Emerging economies and cross-border insolvency regimes: missing BRICs in the international insolvency architecture (Part I)

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Many of the world's major advanced economies are subject to some form of cross-border insolvency regime, whether of an international or regional scope. However, despite this clear and important progress in the adoption of cross-border insolvency regimes among many advanced economies, there appears to be a glaring gap in the international insolvency architecture. Specifically, very few of the major emerging economies – and none of the BRIC countries (Brazil, Russia, India and China) – have adopted the UNCITRAL Model Law on Cross-Border Insolvency or otherwise enacted effective alternative regimes for handling cross-border insolvencies. With their growing integration into the global economy, these emerging economies may face a rising number of cross-border insolvencies at some point in the coming years. Nonetheless, while the current absence of cross-border insolvency regimes in major emerging economies may not represent an immediate problem in the next few years, it may pose challenges for the international insolvency framework over the longer term.

In recent years, many countries around the world have recognised the importance of establishing a regime for addressing cross-border insolvencies, a topic that is becoming more and more significant given the ever-increasing globalisation of the world economy. Indeed, the UNCITRAL Model Law on Cross-Border Insolvency, which was promulgated by the United Nations in 1997 and which established the international standard in this area, has so far been adopted by 19 jurisdictions across the globe according to the tally kept by UNCITRAL.[1]

The states that have adopted the UNCITRAL Model Law reflect a diverse group of countries economically and geographically. Importantly, this group of adopting states includes among its ranks leading advanced economies[2] such as the United States, Japan and the United Kingdom – each of which ranks as one of the top ten economies in the world[3] – as well as other advanced economies such as Australia, Canada and South Korea. In Europe, while adoption of the UNCITRAL Model Law has been fairly limited (particularly among the larger economies of Western Europe),[4] all of the Member States of the European Union are bound by the EU Insolvency Regulation which, broadly speaking, effectively establishes a regional cross-border insolvency regime among the EU states themselves with respect to cross-border insolvency cases arising within the EU itself.[5]

Thus, between the countries that have adopted the UNCITRAL Model Law and/or the EU Regulation, many of the world's major industrialised or advanced economies are subject to some form of cross-border insolvency regime, whether of an international or regional scope.

However, despite this clear and important progress in the adoption of cross-border insolvency regimes among many advanced economies, there appears to be a glaring gap in the international insolvency architecture.[6] Specifically, very few of the major emerging economies[7] have adopted the UNCITRAL Model Law or otherwise enacted effective alternative regimes for handling cross-border insolvencies.

As has been widely commented on, these emerging economies are seen as representing some of the most dynamic economies globally. In particular, these economies are considered to be playing an increasingly significant role in the global economy whether measured, for example, in terms of their GDP levels, their growth rates, their contribution to global growth,[8] their growing role in global trade,[9] and/or the increasing investment flows (both inbound[10] and outbound[11]) involving these countries.

Yet, with their growing integration into the global economy, these emerging economies may face a rising number of cross-border insolvencies at some point in the future. Such cross-border insolvencies could arise from any of the several of the key trends affecting the emerging economies. These trends include the growing foreign direct investment into these countries, the increasing trade and investment between and among the emerging economies themselves,[12] and the 'multinationalisation' of leading corporations from the emerging markets as these corporations operate around the globe (including in other emerging markets).

The foreign investment flowing into the emerging economies might eventually give rise to cross-border insolvency situations where individual emerging economies will have to address requests for recognition from insolvency proceedings in foreign jurisdictions – i.e., inbound cross-border insolvencies for the emerging economies in question. Conversely, outward foreign investment from the emerging economies as well as overseas activity by corporations from the emerging markets might eventually lead to cross-border insolvency situations where the emerging economies might wish to have their own domestic insolvency proceedings recognised in foreign jurisdictions – i.e., outbound cross-border insolvencies for the emerging economies in question.

Furthermore, as noted above, with the increasing investment and trade flowing between and among the emerging economies themselves and with emerging market companies operating overseas (including in other emerging markets), there could eventually be cross-border insolvencies involving two or more emerging economies as opposed to cross-border insolvencies involving simply, say, an emerging economy and an advanced economy.

Of course, it remains to be seen how soon, and how many, cross-border insolvencies will eventually arise in these emerging economies, as well as how significant and/or complex these cross-border insolvencies will be.

Nonetheless, while the current absence of cross-border insolvency regimes in major emerging economies may not represent an immediate problem in the next few years, it may pose challenges for the international insolvency framework over the longer term (whether that is in the next decade or over a longer period of time). This challenge may come into sharper focus if and when the number of cross-border insolvencies in these emerging economies reaches a critical mass, particularly if at such time there are no cross-border insolvency regimes in place in these emerging economies to deal with the cross-border insolvencies that do in fact arise.

In Part I of this article, we will provide a broad overview of whether or not various emerging economies – both major emerging economies as well as several rising emerging economies – have adopted cross-border insolvency regimes. In addition, we will consider possible pathways to adoption of cross-border insolvency regimes in emerging economies and outline the types of domestic concerns that may need to be overcome. In Part II of this article, we will explore, among other issues, alternative pathways to the adoption of cross-border regimes for those emerging economies that may need to take intermediate steps or confidence-building measures before such emerging economies may be prepared or in a position to embrace more comprehensive cross-border insolvency regimes.

BRICs and cross-border insolvency

By way of illustration, the so-called BRIC countries[13] – namely, Brazil, Russia, India and China – are often cited as the new star performers in the global economy. Whether or not one agrees with the some of the more optimistic or bullish assessments of the growth prospects of the BRICs over the next few decades and/or with the related predictions that the BRICs will assume a commanding position in the global economy by 2050 (if not sooner), [14] it seems fairly clear that at least some, if not all, of the BRIC countries will continue to be important, if not key, economic players on the global scene in the coming decades.

In fact, the growing economic importance of individual BRIC countries has already begun to manifest itself. For example, as has been widely noted, within the last two years China has claimed the number two spot in the rankings of the world's largest economies jumping ahead of Japan (but still ranking behind the United States).[15] The other three BRICs – Brazil, Russia and India – also now occupy top-ten rankings in the world economy.[16] To be sure, the economic trajectory of the BRICs will not simply be a continuous upward arc, but rather it is virtually inevitable that the BRICs will also experience the normal ups and downs of economic cycles, as reflected, for example, in the current economic slowdowns in the BRICs generally.

Yet, for our purposes, the key point is that despite the growing economic importance of the BRICs in the global economy, not a single one of the four BRIC countries has adopted the UNCITRAL Model Law or otherwise put in place an effective alternative cross-border insolvency regime. For instance, while both Brazil and China modernised and overhauled their insolvency laws in recent years (Brazil in 2005 and China in 2006), neither country adopted the UNCITRAL Model Law or put in place a robust or effective alternative cross-border regime.

China's new insolvency law, the Enterprise Bankruptcy Law of 2006, does in fact contain a cross-border provision in Article 5 of the new law, but this provision is widely considered to be very restrictive in its potential application to foreign insolvency proceedings seeking recognition in China. Among other shortcomings, Article 5 of the new law requires the existence of treaty and/or reciprocity in order for recognition to be granted to a foreign proceeding, but as has been noted by commentators, China does not have any such treaties or clearly established reciprocal relations in place.[17] Article 5 of the new law also contains an extremely expansive public policy exception[18] (which stands in marked contrast to the very narrow 'manifestly contrary' standard for the public policy exception set forth in the UNCITRAL Model Law).[19]

Brazil's new insolvency law, on the other hand, does not contain any provisions at all dealing with cross-border insolvency issues. The result is that there is no clear roadmap for handling cross-border insolvencies in Brazil, with the attendant uncertainty and unpredictability that this could bring to any cross-border situation involving Brazil.[20]

It should be noted that in some (but not all) circles, South Africa is also considered to have joined the original four BRIC countries in forming an expanded five-member country grouping known as the BRICS.[21] In that expanded country grouping, South Africa would be the only country that has enacted the UNCITRAL Model Law having done so in 2000. However, South Africa is basically the exception that proves the rule – that is, while South Africa has adopted the UNCITRAL Model Law, South Africa's cross-border insolvency statute contains a threshold procedural requirement that has not yet been satisfied.[22]

Rising emerging economies beyond the BRICs

Beyond the BRICs, there are other emerging economies smaller than the BRIC economies that are now attracting increasing attention as potential rising stars in the global economy based on their population size, demographics (especially the presence of younger populations) and/or natural resources, among other factors. However, even among these newer groupings of emerging economies,[23] one also finds a fairly limited number of countries that have adopted the UNCITRAL Model Law.[24]

For example, countries that show up on one or more of the various lists of such up-and-coming economies are countries such as Bangladesh, Colombia, Egypt, Indonesia, Mexico, Nigeria, Philippines, South Africa, South Korea, Turkey and Vietnam.[25] But among the foregoing countries, only a few of them – namely, Colombia, Mexico and South Korea[26] – have so far adopted the UNCITRAL Model Law, and this underlines the fact that cross-border insolvency regimes have yet to make significant inroads into the emerging economies.

Viewed from a slightly different perspective, one can look at several geographic regions around the world such as Asia, Latin America and Africa – which are all regions with a strong concentration of emerging market economies and/or developing countries – and consider the extent to which the UNCITRAL Model Law has been adopted by countries in these regions.[27] For instance, in the entire Asia-Pacific region, only four countries have adopted the UNCITRAL Model Law: Australia, Japan, New Zealand and South Korea. Within South East Asia, which is one of the most dynamic parts of Asia consisting of several large, growing emerging market economies, not a single country in the region has adopted the UNCITRAL Model Law.

Similarly, in all of Latin America, only two countries have adopted the Model Law: Colombia and Mexico. In Africa, strictly speaking a region consisting more of 'frontier markets' or developing countries[28] than emerging markets, only two countries, South Africa and Eritrea, have adopted the Model Law (even though, as noted above, South Africa's cross-border statute has not yet fully come into effect).[29]

In other words, there are major parts of the globe – in Asia, Latin America and Africa – where cross-border insolvency regimes, whether in the form of the UNCITRAL Model Law or otherwise, appear to have taken root in only a very limited way.

Pathways to adoption of cross-border insolvency in emerging markets

Nevertheless, given the growing interconnectedness of the global economy, it would arguably be a very positive and desirable development if in the coming years many of the major emerging markets that are currently lacking a cross-border insolvency regime would move to adopt some form of such a cross-border regime. Such a development could be beneficial to cross-border insolvency practice in particular as well as the international insolvency architecture generally.

Some countries may be closer to adopting the UNCITRAL Model Law than others, and other countries may consider it necessary to take some intermediate steps before embracing a comprehensive cross-border insolvency regime such as embodied in the UNCITRAL Model Law. In some major emerging markets, introducing a cross-border insolvency regime may fit into a broader strategy of achieving other reforms and revisions to a nation's existing insolvency law.

For instance, in Brazil, leading professionals and academics in the insolvency and restructuring field have been working diligently on developing a new package of potential amendments to the Brazilian insolvency law that was enacted in 2005.[30] As part of their broader review of Brazil's new insolvency law, these professionals and academics have apparently been considering the issue of cross-border insolvency and the merits of the UNCITRAL Model Law. If these professionals and academics were ultimately to recommend the adoption of the UNCITRAL Model Law as part of an overall insolvency law reform package, it would then be up to the political system to make the adoption of the UNCITRAL Model Law a reality.

Yet, whether or not adoption of the UNCITRAL Model Law would be able to gain the necessary traction in the Brazilian political system – including whether it could get to the point of being taken up for consideration by the Brazilian legislature – might depend on whether the advocates for the UNCITRAL Model Law could generate sufficient support among key stakeholders in Brazil's financial system and economy generally. Key stakeholders would probably need to understand and be able to articulate for other actors in the Brazilian system why, for example, adoption of the UNCITRAL Model Law would make sense for an economy such as Brazil's which has become increasingly integrated into the global economy and which has become an increasingly popular destination for foreign investment.

Ultimately, however, adoption of the UNCITRAL Model Law would require action by Brazil's national legislature and then its president, and both the legislature and president would probably need to understand and/or be convinced that instituting a sound and effective cross-border insolvency regime would bring significant advantages to Brazil and its economy or at least that any domestic concerns with respect to going down this path would be outweighed by the advantages of doing so. Of course, it clearly remains to be seen whether the Brazilian political system will eventually be able to reach this end result of adopting the UNCITRAL Model Law.

Other countries may come at this issue from a slightly different orientation. For instance, it may be that countries such as China will be inclined to take a more gradualist or incremental approach towards adoption of a comprehensive cross-border insolvency regime, and perhaps that will be the only way to introduce a robust cross-border insolvency regime in a country such as China.

Specifically, until the adoption of its new Enterprise Bankruptcy Law of 2006, China had what might be considered as a strictly 'territorialist'[31] approach to cross-border insolvency. While as discussed above the cross-border provision in the new law (ie, Article 5) has some fairly serious limitations, it nonetheless is seen as representing a move away from the strictly territorialist position that China had held previously for many years.[32]

Thus, in future iterations of its insolvency law (whether by amendments to China's new insolvency law or through judicial interpretations of that law),[33] perhaps China will continue down this path and eventually embrace an even more 'universalist' approach to cross-border insolvency than is currently provided for in Article 5 of the new law. If it eventually does so, it may be necessary for China to move down this path on a relatively gradual or incremental basis. However, in order to get to this point in China, it may be necessary (no pun intended) to further 'socialise' the idea of the need for a more universalist cross-border insolvency regime among key stakeholders in China, which is a process that could undoubtedly take some time to carry out.

Nonetheless, whether China ever ends up going the full distance and adopting something along the lines of the UNCITRAL Model Law obviously remains an open question and will be subject to the interplay of political factors within China itself, including crucially whether the political leadership in China sees such a step as being in China's national interest. For the reasons noted below, a country such as China would likely have to address various domestic concerns before it would be in a position to embrace more fully a more universalist approach to cross-border insolvency.

Yet, the issue of when and how China might eventually revisit cross-border insolvency issues could be affected by matters of practical necessity. For example, this might happen if China were to face an upsurge in significant inbound cross-border insolvencies and found itself ill-equipped to address such cross-border insolvencies, or if at some point in the future Chinese policymakers were to become concerned (for reputational reasons or otherwise) that China was seriously out of step with international 'best practices' in this area. Or this might happen if in the future Chinese policymakers were to focus on the importance of cross-border insolvency regimes because Chinese insolvency proceedings were then having difficulty gaining recognition in certain foreign proceedings due to a lack of UNCITRAL Model Law-type statutes in the corresponding foreign jurisdictions, or it might happen for any combination of the foregoing reasons.

Overcoming domestic concerns to cross-border insolvency regimes

As a general matter, the issues of what type of cross-border regime the emerging economies countries will ultimately adopt and when they adopt it will obviously play out in the individual countries themselves and will depend on the unique internal dynamics of each of the individual countries, including the all-important political dynamics within these countries. Some countries may be reluctant to adopt a robust cross-border insolvency regime due to concerns about how such a regime would affect, as they see it, their national sovereignty. Such reservations may flow from concerns traditionally associated with the territorialist conception of cross-border insolvency, but they also may relate to broader nationalist sentiments, including, amongst other things, a possible suspicion of foreign economic interests.

For example, some jurisdictions may be concerned that the primary benefits of such a cross-border insolvency regime will accrue to foreign parties, particularly foreign creditors, at the expense of local creditors (eg, if such a regime leads to the turnover of assets within its jurisdictions to foreign creditors in connection with a foreign insolvency proceeding). These types of concerns, whether valid or not, may strike a discordant note within jurisdictions considering whether they should adopt the UNCITRAL Model Law or any alternative cross-border regime.

In other words, some countries could well have a high hurdle to overcome in implementing an effective cross-border regime if they are faced with deep-seated reservations such as those outlined above. However, that is why the advocates for the adoption of the UNCITRAL Model Law or any alternative cross-border insolvency regime in a given country will probably need to mobilise support among key stakeholders within that country as well as make a persuasive case demonstrating that adopting the UNCITRAL Law or an alternative cross-border regime will be in that country's national interest. Yet, advocates for this position will not have to construct arguments in favour of this position in a vacuum but instead will be able to draw, for instance, on the pioneering work of Professor Jay Westbrook in this area in support of a universalist conception of cross-border insolvency.[34]

Conclusion

In short, those emerging economies that have not yet adopted a cross-border-insolvency regime, in the form of the UNCITRAL Model Law or otherwise, might be well advised to focus on this issue in the coming years before it develops into a problem for these countries in addressing any cross-border insolvencies in which they are involved. However, to achieve success in putting in place an effective cross-border insolvency regime, individual emerging economies will need to be comfortable that the adoption of a cross-border regime will be consistent with their respective conceptions of what is in their national interest.

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Notes

1 See Status: 1997 – UNCITRAL Model Law on Cross-Border Insolvency (UNCITRAL, 1997) available at **www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html** [last accessed 2 September 2012]. As UNCITRAL notes, a jurisdiction will be considered as having the UNCITRAL Model Law even if its corresponding national legislation has some variations from the UNCITRAL Model Law itself: 'A model law is created as a suggested pattern for law-makers to consider adopting as part of their domestic legislation. Since States enacting legislation based upon a model law have the flexibility to depart from the text, the above list is only indicative of the enactments that were made known to the UNCITRAL Secretariat. The legislation of each State should be considered in order to identify the exact nature of any possible deviation from the model in the legislative text that was adopted.' *Ibid*.

2 'Advanced economies' is a term for which there is not necessarily a uniform definition. However, the International Monetary Fund does classify 34 of the economies in the world as 'advanced economies'. See 'Tensions from the Two-Speed Recovery: Unemployment, Commodities, and Capital Flows', *World Economic Outlook* (International Monetary Fund, April 2011) p 169, available at **www.imf.org/external/pubs/ft/weo/2011/01/pdf/statapp.pdf**. The IMF will classify an economy as an 'advanced economy' based on the following criteria: per capita income level; export diversification; and degree of integration into the global financial system. See Rebecca Nelson, *Sovereign Debt in Advanced Economies: Overview and Issues for Congress*, Congressional Research Service (February 2012) p 1, available at **www.fas.org/sgp/crs/misc/R41838.pdf** (citing IMF criteria).

3 For rankings of world economies, see *The World Factbook*, Central Intelligence Agency (September 2012), available at **www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html?countryName=United States&countryCode=us&regionCode=noa&rank=2#us** (2011 estimates of GDP measured on the basis of so-called purchasing power parity (PPP)).

4 In Western Europe – apart from the United Kingdom – none of the major economies such as Germany, France, or Italy have adopted the UNCITRAL Model Law. See Status: 1997 – UNCITRAL Model Law on Cross-Border Insolvency (UNCITRAL, 2007) **www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html** [last accessed 2 September 2012]. By contrast, various countries in Central and Eastern Europe as well as Southern Europe have adopted the UNCITRAL Law, including Greece, Montenegro, Poland, Romania, Serbia, and Slovenia. *Ibid*.

5 Under the EU Regulation, specifically enumerated insolvency proceedings within an individual Member State of the EU (as set forth in Annex A to the EU Regulation) are given cross-border effect within the other member states of the European Union. See Bob Wessels, Bruce Markell and Jason Kilborn, *International Cooperation in Bankruptcy and Insolvency Matters* (Oxford University Press, 2009) p 140. ('Automatic recognition should therefore mean

that the effects attributed to the insolvency proceedings by the law of the State in which the proceedings were opened (*lex concursus*) extend to all other Member States.')

It is important to bear in mind that the EU Regulation does not address the recognition of insolvency proceedings arising from outside of the European Union. See Jay L Westbrook et al, *A Global View of Business Insolvency Systems* (The World Bank, 2010) p 259. ('Another deficiency of the Regulation is its complete neglect of the world outside its member states. There is no indication as to how cases shall be treated with respect to non-EU member states.')

The EU Regulation is currently undergoing a process of review and revision, and there have been various proposals for significant changes to the EU Regulation as it is currently formulated. See *Revision of the European Insolvency Regulation, Proposals by INSOL Europe* (INSOL Europe, 2012).

6 By the phrase 'international insolvency architecture', we are referring not just to the relevant legal regime, such as the UNCITRAL Model Law, but also to the number and composition of countries that have signed up to such a legal regime through their respective domestic laws or otherwise.

7 There does not appear to be a single widely agreed upon definition of what constitutes an 'emerging market' or 'emerging market economy'. In one paper, the International Monetary Fund defined an 'emerging market' as follows: 'Developing countries' financial markets that are less than fully developed, but nonetheless broadly accessible to foreign investors.' *Global Financial Stability Report: Market Developments and Issues*, International Monetary Fund: Glossary (International Monetary Fund, September 2004) p 161, available at **www.imf.org/External/Pubs/FT/GFSR/2004/02/pdf/glossary.pdf**. As a matter of terminology, in this article, we use the terms 'emerging market' and 'emerging economy' interchangeably.

Some observers have raised the question as to whether some of these emerging economies have in fact already 'emerged' and thus are no longer strictly speaking 'emerging' economies. Indeed, the terminology may need to change to describe those 'emerging economies' or 'emerging markets' that have truly 'emerged' and which as to some of the countries, at least on the economic dimension, have reached (or even surpassed) the level of many 'advanced economies' or 'industrialised' countries, even if these newly emerged economies lack some of the indicia (eg, well-developed legal systems, etc) that are traditionally associated with what are considered to be advanced economies or industrialised or developed countries. See, generally, Paul La Monica, *Emerging Markets? They've Already Emerged*, (CNN Money, 11 November 2010), **http://money.cnn.com/2010/11/11/markets/thebuzz/index.htm**; Jenara Nerenberg, *Emerging Markets Have Emerged: Next Stop for Some Companies the Global Fortune 500*, (Fast Company, 20 January 2011), **www.fastcompany.com/1719085/emerging-markets-have-emerged-next-stop-some-companies-global-fortune-500**.

8 The contribution of the emerging economies to global growth was particularly striking in the wake of the recent global financial crisis when these countries were credited with playing an important role in helping pull the global economy out of a global recession. On a related point concerning the new dynamism of the emerging economies in the global economy, see Michael Spence, *The Next Convergence: The Future of Economic Growth in a Multispeed World* (Farrar, Straus & Giroux, 2011) p 8. ('The emerging economies have rebounded from the [global financial] crisis surprisingly quickly. They are now the main engine of global growth.')

9 See Jim O'Neill, *The Growth Map: Economic Opportunity in the BRICs and Beyond* (Portfolio/Penguin, 2011) p 40 (noting that, as to a subset of the emerging economies, the role of the BRICs – Brazil, Russia, India and China – in global trade is expanding 'much faster than world trade overall.').

10 See 'Capital Flows to Emerging Market Economies', Institute of International Finance Research Note, (Institute of International Finance, 1 June 2011), available at **www.iif.com/press/press+190.php** (noting increase of capital flows in 2010 and expected increases in such flows for 2011 and 2012). Of course, capital flows into these economies can ebb and flow depending on various international and domestic factors.

11 See *Foreign Direct Investment from the Emerging Markets: The Challenges Ahead*, eds Karl P Sauvant, Wolfgang A Maschek and Geraldine McAllister (Palgrave Macmillan, 2009) p 16, available at **www.vcc.columbia.edu/pubs/documents/FDIfromEMs-FM-13August09.pdf** ('The rise of outward investment from emerging markets has contributed to the growth in FDI [foreign direct investment] globally.').

12 This is sometimes referred to as 'South-South trade'.

13 The origin of the term 'BRICs' is commonly traced to a 2001 paper by Jim O'Neill of Goldman Sachs. See Jim O'Neill, 'Building Better Global Economic BRICs', Goldman Sachs Global Economic Paper No. 66 (30 November 2001), available at **www.goldmansachs.com/our-thinking/topics/brics/brics-reports-pdfs/build-better-brics.pdf**.

14 Dominic Wilson and Roopa Purushothaman, 'Dreaming with BRICs: The Path to 2050', Goldman Sachs Global Economic Paper No. 99 (1 October 2003) p 4, available at **www.goldmansachs.com/our-thinking/topics/brics/brics-reports-pdfs/brics-dream.pdf**. Among other predictions, the paper posited propositions such as the following: 'In less than 40 years, the BRICs' economies together could be larger than the G6 [US, Japan, Germany, France, Italy and UK] in US dollar terms. By 2025 they could account for over half the size of the G6. Currently they are worth less than 15%.' *Ibid* at 4. 'Of the current G6 […] only the US and Japan may be among the six largest economies in US dollar terms in 2050.' *Ibid*.

In more recent years, Jim O'Neill and his colleagues at Goldman Sachs have moved forward some of their timetables for the BRICs achieving a commanding position in the global economy based on faster-than-expected growth rates for the BRICs in recent years. See Jim O'Neill and Anna Stupnytska, 'The Long-Term Outlook for the BRICs and N-11 Post Crisis', Goldman Sachs Global Economic Paper No. 192 (4 December 2009) pp 21–23, available at **www.goldmansachs.com/our-thinking/topics/brics/brics-reports-pdfs/long-term-outlook.pdf** ('Our current projections show that China may now overtake the US 14 years earlier than we thought originally – we now expect it to become the largest economy in the world by 2027, vs 2041 previously.').

To be sure, as popular as the BRIC moniker has become and as widely discussed as the BRIC thesis has been, the BRIC thesis has also received some criticism. See eg, Markus Jaeger, 'COMMENT: Rise of the BRICs Revisited', Deutsche Bank Research (June 2009), available at **www.dbresearch.com/servlet/reweb2.ReWEB?addmenu=false&document=PROD0000000000241888&rdShowArchivedDocus=true&rwnode=DBR_INTERNET_EN-PROD$BANKENTEAM21&rwobj=ReDisplay.Start.class&rwsite=DBR_INTERNET_EN-PROD** (criticising BRIC thesis for understating the role of China vis-à-vis the three other BRICs taken together). See also David Rothkopf, 'The BRICs and what the BRICs would be without China…', Foreign Pol'y (15 June 2009), available at **http://rothkopf.foreignpolicy.com/posts/2009/06/15/the_brics_and_what_the_brics_would_be_without_china**.

15 See Andrew Monahan, 'China Overtakes Japan as World's No 2 Economy', *The Wall Street Journal* (14 February 2011), available at **http://online.wsj.com/article/SB10001424052748703361904576142832741439402.html**.

16 This is based on a so-called purchasing power parity (PPP) measure of GDP as opposed to a nominal value measure of GDP. It should be noted, of course, that China's per capita income is not even in the top 100 in world rankings which still places it squarely in the ranks of developing countries, and China faces other major economic and social challenges such as substantial income inequality and significant regional disparities in levels of development. See *The World Factbook*, Central Intelligence Agency, **www.cia.gov/library/publications/the-world-factbook/geos/ch.html** [last updated 24 August 2012] (source for data on GDP and GDP per capita is based on 2011 estimates). For further discussion of the major challenges facing China, see, generally, Michael Spence, *The Next Convergence: The Future of Economic Growth in a Multispeed World* (Farrar, Straus & Giroux, 2011) pp 194–198.

17 See Charles Booth, *The 2006 Enterprise Bankruptcy Law: The Wait is Finally Over*, [2008] 20 Singapore ACLJ 275, 313–314 ('as China has not entered into any relevant treaties or reciprocal relations on cross-border insolvency, Art 5 is unlikely to have much impact at present.'); Jingxia Shi, *Twelve Years to Sharpen One Sword: 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy*, [2007] 16 Norton J Bankr L & Prac, 645, 678 (noting absence of cross-border insolvency treaties entered into by China and also noting that the reciprocity requirement 'renders the assistance from Chinese courts unpredictable and subject by and large to the discretion of the judge.') See also Steven T Kargman, 'Solving the Insolvency Puzzle', China Business Review (September–October 2007), p. 48.

18 China's Enterprise Bankruptcy Law contains the following language in Article 5: 'when believing that the said judgment or ruling does not violate the basic principles of the laws of the People's Republic of China, does not jeopardize the sovereignty and security of the State or public interests, does not undermine the legitimate rights and interests of the creditors within the territory of the People's Republic of China…' Enterprise Bankruptcy Law of the People's Republic of China (promulgated by the Standing Committee of the Tenth National People's Congress, 27 August 2006, effective 1 June 2007), available at **www.china.org.cn/china/LegislationsForm2001-2010/2011-02/11/content_21898381.htm** [last updated 11 February 2011].

19 The UNCITRAL Model Law provides as follows in Article 6: 'Nothing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of this State.' UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment, UNCITRAL Article 6, available at **www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf** [last visited 2 September 2012]. The narrowness of the public policy exception is further reinforced in the Guide to Enactment: 'The purpose of the expression "manifestly", used also in many other international legal texts as a qualifier of the expression "public policy", is to emphasize that public policy exceptions should be interpreted restrictively and that article 6 is only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the enacting State.' *Ibid* at paragraph 89.

20 Without any provisions in Brazil's new insolvency law dealing specifically with cross-border insolvency, Brazil essentially remains reliant in the cross-border insolvency area on, among things, decades-old treaties and conventions, such as the Code of Bustamante of 1928 which is only applicable among the signatory countries – mostly smaller Latin American countries – and whose 'practical application has been somewhat limited'. Thomas Felsberg and Paulo Campo Fernando Campana Filho, 'Brazil' in *Restructuring and Insolvency 2012* ed Bruce Leonard (Getting the Deal through, 2011) at 71. See also Thomas Felsberg, Steven Kargman and Andrea Acerbi, 'Brazil Overhauls Restructuring Regime', Int Fin L Rev [2006] 40, 44 (January 2006) ('[the] failure to incorporate the Model Law will maintain the uncertainty and unpredictability that existed under the old law with respect to multi-jurisdictional insolvencies that include a Brazilian component […]'). For a detailed discussion of cross-border insolvency law in Brazil, see Paulo Fernando Campana Filho, 'The Legal Framework for Cross-Border Insolvency in Brazil', 32 Houston J Int'l L Rev 97 (2010).

21 South Africa was invited to attend its first BRIC summit meeting in April 2011 which appeared to confer some BRIC-type status on South Africa. See Nasreen Seria, *South Africa is Asked to Join as a BRIC Member to Boost Emerging Markets* (Bloomberg, 24 December 2010) **www.bloomberg.com/news/2010-12-24/south-africa-asked-to-join-bric-to-boost-cooperation-with-emerging-markets.html**. For the argument as to why South Africa should not be considered in the same grouping as the original BRICs, see Jim O'Neill, *The Growth Map: Economic Opportunity in the BRICs and Beyond* (Portfolio/Penguin, 2011) p 106 ('as far as economic criteria are concerned it is difficult for me to think of South Africa as a genuine BRIC.').

22 It was a requirement of South Africa's cross-border insolvency legislation that the Minister of Justice designate States as to which the legislation would be effective, but apparently the Minister of Justice has not designated any such States. See Clare van Zuylen (Bowman Gilfillan), 'South Africa' in Restructuring and Insolvency 2012 ed Bruce Leonard at 436; *Challenges of Cross-Border Insolvency*, Tanner DeWitt Solicitors, **www.tannerdewitt.com/media/publications/challenges-of-cross-border-insolvencies.php** [last visited 2 September 2012].

23 Some of these groupings include countries that are not, strictly speaking, 'emerging economies' but rather 'frontier markets' or even simply 'developing countries'. For example, countries such as Bangladesh, Nigeria, and Vietnam, which show up on at least one of these lists of up-and-coming economies, might considered to be 'frontier markets'. However, the distinctions between some of these categories can be somewhat blurry (a point that applies as well to the discussion of country categories in other parts of this article). For one listing of 'frontier markets', see Ruchir Sharma, *Breakout Nations: In Pursuit of the Next Economic Miracles* (WW Norton & Co, 2012) p 261–262.

24 For this and related analysis, we are using the UNCITRAL Model Law as a simple proxy for whether countries have an effective cross-border insolvency regime. To be sure, in order to fully address whether a country has adopted a cross-border insolvency regime, one would have to review in detail the individual insolvency legislation of each country in question, but such a country-by-country analysis of the relevant insolvency legislation for all of the emerging economies discussed in this article is beyond the scope of this article. For purposes of determining whether a country has adopted the UNCITRAL Model Law in the ensuing discussion, we refer to the official UNCITRAL website at **www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html** [last visited 2 September 2012].

25 Different analysts have developed different lists of various emerging markets to keep an eye on, and some of these lists have their own acronyms. Jim O'Neill, the creator of the BRIC concept, and his colleagues at Goldman Sachs have developed the concept of the 'Next 11' which includes the next 11 most populous emerging markets after the BRICs. The Next 11 includes the following countries: Bangladesh, Egypt, Indonesia, Iran, South Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam. Of the Next 11, only South Korea and Mexico have adopted the UNCITRAL Model Law. The 'CIVETS' grouping, which focuses in particular on countries with young populations, includes Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa (The 'CIVETS' countries are the target investee countries for an investment fund run by HSBC Global Asset Management.). In this grouping, only two countries – Colombia and South Africa – have adopted the UNCITRAL Model Law. The 'MAVINS' grouping, which focuses on countries with commodities and expanding domestic markets, includes Mexico, Australia, Vietnam, Indonesia, Nigeria and South Africa, and in this grouping, Mexico, Australia and South Africa have adopted the UNCITRAL Model Law. (As noted above in the case of the CIVETS grouping, some of the groupings are not developed simply for academic purposes, but rather may be tied to specific investment products offered by investment funds and/or investment firms).

For background on the Next 11, see Dominic Wilson and Anna Stupnytska, 'The N-11: More than an Acronym', Goldman Sachs Global Economics Paper No. 153 (28 March 2007) **www.chicagobooth.edu/alumni/clubs/pakistan/docs/next11dream-march%20'07-goldmansachs.pdf**. For information on CIVETS, see John Greenwood, 'After BRICs, CIVETS?', The Wall Street Journal (18 September 18, 2011), **http://online.wsj.com/article/SB10001424053111904716604576546632573895382.html**. For information on the MAVINS, see Vincent Fernando and Jon Wiesenthal, (The Next BRICs: Six Surging Countries You Must Pay Attention to This Decade), Business Insider (6 January 2010), **www.businessinsider.com/the-next-10-brics-2010-1?op=1**.

26 South Korea occupies an interesting position in the classification of economies as it does not seem to fit neatly into the existing classification categories, such as developed country versus developing country or advanced economy versus emerging market. See Jim O'Neill, *The Growth Map: Economic Opportunity in the BRICs and Beyond* (Portfolio/Penguin, 2011) p 98 ('South Korea in particular is closer to a developed country than a developing one, and its GDP per capita and high growth environment scores reflect that.').

27 For the status of states that have adopted the UNCITRAL Model Law, see the UNCITRAL website at **www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html** [last visited 2 September 2012].

28 'Frontier markets' are defined as 'small, illiquid stock markets that are generally considered to be at a much earlier stage of economic and financial market development than emerging markets.' See John Christy, 'Frontier Markets Definition, About.com, **http://internationalinvest.about.com/od/glossary/g/frontiermarket.htm** [last visited 2 September 2012]; See also Ruchir Sharma, *Breakout Nations: In Pursuit of the Next Economic Miracles* (WW Norton & Company, Inc, 2012) p 187 ('"Frontier" is a term that has come into regular use only since about 2007, and it is defined in several different ways, but the simplest way to think about these nations is that they are open to foreign investors but do not follow orthodox market rules.').

29 Of course, South Africa and Eritrea are very much of an odd pairing: South Africa is considered to be the largest economy in Africa whereas Eritrea is only a tiny economy by comparison. However, as a minor historical footnote, Eritrea was, according to UNCITRAL's tally of adopting states, the first country to have adopted the UNCITRAL Model Law having done so in 1998. Status: 1997 – UNCITRAL Model Law on Cross-Border Insolvency, (UNCITRAL, 2007) **www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html** [last visited 2 September 2012].

30 See Thomas Felsberg and Paulo Campo Fernando Campana Filho, 'Brazil' in *Restructuring and Insolvency 2012* ed Bruce Leonard (Getting the Deal through, 2011) at 71.

31 The fundamental dichotomy in cross-border insolvency involves 'universalism', on the one hand, and 'territorialism', on the other hand. Professor Westbrook describes 'universalism' as the 'administration of multinational insolvencies by a leading court applying a single bankruptcy law […]', and he describes 'territorialism' as the approach by which 'each country would seize local assets and apply them for the benefit of local creditors, with little or no regard for foreign proceedings'. Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, [2000] 98 MICH L REV 2276, 2277, 2282. For further discussion of the competing approaches of universalism and territorialism, see also Bob Wessels, Bruce Markell and Jason Kilborn, *International Cooperation in Bankruptcy and Insolvency Matters* (Oxford University Press, 2009) p 40–50.

There also variations on pure universalism and pure territorialism such as 'modified universalism' which is considered a decent characterisation of the approach taken by the UNCITRAL Model Law. 'Modified universalism' has been described as 'accept[ing] the central premise of universalism, that is, that assets should be collected and distributed on a worldwide basis, but reserves to local courts discretion to evaluate the fairness of home country procedures and to protect the interests of local creditors.' *See* Look Chan Ho, *Perfecting the Union, Perfecting Universalism*, [2009] 2 Corporate Rescue & Insolvency 71.

32 Indeed, when China enacted its new law in 2006, its cross-border provision, Article 5, while not fully embracing the 'modified universalist' approach embodied by the UNCITRAL Model Law, nonetheless represented an advance over China's former approach of strict territoriality. See Jingxia Shi, *Twelve Years to Sharpen One Sword: 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy*, [2007] 16 Norton J Bankr L& Prac 645, 677 ('While this clause [Article 5] does not subscribe to a clear-cut universality approach, it moves away from the territoriality approach and can be termed "revised universality."').

33 Judicial interpretations issued by the Supreme People's Court can play an important part in the development of law in China. See Jingxia Shi, *Twelve Years to Sharpen one Sword: 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy.* note 32 above, at 695 n217 ('In China, the Supreme Court from time to time issues judicial interpretations, ie, guidance on implementation of particular laws. They are very important supplements to the legislation and govern the trial practices of courts on all levels.'); see also Charles Booth, *Drafting Bankruptcy Laws in Socialist Market Economies: Recent Developments in China and Vietnam*, [2005] 18 Colum J Asian L 93, 99–100.

34 See Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choices of Law and Choices of Forum*, [1991] 65 Am Bankr LJ 457, 464–66 (discussing 'rough wash" and 'transactional gain' arguments in favour of universalism). We will discuss possible arguments that can be made in favour of a robust cross-border insolvency regime in further detail in Part II of this article.

Emerging Economies and Cross-Border Insolvency Regimes: Missing BRICs in the International Insolvency Architecture (Part II)

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This is the second part of an article published previously in *Insolvency and Restructuring International*. In this part, we will explore intermediate steps that emerging economies might adopt as a means of growing more comfortable with the concepts that are central to any meaningful cross-border insolvency regime – particularly concepts such as recognition of foreign insolvency proceedings in a domestic proceeding, coordination and cooperation between proceedings pending in different jurisdictions, and the proper treatment of foreign creditors in domestic proceedings – as well as how these concepts are applied in practice in actual cross-border situations.

In Part I of this article published in the prior issue of this journal, we surveyed the international landscape and discussed a significant gap in the existing international insolvency architecture – namely, the absence of effective cross-border insolvency regimes in many emerging economies around the world, particularly in each of the so-called BRIC countries (Brazil, Russia, India and China) but also in other major emerging market jurisdictions. Part I focused primarily on the issue of comprehensive cross-border insolvency regimes, notably the UNCITRAL Model Law on Cross-Border Insolvency which establishes the international standard in this area,[1] and the very limited extent to which major emerging economies have adopted such comprehensive cross-border insolvency regimes. In Part I, we also outlined possible pathways that emerging economies might pursue that could lead to the adoption of such comprehensive cross-border insolvency regimes in these jurisdictions.

In Part II, we will explore intermediate steps that emerging economies might adopt as a means of growing more comfortable with the concepts that are central to any meaningful cross-border insolvency regime – especially concepts such as recognition of foreign insolvency proceedings in a domestic proceeding, coordination and cooperation between proceedings pending in different jurisdictions, and the proper treatment of foreign creditors in domestic proceedings – as well as how these concepts are applied in practice in actual cross-border situations. The intermediate steps that we will discuss, including regional approaches to cross-border insolvency, might serve to pave the way ultimately for the adoption by these emerging market jurisdictions of a more comprehensive cross-border insolvency regime. Finally, we will also consider the challenges that emerging economies might face in implementing cross-border regimes, as well as discuss ways in which both national and international policymakers can bring further attention to the issue of cross-border insolvency law reform.

Regional approaches to cross-border insolvency

Some countries that are considering whether to adopt a cross-border insolvency regime, may be inclined to consider the issue from a regional perspective, consisting in taking into account what their neighbouring countries have done or plan to do in the field of cross-border insolvency. In many cases, the neighbouring countries may be some of their largest trading partners, and thus an individual country in a particular region may be reluctant to embrace a cross-border insolvency regime unless its neighbours do so as well, thereby giving rise to the cross-border insolvency equivalent of something akin to an Alfonse-Gaston routine.

Some regions may be relatively well integrated economically and/or politically and thus might be strong candidates for adopting a regional approach to cross-border insolvency issues. For example, the countries of Southeast Asia are increasingly drawing closer together under the rubric of their long-standing regional association, the ten-member Association of Southeast Asian Nations (ASEAN).[2] However, as noted in Part I of this article, not even a single country in the ASEAN region has yet adopted the UNCITRAL Model Law on Cross-Border Insolvency.

Nonetheless, cross-border insolvency matters are not an unknown issue to the ASEAN countries as reflected in the case of the high-profile US$13.9bn Asia Pulp & Paper (APP) restructuring of just over a decade ago. The APP restructuring involved a complex cross-border situation in which the holding company was located in Singapore but the operating companies were located in other jurisdictions, notably Indonesia and China (neither of which had adopted the UNCITRAL Model Law). The APP restructuring spilled over into the Singapore courts (as well as the courts of several other jurisdictions), but the Singapore courts at both the trial court and appellate level refused to grant a petition by certain creditors for so-called judicial management of the Singapore holding company.

The Singapore courts expressed concern that any judicial managers appointed by a Singapore court might experience difficulty in exerting control over the Indonesian and Chinese operating company subsidiaries.[3] One wonders, however, whether the Singapore courts would have come to a different result or at least analysed the case differently if, for example, at the time this litigation was brought, a cross-border insolvency regime such as the UNCITRAL Model Law had been in effect in Indonesia.

Outside of ASEAN, in other parts of the world, new regional groupings are springing up, such as the East African Community,[4] and these new regional groupings might also be good candidates for pursuing a regional approach to cross-border insolvency issues. Some of the countries in such regions are actively pursuing strategies of economic development and such strategies are based in no small part upon strengthening intra-regional trade and investment. In such an environment, issues involving cross-border insolvency are likely to come to the fore at some point in the coming years, as the process of regional economic integration develops further.

Ideally, of course, these regional groupings would encourage all of their members – or even a subset of their members – to adopt the UNCITRAL Model Law on Cross-Border Insolvency (which, after all, stands as the international community's landmark effort in establishing a comprehensive set of rules related to cross-border insolvency). If all of the members of a regional grouping adopted the UNCITRAL Model Law at the same time, this might help an individual member of the regional grouping to overcome any concerns it might have that it would be acting alone in adopting the UNCITRAL Model Law, while perhaps none of its neighbours would follow suit. For some countries, such concerns regarding possible inaction by their neighbours might well serve as a strong disincentive to move forward with the UNCITRAL Model Law or some other full-blown cross-border insolvency regime.

Alternatively but less optimally, individual countries within a given region might adopt what is sometimes referred to as an 'UNCITRAL-lite' approach. Such an approach involves adopting the UNCITRAL Model Law but building into the implementing domestic legislation a reciprocity requirement. Under a reciprocity-based approach, the state that is requesting recognition in a foreign jurisdiction under a Model Law-type statute would only be granted recognition in the receiving state if the requesting state's own domestic insolvency law contained an UNCITRAL Model Law-type statute. [5]

As another fallback to going the full distance and completely embracing the UNCITRAL Model Law (whether in its pure form or UNCITRAL-lite form), the countries comprising a given region might be encouraged to enter into a regional treaty on cross-border insolvency governing cross-border insolvencies arising within that particular region. One obvious template for this approach would be the EU Regulation on Insolvency (which itself is currently undergoing a process of revision within the European Union).[6]

This type of regional treaty-based approach might serve as an important confidence-building measure among the countries in the region with respect to how cross-border insolvency issues are addressed and resolved. To be sure, as noted in Part I, a regional treaty-based approach such as embodied in the EU Regulation on Insolvency may have a serious gap in its coverage if it does not deal by its terms with the issue of how insolvencies arising from jurisdictions outside the particular region in question should be addressed to the extent that such foreign insolvencies intersect with insolvencies in the region itself.

In the area of cross-border insolvency, which is relatively complex and which also involves delicate issues of sovereignty and jurisdiction of national courts (especially with respect to the potential tensions between domestic courts and foreign courts), the value of confidence-building measures should not be underestimated. Moreover, such a regional treaty-based approach might even lead eventually to a greater acceptance among the region's member states of a broader cross-border insolvency regime such as the UNCITRAL Model Law.[7]

Cross-border insolvency protocols as a confidence-building measure

Some countries, particularly those that may be at a relatively early stage of their economic and legal development, may regard establishing a formal, full-blown cross-border insolvency regime as simply a bridge too far at this point in their development. However, even for these countries, there are steps that they can take to acclimate themselves to cross-border insolvency issues without the need at the outset to necessarily introduce a formal or elaborate cross-border insolvency regime.

Specifically, one way to do this would be for emerging economies or developing countries to introduce the use of cross-border insolvency protocols in situations where there are insolvency proceedings pending in multiple jurisdictions.[8] In recent years, protocols have become increasingly more complex as cross-border insolvencies themselves have become increasingly more complex, as was evident for example in the multilateral protocol that was entered into in connection with the Lehman Brothers insolvency proceedings pending in numerous jurisdictions around the world.[9] However, there is no need for emerging economies and developing countries to be intimidated from using protocols simply because certain recent high-profile cross-border insolvencies such as Lehman Brothers have involved fairly intricate protocols.

Instead, emerging economies and developing countries might look to some of the earlier protocols that addressed a range of basic matters that needed to be coordinated in a cross-border insolvency situation.[10] Such simpler, more straightforward protocols might be more appropriate models for emerging economies and developing countries, given that any cross-border insolvencies involving these countries may not raise the difficult challenges that have been faced in recent years in some of the more complicated cross-border insolvencies arising in the advanced economies.

Yet the emerging economies and developing countries might soon discover what the more advanced economies have already discovered: namely, protocols have proven to be fairly useful in coordinating insolvency proceedings pending in multiple jurisdictions[11] and, importantly, protocols give the affected parties flexibility in fashioning a solution well-suited to the specific facts and circumstances of the particular cross-border insolvency situation.

Of course, the judges in the relevant jurisdictions need to be comfortable with their authority in approving protocols. Absent an explicit statutory grant of authority to engage in cooperation with foreign jurisdictions such as set forth in the UNCITRAL Model Law (and thus possibly in any corresponding domestic legislation in the jurisdictions in which the UNCITRAL Model Law has been adopted).[12] This may be easier for common law judges to do than civil law judges in light of the generally broader discretionary authority of common law judges.

Again, however, for those countries that do not yet have in place an effective cross-border insolvency regime, introducing cross-border insolvency protocols into the equation could be a very useful confidence-building measure. The protocols could serve to provide these countries with valuable hands-on experience in dealing with cross-border insolvency issues and coordinating domestic proceedings with proceedings pending in foreign jurisdictions. Moreover, protocols could be a very important building block for what perhaps at a later date might be a broader embrace by these emerging economy jurisdictions of a more full-blown cross-border insolvency regime along the lines of the UNCITRAL Model Law or otherwise.

Challenges to implementing a cross-border insolvency law regime

The usual caveats regarding commercial law reform in domestic systems around the world apply to the introduction of cross-border insolvency law regimes in individual jurisdictions. This is particularly true where such regimes are being introduced in emerging or developing economies whose legal systems are generally less well developed than those of advanced economies.

First, the introduction of such cross-border regimes will depend on already having in place or developing the necessary supporting infrastructure to implement such regimes. In other words, for such a cross-border insolvency regime to work effectively, there should be a capable corps of judges, professionals and other relevant stakeholders present in the relevant jurisdiction. This may require training – in some cases, very extensive training – of the relevant stakeholders in order to familiarise them with the key concepts of cross-border insolvency generally as well as the more specific, technical aspects of the UNCITRAL Model Law.[13]

Secondly, concerns relating to rule of law – or, more precisely, the lack thereof – also apply and can present a potential obstacle to meaningful implementation of a cross-border insolvency regime. Specifically, if courts in a given jurisdiction do not function properly due to corruption, a lack of independence, or even a lack of competence, one cannot reasonably expect a new cross-border insolvency regime (or, for that matter, even the jurisdiction's basic domestic insolvency regime itself) to function effectively, either.

In fact, in some countries where adherence to the rule of law is highly questionable, it may make very little difference as a practical matter whether or not the country adopts the UNCITRAL Model Law. With or without the UNCITRAL Model Law, the outcomes in particular cases in such problematic jurisdictions may tend to rest on extrajudicial factors and influences rather than on the issues that are properly before the reviewing court itself.[14]

Thirdly, in some countries, developing a cross-border insolvency regime may have to wait until those countries first establish a sound and well-functioning domestic insolvency law regime. In such countries, it may be premature to introduce cross-border insolvency regimes if there is not yet a domestic insolvency regime in place that works well. Such countries and their relevant stakeholders may need to develop experience with a domestic insolvency law regime before they embrace a cross-border insolvency regime.

To be sure, emerging market or developing country jurisdictions should not use this as an excuse for inaction in moving towards or ultimately embracing a cross-border insolvency regime. Instead, this is simply to sound a cautionary note, as these jurisdictions may need to give careful and deliberate consideration to the proper sequencing in introducing domestic insolvency law reform relative to introducing cross-border insolvency law reform. While some countries may be comfortable introducing both domestic and cross-border regimes at the same time, other countries may need to deal first with the basic issues of implementing a sound domestic insolvency law before they embark on the challenge of addressing cross-border insolvency issues in their domestic legislation.

Overcoming implementation challenges

Nonetheless, in certain jurisdictions, it may be possible to overcome some of the challenges related to implementation of a cross-border insolvency regime, particularly where those challenges relate principally to the competence or experience levels of the courts and other relevant stakeholders. Specifically, in some jurisdictions, specialised courts such as commercial courts (or special commercial chambers) focused solely on handling commercial matters have shown their value in the insolvency area by bringing specialised expertise to bear on matters that might be too technical or complex for courts of general jurisdiction which do not possess the same level of expertise, sophistication or experience in dealing with complex commercial issues.

Similarly, in the cross-border insolvency context, it might be desirable to designate institutions such as commercial courts or special commercial chambers – whether new or already existing in a given jurisdiction – as the exclusive courts or chambers for handling cross-border insolvency cases that arise in that jurisdiction. In this way, cross-border insolvency cases, with their inherent complexities, would be handled by judges who over time would develop experience and, ideally, expertise in addressing cross-border insolvency cases.

Obviously, however, the mere enactment by a country of the UNCITRAL Model Law does not guarantee that the UNCITRAL Model Law will in fact be resorted to by foreign insolvency representatives in a given case or even that the UNCITRAL Model Law will be applied correctly if recognition of a foreign proceeding is sought by such foreign representatives. Indeed, some countries that have adopted the UNCITRAL Model Law have seen very few cases brought under their cross-border insolvency statutes.[15]

Role of policymakers in making cross-border insolvency regimes a reality

For cross-border insolvency regimes in major emerging markets (and developing countries) to become a reality, there will need to be a concerted focus from national policymakers as well as continued attention from those international institutions that have been actively involved in recent years in promoting insolvency law reform around the world. As noted in Part I, each country in question will have to perform its own individualised assessment and analysis of the advantages and disadvantages of adopting a comprehensive cross-border insolvency regime.

Broadly speaking, countries will need to weigh the perceived costs to their national sovereignty versus the potential broader economic benefits that might accrue to the adopting countries. For instance, one issue that countries might evaluate is whether the adoption of a cross-border regime would strengthen a country's involvement and standing in the global economy.

Weighing such costs and benefits was exactly the type of fine-tuned analysis that was undertaken by

New Zealand when it was considering in the late 1990s whether to adopt the UNCITRAL Model Law.[16] As a country whose economy depends heavily on international trade (especially exports) and inbound foreign investment, New Zealand's Law Commission gave special weight, among other factors, to whether the adoption by New Zealand of the UNCITRAL Model Law would promote globalisation and how such adoption of the UNCITRAL Model Law would affect New Zealand's position in the global economy.[17] The New Zealand Law Commission looked favourably upon the impact of the UNCITRAL Model Law on factors such as these and recommended that New Zealand adopt the UNCITRAL Model Law, a step that New Zealand later took.

Policymakers at the international level should continue to give serious attention to the issue of cross-border insolvency law reform. Such policymakers should continue to consult with officials in these emerging markets on the importance of improving their cross-border regimes, particularly as a means of further integration of their respective economies into the global economy. These international policymakers can point to the existing international standard for insolvency law developed by the World Bank and UNCITRAL, as this international standard includes the establishment of a cross-border insolvency regime as one of the critical features of any individual country's insolvency law. Indeed, when the World Bank is called upon to evaluate the adequacy of a country's insolvency regime, it considers whether the country in question has a sound cross-border insolvency framework.[18]

Nonetheless, as Terence Halliday and Bruce Caruthers have pointed out in their seminal work on dynamics of international insolvency law reform,[19] it is critical that such consultations between international institutions and individual countries should be just that – consultations, not directives from outside actors. As Halliday and Carruthers argue, it can be hard to achieve meaningful and sustainable insolvency law reform in a country where such reform is seen as being imposed by outside institutions or actors.

In the end, as discussed above, all countries considering whether to adopt the UNCITRAL Model Law or another comprehensive cross-border insolvency regime need to decide for themselves whether it makes sense for them to do so. Obviously, such countries will need to take into account what they perceive to be the relative advantages and disadvantages of doing so.

Conclusion

As Professor Jay Westbrook[20] and other commentators have noted, one of the major impetuses for the development of a law of cross-border insolvency is that with the expansion of cross-border trade and investment as well as with so many companies operating internationally, the legal regime for insolvency needed to evolve in order to keep pace with developments in the global economy. This provided the intellectual underpinnings for the development of the UNCITRAL Model Law.

In the same vein, in today's global economy where the major emerging economies are already playing such a significant role and with the widely held expectation that they will play an even more prominent role in the coming years, there should clearly be a legal regime in place in the emerging economies to address cross-border insolvencies involving these countries. Yet, as argued in this article, there is a glaring gap in the international insolvency architecture – namely, the very limited extent to which major emerging economies have adopted cross-border insolvency regimes.

While the consequences of this gap for global trade and investment may seem (and, indeed, may actually be) relatively benign at the present time, that may no longer necessarily be the case in the coming years if the emerging economies play an increasingly crucial (if not central) role in the global economy but yet do not have adequate legal regimes in place to address the cross-border insolvencies that will inevitably arise in those jurisdictions. This is why the development of robust cross-border insolvency regimes in the emerging economies should be a priority item for national and international policymakers as they seek to promote commercial law reform in general and insolvency law reform in particular in these increasingly important emerging economies across the globe.

In summary, the global economy is expected to look very different in the next ten to 25 years than it does today, particularly if the emerging economies continue their ascendancy over this period of time. With these changing contours of the global economy, the establishment of cross-border insolvency regimes in the emerging economies that currently lack such cross-border regimes will likely be necessary if the international insolvency architecture that has developed to date is to function effectively in the new global economic environment of the future.

Notes

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1 The UNCITRAL Model Law on Cross-Border Insolvency effectively sets forth the hallmarks of a comprehensive cross-border insolvency regime. As discussed in the *Guide to Enactment* which accompanies the text of the UNCITRAL Model Law, 'Article I, paragraph 1 [of the UNCITRAL Model Law] outlines the types of issues that

may arise in cases of cross-border insolvency and for which the Model Law provides solutions: (a) inward-bound requests for recognition of a foreign proceeding; (b) outward-bound requests from a court or administrator in the enacting State for recognition of an insolvency proceeding commenced under the laws of the enacting State; (c) coordination of proceedings taking place concurrently in two or more States; and (d) participation of foreign creditors in insolvency proceedings taking place in the enacting State.' *Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency*, paragraph 57, p 36 (published as Part II of a document entitled *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*) (adopted by UN in 1997 and published as text in 1999) (available at: www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf, last visited on 23 February 2013).

2 Indeed, the ASEAN countries have announced their goal of forming a region-wide ASEAN Economic Community by 2015; of course, whether or not that goal is realized remains to be seen.

3 See *Deutsche Bank AG v Asia Pulp & Paper Co*, [2002] SGHC 257, paragraph 58 (Sing High Ct), *aff'd*, [2003] SGCA 19, [2003] 2 SLR 320 (Sing Ct App). The trial court stated its reasoning on this point as follows: 'Counsel had indicated that the Petitioners intended to assume control of the APP's Indonesian and Chinese subsidiaries by exercising the company's rights as shareholder in the subsidiaries. With respect, I am not at all optimistic that the task can be so easily achieved by such a route. That may well be the case under our system of law but may not be so under Chinese and Indonesian law, given the anticipated opposition from creditors of those subsidiaries to the judicial management order in the first place, as well as conflict in opinions from the parties' Indonesian and Chinese legal advisers.' (The author was actively involved in the APP restructuring on behalf of one of the foreign creditors, but his client was not a party to the Singapore litigation.)

4 This regional grouping, which came into existence in 2000, consists of Burundi, Kenya, Rwanda, Tanzania and Uganda. While this set of countries may be considered to be comprised more of developing countries as opposed to emerging markets per se, several of these countries have ambitions to move up the economic development ladder or otherwise graduate into higher-income countries.

5 See Samuel L Bufford, *United States International Insolvency Law 2008–2009* (Oxford University Press, 2009), p 579 (noting jurisdictions that have adopted the UNCITRAL Model Law but which have incorporated a reciprocity requirement in their legislation implementing the UNCITRAL Model Law).

6 This approach has been tried in at least one other region, namely among the nations of West and Central Africa that operate under the regional grouping known as OHADA. See, for example, Westbrook, Booth, Paulus & Rajak, *A Global View of Business Insolvency Systems* (The World Bank, 2010), pp 262–264. There is an OHADA legislative act on insolvency law, including provisions dealing with cross-border insolvency, but apparently there has not been much experience in the cross-border insolvency area. For a general discussion of insolvency law issues in OHADA, see Joanna A Owusu-Ansah, 'The OHADA Treaty in the Context of International Insolvency Law Developments,' April 2004 (available at **www.iiiglobal.org/component/jdownloads/finish/398/1555.html**, last visited on 23 February 2013).

7 See, for example, Westbrook et al, note 6 above, at pp 263–264.

8 For an excellent introduction to protocols, see the UNCITRAL publication in this area, *UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation* (2009), available at: **www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2009PracticeGuide.html,** last visited on 23 February 2013. For an extensive collection of protocols from many cross-border insolvencies, see the website of the International Insolvency Institute (available at: **www.iiiglobal.org/component/jdownloads/viewcategory/395.html**, last visited on 23 February 2013).

9 A copy of the Lehman Brothers protocol is available at: **www.iiiglobal.org/component/jdownloads/finish/573/4339.html**, last visited on 23 February 2013. Judge Allan Gropper describes some of the unique challenges faced by the Lehman: 'The disputes involving the affiliates of Lehman Brothers, which involved 75 distinct bankruptcy proceedings relating to its more than 7,000 subsidiary entities in over 40 countries, were even more protracted. It took the insolvency administrators of the 18 major foreign subsidiaries of Lehman Brothers seven months to work out a protocol that contained general principles of coordination and cooperation, and in which the administrators agreed to cooperate in attempting to calculate the inter-company claims among the group.' See Allan Gropper, 'The Arbitration of Cross-Border Insolvencies,' *American Bankruptcy Law Journal* (June 2012).

10 See, for example, Samuel L Bufford, *United States International Insolvency Law 2008-2009* (Oxford University Press, 2009), at p 144 (discussing procedural issues commonly addressed by protocols, including claims filing, claims adjudication, notice, asset disposition, and information sharing).

11 See, generally, Paul Zumbro, 'Cross-border Insolvencies and International Protocols – an Imperfect but Effective Tool,' *Business Law International* (May 2010). See also Ralph R Mabey and Susan Power Johnston, 'Coordination Among Insolvency Courts in the Rescue of Multinational Enterprises,' *Norton Annual Review of International Insolvency* (2009 Edition), p 33; and Joseph J Bellissimo and Susan Power Johnston, 'Cross-Border Insolvency Protocols: Developing an International Standard,' *Norton Annual Review of International Insolvency* (2010 Edition), p 37.

12 See, for example, Article 25 of the UNCITRAL Model Law on Cross-Border Insolvency (authorising 'the court to cooperate to the maximum extent possible with foreign courts or foreign representatives…'); and section 1525 of the US Bankruptcy Code (provision corresponding to Article 25 of the UNCITRAL Model Law).

13 In terms of primers on the UNCITRAL Model Law, there is probably no better source than the publication entitled *UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective* (2011) (available at **www.uncitral.org/uncitral/uncitral_texts/insolvency/2011Judicial_Perspective.html**), as well as, of course, the original *Guide to Enactment* (1997) that accompanied the UNCITRAL Model Law and provided extensive commentary on the text of the UNCITRAL Model Law.

14 For instance, in some systems, corruption is so pervasive that court decisions in these jurisdictions are highly suspect.

15 For instance, in Mexico, apparently only a limited number of cases have been brought under its cross-border insolvency statute. See INSOL's new publication on cross-border insolvency indicating that only three cases have been filed under Mexico's cross-border statute since the statute's enactment in 2000, namely *Xacur*, *IFS Financial Corporation*, and *Mark Allen Dennis*. Carlos Sanchez-Mejorada y Velasco, Chapter 26, 'Mexico', *Cross-Border Insolvency II: A Guide to Recognition and Enforcement* (INSOL International, 2012) at pp 172–73. (Yet, other developing countries/emerging markets that have adopted the UNCITRAL Model Law have apparently had even fewer filings than Mexico under their cross-border statutes.) See also Thomas S Heather, Chapter 16, 'Mexico', *The Restructuring Review* (Fifth Edition) (Christopher Mallon, editor, 2012) at pp 219–20 (indicating that while there have been few filings under the Mexican cross-border statute, it has been more common for Mexican companies to file in the US under Chapter 15). The trend of Mexican insolvency proceedings seeking recognition and relief in the US under Chapter 15 recently hit a speed bump in the *Vitro* case where the US Court of Appeals for the Fifth Circuit affirmed a Bankruptcy Court ruling that a Mexican plan of reorganisation (a so-called *concurso* plan), authorising the non-consensual release of third-party releases as part of a plan approved by a Mexican court, should not be enforced in the US under Chapter 15. *In re Vitro, SAB de CV*, No 12-10542, 2012 WL 5935630 (5th Cir 28 November 2012).

It is instructive to note, however, that, according to an empirical study by Professor Jay Westbrook, the United States courts have granted recognition in hundreds of Chapter 15 cases from all over the world since the enactment of Chapter 15 in 2005 and that the US courts 'granted some form of recognition in around 95 per cent of the cases filed. Jay Lawrence Westbrook, 'An Empirical Study of the Implementation in the United States of the Model Law on Cross Border Insolvency' (abstract available at: **http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2162964** (last visited on 11 February 2013). Among other interesting findings, the Westbrook study indicates that approximately two-thirds of the Chapter 15 filings (383 filings out of a total of 577 filings) have come from only two countries, namely the United Kingdom and Canada, notwithstanding the fact that filings have come from approximately 20 separate jurisdictions worldwide.

16 See New Zealand Law Commission, Report 52, February 1999, *Cross-Border Insolvency: Should New Zealand Adopt the UNCITRAL Model Law on Cross-Border Insolvency?* (available at: **www.nzlii.org/nz/other/nzlc/report/R52/**, last visited on 11 February 2013). For countries undertaking the process of deciding whether to adopt the UNCITRAL Model Law, the report of the New Zealand Law Commission provides an excellent template and roadmap for evaluating the myriad considerations involved in such a decision-making process.

17 *Ibid*, at p 39 (referring to various economic factors associated with the possible adoption by New Zealand of the UNCITRAL Model Law that would be 'likely to reduce transaction costs and promote trade and capital flows thereby improving the economic well-being of the New Zealand economy').

18 Such an evaluation would be undertaken as part of a so-called ROSC ('Report on the Observance of Standards and Codes') related to a country's insolvency and creditor/debtor regimes. Principle C15 of the World Bank *Principles and Guidelines for Effective Insolvency and Creditor Rights System*, which is one of the elements of such an insolvency-related ROSC, deals specifically with 'international considerations' of a country's insolvency law. The Principle provides that '[i]nsolvency proceedings may have international aspects, and a country's legal system should establish clear rules pertaining to jurisdiction, recognition of foreign judgments, cooperation among courts in different countries and choice of law'.

19 See, for example, Terence C Halliday and Bruce G Carruthers, *Bankrupt: Global Lawmaking and Systemic Financial Crisis* (Stanford University Press, 2009). See also book reviews of the same by Steven T Kargman, *Insolvency and Restructuring International*, April 2010, Vol 4 No 1, pp 46–49; and *INSOL World*, First Quarter 2010 , p 9.

20 See, for example, Jay L Westbrook, 'Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum', 65 *Am Bank LJ* 457 (1991).

Convergence in National and International Insolvency Laws Since 2002

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This article reviews the efforts and progress of international organisations, states and insolvency experts since 2002 towards convergence of national and international insolvency regimes. In 2002, Professor Doctor Christoph Paulus of Humboldt University in Berlin authored a seminal article on this convergence, predicting that its pace would accelerate in the immediate future and move towards harmonisation of insolvency law worldwide. The authors of this article believe that Professor Paulus' prediction was on target and review a number of examples of such convergence including: (i) the increasing enactment of the UNCITRAL Model Law by states; (ii) the enactment of reorganisation statutes permitting management to remain in possession of their assets while they propose a reorganisation plan; and (iii) efforts by the European Commission to tailor the European Insolvency Regulation, adopted in 2002, to modern insolvency practice.

Ten years ago, Professor Doctor Christoph G Paulus, a professor of insolvency law at the Humboldt University in Berlin and a prominent authority in European and international insolvency law, published an article entitled *Comparison of National and International Insolvency Law: A Story of Success.*[1] In his article, Professor Paulus offers a series of specific observations about the then existing trend in insolvency law that, as he noted, had 'in the last few years. . . . moved in a remarkable way into the center of general interest and, in doing so, has become the object of studies about comparative which only ten years ago would not have been thought possible'.[2] According to Paulus, insolvency law worldwide had received 'a push… that had led to a worldwide convergence in this field of law today'.[3]

When Professor Paulus authored this article, sea-changes were occurring in national and international insolvency jurisprudence. In 1997, the United Nations Commission on International Trade Law ('UNCITRAL') adopted its Model Law of Cross-Border Insolvency (the 'Model Law') and, as of 2002, only five nations had adopted the Model Law. In addition, the International Monetary Fund ('IMF') and the World Bank published in 1999 and 2001 respectively, and in direct response to the East Asian Crisis of 1997–1998,

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WHAT'S INSIDE

SEE P. 51 FOR DETAILS ON UPCOMING AIRA EVENTS:

11TH ANNUAL ENERGY SUMMIT & 22ND ANNUAL POR CONFERENCE

THE BRAVE NEW WORLD OF SOVEREIGN DEBT RESTRUCTURING: THE CHINA CONUNDRUM AND OTHER CHALLENGES[1]

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The past few years have not been kind ones generally for emerging economies and developing countries around the globe. These economies were hard hit by the economic fallout from the two external shocks without precedent in recent history, namely the once-in-a-century COVID-19 pandemic and then the Ukraine war, the first major ground war in Europe in 75 years. Apart from a relatively strong economic recovery in 2021 in which these economies grew by nearly 7% (according to the International Monetary Fund (IMF)), these economies experienced less-than-stellar growth in 2022 in the range of 3.4% to 4% according to the World Bank and the IMF, respectively, and much improved results are not expected for either 2023 or 2024.

Perhaps more troubling is that slow growth for the emerging and developing economies is expected to continue over the remainder of the 2020s. In fact, the World Bank recently published a report indicating that these economies may experience an average growth rate of 4% over the 2020s compared to an average growth rate of 6% in the period 2010-2020, and the report suggested that that the actual growth rate for the 2020s could even turn out to be lower in the event of a global recession or global financial crisis. Some commentators are even raising the specter of a "lost decade" in the 2020s for emerging economies and developing countries, something that the countries of Latin America experienced in the sovereign debt crisis of the 1980s.

Current Sovereign Debt Landscape for Emerging Economies and Developing Countries

Sluggish growth, however, is not the only problem facing these economies. Many of these economies are now suffering from a broad array of economic ills, including high inflation (especially with respect to food and energy costs), depreciating currencies, widening balance of payment deficits, dwindling foreign exchange reserves, and shortages of critical commodities and supplies.

The economic travails of these emerging and developing economies are only likely to continue to get worse if global interest rates remain at relatively high levels and/or if, as some predict, the global economy slips into a worldwide recession in the coming months. Furthermore, China's slower-than-expected post-pandemic economic recovery may well have a dampening effect on the global economy in general and the emerging economies and developing countries in particular.

Against this backdrop, it is perhaps therefore not surprising that many emerging economies and developing countries are currently experiencing sovereign debt distress or are at risk of experiencing such distress in the coming months. Many of these economies incurred substantial new debt during the pandemic on top of what were already historically high debt levels that existed pre-pandemic. (The IMF considers a country to be in debt distress when, particularly as a result of an unsustainable debt burden, "a country is unable to fulfill its financial obligations and debt restructuring is required.")

By the reckoning of the IMF, as of January 2023, 60% of low-income countries were either in debt distress (15% of low-income countries) or at high risk of debt distress (45% of low-income countries), and the IMF indicated that this 60% figure was double the corresponding percentage in 2015. In addition, as of late 2022, according to a Bloomberg index of 72 emerging economies, at least 15 emerging economies had debt trading at distressed debt levels (i.e., 1000 basis points over US Treasuries).

Debt servicing costs, particularly in view of the currently prevailing higher interest rate environment and the marked depreciation of local currencies (which affects the cost of servicing hard currency-denominated debt), are eating up an ever-increasing percentage of government revenues in many developing countries. This is possibly nowhere more evident than in the countries of Africa, especially those of sub-Saharan Africa. For African countries as a whole, 17% of government revenues are spent on debt servicing costs which is the highest level since 1999, according to a report in *The Economist*. As a general matter, external debt servicing costs for sub-Saharan countries are expected to rise 50% from 2019 to 2026, according to a December 2022 article in *Bloomberg*.

At a very concrete level, this means that debt servicing costs in a number of countries are eclipsing the amount of government revenues that can be devoted to government expenditures on health, education, and other social services—i.e., expenditures intended to meet the basic human needs of the local populations. As noted recently in *The Economist*, "In 2010 the average sub-Saharan country spent 70% more on health per person (US$38) than on external debt (US$22). By 2020 spending on debt service was 30% higher."

[1] Note: This article originally appeared in *International Insolvency & Restructuring Report 2023/24* (IIRR) and is reprinted with the kind permission of IIRR's publisher, Capital Markets Intelligence Ltd. (https://www.capital-markets-intelligence.com). Unless otherwise specifically noted, this article speaks of developments only as of mid-May 2023 and does not address any subsequent developments.

Continued from p.15

The China Conundrum

In terms of the international financial community's reaction to this situation, the good news is that the issue of sovereign debt distress in the emerging and developing economies is now receiving the high-level attention it deserves. Thus, this issue was front and center at the recent annual spring meetings of the World Bank and the IMF.

However, the bad news is that the issue does not lend itself to easy or straightforward solutions that are palatable to both sovereign debtors and their creditors (whether such creditors are, for example, international financial institutions such as the World Bank and the IMF, private sector creditors such as bondholders or commercial banks, or bilateral creditors/national governments). Moreover, the issue appears to have become subject to geopolitical tensions between the US and the West, on the one hand, and China, on the other hand.

There are several ongoing high-profile situations of sovereign default and sovereign debt restructuring discussions, including among others Zambia and Sri Lanka, and yet after extended periods of time, sovereign debt restructuring deals have not been reached between the respective sovereigns and their creditors. To take but one example, Zambia defaulted on its sovereign debt over two-and-a-half years ago (and thereby became the first sub-Saharan nation to do so in recent years), and it still has not reached a restructuring deal with its creditors.

[UPDATE: In late June, Zambia finally reached a deal with its principal bilateral creditors, including members of the Paris Club of industrialized countries and other non-Paris Club creditors, particularly China which reportedly holds one-third of Zambia's outstanding external debt. According to press reports, the deal apparently involves rescheduling Zambia's debt repayments over a twenty-year period, with a three-year grace period on principal payments, and a clause requiring Zambia to obtain similar treatment from its private sector creditors. The deal enabled Zambia to receive a second tranche of funding from the IMF under a previously agreed arrangement that Zambia had entered into with the IMF. Notwithstanding the deal with its bilateral creditors, Zambia has yet to come to an agreement on a restructuring with its foreign bondholders (who hold both local and foreign currency-denominated debt) or other private sector creditor constituencies such as commercial banks.]

Zambia, which is estimated to have an external debt burden of approximately US$20bn, has a very diverse creditor body, including bondholders (both foreign and local), bilateral/national government creditors (other than China), Chinese lenders, multilateral institutions, and banks. But Chinese lenders have far and away the largest official exposure, estimated to be approximately US$6bn or just under one-third of Zambia's overall external indebtedness.

China is an actor in so many of the current wave of sovereign debt restructuring situations because it is the largest official bilateral creditor to emerging economies and developing countries taken as a whole, with much of the Chinese lending in the last decade having been connected to China's Belt and Road Initiative.

Other non-Chinese creditor constituencies have the following exposures to Zambia, according to a recent report in the *Financial Times*: international development banks (US$2.7bn), various Western governments (US$1.3bn), banks (US$1.6bn), local currency-denominated bonds held by foreigners (US$3.3bn), and international dollar-denominated bonds (US$3.3bn).

Criticisms from the Western International Financial Community

In the lead-up to and during and after the recent IMF-World Bank spring meetings, China came in for unusually harsh criticism from US Treasury Secretary Janet Yellen, outgoing World Bank president David Malpass, and IMF Managing Director Kristalina Georgieva, all of whom asserted that China was a major, if not the primary, obstacle holding back progress in these sovereign debt restructuring situations.

As Treasury Secretary Yellen said in a speech in late April, "China's participation is essential to meaningful debt relief, but for too long it has not moved in a comprehensive and timely manner. It has served as a *roadblock to necessary action*" (emphasis added). For her part, IMF Managing Director Kristalina Georgieva said in early April, "China has been very slow to recognize that multilateral debt restructuring requires China to *play by the rules* that are already established" (emphasis added). World Bank President David Malpass has criticized China for "asking lots of questions in the creditors' committees," seemingly suggesting that China is simply looking for a way to slow down, if not stall, debt restructuring discussions.

The US Treasury, the IMF, and the World Bank, as well as Western creditors and Western governments generally, criticize China's role in these debt restructuring situations on several grounds. (For ease of reference, I will use the term "Western international financial community" to describe collectively all of these parties.) First and perhaps most importantly, they maintain that China is unwilling to consider debt forgiveness (aka "haircuts") which they believe must be an indispensable element of any overall sovereign debt restructuring solution for the countries in question.

They also believe that many of the countries in question are facing debt burdens that are manifestly unsustainable and that these countries therefore require debt forgiveness as opposed to merely loan rescheduling (which has been China's traditional approach to sovereign debt restructuring). The Western international financial community believes that loan rescheduling is a grossly inadequate response in light of the degree of debt distress currently facing many sovereigns.

Second, Western creditors, whether private creditors (such as bondholders) or bilateral creditors, do not wish to forgive debt if that means essentially that the debt they have forgiven could then effectively be used by the relevant sovereign to continue servicing the debt of Chinese creditors. Furthermore, it seems that the IMF as well would be reluctant to lend into a situation where such IMF loans could be used to service the unrestructured debt of Chinese creditors.

Third, the Western international financial community points out that China does not like to engage in multi-creditor restructurings and instead prefers to work out bilateral restructurings between itself and the sovereign. They believe China does not wish to share information with other creditors as is often the case in many multi-creditor restructuring situations and that China instead prefers to handle these restructurings on an opaque basis.

Indeed, China's initial lending to the countries in question is often shrouded in secrecy and confidentiality so that basic information about the loans (including the size of the loans, the interest rate on the loans, the maturity structure of the loans and any security attached to the loans) remains unknown to the sovereign's other creditors. This approach runs absolutely counter to one of the central principles of the Paris Club, specifically the notion of transparency and information-sharing among the parties.

China committed to working with other bilateral and private creditors when it signed up to the Common Framework unveiled by the G-20 countries in 2020, the framework which was supposed to bring Western bilateral creditors, China, and private creditors such as bondholders into a unified, Paris Club-like restructuring process. Nonetheless, the Western international financial community basically believes that China has been dragging its feet in living up to the terms of the Common Agreement, even if, for example, China has agreed to serve as the co-chair, along with France, of the creditors' committee for Zambia. (The Common Framework has only been relied upon by four sovereign debtors—namely, Chad, Ethiopia, Zambia, and Ghana—and only one sovereign, Chad, has completed a sovereign debt restructuring under the Common Framework. However, the Chad restructuring involved only the rescheduling, but not the forgiveness, of Chad's debt.)

Finally, the Western international financial community faults China for questioning the so-called "preferred creditor status" of international financial institutions such as the World Bank and IMF. By virtue of the preferred creditor status claimed by these institutions, they are excluded from participating in any restructuring of the sovereign's debt (i.e., taking a "haircut") in contrast to other creditors such as bilateral creditors, private sector creditors, and others. China has argued that there needs to be fair burden-sharing for all creditors, including the international financial institutions that claim preferred creditor status, and thus, in China's view, all creditors should participate in sovereign debt restructurings.

However, the Western international financial community is adamantly opposed to eliminating the preferred creditor status for institutions such as the World Bank and the IMF. For example, they argue, that the World Bank would not be able to provide concessional (or below-market rate) financing or grants to its borrower countries if it did not have its preferred creditor status, because otherwise it would lose its top credit rating assigned by the rating agencies and thereby be impeded in its ability to access cheaper financing in the international capital markets.

It should be noted that, although it is sending some mixed signals, China has recently given some indications that it may be softening its position on opposing special treatment for institutions claiming preferred creditor status. In return, China would expect institutions such as the World Bank to provide concessional financing to the sovereign debtor undergoing a sovereign debt restructuring.

China, of course, has countered the foregoing arguments with various defenses of its own. For example, China has claimed that much of the sovereign debt distress that now exists among many developing countries and emerging economies is attributable to the interest rate hikes initiated by the Federal Reserve over the past year. Further, China argues that the bulk of its lending, as it is tied to infrastructure projects, is enhancing the productive capacities of the countries in question whereas the loans from the international financial institutions, for example, may be used for general financing purposes, such as closing budget gaps and meeting external financing requirements. To be sure, many of the BRI projects have not worked out as intended.

Clash of Systems and World Views

It is clear to many observers that China does not want to play by the sovereign debt restructuring rules established by Western powers (particularly under the leadership of the US) and effectuated through institutions such as the Bretton Woods institutions of the IMF and the World Bank and the debt restructuring club for the advanced Western economies, the Paris Club. (Importantly, China is not a member of the Paris Club.)

But fundamentally China's unwillingness to play by those rules may reflect the fact that China is trying to construct its own China-centric international financial system, with its own parallel set of institutions and programs, including the Asian Infrastructure Investment Bank (AIIB), the New Development Bank (the so-called BRICS Bank), and its own ambitious development programs such as the Belt and Road Initiative. China does not believe that its voting power in existing international institutions such as the World Bank and the IMF is commensurate with its economic standing in the global economy. China is also seeking a broader international role for its own currency, the renminbi, in international financial transactions, a move that appears to have gained some momentum in the wake of the Western sanctions that were imposed against Russia after the start of the war in Ukraine.

Furthermore, China has its own distinctive way of looking at the world. China does not see itself as a secondary or subservient player on the international stage but rather views itself as occupying a, if not *the*, central role in the international system (whether this is attributable to China's traditional conception of itself as the "Middle Kingdom" in the international system or to some other factor or dynamic). And this is particularly true now that China has the second largest economy in the world measured in nominal GDP or, as of a few years ago, the largest economy in the world measured in terms of purchasing power parity (PPP).

Thus, it is likely that as China looks out on the existing international financial architecture for handling sovereign debt restructuring, it sees a system dominated by Western interests which is not consistent with what China likely considers its proper place in the international financial system. Moreover, in the light of the Chinese notion of "loss of face," it is unlikely that China welcomes being publicly upbraided by officials from Western governments and the international financial institutions on how it should (or should not) conduct itself in the sovereign debt restructuring system such as it is.

Finally, as some observers have noted, it may well be that China's position on favoring debt rescheduling over debt restructuring

Continued from p.17

(or loan forgiveness) is driven by the fragile financial condition of many of China's largest financial institutions, particularly its large state-owned commercial banks. These institutions had large exposures to China's collapsed property sector and were also adversely affected by the serious economic fallout from the pandemic-related lockdown of the Chinese economy.

If the fragile financial condition of the Chinese banks is indeed a driving factor behind their position opposing debt restructuring, that maybe reminiscent of the position that the US money banks took in the early years of the epic 1980s debt crisis. At that time, these banks were in their own perilous financial condition, given their overexposure to many troubled economies in the developing world and favored rolling over loans to developing countries rather than restructuring those loans, and the US government effectively supported such a stance with the so-called Baker Plan unveiled in 1985. US banks were not in a position to take haircuts until the late 1980s when the banks had rebuilt their capital positions, and that paved the way for the US government's Brady Plan in 1989 and the advent of Brady bonds (which converted bank loans to bonds).

The foregoing is certainly not in any way intended to defend China's way of doing business in sovereign debt restructurings or in its sovereign lending generally. Among other things, one could rightly be very critical of China's opacity in both its lending and restructuring activities. One could also be equally critical of China's past lending to countries that seemed to contribute to debt sustainability problems for many countries that already had heavy, if not virtually unsustainable, debt burdens prior to the Chinese lending. Further, one could legitimately question whether some of the Chinese lending was used to finance certain infrastructure projects that ended up being totally unviable from an economic standpoint.

Other Challenges

The current sovereign debt restructuring landscape poses several other significant challenges.

Local Debt

In some of the new crop of sovereign debt restructuring situations, a new variable has to be taken into consideration: namely, the role of bonds that the sovereign has issued in the local currency. In the past, as these local currency-denominated bonds generally represented only a small part of the overall debt burden, they were not addressed as part of the overall sovereign debt restructuring solution applicable to external debt.

However, there are now countries such as Ghana where the local bonds represent a relatively significant part of the country's overall debt burden. This is a result of the concerted efforts by governments in many emerging and developing economies in the last decade or longer to develop local capital markets. (Pakistan and Sri Lanka also have considerable local debt components as part of their overall debt burden.)

In Ghana, for this year local currency-denominated debt was expected to represent 41% of Ghana's GDP whereas its external debt was expected to represent 45% of Ghana's GDP, according to IMF projections made before Ghana's default last December. However, as reported in the *Financial Times*, Ghana's debt servicing costs this year for its local debt (expected to represent approximately 50% of central government revenues) were projected to actually exceed debt servicing costs this year for its external debt (expected to represent approximately 13% of central government revenues).

Accordingly, in sovereign debt restructurings where there is a large local bond component as part of the overall debt burden, other creditors may want to include the holders of local bonds in the overall sovereign debt restructuring so that there is fair burden-sharing across all creditor constituencies. In fact, in the case of Ghana, the IMF apparently insisted that the government of Ghana include the local debt in its restructuring plan in order to receive an IMF financing package. (There is also the issue of whether there should be different treatment for local holders of local currency debt versus foreign holders of local currency debt).

There is a problem, however, in that many of the bonds issued by the sovereign in the local currency may be held by local financial institutions, such as local banks, pension funds, and insurance companies. Therefore, to the extent that a debt restructuring calls for holders of local currency-denominated bonds to take a haircut, this could potentially cause a big hole in the balance sheet of the country's financial institutions.

In turn, this could risk undermining the stability of the local financial system which would obviously be a very undesirable result of the process of restructuring local currency bonds. Thus, unless the local banks, for example, are recapitalized, what started as a sovereign debt crisis for the country in question could end up also becoming a banking or financial crisis for that particular country.

Pakistan

Today the Zambias, Ghanas, and Sri Lankas of the world may seem like major sovereign debt crises. However, there is one country that is currently experiencing huge economic and financial problems where a sovereign debt crisis in the very near future is not beyond the realm of possibility and whose outstanding debt dwarfs the debt burden of some of the sovereigns currently facing debt crises. That country is Pakistan.

As of early 2023, Pakistan had an outstanding external debt burden of approximately US$125bn. Of immediate concern, it has been reported that Pakistan has a debt payment of approximately US$3bn coming due in June which it looks unlikely to be able to make, unless it receives a financing package from the IMF or funding from a third country. Pakistan's economy is in a serious downward spiral, and obviously Pakistan suffered a huge blow with the catastrophic nationwide flooding last summer. It is suffering from very high inflation, its local currency, the Pakistani rupee, has hit all-time lows against the US dollar, and Pakistan has also been experiencing serious shortages of food, fuel, and medicines. There have been widespread power outages throughout Pakistan since, among other things, Pakistan cannot import the fuel that it needs to run its power plants.

[UPDATE: On July 12, the IMF Board approved a $3 billion standby arrangement (SBA) for Pakistan, with an immediate disbursement to Pakistan of $1.2 billion. Around the same time, Pakistan was also reportedly set to receive $1 billion from the United Arab Emirates and $2 billion from Saudi Arabia. With the new funding from these sources, Pakistan was apparently able to avoid a payment default on its outstanding external sovereign debt.]

Pakistan has also run down its foreign exchange reserves to dangerously low levels. As of mid-March, Pakistan was estimated to have foreign exchange reserves of a mere US$3.6bn, which has been estimated to represent funding for approximately just one month of imports.

The IMF has apparently been mulling a large program for Pakistan, reportedly in the range of US$6.5bn. Nonetheless, while the IMF has noted "substantial progress," it wants to see further progress from Pakistan on finalizing funding commitments—or, in IMF parlance, "financing assurances"—from various countries before it approves any new loan. (Debt restructuring commitments are another form of "financing assurances" that the IMF looks for before approving an IMF program for a distressed sovereign and/or approving loan disbursements to that sovereign, and that is another reason why China's reluctance to commit to the "haircuts" in multi-creditor restructuring situations that are dependent on IMF financing is considered a problem.)

Significantly, it is estimated that as much as one-third of Pakistan's external debt is owed to China and Chinese lenders. Pakistan was one of the major recipients of Chinese lending for China's Belt and Road Initiative projects, and indeed the China-Pakistan Economic Corridor (CPEC), consisting of many different types of infrastructure projects in Pakistan, was considered by China to be a flagship, if not *the* flagship, BRI project. (To be sure, like many BRI projects in various countries around the globe, the CPEC has been beset by a number of problems, including cost overruns, construction problems, debt repayment difficulties, etc.)

Thus, if Pakistan experiences a sovereign debt crisis and requires a sovereign debt restructuring, it could encounter the "China conundrum" discussed above that has been present in some of the ongoing cases such as Zambia and Sri Lanka. But given the size of Pakistan's overall external debt burden, this issue will manifest itself on a vastly larger scale and thus may be even more difficult to resolve than in those other countries.

Private sector creditors

Despite the intense focus in recent public debates on the role of Chinese lenders in sovereign debt restructurings, it should not be forgotten that, for a number of emerging economies and developing countries, the amount of outstanding external debt held by private sector creditors, principally bondholders (but also including commercial banks and non-traditional creditors such as commodity trading firms like Glencore), represents a not insignificant component of their overall debt burden.

In recent years, many emerging economies tapped the international capital markets to raise financing, with some being first-time issuers of eurobonds, including several countries in sub-Saharan Africa. Thus, bondholders have become a critically important creditor constituency in a number of the recent sovereign debt restructuring situations. Yet, the presence of bondholders, especially where there are numerous bondholders and where the bondholders themselves may have differing interests, can potentially complicate the overall sovereign debt restructuring process.

It is not uncommon for bondholders, particularly in large, complex sovereign debt restructuring situations, to have challenges in coordinating among themselves, and such coordination challenges among the bondholders can potentially make it more difficult for all of the relevant stakeholders in a sovereign debt restructuring situation to negotiate and come to a consensus on how the overall debt restructuring should be addressed and resolved. Furthermore, to the extent that the various types of private sector creditors (e.g., bondholders, commercial banks, etc.) have differing agendas and/or competing interests, that could only make the sovereign debt restructuring process more difficult since intercreditor disputes in these types of situations can be particularly thorny and not conducive to easy solutions. Finally, it remains to be seen whether private sector creditors such as bondholders will be willing to agree to the same restructuring terms as official sector creditors such as bilateral creditors, whether under a "comparability of treatment" principle set forth in the G-20 Common Framework or otherwise.

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Mexico's insolvency law after COVID-19

by Luis Palomino Bernal, Palomino, Flores, Hernández Abogados

Mexico, being within the 20 largest economies in the world and having more than six million companies that have suffered the onslaught of the crisis generated by COVID-19, in addition to the internal management of economic policy, needs the help of professionals today more than ever in insolvency and restructuring. We will briefly comment on our current situation and what needs to be done to address this delicate issue.

Current legislation

For more than a year, our way of working and living has radically changed due to the COVID-19 pandemic. We have become accustomed to communicating through video conferences, whether for work issues with our clients and colleagues, academic and social activities, or, with regard to our professional performance, to process a trial entirely online.

In this maelstrom of changes, we have seen how different laws on insolvency have been modified in a number of countries, so today what we knew up to March 2020 has changed dramatically.

However, Mexico is the exception.

On May 12, 2000, the bankruptcy law was published in Mexico, to regulate the insolvency procedure for merchants. Here the insolvency procedure of financial institutions and auxiliary credit institutions is also regulated in an accessory way.

However, Mexico does not have an effective and efficient legislation that regulates the insolvency of the non-merchant natural person or consumers.

There is also no special legislation to regulate the insolvency of financial institutions. They depend, as already mentioned, on the bankruptcy law enacted for merchants.

Similarly, there is no legislation that regulates the insolvency of sovereign entities.

Therefore, the only current legislation that is applied in Mexico in insolvency situations is the bankruptcy law, which has been modified four times: in 2007, in 2014, in 2019 and at the beginning of 2020. The most important modifications were in 2007 but especially in 2014. The last two have been minor.

Before the pandemic, in Mexico those dedicated to litigating issues of insolvency and financial restructuring of companies had detected the need to reform the legislation or to generate new laws that address the following specific issues:

1. the bankruptcy law needs to be flexible in the case of micro, small and medium-sized enterprises;
2. a legislation is needed to address the insolvency of natural persons and/or consumers;
3. an exclusive legislation needs to be issued to deal with the insolvency of credit institutions and the like;
4. real Alternative Dispute Resolutions in matters of insolvency are needed, since the current ones are insufficient; and
5. finally, Mexican lawyers dedicated to the insolvency process require that the reforms of 2014 be implemented in reality.

In other words, in 2014 the online trial in bankruptcy matters was implemented and federal district judges with exclusive competence in commercial and insolvency matters were established or created by law. But nowadays the online bankruptcy proceedings have not been implemented and the exclusive federal district judges in commercial and insolvency matters have not been created in the main cities of Mexico to deal with such procedures in an efficient and timely manner.

While the lack of implementation of the bankruptcy online trial was not an issue from which we suffered before the pandemic, but the lack of specialised judges is a major issue, since the courts that today process the insolvency trial are also familiar with many other procedures (including amparo), which is why in practice they constantly reject bankruptcy proceedings.

Emergency legislation

At the beginning of the pandemic, several members of the Bankruptcy Commission of the Mexican Bar Association began to analyse what would be optimal but also possible for our legislation to adapt to this health contingency. It was very difficult and very complex to achieve the reforms of the size and scope that I referred to at the beginning of this work, so instead we set ourselves a simpler objective to add an emergency chapter only applicable in such times like those experienced during the pandemic.

Thus, a series of works began that concluded in the presentation of an initiative to reform the commercial bankruptcy law dated April 28, 2020, in which it was proposed to add a 15th title called: Emergency Bankruptcy Regime. To date, the said reform is still pending approval.

The reform proposal starts from the premise that in times of crisis the best way to proceed is by using the same legislation that we have but applying exception rules. Therefore, it was proposed that a specific chapter should be added where it would be possible to process bankruptcy processes in a more flexible way.

There are 11 main points contained in this proposal:

1. The processing of the electronic trial without the need to bring a physical file to court.
2. The application form for a company that requires a voluntary insolvency proceeding will be very simple: under oath, the company has to declare before the federal court fits under insolvency premises that the law establishes, without having to prove them at the moment of the filing.
3. Automatic stay: Maximum three days after the filing, the court shall admit the insolvency proceeding, as mandatory. And without any requirement, the court must order the stay of any execution agains the company.
4. All the frozen bank accounts will be liberated: Nowadays this is a problem, because the federal judges are very clear that once the insolvency proceeding is initiated nobody can freeze an account, but accounts seized before the initiation of the proceeding are more complicated to liberate.
5. There is no appeal versus the bankruptcy declaration.
6. More power to the federal judges' resolutions: Arrest for anyone that disobeys the order or if the creditor disobeys they will loss every right they have at the contest.
7. The stay includes collaterals.
8. Fresh money: Within five days from the petition, the court can authorise the loan of new money, and those creditors will have preference.
9. Tax debts will not have any preference in the insolvency proceeding.
10. Bankruptcy: Labour executions will be transacted before the bankruptcy judge.
11. Bankruptcy: After liquidation, will lead to discharge.

Total opposition of the banks to the reform proposal

On May 15, 2020, the Mexican Banking Association issued a statement in which they considered the proposed reform initiative inconvenient, untimely and unnecessary.

Basically, the banks introduced five reasons to oppose the reform proposal:

1. First, they pointed out that the direct beneficiaries of the said reform would be large corporations and not small and medium-sized companies. This is totally false, since from

the year 2000 and up to date it is precisely the large companies who have been able to use the Concurso Mercantil in Mexico, because the requirements are so complex and onerous that they are out of the reach of small and medium-sized companies. In other words, what the reform is trying to do is allow these micro, small and medium-sized companies easily and quickly access to the insolvency procedure.

2. The banks say that, instead of a reform to the insolvency law, the small and medium-sized companies must use alternative means of dispute resolution (ADRs); however, they omit to point out that in Mexico we do not have the alternative means for efficient and effective dispute resolution in an insolvency case.
3. They also point out that by eliminating requirements to go to an insolvency process, there will be many more companies that can benefit from this procedure and, therefore, having more commercial insolvency procedures will violate the equal treatment between the parties: The principle of equality between creditor and debtor will be violated.
4. They also point out that insolvency proceedings are contrary to the rights of creditors. Obviously, the insolvency process tends to protect creditors, but we must not lose sight of the fact that the legal asset protected in the first place is the rescue of the company. That is to say, first you have to seek to safeguard the company and obviously you will have to have certain sacrifices between all parties, including creditors.
5. Finally, they point out that a rescue or aid of any kind should not be generated to the debtor companies to maintain the balance between said companies and the banks themselves. However, in the 1995 crisis in Mexico, the so-called Tequila Effect, there was a bank rescue of incalculable magnitude called Fobaproa. While the banks were helped out by the Mexican government in 1995, they are adamantly opposed to a similar bailout for the business sector now.

The judges: our salvation

The proposed reform is still stagnant in the branches of the Mexican legislative framework and what we have now is what we have had for the last 21 years: *La Ley de Concursos Mercantiles*.

Therefore, with the tools we have, we must work to move forward all the companies that face non-compliance and liquidity problems at this time by using the Mexican federal judiciary to begin to admit all commercial insolvency procedures either through the request of the merchant himself or the petitions of the creditors.

The admission must be immediate without requiring unnecessary documents from the parties and the same immediacy protection must be granted to the company, the Automatic Stay, and the court must order the suspension of all enforcement proceedings against the assets and rights of the merchant, for the benefit of the merchant protects the source of employment and generation of wealth as well as for the benefit of the creditors.

In Mexico the timely implementation of the insolvency legislation and the rapid response that we obtain from the courts of the federation's judicial power, will make a great difference that will mark the way in which Mexico attends to and solves insolvency problems during and after the pandemic.

We are basically in the hands of the federal judges so that in a historic act at a national level they stop rejecting the admission of the processes of insolvency and address this problem so as not to lose our economy and its value and can rescue as many companies as possible.

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Rescue of an Oil & Gas Company in Mexico through Precautionary Measures granted in *"Concurso Mercantil"*

For insolvency litigators in Mexico, judicial precautionary measures are of vital importance, since the success of an insolvency procedure before the federal courts depends to a great extent on the good and proper implementation of these legal tools.

For the insolvent merchant, precautionary measures dictated in a timely manner and with the due scope may mean the rescue of the company rather than its premature liquidation.

Since the creation of the Specialised Insolvency Courts in March 2022,[1] the Specialised Judges have understood that in order to achieve the primary purpose of the law,[2] which is the preservation of the company, it is not only necessary to issue precautionary measures to protect the assets and rights of the company from judicial auctions, foreclosures and bank accounts seizures. Rather, it is equally important to take precautionary measures to allow the company to continue its operations, ordering the preservation of its current contracts and its legal capacity to continue contracting with third parties.

This is where we find a great area of opportunity within insolvency law, to break away from the traditional system that only protects the merchant from execution on its assets and rights, extending that protection to practically any measure that is necessary and indispensable for the company in insolvency to be able to continue with its ordinary operation.

Article 37 of the *"Ley de Concursos Mercantiles"* establishes that the Judge may order at any stage of the insolvency proceeding, ex officio or at the request of a party, any precautionary measure deemed necessary. It further indicates a list of precautionary measures that may be dictated in the insolvency proceeding, among which are: (i) suspension of payments (legal moratorium); (ii) stay of executions; (iii) prohibition to sell or encumber assets; (iv) judicial psecuring of assets; (v) intervention of the company´s cash flow; (vi) Prohibition to transfer resources or securities in favour of third parties; (vii) the rooting of the merchant so he cannot leave the city; and (viii) any other measure of a similar nature.

This last point gives freedom to the parties to request, and to the Judge to dictate, the special precautionary measures that are adapted to the needs of each of the companies, which are necessary for the company to be able to continue with its ordinary operation.

[1] *"PLENO DEL CONSEJO DE LA JUDICATURA FEDERAL", "ACUERDO GENERAL 4/2022"*, 2022. (https://acrobat.adobe.com/id/urn:aaid:sc:US:ad2914ca-0e0d-498b-a3f3-b581be118f94)

[2] *"Ley de Concursos Mercantiles"*. Article 3. *"La finalidad de la conciliación es lograr la conservación de la empresa del Comerciante mediante el convenio que suscriba con sus Acreedores Reconocidos. La finalidad de la quiebra es la venta de la empresa del Comerciante, de sus unidades productivas o de los bienes que la integran para el pago a los Acreedores Reconocidos".*

In this context, we are going to analyse a relevant case in Mexico regarding an involuntary insolvency proceeding of an oil and gas company. The merchant was notified of the “Concurso Mercantil” in January 2023. The main business activity of the company is the supply of fluids for the drilling of oil wells, both offshore and onshore.

The line of business or activity of the trader is important, since in Mexico the exploitation of the oil industry is reserved exclusively to the State, which, through the public company "*Petróleos Mexicanos*" (PEMEX) and its subsidiaries, executes these activities directly or by awarding contracts to private entities. Therefore, the commercial activity of private companies in the oil industry in Mexico depends entirely on the government.

Even though Article 87 of the *"Ley de Concursos Mercantiles"* provides that any contractual stipulation that establishes modifications that aggravate the terms of the contracts for the merchant (except for the exceptions expressly established in this law), and that we have judicial precedents in this regard,[3] the truth is that Mexican legislation on public contracts[4] prohibits the award of a public contract to any contractor declared in insolvency proceedings even in the conciliation stage, including those related to PEMEX.

In this context, public entities -including PEMEX- often include clauses that grant the contracting party the unilateral decision to rescind or terminate a contract if one of the parties enters into insolvency proceedings, even in the absence of a judicial declaration.

It should be noted that insolvency proceedings in Mexico are divided into three stages:

a) ***"Visita"*:** the phase in which a specialist determines whether the company meets the legal requirements to enter into insolvency proceedings.

b) ***"Conciliación"*:** the stage in which it has already been determined that the company is insolvent in terms of the law and formally enters into a reorganisation proceeding call “Concurso Mercantil” The main purpose of the Concurso is that the parties reach a Plan.

c) ***"Quiebra"*:** the stage in which a specialist is entrusted with the liquidation of the companies assets, due to its unfeasibility, either at the request of the company's management or due to lack of agreement during the "conciliation" stage.

Due to the widespread ignorance of insolvency law in Mexico, the *"visita"* or even the *"conciliación"* process is confused with an imminent state of liquidation of the company, which causes public entities to enforce contract termination clauses, fearing that the contractor will fail to comply with its obligations.

[3] “*Semanario Judicial de la Federación y su Gaceta*”. «CONCURSO MERCANTIL. EL JUEZ PUEDE SUSPENDER LOS EFECTOS DE CUALQUIER ESTIPULACIÓN CONTRACTUAL QUE CON MOTIVO DE LA PRESENTACIÓN DE LA SOLICITUD RELATIVA O DE SU DECLARACIÓN, ESTABLEZCA MODIFICACIONES QUE AGRAVEN LA SITUACIÓN DE LAS COMERCIANTES O IMPIDAN INICIAR EL TRÁMITE DEL JUICIO CONCURSAL», Book 7, Volume IV, November 2021, page 3322.

[4] *"Ley de Contratación, Arrendamiento y Servicios del Sector Público*". Article 50. *“Las dependencias y entidades se abstendrán de recibir proposiciones o adjudicar contrato alguno en las materias a que se refiere esta Ley, con las personas siguientes: […], VI. Aquellas que hayan sido declaradas sujetas a concurso mercantil o alguna figura análoga;”*

This implies a serious risk for the viability of the companies, since public contracts can be terminated without any legal justification (even when they have not entered into a liquidation procedure), putting them in serious financial problems and, obviously, preventing them from being able to restructure, because since they no longer have the contracts or can no longer carry out their main activity, with what do you support the financial restructuring plan?

It also has an imminent impact on the public interest, as third parties doing business with the contractor, its employees and the IRS itself will also be harmed.

In this context, this oil and gas company, anticipating that PEMEX could terminate the current contracts to which the defendant company was a party, as well as that its participation in bids for new projects could be restricted, requested from the Specialised Judge a precautionary measure to maintain the company's current agreements with PEMEX and maintain the possibility for the company to obtain new contracts.

Although the Law does not establish a specific protective measure such as the one proposed in this case, it provides that the Specialised Judge has sufficient powers to dictate the protective measures he / she deems appropriate to safeguard the viability of a company party to an insolvency proceeding.

After analysing the situation, the Judge determined to grant the precautionary measures requested by the trader[5] and ordered to notify PEMEX in this regard, since the Judge considered that it is indispensable to maintain the main income of the company, not only for the benefit of the company, but also for the benefit of its creditors.

The precautionary measures issued were as follows[6] :

1) The prohibition to *"Pemex Exploración y Producción"* to rescind and / or terminate or terminate, to limit the participation of the trader and to suspend the making of payments in favor of the trader, with respect to [various] work contracts.

2) The legal capacity to submit proposals, participate in public bids and, if applicable, be awarded contracts with "Petróleos Mexicanos" and/or its related companies and/or subsidiaries, be maintained for the duration of this procedure.

Subsequently, the company was declared in Concurso Mercantil at the stage of *"Conciliación"* and the judge ratified the validity of the precautionary measures, considering that they are essential to safeguard the integrity of the company's business.

It is important to highlight the Insolvency Judge's assessment of the *"Ley de Concursos Mercantiles"* over other federal laws. In this case it was over the *"Ley de Contratación, Arrendamiento y Servicios del Sector Público",* since priority was given to the social and public

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[5] "PALOMINO, FLORES, HERNÁNDEZ" is the law firm advising the merchant.

[6] Judicial resolution. - https://acrobat.adobe.com/id/urn:aaid:sc:US:b11a1468-a4d4-47c5-a65a-1c55cf710290

interest of preserving the companies and avoiding that the generalised default of payment obligations jeopardise the viability of the company and of the others with which they maintain a business relationship.

This determination set a relevant precedent due to the context in which they were granted, with laws that are in conflict with each other, which has been essential for the company to continue operating and maintaining its viability.

To date, the procedure continues in the "Conciliación" stage, with an extension granted in March 2024, highlighting that, due to the protective measures granted, the company has remained a viable business and is close to entering into an agreement with its creditors, which will allow it to restructure and finish a successful Concurso Mercantil.

In conclusion, it is clear that the *"Ley de Concursos Mercantiles"* provides the necessary legal framework for companies in a state of insolvency to follow the financial restructuring procedure without being limited or restricted in their ability to continue with their ordinary operations, or without the risk of cancellation of contracts that are indispensable for the generation of income.

These precautionary measures can be as broad as the need of each company. As we have seen in the precedent mentioned above, through a correct approach before the Insolvency Judge, (where the the company maintains its capacity to keep in force the contracts entered into or enter into new contracts with the public entities ("PEMEX")), it was possible to obtain precautionary measures in which the social and public interest of preserving the private companies in insolvency was prioritised over the interest of the public company.

Mexico City, April 4, 2024

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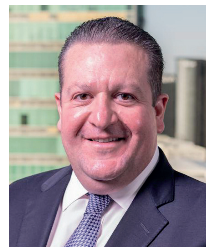
Mexico's new specialised insolvency courts and the much-needed reforms to the insolvency law



By Luis Palomino, Palomino Flores Hernandez Abogados.

The idea behind this article is that in a few lines the reader will have a clear idea of the four basic changes needed to improve the Mexican insolvency system. The great news is that one of them just happened a year ago in 2022.[1] Regarding the other three, the forum of Mexican lawyers dedicated to insolvency, together with the competent authorities, are working hard to make them happen soon, and it is in these spaces where we hope to draw the attention of institutions such as the World Bank, UNCITRAL, III[2], IICD[3], INSOL and our colleagues within these institutions to achieve it.

Since the entry into force of the Mexican Insolvency Law "Ley de Concursos Mercantiles" (LCM) in May 2000, we have had a problem: The Federal District Courts were given exclusive jurisdiction to hear all insolvency proceedings in Mexico.[4]

As a result, all insolvency proceedings in our country were heard by judges who were not specialised in the matter, since they were specialists in amparo proceedings and in civil, administrative and labour matters, including criminal matters.

Said courts had never conducted an insolvency trial, they were never prepared for it and for 22 years they have more or less rejected this type of proceeding. Proof of this is that in Mexico, from 2000 to date, less than 1,000 proceedings of this nature have been processed and the proceedings that have been rejected by district judges throughout the Mexican Republic are countless.

As a cultural fact, restructuring and bankruptcy proceedings before the LCM became effective in Mexico[5] were processed in the local courts of each state in Mexico. It was these state courts that were the ones that had the knowledge and experience to carry out the conduct of all "suspensiones de pago" and bankruptcies in Mexico.

From one day to the next, given that our insolvency legislation is of public order, concurrent jurisdiction in this matter was eliminated, so local judges were no longer legislated to handle this type of proceeding and when the LCM entered into force, it was the Mexican Federal Judges who assumed full legislation. They were not qualified for the task, however, and due to administrative circumstances, they were never able to organise themselves to be so.

In multiple national and international forums I have been asked my opinion on why, in spite of Mexico being one of the 20 largest economies in the world with more than six million companies, there has only been an average of 30 or 40 insolvencies per year:

My answer has always been the same, we need four fundamental changes to happen:

1. Specialised insolvency courts with sufficient powers to enforce their determinations.
2. Automatic Stay.
3. An Insolvency Law (LCM) that provides for an effective regulation of MSMEs (Micro, Small and Medium Enterprises).
4. Fast and efficient access to fresh money, new money, DIP financing.

Courts specialised in insolvency. A required reality in Mexico.

We have already taken a first big step towards this reality.

On February 24, 2022, General Agreement 4/2022 of the Federal Judiciary Council was issued and was published in the Official Gazette of the Federation on March 4, 2022. It became effective the day after its publication.

By means of this agreement, the First and Second District Courts in Commercial Bankruptcy Matters were created in Mexico City with jurisdiction throughout the Mexican Republic to hear all cases in bankruptcy matters in our country.

Finally, in Mexico we have the long-awaited specialised insolvency courts, and they have been in operation for more than a year now.

The results have been quite good, since rejections of bankruptcy proceedings have decreased considerably and every day the deadlines are becoming more agile and the criteria of both courts are taking shape.

This does not mean that the LCM should not be modified so that the creation of court and its regulation is not only not passed into law but also extends to more cities or forums within the country. But above all, I consider that the LCM should provide the insolvency judge with more powers to enforce its determinations in such a way that there is no person or institution that would hesitate to comply with or execute immediately any order issued by such a court.

The expected insolvency reform.

In January of this year, for the first time in the history of our country, a woman - Minister Norma Lucía Piña Hernández - was elected President of the Supreme Court of Justice of the Nation and of the Federal Judiciary Council for a four-year term.[6]

In her proposal and work plans, the Minister President proposed an improvement of IFECOM[7], which is the Mexican organism that regulates insolvency practitioners and insolvency law (LCM).

Since then, conferences and panels have been held in Mexico where various lawyers and specialists in the field have presented the problems they have encountered in the past and the parts of the law that they consider should be reformed and changed so that our insolvency system can be effective and efficient.

As I mentioned earlier, it is imperative that any reforms contain, in addition to the previously mentioned specialised courts, the following:

1. Automatic stay

Automatic stay (or the "Stay") is one of the most important and powerful protections and tools available to a debtor in bankruptcy in Section 362 of the Bankruptcy Code of the United States of America.

Triggered immediately on filing of the bankruptcy petition, it automatically stops the majority of all acts and proceedings against the debtor and their property. It is a nationwide injunction barring almost all actions against the debtor and their property, including the exercise of remedies concerning collateral, enforcement of pre-petition judgments, litigation, collection efforts, and acts to create, perfect, and enforce liens granted before the date the bankruptcy petition was filed.

The automatic stay has a broad scope, applying to all creditors, whether secured or unsecured, and to all of the debtor's property, wherever located. It forbids creditors from pursuing both formal and informal actions and remedies against the debtor and their property. It also covers remedies that could be exercised outside of the US.

The concept is very simple: We should have the automatic stay in Mexico.

2. Regulation of MSMEs

In Mexico we must be allowed to make the LCM more flexible with regard to MSMEs. The latter are subject to a slew of requirements before they can access any insolvency proceeding. The verification, for example, requires a lot of documentation[8], which is why in México it has only been used by large corporations.

Also, the insolvency process of the company in distress must be allowed to proceed alongside the insolvency process of its joint obligors or guarantors, even when they are not merchants, given that they are normally 100% involved in the whole business.

The main problems facing an MSME when filing are:

a) If you are filing as a debtor, you need to present substantial information that most MSMEs won't have ready.[9]

b) In most cases[10] the judge will order a practice known as the *Visita*, where a professional will audit the company to analyse if it qualifies for the procedure. This *Visita* incurs a cost for the debtor that a lot of MSMEs cannot afford[11]. It is also a process that takes a lot of time that the debtor cannot spare before entering the restructuring process.

c) Once entered into the restructuring process, an insolvency professional[12] must be appointed, whose fees the debtor must pay. That is expensive.

It would obviously be very complex to create new legislation designed purely for MSMEs. However, if we modified the existing legislation to apply to MSMEs it could work as follows:

a) Reduce to a minimum the documents that you need to present.

b) Reduce the cost of the insolvency professional, or transfer these costs to the court instead.

c) Reduce court participation.

d) March 2022 did see the implementation of special courts, but we only have two for the whole country, we need more.

e) If the debtor requires it, allow the natural parties that are collateral to the process, to join the process as a group of companies, even if they are not merchants.

f) Allow a discharge for the natural parties and a fresh start.

g) Give options to the debtor facing tax and labour problems.

h) In liquidation, let the trustee sell with the minimum formalities.

i) New money, as I will discuss in the next point.

New money. Fresh money.

Finally, even with specialised judges and perfect legal regulation for small and medium-sized companies, there is no way we can move forward towards orchestrating successful restructurings in our country without companies having access to financing.

New, fresh money is what allows a company to move forward, since the suspension of payments, the write-offs and the terms that can be achieved with a restructuring plan are often not enough without a fresh injection of capital.

The problem in Mexico is not only that it is necessary to reform the insolvency law so that these types of determinations, for example when the judge authorises a credit against the estate, are not subject to appeal. This generates legal certainty for the new creditor and encourages them to lend.

The national banking legislation and the circulars issued by the Bank of Mexico restrict the granting of this type of credit. This needs to be modified. Without this, it will be practically impossible to grant financing to companies undergoing restructuring processes in our country.

That is why many companies go to the U.S. courts to apply for Chapter 11, because, although it is very expensive and does not protect them from any enforcement in Mexico, it allows them access to financing, which at the end of the day is what ends up rescuing companies. If we change our legislation in this regard, Mexican companies would not have to go to other jurisdictions to restructure, they could do it perfectly well in our own country.

Conclusion

Based on the above, and given the 22-year backlog, it is clear that Mexico has taken a giant step forward by establishing specialised insolvency courts. We hope that the restructuring processes will be expedited and that more specialised courts will be created to meet the demand generated. However, this one step does not overcome all of the obstacles and the fact remains that the law must be further reformed based on these three fundamental axes:

1. The granting of 'automatic stay'
2. More agility given to the restructuring of MSMEs and

3. The elimination of all restrictions on financing for companies in insolvency proceedings.

As I have pointed out, I believe that it is very important to take into account the work carried out with respect to the MSMEs to allow these companies, which represent more than 99% of our economy, to be able to restructure quickly. This means, without much paperwork and in such a way that the costs and the requirements that are requested today are eliminated so that these companies can enter the insolvency procedure to solve their financial crisis and get access to new money with an automatic stay in all matters.

If we achieve the above, our insolvency system will be efficient, agile and effective, and this will generate legal certainty for investment and provide the basis for Mexico's economic growth.

Notes

1 We will comment later on how it should be improved.

2 International Insolvency Institute

3 Instituto Iberoamericano de Derecho Concursal

4 Article 17 LCM.

5 They were processed in accordance with the Bankruptcy and Suspension of Payments Law.

6 Until December 2026. We should appoint that one of the insolvency Judges is a woman also.

7 Instituto Federal de Especialistas de Concursos Mercantiles.

8 Article 20 LCM.

9 Article 20 *LCM*.

10 Except if you file a prepack.

11 Around 7,000 US Dollars.

12 *Conciliador*.

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Tackling Emerging Market Restructurings:

Ten Major Challenges

Three-Part Series of Articles Published in *International Financial Law Review (IFLR)* [*]

Fall 2002-Summer 2003

By Steven T. Kargman, President, Kargman Associates/International Restructuring Advisors

Part I **December 2002**, "How to Tackle Debt Restructuring in Emerging Markets," pp. 41-45

> Part I discusses four major challenges in emerging market restructurings: 1) organizing the creditor body; 2) trying to make timely progress in the restructuring process; 3) navigating the local legal framework and the local insolvency law; and 4) determining the role of the controlling shareholder in the restructured company.

Part II **July 2003**, "Tackling Restructuring in Emerging Markets (Part II)," pp. 57-61

> Part II discusses three additional major challenges: 1) managing the process for resolving intercreditor issues; 2) establishing financial parameters for a deal; and 3) establishing realistic creditor recovery expectations.

Part III **August 2003**, "Tackling Restructuring in Emerging Markets (Part III)," pp. 43-46

> Part III discusses the final three major challenges covered in the series: 1) determining whether to pursue a stand-alone or strategic investor-based restructuring; 2) preventing the dissipation of debtor assets during a lengthy restructuring process; and 3) assessing whether a consensual restructuring is feasible.

How to tackle debt restructuring in emerging markets

Dealing with bad debts in emerging markets is often a difficult and worrying experience. Local legislative frameworks and business practices can be bewildering and unfriendly to outside creditors. Steven Kargman* offers advice on some of the key challenges they may face

The present slowdown in the global economy has focused renewed attention on the issue of restructuring troubled loans in emerging markets. Debt restructurings in these markets often represent a unique amalgam of legal, business, financial and strategic issues. While these restructurings can be incredibly complex, there are a number of common issues that recur in corporate debt restructurings around the world.

This article examines the major challenges in debt restructurings in the emerging markets. It does so principally from a creditor perspective and will focus on the restructuring of troubled loans to private sector borrowers, primarily in the so-called *out-of-court*, "consensual restructuring" context. The article focuses on the broad issues that affect the overall process and strategy for executing an emerging market debt restructuring rather than on those issues that relate to the types of specific terms and conditions found in many emerging market debt restructuring plans (for example debt buybacks/Dutch auctions, cash sweeps, debt-for-equity swaps, and so forth).

Organizing the creditor body

Before the creditors can deal properly with any of the substantive aspects of the debtor's financial travails as well as consider potential restructuring proposals, they must first undertake the task of organizing themselves into a cohesive body. Organizing the creditor body is a key element in permitting the creditor body to interact effectively with the debtor throughout the course of the restructuring process – a process that can easily last a few years. Typically, the creditors will designate a sub-group of the major creditors to serve as the steering committee. Forming a steering committee may be viewed by many creditors as a mere ministerial task and therefore may be given short shrift in the rush, and perhaps understandable desire, to quickly address the substantive elements of the restructuring process. However, if the design and composition of the steering committee is not given the proper consideration that it deserves at the outset of the restructuring process, this can have the potential to severely handicap the creditors as they move forward with the process.

Membership

In organizing a steering committee, the creditors will generally want the committee to consist of some of the largest creditors as well as be representative of the possibly diverse universe of creditor interests (for example, commercial banks, bondholders, sovereign export credit agencies, international financial institutions, and so on). At the same time, and very importantly, the creditors will not want the steering committee to be so large that it is unwieldy. There is no magic number for the optimal size of a steering committee. Nonetheless, depending on the specific facts and circumstances of a given restructuring, creditors as a very general rule may attempt, if possible, to limit the size of a steering committee to 10 or fewer members.

In deciding on the size of the steering committee, the creditors will have to consider whether the proposed size will help or hinder them in their ability to make decisions. The size of the steering committee will be particularly relevant if, as is not infrequently the case, the steering committee intends to operate by group consensus in making decisions on the full range of issues that will be addressed in the course of a restructuring. The creditors will also have to consider whether the proposed size of the steering committee permits and facilitates constructive communication and negotiation with the debtor.

The debtor may potentially have misgivings about engaging in a frank and meaningful discussion with a steering committee if the committee is too large. The debtor may also be reluctant to share confidential business and financial information with such a large group. Similarly, the debtor may question the value of negotiating with a steering committee that is too large and possibly unfocused or not cohesive. Yet even a large steering committee may be able to surmount some of these concerns on the part of the debtor by forming an executive committee or smaller negotiating team that will take the lead on behalf of the full steering committee in negotiating with the debtor.

Once the steering committee is formed, the creditors will have to address a number of important and practical implementation issues. To begin with, the creditors will have to decide whether the steering committee should have a steering committee chairman, usually

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drawn from one of the principal creditor institutions, who will play a leadership role on behalf of the creditor body. Making such a selection may involve delicate issues of institutional pride on the part of the various creditors that are members of the steering committee, several of which may wish for one reason or another to lead a particular steering committee assignment. In the end, some steering committees decide to have a chairman, whereas others do not. If a steering committee does appoint a steering committee chairman, the members of the steering committee may, formally or informally, define the latitude given to the chairman in negotiating with the debtor and otherwise making key decisions.

In a number of emerging market jurisdictions, creditors may prefer to pursue an *out-of-court* restructuring solution precisely because the local insolvency law regime may be unfavorable to creditors

For those steering committees without a chairman, the leadership and organizational responsibilities normally assumed by a chairman may well be more diffuse. These responsibilities may end up being shared informally among various steering committee members. It may even be the case that the committee's outside advisers, including its financial advisers and legal counsel, will end up stepping into the breach and, of necessity, playing a more prominent role in the process.

Funding the committee

A second important implementation matter concerns how the steering committee will fund itself. This can be a critical issue since the expenses of the steering committee's advisers, such as an outside financial adviser and outside counsel, can be quite substantial over the course of what may well be a lengthy restructuring process. The steering committee may inevitably lean heavily on the advice, recommendations and analysis of its outside advisers in order to evaluate and develop restructuring proposals and otherwise to help advance the restructuring process. This will create an additional incentive for the creditors to ensure that the funding of these expenses is adequately provided for.

The creditors will obviously prefer the debtor to assume responsibility for these costs. If the debtor does agree to bear these costs, the creditors, in order to avoid or at least minimize continuing disputes over reimbursement of adviser expenses, may seek to have the debtor establish escrow accounts that will be dedicated to funding these expenses. From the creditors' standpoint, ideally such escrow accounts should be located offshore from the debtor's home jurisdiction and should be subject to the control only of the creditors and not the debtor. The creditors will want to eliminate any right on the part of the debtor to claw back amounts deposited in these accounts as long as the restructuring is still under way and has not been terminated.

Such escrow accounts may be set up in one of two basic ways: the first is to fund steering committee expenses out of the escrow account as the steering committee advisers submit their invoices, and the second is to have the escrow account serve only as a back-up to be drawn upon if the debtor does not pay the invoices on a timely basis. It should be noted that, in addition to expenses incurred by the steering committee's advisers, the committee members may have their own expenses, such as travel expenses in connection with attending committee meetings or negotiating sessions, and the committee members may therefore seek reimbursement of such expenses.

Nonetheless, even the establishment of such escrow accounts may not entirely eliminate disputes by the debtor over the payment of expenses for the steering committee's advisers. It is not uncommon for debtors to dispute particular invoices relating to steering committee expenses. Such disputes can in certain instances take a significant amount of time to resolve, and thus certain debtors have been known to use billing disputes as a deliberate delaying tactic.

Notwithstanding the desire of the creditors to the contrary, it is not always possible that the debtor will be in a position to fund the steering committee's expenses. In the first place, the debtor simply may not have the available financial resources to do so in light of its continuing financial difficulties. Of course, the mere fact that the debtor is experiencing financial difficulties does not mean that it will necessarily be unable to fund the expenses of the steering committee. If the debtor is not paying debt service on its outstanding debt obligations, it may well have the necessary funds to defray the expenses of the steering committee. Yet whether or not the debtor is financially capable of assuming these costs may vary from case-to-case.

Second, there may be legal constraints on the ability of the debtor to fund the steering committee's expenses. Specifically, this might be the case if the debtor is involved concurrently in both an *out-of-court* restructuring process as well as a pending insolvency proceeding. Under those circumstances, the debtor, depending on the particular jurisdiction involved, may be precluded by local law from granting a priority to the steering committee creditors over the rest of the creditor body. Under the applicable law of the relevant emerging market jurisdiction, in contrast to Chapter 11 in the US, it is conceivable that there may be no special treatment or legal status afforded to a committee of creditors involved in an insolvency proceeding.

Nonetheless, if the creditors have to fund their own steering committee expenses because of constraints such as those outlined above, they will have to decide among themselves how the expenses of the steering committee will be allocated among the steering committee members. The main issue is whether the expenses will be allocated *pro rata* on the basis of respective exposures of the steering committee members or allocated equally among all steering committee members. Where the steering committee is required to fund its own expenses, the steering committee creditors will also have to decide whether they should establish in advance a kitty for such expenses based on an estimate of anticipated expenses over a specified period of time, or, alternatively, whether steering committee members should be assessed for such expenses only after the expenses have been incurred and the appropriate invoices have been submitted. A number of these types of matters may be memorialized in a steering committee agreement (which may also address such issues as confidentiality of steering committee deliberations and other administrative matters), although not all steering committees will enter into such formal agreements.

It should be recognized that, if a steering committee is forced to self-finance its activities, this can give the debtor an important tactical advantage. If the restructuring drags on for a long period of time with the result that the individual fees paid by each of the steering committee members continue to mount to significant levels, the steering committee members may lose their appetite for continued battle with the debtor. This will be particularly true if the negotiations with the debtor are contentious and protracted. The debtor may be well aware of this dynamic and indeed may seek to take advantage of it by attempting to use delays in the restructuring process as a means of effectively waging a war of attrition with the creditors.

Trying to make timely progress in the restructuring process

Many emerging market restructurings can, for various reasons, easily take a few years to complete, and the creditors and debtor may have sharply divergent perspectives on whether it is in their fundamental interest to achieve a relatively quick solution. It is not uncommon in restructuring situations for debtors to believe that time is on their side, and this perception on the part of debtors is often grounded in reality. By contrast, the creditors may generally view time as their enemy. Since many restructurings involve some form of debt service moratorium or debt standstill, the creditors will be anxious to reach a restructuring solution as promptly as possible. The creditors obviously will want their debt service payments to resume at the earliest possible date.

The debtor, on the other hand, may be less motivated to keep the process moving forward with any type of alacrity. Assuming that it can continue to meet its working capital and other basic needs and otherwise continue to function as a going concern, some debtors may be perfectly content to maintain a debt service moratorium or debt standstill. By foregoing debt service payments, the debtor may be able to accumulate some cash on hand, which may well be beyond the reach or control of the creditors. Under such circumstances, it is not inconceivable that certain debtors may therefore be relatively uninterested in actively pursuing and reaching a restructuring solution with their creditors. However, it should be noted that certainly not all debtors will behave this way. Debtors, for example, that are genuinely concerned about their long-term reputational interests and, in particular, their ability to tap the capital and credit markets in the future may take a less cavalier attitude towards advancing the restructuring process.

Timetables

In light of these possibly divergent perspectives between the creditors and debtor on the urgency of the restructuring task, creditors may seek to establish timetables for accomplishing key milestones in the restructuring process. If possible, such timetables may be discussed with and agreed upon with the debtor. This process could involve some negotiation between the two sides on what are realistic deadlines and what are the important milestones in the process. Each of the major phases of the restructuring process – such as the creditors' due diligence investigation of the debtor, negotiation of a term sheet, documentation of the restructuring deal and, finally, closing the deal – will have its own major milestones. For instance, in the due diligence phase of the process, some of the relevant milestones may include, among other things, the following items: (i) negotiating and signing confidentiality agreements between steering committee members and their outside advisers, on the one hand, and the debtor, on the other hand; (ii) agreeing on an appropriate scope of work for the due diligence investigation (which will likely be undertaken by a financial adviser to the steering committee); and (iii) receiving specified financial and business information from the debtor, such as business plans, cash flow projections, sales and pricing information (historical and projected), and so forth.

The presence of a fairly specific and detailed timetable may help bring discipline to the process so that it does not proceed in a haphazard or desultory fashion. In addition, a timeline may help the creditors determine whether or not the debtor is trying to advance the restructuring process or is instead attempting to deliberately delay the process. In certain restructurings, creditors will need to ask themselves whether the lack of progress is based on justifiable reasons, such as the complexity of documenting a given restructuring deal or the intricacy of the debtor's business organization and structure, or whether the delay is an indication that fundamentally the debtor is not negotiating in good faith. In the latter case, the creditors may be forced to come to the conclusion that a consensual restructuring with such a debtor may not be a realistic or viable option.

Navigating the local legal framework and the local insolvency law

It may seem somewhat counterintuitive that even in those circumstances where the creditors may be attempting to reach an *out-of-court* restructuring solution with the debtor, the creditors nevertheless need to be intimately familiar with the insolvency law regime of the relevant jurisdictions. Although obviously insolvency law regimes can vary from jurisdiction to jurisdiction, the insolvency laws of the relevant jurisdiction (or of several jurisdictions in the case of a multi-jurisdictional restructuring) may determine whether the creditors are on a level playing field with the debtor. As a related matter, the insolvency law may also help determine whether one party rather than the other may potentially have greater leverage in the restructuring process itself.

In a number of emerging market jurisdictions, creditors may prefer to pursue an *out-of-court* restructuring solution precisely because the local insolvency law regime may be unfavourable to creditors. Although creditors may not be enamoured of the prospect of an *out-of-court* restructuring exercise given that it may ultimately turn into a protracted process, the creditors may have an even greater aversion to having the case resolved in an insolvency proceeding if the relevant insolvency law significantly disfavours creditors. For example, the former suspension of payments law in Mexico, which was replaced in May 2000 with the new *Concurso Mercantiles* law, provided debtors with numerous opportunities for delay. (The suspension of payments law remains in effect for those cases filed before the effective date of the new law and, as a result, there are several large cases still pending under the suspension of payments law.) Although the old law by its terms prescribed fairly specific timelines for taking certain actions such as, publishing notice of the suspension of payments, these timelines were often observed in the breach. The result was that suspension of payments cases could drag on unresolved, in some instances for 10 years or more. During this time, the creditors received no debt service, no interest accrued on their outstanding debt, and foreign-denominated debt was converted to debt denominated in the local currency, pesos, for purposes of the suspension of payments.

In addition to understanding the local insolvency law itself, the creditors need to be concerned with how the law is applied and interpreted in practice by the courts and whether the local judicial system operates fairly and independently. It is possible that the local insolvency law on its face may not be especially prejudicial to the interests of creditors. However, depending on the particular jurisdiction involved, the local law may as a matter of practice be applied in ways that can seriously disadvantage creditors, whether the creditors are foreign or domestic.

Level playing field?

Where the insolvency law clearly favours the debtor, the creditors may potentially have less leverage in the restructuring process. In such a case, the debtor may know that the creditors do not want the case to end up in a local insolvency proceeding. As a consequence, the debtor may believe that it can take a harder line in the negotiations and hold out for the results that it is seeking, whether or not such results are achievable in the near term. Or, even worse, the debtor may attempt to run out the clock without actively seeking, or even perhaps by affirmatively impeding, a restructuring solution.

There are additional reasons that the creditors need to be aware of the local insolvency law in particular and local laws in general. First, certain independent-minded creditors who are not firmly committed to the consensual restructuring path (or who are not in agreement with the course of action being pursued by the steering committee) may attempt to increase the pressure on the debtor by turning to the courts for relief. They may look to the courts by pursuing a simple debt recovery action on their defaulted loans or perhaps even by initiating an involuntary insolvency proceeding.

Second, if the creditors on the steering committee themselves believe that the consensual restructuring is not making any progress, they may wish to explore more aggressive or even adversarial alternatives, such as any available options under the local insolvency law. Specifically, the creditors may consider the possibility of seeking either the involuntary reorganization or liquidation of the company. These basic remedies available to the creditors may take different forms in the relevant jurisdictions. For instance, in Singapore there is a remedy known as judicial management, which is a form of reorganization pursuant to which in general terms the court-appointed judicial manager replaces the company's board of directors and effectively assumes control over the company's assets and business.

Again, with respect to each of these possible options, the creditors will need to decide whether or not any of the given options represents a realistic creditor remedy in light of how the local law is actually applied in practice. For example, in Mexico under the old insolvency law, even though liquidation was formally provided for in the law, as a practical matter it was exceedingly difficult for creditors ever to succeed in forcing a debtor into liquidation.

Third, the creditors may wish to consider what role the local insolvency law can play in achieving approval by the creditor body of a completed restructuring plan. Specifically, creditors will want to analyze whether local law provides a mechanism for a cramdown of a restructuring plan on dissenting creditors and whether local law provides for the possibility of seeking approval for something akin to a prepackaged restructuring plan. If the restructuring involves multiple jurisdictions, the creditors may wish to analyze the laws of the relevant jurisdictions also in order to determine whether one or more of these may have more favourable procedures with respect to these issues than the other jurisdictions involved in the restructuring. This in turn could prompt analysis of the extent to which proceedings in one jurisdiction would be recognized in other relevant jurisdictions. In short, the process of obtaining approval for a restructuring plan, even one developed in an *out-of-court* negotiation, could require the creditors to undertake thorough legal analysis and planning regarding these issues in the multiple jurisdictions.

In order to properly evaluate all of these various local law issues and in particular to receive guidance on how the local law is applied in practice, the creditors will often retain local counsel in the relevant jurisdiction(s). Certain individual creditors, particularly those with large exposures, may decide to retain local counsel on their own, and creditors that are members of a steering committee may also decide to retain local counsel as a part of a collective effort. The issue of retaining local counsel is not a trivial matter since a number of emerging market jurisdictions may not necessarily have a deep bench of corporate law firms that can handle complex and sophisticated international debt restructurings. Therefore, the demand for the services of such law firms may easily outstrip the supply, particularly where the creditor body in a given restructuring consists of a multitude of significant creditor institutions.

Determining the role of the controlling shareholder in the restructured company

Many emerging market restructurings involve the phenomenon of the so-called controlling shareholder, meaning the shareholder that holds a controlling interest in the debtor company. These controlling shareholders may represent influential family interests in the host country. Such shareholders may not only hold a large and controlling equity stake in the debtor company, but various members of the family of the controlling shareholder may also occupy a number of the key management positions with the debtor. In short, in a number of emerging market jurisdictions, there may be no clear demarcation between ownership and management of certain debtors given the unique role of the controlling shareholders.

In certain restructurings, the creditors may believe, correctly or otherwise, that a fair amount of the debtor's financial travails can be attributed to the mismanagement of the company's affairs by the controlling shareholder. As a result, in the restructuring process, the creditors may initially be interested in crafting a restructuring plan that involves the removal of the controlling shareholder from any continuing role in management. Fundamentally, the creditors may believe that they are faced with a simple binary choice – namely, to keep existing management or to have existing management forced out of the company. Yet, in reality and to their possible dismay, the creditors may be confronted with much less of a clear-cut choice than appears at first blush.

Controlling shareholders

In many instances, the controlling shareholders may be deeply entrenched and hence very difficult to remove from their dominant position at the debtor company. As the Asian Development Bank noted in a 1999 report on insolvency law issues in the Asian-Pacific region, the owners of financially distressed corporations are often driven by a fear of loss of control of the corporation. (The same observation could be applied with equal force to certain emerging markets in other parts of the world.) A similar point relating to insolvency proceedings was made recently by Samuel Tobing, chief operating officer of the Indonesian-based Jakarta Initiative Task Force, in a July 2002 presentation to an Asia Pacific Economic Conference symposium. He said: "It should be noted that in certain emerging economies, corporate assets are concentrated in the hands of a small number of well-connected individuals or families. When faced with the loss of ownership, these groups may seek to exert their influence to frustrate the operation of the insolvency system." Given the attitudes described above, certain controlling shareholders involved in restructuring situations may be unwilling to agree to – and indeed may possibly even try to scuttle – any restructuring plan that would have the effect of removing them from power in the management structure of the debtor company.

However, if it is clear that the creditors will be unable to remove the controlling shareholders from management, the creditors as part of the restructuring plan may nevertheless try to institute a range of corporate governance reforms. Such reforms may be designed to limit and control the power and influence of the controlling shareholders in the restructured company.

Corporate governance reforms

Specifically, among a range of such possible corporate governance reforms, the creditors may try to reconfigure the company's board of directors and its committee structure. For example, the creditors may seek to have independent directors play a greater role, and they may seek to have certain board committees, such as the audit committee, have direct oversight over certain management functions. The creditors may be aided in their efforts at such corporate governance reform by changes in the local corporate and securities law. For instance, in Mexico, recent changes to the securities laws require the establishment of independent audit committees for public companies.

In addition, the creditors may seek greater internal management and audit controls in certain key areas of the debtor's operations such as in the finance functions of the debtor. By way of example, the creditors may attempt to impose greater control over the process by which company officials can approve disbursements and sign cheques, particularly for disbursements over specified dollar thresholds. The creditors may also seek to subject certain types of transactions, such as related party transactions or major corporate transactions including proposed mergers, acquisitions or asset dispositions, to supermajority approval requirements by the board of directors or the shareholders, as the case may be. Such proposed corporate governance reforms should be carefully analyzed by local counsel to ensure that they are consistent with the local corporate and securities laws.

In sum, in a number of emerging market restructurings, the creditors may be faced with the unpleasant but stubborn reality that they will not be able to remove the controlling shareholder from management or eliminate the controlling shareholder's continued equity control of the debtor. The creditors may therefore have to shift their focus to developing an approach for a restructuring plan that seeks to contain and circumscribe the power and influence of the controlling shareholders in the restructured company. As discussed above, they may try to accomplish this objective by attempting to institute various corporate governance reforms as part of the overall restructuring plan.

Yet, in pursuing corporate governance reforms, the creditors may encounter strong resistance if the proposed reforms would have the effect of stripping the controlling shareholders of more power than they are willing to give up. Consequently, there may be considerable tension between the corporate governance reforms that the creditors may be seeking, on the one hand, and the limited amount of power that the controlling shareholders may be willing to give up, on the other hand. This tension is an important substantive matter that will have to be addressed in the context of the overall restructuring discussions and negotiations between the creditors and the debtor.

It should be noted, however, that the manner in which this tension is addressed and resolved could have a spillover effect on how the rest of the restructuring negotiation progresses. The breadth and scope of proposed corporate governance reforms may possibly affect how the controlling shareholder views the rest of the restructuring package, including the proposed economic terms of any restructuring deal. If the controlling shareholder views the proposed corporate governance reforms as being overly restrictive, this could possibly have a dampening effect on the eagerness and willingness of the controlling shareholder to close a restructuring deal itself.

In such circumstances, the creditors may be forced to consider how integral the proposed corporate governance reforms are to the overall restructuring deal. The creditors may therefore be faced with a difficult choice. One possibility is that the creditors may be willing to walk away from the proposed overall restructuring deal (or consider the possibility of doing so) if, in the course of the negotiations, they cannot achieve all or even most of their important corporate governance objectives. Another possibility is that the creditors may be willing to make certain compromises on corporate governance issues that are demanded by the controlling shareholder and accept what may be a "less-than-perfect" corporate governance structure in the interest of reaching agreement on, and then ultimately closing, an overall restructuring deal.

The creditors may be faced with the unpleasant but stubborn reality that they cannot remove the controlling shareholder from management or eliminate the controlling shareholder's continued equity control of the debtor

However, whether compromise on such issues is an acceptable course of action may be viewed differently by various creditors within the creditor body. For certain creditors, corporate governance issues may involve important issues of principle and philosophy, and this may affect their willingness to compromise on these issues. Moreover, some creditors may view certain corporate governance issues, such as having in place an effective system of cash controls, as having a critical impact on whether the economics of the restructuring deal can be achieved over time. This, too, may affect how willing such creditors are to compromise. On the other hand, there may be certain creditors who, for various reasons, place relatively less importance on corporate governance issues. In short, the possibility of divergent views within the creditor body on the relative importance of corporate governance issues to the attractiveness and acceptability of the overall restructuring deal is a matter that will need to be addressed and discussed within the creditor body in general and the steering committee in particular. ▮

Tackling restructuring in emerging markets (part II)

Steven Kargman continues his series of articles advising creditors and debtors on managing debt restructurings outside of developed insolvency regimes

In a previous article (IFLR, December 2002), we examined four central challenges in emerging market out-of-court debt restructurings: organizing the creditor body; trying to make timely progress in the restructuring process; navigating the local legal framework and the local insolvency law; and determining the role of the controlling shareholder in the restructured company. In this article, we will look at three more challenges in emerging market restructurings: managing the resolution of intercreditor negotiations; setting the financial parameters for a restructuring; and establishing realistic creditor recovery expectations.

Managing the process for resolving intercreditor issues

The creditor body of any given debtor may be characterized by various competing creditor interests and claims that will be the subject matter and focal point of any intercreditor discussions and negotiations that take place during the course of the restructuring process. In the first place, in any given creditor body, there may be the usual tensions between secured and unsecured creditors. Although out-of-court restructurings do not necessarily have strict priority rules, secured creditors may well seek some preferential treatment in any plan that is ultimately agreed. However, in certain restructuring situations, before unsecured creditors agree to give preferential treatment to creditors claiming to hold security interests in the restructuring plan, the unsecured creditors may ask creditors claiming a security interest to demonstrate or prove, albeit in an out-of-court context, that as a legal matter they actually have the security interests that they purport to have.

If the debtor has a corporate group structure, creditors to subsidiaries with putatively stronger cash flows may seek more favourable financial terms than creditors to subsidiaries with putatively weaker cash flows. To be sure, the relative cash flow positions of such subsidiaries may change over time, even during the course of the restructuring process itself. This may be the case if, for example, the restructuring extends over a long period of time and the respective subsidiaries of the debtor are involved in different lines of business with different cost structures for their inputs and/or different prices structures for their products.

Also, creditors to operating companies of the debtor, whose debt is to be serviced by the cash flows of these operating companies, will have opposing interests to those creditors at the holding company level whose debt is serviced by the proceeds from dividends from the operating companies. Nonetheless, even though the holding company creditors would normally be seen as structurally subordinated to the operating company creditors, in certain cases, the holding company creditors may still seek some benefit from the cash flows of the operating companies as part of any restructuring solution. Among other things, the holding company creditors may seek some value for any inter-company loans that the holding company has made to the operating companies. As a result, in such situations, the holding company creditors and the shareholders in the holding company may seek, for example, to have so-called *management fees* paid up to the holding company level.

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Whether or not the holding company creditors will succeed in such efforts will depend on the facts and circumstances of a given restructuring. Obviously, however, the operating company creditors will likely resist and try to minimize any special deals for the holding company creditors and, to the extent possible, will try to maintain the structural subordination of the holding company creditors. Nonetheless, it is possible that the debtor in such a holding company structure and its controlling shareholders will not want to close a restructuring with the operating company creditors alone unless the concerns of the holding company creditors are also addressed. Thus, even if the debtor has satisfactorily addressed the concerns of its operating company creditors, the debtor and its controlling shareholders may not wish to consider the restructuring process as having successfully reached closure if the debtor continues to face unrestructured debt claims from the holding company creditors.

Creditors face the question of when and how they should attempt to resolve difficult, and even potentially divisive and contentious, intercreditor issues

Creditors whose debt has one set of economic terms (for example, shorter repayment periods, or debt payments that are amortizing as opposed to being payable in one payment at maturity) may take a different view of issues from creditors whose debt may have less favourable economic terms. Similarly, creditors who have potentially more favourable legal rights and remedies (for example, shorter time periods for accelerating debt and otherwise exercising creditor remedies) may take a different approach from those creditors who have less favourable legal rights and remedies. These divergences of interest may be even more prominent in smaller restructurings involving fewer creditors where the interests of individual creditors are likely to receive greater attention.

Timing

Meanwhile, creditors face the question of when and how they should attempt to resolve difficult, and even potentially divisive and contentious, intercreditor issues. One approach is to first reach a deal with the debtor and then attempt to resolve intercreditor issues. Another is for the creditors to begin intercreditor discussions either before or at the same as the creditors begin negotiations with the debtor on an overall restructuring deal. There are advantages and disadvantages to each approach, and the decision on which approach to pursue is usually not made in isolation but rather is affected and shaped by the facts and circumstances of a given restructuring.

On the one hand, deferring intercreditor discussions can have the positive effect of focusing the creditors' attention on what they may view as the main game, namely reaching an acceptable restructuring deal with the debtor. To the extent that the intercreditor discussions are likely to be contentious, deferring such discussions until later in the process may enable the creditors to present a more unified front to the debtor in restructuring negotiations. It may also eliminate what may become a needless internal distraction among the creditors as they begin the process of negotiating with the debtor.

Furthermore, to the extent that the intercreditor issues are driven by considerations of economic value, it could be argued that deferring intercreditor discussions might make sense from a practical standpoint. By this reasoning, the creditors may first want to know what will be the overall value that they will be receiving from the debtor in the restructuring deal and only then decide how they plan to divide and allocate such value among the various creditor interests.

On the other hand, deferring intercreditor discussions until an overall restructuring deal is reached with the debtor could possibly lead to an even more protracted process than would otherwise exist. It may mean that the implementation of the restructuring itself will have to be delayed until the intercreditor issues are resolved. In some restructurings, this can take a long time as the various creditor interests and constituencies negotiate among themselves, which can become a messy and divisive process. Under such circumstances, this may be a good reason to initiate such intercreditor discussions sooner rather than later.

If the intercreditor discussions begin in earnest only relatively late, any resulting delay in implementing the restructuring deal may play directly into the debtor's hands. This may be the case if the debtor is not firmly committed to the deal and is seeking a reason not to move forward with it. To the extent that the debtor becomes aware of intercreditor disputes, it may seek to exploit the situation by playing one creditor constituency off against another. Such a *divide and conquer* strategy on the part of the debtor may also lead to further delay in implementing any restructuring plan.

Nonetheless, in certain cases, the creditors may actually prefer that the debtor become directly involved in intercreditor issues and serve to mediate intercreditor issues between the various creditor constituencies. However, the decision to engage the debtor directly in intercreditor discussions will depend on the creditors' perception and judgment as to what type of debtor is involved. The creditors may seek such a role for the debtor only in those circumstances where the creditors have some confidence in the debtor's desire to close a restructuring deal in a timely and reasonable fashion. In particular, the involvement of the debtor in intercreditor issues may be viewed as necessary if the disparate creditor constituencies are having a difficult time working out such issues on their own without involvement by a third party.

Although the creditors may try to carefully sequence the intercreditor discussions, sometimes events drive the timing of the intercreditor discussions relative to the timing for the development and negotiation of the overall restructuring plan. For instance, it could be the case in a particular troubled loan situation that upon the occurrence of specified events of default, certain secured creditors may have the right to trap cash in designated offshore collateral accounts and may choose to exercise that right. This could put the debtor in a precarious financial position if, without access to the cash trapped in the collateral accounts, the debtor becomes short of cash to continue its normal operations.

In such circumstances, these secured creditors will be in a position to influence how the restructuring process unfolds, including the process by which intercreditor issues are addressed. These secured creditors may not be willing to release the cash, or they may release it only sparingly, unless and until their intercreditor concerns are addressed to their satisfaction. The unsecured creditors as well as the debtor may be faced with relatively limited options. To keep the debtor operating as a going concern, the unsecured creditors and the debtor itself may need to make key concessions to the secured creditors who are trapping cash.

Finally, in some restructurings, the creditors will try to resolve intercreditor issues among themselves and negotiate a restructuring deal with the debtor at the same time. The creditors have to decide whether, in light of the particular circumstances of a given case, such an approach will permit progress to be made on both fronts or whether the process of trying to accomplish both will unduly complicate matters, possibly limiting progress on either or both fronts.

In short, managing the process for resolving intercreditor issues is not at all an inconsequential element in the overall restructuring process. Unless handled properly, the intercreditor issues, particularly if these issues are divisive and pit important creditor interests against one another, can have the potential to disrupt or sidetrack the overall restructuring negotiations between the creditors and the debtor. Unlike other important aspects of the restructuring process, intercreditor issues and the process by which they are resolved tend to be within the control of the creditors. But the creditors need to consider how these issues can be addressed in an orderly and effective manner without unnecessarily distracting or dividing the creditor body as it engages in possibly difficult negotiations with the debtor.

Establishing financial parameters for a deal

Restructuring plans cannot be drawn up in a vacuum but instead are generally based on a number of key financial and economic assumptions. Fundamentally, both the creditors and debtor will be grappling with the issue of what is the company's level of so-called sustainable debt. This is generally understood to be the amount of debt that the company can comfortably service going forward. The creditors and debtor may have differing views on what is the appropriate level of sustainable debt. The debtor usually will push for a lower figure since this will mean that it will have less outstanding debt to service in the future. The creditors, by contrast, normally will push for a higher figure since this will limit, for example, the amount of debt write-offs (so-called haircuts) or debt-for-equity swaps that they may be forced to accept. Yet, in a number of cases, even the creditors may not want an unreasonably high level of sustainable debt, since they would not want to be faced with the need to work through another debt default by the company at any time in the near future.

Determining the level of sustainable debt is not a precise science. As part of the analysis and as part of any broader assessment of the company's future financial viability, the parties may find it necessary to make certain assumptions. These assumptions may include: the cash flow projections for the company; pricing trends for the company's inputs and outputs; industry trends (locally, regionally and even globally) affecting the company, such as competition and consolidation; the effect of government policies such as import restrictions or tariffs; and perhaps general macroeconomic conditions that may have an important impact, for example, on demand for the company's products. Also, it is not uncommon for parties involved in a debt restructuring to consider the debt service coverage ratios for comparable companies, if any, as a means of ascertaining what is the sustainable debt for the debtor undergoing the restructuring. Many of these matters are likely to be reflected, directly or indirectly, in any financial models developed by the financial advisers to the creditors and the debtor, including in the assumptions underlying any such financial models.

Some of these matters will be clarified in the creditors' due diligence investigation of the company's business operations and financial condition, which is a process that is often conducted by the financial adviser to the creditors' steering committee. That is why the due diligence process is so critical to the interests of the creditors. It is also why it is so important for the creditors to draft and negotiate a scope of work for the financial adviser conducting the due diligence investigation that has a sufficiently wide berth so that the financial adviser can look at relevant company records and information, historical and projected, and develop an assessment of the company's business and prospects that is as complete and accurate as possible.

Restructuring plans cannot be drawn up in a vacuum but instead are generally based on a number of key financial and economic assumptions

Perhaps not surprisingly, debtors in certain cases try to negotiate a narrow scope of work and thereby limit the financial adviser's ability to examine certain areas of the company's business or certain categories of information. For instance, although the debtor may not say so expressly, in certain cases the debtor may not want the creditors and their financial adviser to have free rein to examine historical transactions. In such cases, there may be some transactions that are possibly of questionable validity or otherwise embarrassing to the debtor, including for instance certain types of related party transactions that may not have been entered into on arms-length terms. In other cases, however, the debtor may simply be trying to control the costs of the due diligence investigation or trying to agree upon a scope of work that can be completed in a reasonable period of time.

Yet, apart from those matters that are susceptible to due diligence of the debtor's operations, other matters may require the creditors and debtors to make educated guesses concerning important financial or economic issues, and there may be differences of opinion. This can affect how the two sides view the economic parameters of any restructuring deal.

There is one area where it would appear that creditors and debtors should not have much difficulty in agreeing on a key financial parameter: the amount of all outstanding debt of the company. Yet from time to time this issue, too, becomes embroiled in controversy. Again, the debtor may seek to keep this figure as low as possible and may therefore challenge the validity of various creditor claims, while each individual creditor will be seeking to have all amounts due it recognized for purposes of the restructuring. The creditors and debtor will ultimately have to come to some agreement on a procedure for recognizing outstanding creditor claims. Nonetheless, there may be much wrangling about how this process should be conducted, whether a third party should be engaged for this purpose, and who has the final word on which debts are recognized and for what amounts.

In any such out-of-court proof of claims process, the creditors will want to exercise caution in submitting their claims. The creditors must be careful that any submissions they make will not prejudice any claims that they later file in an insolvency proceeding or other court proceeding, such as a debt recovery action. Of course, the creditors may be able to protect themselves by inserting appropriate disclaimers and reservation-of-rights language in any submissions that they make to the debtor, and creditors should consult with their counsel on such matters.

Creditors need to be realistic in establishing recovery expectations or otherwise 'the perfect can easily be the enemy of the good'

There may also be issues involving questions of legal interpretation and analysis. For instance, the valuation attributable to original issue discount (OID) bonds under the law governing such bonds may differ significantly from the insolvency principles or laws of the jurisdiction of the debtor. Indeed, local law may not even clearly address the matter. How such issues are resolved can make a difference in determining the amount of outstanding debt for purposes of the restructuring.

Once these financial and economic parameters have been determined, they provide the critical underpinnings for designing a restructuring plan. But to the extent that the creditors believe that some of the cash flow assumptions underlying the plan are conservative or even speculative, they may try to incorporate an *excess cash* mechanism into the restructuring. Such a mechanism is generally designed to allow the creditors to benefit, by paying down debt or otherwise, from cash flows generated in excess of certain pre-determined baseline amounts. Nonetheless, excess cash mechanisms are necessarily not self-executing but, absent for example changes or reforms to the debtor's corporate governance structure, may depend on implementation by the debtor's management and therefore may be only as strong or as weak as the debtor's management itself. That is why in certain cases creditors may try to ensure that excess cash mechanisms are coupled with overall corporate governance reforms of the debtor, such as outside or third-party oversight or involvement in the debtor's financial operations including the possibility of instituting cash controls.

Establishing realistic creditor recovery expectations

The creditors in general and their steering committee in particular will be interested in seeking a restructuring solution that maximizes the recovery prospects of the creditors. As a corollary, creditors generally seek to minimize the amount of debt write-offs. Nonetheless, the creditors need to be realistic in establishing recovery expectations or otherwise 'the perfect can easily be the enemy of the good'. In certain restructurings, creditors may expect a very strong recovery (well into the 80% to 90% range), whereas in other restructurings, creditor recovery expectations may be rather modest (below, and sometimes well below, 50%). Expectations will turn on many factors, such as whether the debtor can reasonably expect to generate strong cash flows and what type of market position the debtor will be in relative to its competitors.

In certain cases, based on recovery expectations, creditors may hold out for desired improvements in a proposed restructuring plan that the creditors believe will improve their recovery prospects by a certain incremental percentage. But it is possible that the creditors may be striving to obtain changes in the restructuring plan that, for whatever reason, the debtor may never agree to. By seeking or even insisting on such changes to the restructuring plan, the creditors may jeopardize the very plan that is then under consideration.

In assessing whether proposed changes to improve a restructuring plan are likely to be accepted by the debtor and its controlling shareholders, it is important for the creditors to understand how the local insolvency law shapes the debtor's incentive structure. The debtor may have little incentive to consider or accept improvements to a restructuring deal proposed by the creditors if the local insolvency law does not pose much of a threat. This may be the case if there is no reasonable prospect or likelihood under the local law that the debtor can be placed into an involuntary insolvency proceeding. The creditors may also face a relatively unmotivated or uncooperative debtor if the debtor is able to seek the protection of the local insolvency law to keep the creditors at bay for an extended period of time. Under the old Mexican suspension of payments law (which was replaced in May 2000 with the *Concurso Mercantiles* law), it was not unusual for debtors to remain in suspension of payments for a number of years.

It may also be difficult to gauge how long the negotiations will take to arrive at the creditors' preferred result, assuming it can be achieved at all. Even if the debtor and its controlling shareholders ultimately agree to certain creditor-proposed changes that may be designed to enhance recovery rates, this may be far from the end of the process. For one thing, in certain cases, the debtor and its controlling shareholders may agree to certain deal points on a term sheet basis and then take various actions to frustrate that agreement as the parties move to documenting the deal. Or the debtor may simply revisit and re-open points that had been previously agreed on in the term sheet. Furthermore, some structures, however desirable from the creditor perspective, may be very difficult to implement as a practical matter. For instance, the more complex the restructuring terms are, the more intricate the restructuring documentation is likely to be, and this may create opportunities for continued dispute and disagreement between the debtor and the creditors as the restructuring documentation itself is negotiated. In addition, in some cases, certain elements of the restructuring plan may raise regulatory concerns, whether anticipated or not, specific to the host country jurisdiction.

As much as creditors tend to focus on recovery percentages during the negotiations, they should bear in mind that these are essentially notional amounts based on projections and various financial and other assumptions. There can be much uncertainty as to certain factors that go into determining recovery rates, such as any value assigned to the equity if there is a debt-for-equity swap as part of the restructuring plan. In addition, different creditors involved in a restructuring may have divergent views on fundamental economic issues that go into a recovery rate calculation, such as what is the appropriate discount rate to arrive at a present value calculation or how to treat accrued but unpaid interest.

Finally, not all creditors will look at recovery rate issues the same way. In particular, creditors that were original lenders to the debtor will likely have a very different perspective from creditors that purchased their debt in the secondary market at a deep discount. In certain large emerging market debt restructurings, bondholders may hold a significant portion of the outstanding debt. Some of the bondholder participants, such as so-called vulture funds, may have purchased their debt in the secondary market at distressed debt prices. They may look at recovery-related issues from the perspective of whether they are coming out ahead, and by how much, relative to the discounted cost at which they purchased their debt in the secondary market.

This perspective of purchasers of distressed debt may affect how these creditors view the acceptability of any restructuring plan. It may also affect their decision whether to hold their debt until the closing of a restructuring or to trade out of their position in the interim if in the meantime they can find a relatively attractive price compared to their purchase price in the secondary market.

Original lenders to the debtor, on the other hand, may measure their recovery against a baseline of their original loan, that is, how they are faring against a recovery of 100 cents on the dollar as would be the case under their loan agreements. Yet, original lenders may also be keeping an eye on how their recovery under any restructuring plan compares to how much they have had to reserve against or write down their existing loans during the course of the restructuring process.

In sum, creditors need to be careful about allowing their negotiating posture to be driven solely or even principally by recovery projections, and these projections and their underlying assumptions need to be carefully analyzed before they are given undue weight. Recovery projections may be one element to be considered in evaluating the acceptability of a proposed restructuring plan, but they are not the only element by any means. Moreover, creditors need to remember that recovery projections are notional amounts and do not yet "represent money in the bank". Any restructuring plan, for example, could have significant implementation risks associated with documenting and then executing the final restructuring deal post-closing, and these complications could render recovery projections much less useful than might appear evident at first glance. ∎

The final part of this series of articles will appear in the August issue of IFLR.

Tackling restructuring in emerging markets (part III)

In the last of his three-part series, **Steven Kargman** completes his advice to creditors faced with the insolvency of emerging market debtors

The final part of this series (which included articles in IFLR, December 2002 and July 2003) completes an overview of ten major challenges facing creditors in emerging market restructurings. This article concludes this overview by examining three additional issues facing creditors: deciding whether to pursue a stand-alone or strategic investor-based restructuring; preventing the dissipation of assets during a potentially lengthy restructuring; and assessing whether a consensual restructuring is feasible or whether alternatives should be explored.

Determining whether to pursue a stand-alone or strategic investor-based restructuring

As a threshold matter, the creditors will have to decide whether they will seek a stand-alone restructuring, that is, a restructuring of the debtor *as is* without involvement of a third party, or a restructuring based on the involvement of a strategic investor such as through an acquisition, merger or joint venture. The creditors may not be able to form an opinion on this issue at the very outset of the process because, as discussed in the last article (IFLR, July 2003), they may need to conduct further due diligence to better understand the financial condition and business operations of the debtor. In addition, the mere fact that the creditors prefer one approach as opposed to the other may not mean that the debtor and its controlling shareholders will necessarily agree with the creditors' point of view on this matter. Obviously, however, deciding whether the restructuring will be a stand-alone restructuring or a strategic investor-based restructuring will have crucial consequences for the ultimate contours of any restructuring plan.

In certain circumstances, the creditors may seek the involvement of a third-party strategic investor for various reasons. First, it is possible that the strategic investor may bring highly valued management expertise in the debtor's industry, and the creditors may believe that as part of any restructuring the debtor's management team needs to be bolstered, if not replaced entirely. Second, the strategic investor may also be able to provide a meaningful and/or significant infusion of capital for the debtor, which may be a critical element in any restructuring plan, particularly if the debtor is seriously overleveraged. Third, the strategic investor may have a better track record than the debtor of dealing with financial adversity, which may be reflected in how the strategic investor has addressed prior downturns in the economic cycle. Therefore, possibly based on the strategic investor's prior history, the creditors may believe that, faced with financial challenges, the strategic investor would be less likely to default on its debt obligations than the debtor. Finally, there may be important and useful synergies between the business operations of the debtor and the strategic investor, which the creditors may believe would help improve the profitability of the debtor's operations.

Nevertheless, it is unlikely that the creditors will simply be able to impose the notion of a strategic investor on the debtor and its controlling shareholders. However, the involvement of a strategic investor may be the recommendation of the debtor's financial adviser as the most effective way to address its financial difficulties. A strategic investor may become attractive to the debtor, and particularly its controlling shareholders, for other reasons. For one thing, the controlling shareholders may be seeking a continued role in the management of the debtor and, depending on the circumstances, the strategic investor may be able or willing to provide the controlling shareholders with some assurance that they will have such a role in the restructured company. Whether or not such a continuing management involvement is a major or minor role, as well a substantive versus an honourary role, could be a focal point of discussions between the strategic investor and the debtor's controlling shareholders.

The outcome of this discussion will be of more than passing interest to the creditors. The creditors will want to be comfortable with the management and corporate governance structure of the restructured company. It should be noted that, in certain cases, the strategic investor might only be interested in pursuing its merger, acquisition or joint venture with the debtor if and only if the incumbent management is removed. This may be the case, for instance, if the strategic investor views the prospect of a continued role for incumbent management as a hindrance to the successful turnaround and restructuring of the company.

Alternatively, the controlling shareholders of the debtor may simply be seeking an exit at the *right price* from the company. In that case, the strategic investor may have to offer the controlling shareholders sufficient financial consideration to achieve that end.

If in fact the debtor and its controlling shareholders are amenable to bringing a strategic investor into the equation, the creditors will have to grapple with several important procedural issues. They may have to address questions such as the following:

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- How will potential strategic investors be identified?
- Will the creditors defer to the decisions and recommendations by a special financial adviser employed by the debtor for that purpose (whose role in certain cases may be separate from the debtor's restructuring adviser)?
- Will there be an organized bidding or auction process, or will it be more informal? and
- How long an exclusivity period will a potential strategic investor have?

This last question could be of considerable significance to the creditors since during this period the creditors may continue to be subject to a debt service standstill or moratorium, in which case most of the creditors may not be receiving any debt service payments. Under such circumstances, the creditors may not be interested in permitting the potential strategic investor to have too long an exclusivity period. The creditors may be concerned by the possibility that at the end of such a period, the strategic investor candidate may simply decide to walk away from the deal based on its due diligence or for other reasons. If that happened at the end of a long exclusivity period, the creditors may have lost valuable time in having their debt restructured and debt service payments resumed. Moreover, the creditors may also be concerned that the debtor and its controlling shareholders will use a long exclusivity period as another way to run out the clock on a restructuring solution.

If the potential strategic investor decides to move beyond due diligence and begins to negotiate the terms of its strategic investment, the creditors will then have to consider what their level of involvement in the process should be. Should they permit the strategic investor to engage in bilateral discussions with the debtor and its controlling shareholders, or should the creditors and particularly their steering committee insist on being included, even as an observer, in such discussions? The debtor (and perhaps even the potential strategic investor) may wish to keep the creditors at arm's length while the terms of the strategic investment are negotiated. However, the creditors may have a strong interest in understanding how the transaction between the strategic investor and the debtor will work.

Among other matters, the creditors may well have an interest in understanding any continuing management role for the debtor and its controlling shareholders. In addition, the creditors may have an interest in how much equity the debtor and its controlling shareholders have been promised if there is to be a debt-for-equity swap as part of the overall debt restructuring. Obviously, the creditors will also want to know if the terms of the strategic investment are premised on certian debt restructuring parameters, such as any proposed forgiveness of debt. Furthermore, they may want to understand the terms and scope of any proposed releases from liability that the debtor and/or its controlling shareholders are seeking.

Finally, if there is a strategic investor, the creditors will have to determine how they should negotiate the debt restructuring given that there may simultaneously be continuing discussions and negotiations relating to the terms of the strategic investment. The creditors will need to decide who should be at the negotiating table for the debt restructuring discussions. They will have to consider whether these should be strictly bilateral discussions between the creditors and the strategic investor, or whether there is any role for the debtor and its controlling shareholders in these discussions.

In sum, the prospect or possibility of a strategic investor entering the picture may be attractive for creditors in certain situations, but the creditors need to determine what role they will want to have – and what role they can arrange for themselves with the other parties – in the discussions concerning the terms of the strategic investment. The creditors also need to consider whether the various discussions and negotiations pertaining to both the strategic investment and the debt restructuring should be essentially two-party or three-party discussions. As much as the debtor and the controlling shareholders may try to manage the process on a bilateral basis with the potential strategic investor without the active involvement of the creditors, for their part, the creditors may have a critical stake in how these issues are addressed, including for example how potential bidders are identified and how long any exclusivity period will run.

Preventing the dissipation of debtor assets during a lengthy restructuring process

One of the important challenges facing the creditors may be maintaining the *status quo* while the debtor's financial situation is sorted out during the restructuring process. The debtor and its financial adviser may refer to the need to *stabilize* the debtor's business operations before any restructuring plan can be seriously considered or negotiated. Among other things, the debtor and its financial adviser may argue that, as part of this *stabilization* process, cash flows need to be *normalized* from their present *crisis* levels before reliable cash flow projections, which would underpin any restructuring plan, can be developed for the coming years, including the period covered by the restructuring plan.

The creditors, on the other hand, may have a different concern and priority: they may be concerned that, during the restructuring process, certain assets of the debtor may be dissipated or siphoned out of the debtor, and this could be detrimental to the restructuring process itself and to the fundamental interests of the creditors. Specifically, the creditors may be worried that, if there were to be such a dissipation of assets, there could be less economic value available for the creditors if and when any restructuring plan is ultimately agreed on and then implemented. This could have major consequences for the creditors' ultimate recovery.

Such a concern on the part of creditors is generally consistent with the third principle of *The Statement of Principles for a Global Approach to Multi-Creditor Workouts*, which was developed by the Insol Lenders Group under the auspices of Insol International. This principle states: "During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date." The commentary accompanying this principle refers to "prejudicial action[s]", such as "transferring assets or value away from the companies to which the participating creditors have recourse…or otherwise running down or shifting value from its business so that the prospects of repayment to the relevant creditors are diminished".

In emerging market restructurings, dissipation of assets during the restructuring process may not be simply an academic or abstract concern. In certain restructurings, creditors have experienced situations where debtors have come to the creditors and reported that funds are supposedly "missing" from the debtor that may total many millions of dollars. In other cases, creditors have been concerned about certain related party transactions and whether value has been transferred from the debtor to non-debtor affiliates for considerably less than arm's length consideration.

Moreover, in some cases, the creditors have been concerned that the debtor may be using available cash to buy back debt in a process that is not necessarily transparent to the creditors. The debtor may buy back debt of its favoured creditors. Or the debtor or certain of its affiliates may buy back debt in the secondary market, particularly if the debt is trading at deeply discounted prices. Among other things, the debtor and its controlling shareholders may view debt buybacks as a way to maximize their chance of retaining equity control, or at least as large an equity stake as possible, of the restructured company. If the restructuring plan involves or could conceivably involve a debt-for-equity exchange, the debtor and its controlling shareholders may calculate that the more company debt that they hold, the more equity that they would receive in any debt-for-equity exchange.

To address such concerns, the creditors may try to exercise tighter control and oversight over the debtor's cash flows. The creditors may try to implement a so-called cash monitoring system for this purpose. Although cash monitoring may be an important element of the creditors' proposals for reforming the corporate governance structure of the debtor post-restructuring, the creditors may also try to institute such a programme during the restructuring process itself. As is the case with the creditors' ability to conduct a thorough and unfettered due diligence investigation, the debtor in particular restructurings may try to sharply curtail or dilute any such cash monitoring programme. Certain debtors may well try to block the implementation of such a programme from the start, and failing that, such debtors may be uncooperative or otherwise try to frustrate the implementation of such a programme.

At its most basic level, in designing a cash monitoring programme, the creditors will be interested in establishing procedures whereby, for example, the debtor's cash receipts and cash disbursements can be closely monitored, preferably by outside third parties such as independent accounting firms. The creditors will have to decide several important and practical implementation issues. Among other matters, the creditors will have to consider whether cash monitoring should apply only to transactions above a certain dollar threshold and, if so, what should be the relevant threshold. Also, the creditors will have to consider whether they are comfortable being advised of covered disbursements only after-the-fact or whether they wish to be advised pre-disbursement. (Obviously, however, to the extent that the creditors seek to go beyond simply receiving reports on cash disbursements and instead seek to exercise actual approval rights over cash disbursements, they will need to be very sensitive to and aware of lender liability concerns under the laws of the relevant jurisdictions.) Of course, all of these implementation matters will have to be discussed and negotiated with the debtor and, as noted above, certain debtors may not be particularly receptive to such proposals.

From the creditors' standpoint, the importance of an effective cash monitoring programme during the restructuring process cannot be easily overstated. Complex emerging market restructurings can easily last for a period of several years. If there is a debt service moratorium or debt standstill in place, the debtor may be effectively "saving" large sums of money that it would otherwise be paying to the creditors in the form of debt service payments. Creditors who are not receiving debt service payments during this period will therefore want to know how the debtor is using its available cash resources. (Notwithstanding the existence of a debt service moratorium or debt standstill, certain creditors preferred by the debtor, such as possibly some of the local creditors, may receive debt service payments during this period.)

As noted above, certain debtors and their controlling shareholders may find various ways to siphon cash out of the debtor. That is why cash monitoring can be so important to the creditors. Cash monitoring may provide the creditors with an important check on the debtor's ability to use cash resources in ways that are not consistent with the interests of the creditors. Cash monitoring may also help the creditors determine whether the debtor is meeting its financial targets during the course of the restructuring process itself.

But the creditors should not expect the debtor and its controlling shareholders to accept the principle of cash monitoring without a fight, and even if the creditors are ultimately able to put some type of cash monitoring programme in place, certain debtors and controlling shareholders may do everything they can to dilute the effectiveness of such a programme as it is carried out and implemented. Nonetheless, while the creditors may push hard in the restructuring negotiations for an effective programme of cash monitoring that would be instituted post-restructuring, the creditors may also not wish to overlook the need to make cash monitoring a priority item to be implemented in some form during the restructuring process itself.

Assessing whether a consensual restructuring is feasible

At a certain point in the restructuring process, depending on the facts and circumstances of the particular case, it is possible that the creditors may become deeply disenchanted and frustrated with the lack of progress. The creditors may reach this stage if the restructuring process has lasted for several years, as have several large emerging market restructurings in recent years. The creditors may begin to have serious doubts about whether a consensual restructuring solution is in fact achievable in a reasonable period of time or whether, in their view, the debtor appears to be simply interested in delay and obstruction. The creditors may wish to perform this type of reality check on a fairly regular basis if the restructuring process appears to be proceeding far less smoothly than the creditors can reasonably expect under the circumstances. Nonetheless, it may not always be easy to make a clear-cut or definitive determination on this issue since the debtor and its controlling shareholders may be sending mixed signals, perhaps even deliberately so.

On certain matters, it may be abundantly clear that the debtor is not cooperating at all with the creditors. Such might be the case if the debtor does not deliver financial or business information that is requested as part of the due diligence process, or if the debtor prevents the creditors' financial adviser from having meaningful and relatively unimpeded access to relevant information during the due diligence investigation. Such a lack of cooperation may also be evident if the debtor does not follow through on drafting or providing comments on the restructuring documentation in agreed timetables.

However, on other matters and perhaps even at the same time, the debtor may be making certain positive gestures or statements, or at least going through the motions of appearing to cooperate in reaching a consensual restructuring. For example, the debtor and its legal team may even work on producing drafts of certain major restructuring documents, but then may not follow through on producing other documents or may delay finalizing other key arrangements, such as finalizing the filings and/or security agreements that will be necessary to implement new security arrangements under the restructuring. In some cases, therefore, the creditors may be faced with a debtor that appears to take one step forward and two steps back.

However, if the creditors eventually conclude that the consensual restructuring process is stalled and that the reason is the debtor's apparent lack of good faith or cooperation, then they need to decide what course of action to take. Specifically, they will have to decide whether they should abandon the consensual restructuring path altogether and take a more aggressive and even adversarial stance *vis-à-vis* the debtor. Nonetheless, even in the face of clear evidence of the debtor or controlling shareholders' lack of cooperation, it may not necessarily be an easy decision as a practical matter for the creditors as a group or individually to abandon the consensual restructuring process and take a harder line.

Some creditors may believe that they have already invested so much time, money and resources into the consensual restructuring process that it may be better to simply stick it out and try to reach the best restructuring plan possible with the debtor, as imperfect and flawed as such a plan may be. Among other motivations, these creditors may be anxious to close a restructuring deal, whatever its shortcomings, so that they can put their loans back on accrual as soon as possible. Also, in some restructurings, certain creditors, particularly those creditors that were previously unsecured, may have a certain level of comfort if they have received security as part of the overall restructuring package, which the creditors will look to in the event of a subsequent borrower default. Some creditors may also be concerned that the alternative to the consensual process may not necessarily produce a more desirable economic result than the consensual restructuring plan that is then on the table.

This raises the fundamental issue of whether the creditors, in abandoning the consensual restructuring process, are doing so solely or principally to maximize their recovery of principal and/or whether they are also doing so for reasons of broader principle. As to the latter, the creditors may expect restructuring plans to meet certain minimal standards with respect to financial terms, corporate governance issues, and so on. Of course, it may not necessarily be a mutually exclusive choice in seeking to maximize recovery on the one hand and seeking to vindicate certain broader principles on the other hand. For example, it is possible that taking a tougher stance towards the debtor, including on issues of fundamental principle, may bring the debtor back to the negotiating table at which point the debtor may be prepared to negotiate a better economic deal for the creditors. That may be the hope of the creditors, but there is certainly no guarantee that it will be the result of such an approach.

Other creditors, however, may have lost their patience with the debtor and its controlling shareholders and thus may be fully prepared to consider alternative courses of action. Again, as a starting point, such creditors may wish to consider whether the local insolvency law provides any avenues for forcing a solution on the debtor. Among other options, the creditors will need to consider whether they can commence an involuntary insolvency proceeding *vis-à-vis* the debtor. As noted in the first article in this series, it will be important for the creditors to understand not only what the local law provides by way of statute but also how that law is in fact applied in practice. Therefore, the local insolvency law may expressly provide for the possibility of seeking the involuntary insolvency of the debtor. But as a practical matter, depending on the jurisdiction, it is conceivable that such an effort may rarely be successful. As noted in the first part of this series, local counsel can provide important and useful guidance on such matters.

Of course, even if the creditors do prevail, for instance, in achieving a court order for the involuntary reorganization of the debtor, the debtor and its controlling shareholders may still attempt by various means to frustrate the implementation of a plan developed in an involuntary insolvency proceeding. For example, in certain cases, the controlling shareholders of the debtor have mounted a series of collateral legal challenges that have had the effect of tying up the creditors and/or their representatives in local courts. Similarly, in certain cases, the controlling shareholders have even had criminal charges brought against the creditors and/or their representatives or used administrative processes, such as challenges to immigration visas or work permits, to prevent the creditors' representatives from performing their court-approved functions.

Home advantage

As is often the case, the debtor and its controlling shareholders may have a significant *home court* advantage that should not be discounted or overlooked by the creditors. This advantage may even be more pronounced if some of the largest creditors to the particular debtor are foreign financial institutions (for example, commercial banks, bondholders, export credit agencies, and international financial institutions), which is not unusual in a number of large emerging market restructurings. Obviously, foreign creditors may not necessarily be seen as the most sympathetic parties in the debtor's host country and, recognizing this dynamic, the debtor and its controlling shareholders may not be timid about playing a nationalist card in the local press and in any public discussions of the specific restructuring case.

In a multi-jurisdictional restructuring, in evaluating their available legal options, the creditors may wish to consider whether the laws (and legal systems) of one jurisdiction are more favourable and/or fairer for the creditors than the laws (and legal systems) of the other relevant jurisdictions. As a general matter, the creditors will have to consider their options under the relevant insolvency laws as well as in pursuing debt recovery actions, and they will need to consider the impact of any pending insolvency proceedings on their non-insolvency options. In some cases, although it may potentially be time-consuming, complex and costly, creditors have attempted to recover assets that they believe may have been improperly diverted from the debtor, possibly by its controlling shareholders. Obviously, creditors considering any of these litigation-oriented options should consult with counsel to review and analyze their options in depth.

In short, creditors need to continually evaluate whether the consensual restructuring process is leading them to a desirable or even minimally acceptable outcome. If not, they need to consider whether such the process should be abandoned in favour of a more adversarial, litigation-oriented approach *vis-à-vis* the debtor and its controlling shareholders. In considering whether to pursue such an approach, the creditors will need to thoroughly analyze and review their legal options, as well as the likelihood of success, across perhaps several jurisdictions. They will also need to consider the interplay discussed above between recovery of principal and the pursuit of broader principles. In certain cases, creditors may opt for litigation, whereas in other cases creditors may decide that their litigation options are not overly attractive and that therefore they have to remain with the consensual restructuring process as unsatisfactory as that may be. ■