public opinion. Among other things, they may know how to “work” the local news media. Equally important, such attacks, to the extent that they are targeted at foreign creditors, may play into any nationalist/anti-foreign sentiments that may exist in the host country. Creditors in general may not be very popular to begin with, and foreign creditors are likely to be even less popular. Although the creditors may try to counter such attacks by hiring local public relations advisers, such an effort could very well be an uphill battle for the creditors. Given the debtor’s home court advantage, the creditors may at best hope to neutralize such attacks with an explanation of their own positions.

While the battle for public opinion may appear to be a peripheral matter, it can in certain circumstances in fact be very relevant to the progress of the overall restructuring. In some restructurings, for various reasons, the local host government may become involved in the restructuring or may otherwise be monitoring the progress of the restructuring. If the host government discerns strong public opinion against the position of the creditors, the government, for example, may perhaps try to make it difficult for the creditors to obtain any regulatory or similar approvals (e.g., antitrust, securities laws, etc.) that may be needed to implement a restructuring plan. Or, for instance, the host government may not be particularly receptive to pleas by the creditors to become more involved in the restructuring process such as by serving as an “honest broker” or by having any government-owned or controlled agencies that are creditors play a potentially more constructive role in the process. Finally, if the restructuring ends up in a local insolvency or other local legal proceeding, local public opinion may potentially have an impact on the court handling the case.

Use of Divide-and-Conquer Tactics vis-à-vis Creditors

In most complex international restructurings, there is usually a diverse array of creditor interests involved, and the creditor body may consist of a multitude of creditors. There may be many different types of creditor institutions with exposure to the debtor, including commercial banks (both foreign and domestic), multilateral institutions, bondholders, sovereign export credit agencies, host government agencies, and so forth.

In addition, the creditor body may be characterized by some of the usual competing creditor interests. Specifically, there may be both secured and unsecured creditors, and in a corporate group structure, operating company creditors and holding company creditors as well as creditors who made their loans to certain debtor companies that have putatively stronger cash flows and other creditors who made their loans to debtor companies with putatively weaker cash flows. There may also be creditors who were original lenders to the debtor, whereas there may be other creditors who may have purchased their debt in the secondary market, possibly at a deeply discounted price.

Without any third-party involvement, the intercreditor issues may be hard enough for the creditors to resolve among themselves. These issues by their very nature tend to be intricate and complex and not necessarily susceptible to easy solutions. However, if the debtor and its controlling shareholders seek to meddle in these
issues or otherwise play one set of creditors off against another set of creditors, they can potentially create substantial mischief. Some debtors and controlling shareholders may seek to insert themselves into these intercreditor issues as part of an overall "divide and conquer" strategy vis-à-vis the creditor body.

By way of a basic illustration, the debtor and its controlling shareholders may have separate but simultaneous discussions with operating company creditors on the one hand and holding company creditors on the other hand. The debtor may tell each of these sets of creditors what they want to hear, but which may essentially be in conflict. For instance, the debtor may tell the holding company creditors that it will not agree to any restructuring plan that does not provide a "global" solution that deals with both the operating company debt and the holding company debt. At the same time, the debtor may tell the operating company creditors that restructuring their debt will be the priority, particularly in relation to any restructuring of the holding company debt. Based on what they have both heard from the debtor in their separate discussions, the holding company creditors and the operating company creditors may then have heated arguments among themselves about how the restructuring process should proceed.

Thus, if the debtor does attempt to insert itself in intercreditor issues, this can help create further disunity within the creditor body, which may only serve to prolong the restructuring process. Indeed, given the almost inherently contentious nature of intercreditor issues, creditors can easily become distracted from focusing on the broader restructuring issues, including particularly reaching an overall deal with the debtor, and instead may become preoccupied with issues that are internal to the creditor body and that may have the effect of causing divisions within the creditor body. Accordingly, creditors should be wary if they see that the debtor is attempting to employ "divide and conquer" tactics vis-à-vis the creditor body.

* * *

Where the creditors see a critical mass of these warning signs, they need to step back and evaluate where the out-of-court restructuring process is leading. They may need to re-evaluate whether it is realistic at all to expect that an out-of-court, "consensual" restructuring can be achieved under the circumstances. Each creditor will have to make its own assessment of which warning signs, when present, are sufficiently troubling as well as what constitutes a critical mass of these warning signs.

At a minimum, even where there are some warning signs but perhaps not yet a critical mass of warning signs, the creditors should promptly bring any unconstructive conduct to the attention of the debtor and demand prompt action to address their concerns. But the creditors should realize that, in some instances, this course of action could also end up playing into the debtor's hands—for example, if the parties exchange an endless round of letters debating who is in the right. Yet, in such circumstances, if the creditors believe that the debtor is not being responsive to their concerns about the warning signs that the creditors have brought to their attention, then this may provide the creditors with a further reason to re-evaluate the acceptability of the overall restructuring process.

Ultimately, if the creditors conclude that there is a critical mass of warning signs that indicates fairly clearly or conclusively that the debtor is not genuinely interested in closing a restructuring in a reasonable period of time and/or on commercially reasonable terms, then the creditors may wish to consider alternatives to an out-of-court restructuring. There may be some creditors who, as an exit strategy, want to sell their debt in the secondary market. But there may be other creditors who, for various reasons, decide to hold on to their debt and who may be interested in exploring the possibility of pursuing more aggressive or adversarial options vis-à-vis the debtor, whether under the relevant insolvency laws or, for example, through litigation for the recovery of defaulted debt.12

Any such decision to pursue such options should be undertaken only after careful and thorough consideration based on consultation with outside counsel, which may be local and/or foreign counsel depending on the issues involved. And, despite the possible allure of finally taking what may seem like decisive action vis-à-vis the debtor, the creditors may quickly realize that there may be pros and cons to each possible option. They may learn from their outside counsel, for example, that the options which may seem attractive on paper may not necessarily be very attractive in practice. Some local insolvency statutes, for instance, may appear to provide the possibility for the creditors of pursuing certain options, such as seeking the involuntary liquidation of the debtor, but in practice it is possible that the local courts may rarely grant such relief. Or even if the local insolvency law permits it and the creditors are successful in forcing the debtor into an involuntary reorganization proceeding, the debtor may try to frustrate or at least complicate the implementation of such a reorganization by mounting collateral legal challenges to the creditors in the local courts.

The creditors, therefore, will have to make a realistic assessment of the various options that may be available to
them. But the creditors may only be prompted to begin this process of analyzing and assessing alternative courses of action if, during the course of the restructuring process itself, they remained attuned and vigilant to the warning signs of the non-cooperative debtor.

ENDNOTES

1See, e.g., Wall Street Journal, March 1, 2004, p. A13, “Some Lenders Still Struggle in Asia: Slow Pace of Legal Change Aids Corporate Defaulters At the Expense of Creditors” (noting, for example, that “[a]cross Southeast Asia, some companies that benefited from the lack of strong bankruptcy laws in the 1990s are gaining more advantages”). On a related topic, for an overview of the state of insolvency law reform in Asia, see, e.g., Robert Zafft and Lampros Vassiliou, “The Unfinished Task of Asian Insolvency Reform,” International Financial Law Review, February 2003, pp. 33–35.

2Whether or not the professional fees and expenses incurred by individual creditors are reimbursed by debtor may depend on the facts and circumstances of the particular restructuring. But if the debtor in a given restructuring is likely to reimburse any professional fees and expenses of the creditors, it may be more likely to do so for a grouping of creditors, such as a creditor Steering Committee, as opposed to the fees and expenses incurred by individual creditors. Even if there is some agreement reached with the debtor that individual creditor fees and expenses will be reimbursed, it is possible that such reimbursement might not happen until the closing of the restructuring, and therefore the creditors may be taking the risk that the restructuring will not close.


5See International Monetary Fund, “Involving the Private Sector in the Resolution of Financial Crises—Corporate Workouts” [hereinafter referred to as “Involving the Private Sector”], p. vii (2001), prepared by the Policy Development and Review and Legal Departments. See id. at p. 14 (“...the formal rules must make it relatively easy for creditors to commence proceedings against a defaulting debtor. A credible threat of such action provides a necessary means of bringing the debtor to the negotiating table.”).

6For further information regarding the World Bank and UNCTRAL projects, see generally reports and related materials from the World Bank (available under insolvency topics at www.worldbank.org/ifa) and UNCTRAL Working Group V (Insolvency Law) (available under Working Group V materials at www.uncitral.org/en-index.htm).]

7See, e.g., IMF, “Involving the Private Sector,” p. 12 (“In the case of the judiciary, while in some countries the problem has been training and capacity, in others, there is a strong perception of corruption within the court system.”).

8For a discussion of these matters in the Indonesian context, see, e.g., Samuel Tobing, “Informal Workouts in Indonesia,” paper presented to the Second Forum for Asian Insolvency Reform (FAIR), Bangkok, Thailand, December 16–17, 2002, p. 1 (available at www.oecd.org/dataoecd/42/38/2490452.pdf) (citing two high-profile insolvency cases in Indonesia, PT Asuransi Jiwi Manulife Indonesia and PT Panca Overseas Finance, respectively, the former being the case in which a local court found, later reversed on appeal, that an “Indonesian subsidiary of the Canadian insurer could be bankrupted over a failure to pay a dividend to an ousted former partner” and the latter being the case in which “the debtor was able to obtain confirmation of a composition plan based upon the affirmative vote of a large number of newly-created creditors, despite objections by the IFC [International Finance Corporation] that such claims had been fraudulently created . . .”).

9See Asian Development Bank, Law and Development at the Asian Development Bank (1999 Edition)—Special Report: Insolvency Law Reform in the Asian and Pacific Region, p. 16 (noting that a “principal factor that concerns ‘owners’ of financially troubled corporations in many of the . . . economies is the fear of loss of control of the corporation. This produces an aversion to anything that might put the corporation in a position where others might dictate its immediate and long-term future.”). The report also cites as another principal factor the “stigma” associated with insolvency because “...in the minds of the owners or directors of a corporation, the failure of the corporation represents their failure, which is sometimes accompanied by ‘peer’ judgment resulting in business and social disgrace.” Id.


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