

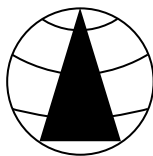


# INSOL INTERNATIONAL

## STATEMENT OF PRINCIPLES

FOR

## A GLOBAL APPROACH TO MULTI-CREDITOR WORKOUTS



# **INSOL INTERNATIONAL**

INTERNATIONAL FEDERATION OF INSOLVENCY PROFESSIONALS

## **STATEMENT OF PRINCIPLES FOR A GLOBAL APPROACH TO MULTI-CREDITOR WORKOUTS**

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Published October 2000



## INSOL INTERNATIONAL

INTERNATIONAL FEDERATION OF INSOLVENCY PROFESSIONALS

I am delighted to introduce the first published edition of the INSOL Global Principles for Multi-Creditor Workouts. The Principles represent the culmination of almost 5 years work on the part of the INSOL Lenders Group and they are to be congratulated on producing what will be a major contribution to the reorganisation of financially troubled companies.

We are honoured that the World Bank, Bank of England and British Bankers Association feel able to endorse the Principles as the enclosed letters show. Additionally INSOL International, in collaboration with UNCITRAL will participate in a three year Asian Development Bank regional technical assistance project commencing in 2001 that will encourage the development of, and strengthen existing, informal restructuring practices in the Asian region. The Principles will be a valuable resource material in this work.

We would be pleased to receive comments on the Principles and suggestions for any ways in which they could be made more useful to the business community.

A handwritten signature in black ink, appearing to read 'Neil Cooper'.

**Neil Cooper**  
**President**

**INSOL International**

**The World Bank**  
Washington D.C. 20433  
U.S.A

KO-YUNG TUNG  
Vice President & General Counsel

October 2, 2000

Mr. Neil Cooper  
President  
INSOL International  
2-3 Philpot Lane  
London EC3M 8AQ  
England

Dear Mr Cooper:

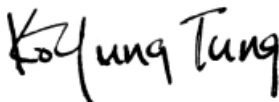
*ILG Principles for Multi-Bank Workouts*

On behalf of the Bank, I would like to thank you for the opportunity to review the recently completed *Principles for Multi-Bank Workouts* developed under the auspices of INSOL International by the INSOL Lenders Group.

The World Bank has been addressing the problems of corporate financial distress on a systemic level throughout the transition experience in Central and Eastern Europe and in the more recent financial crisis context in emerging markets. The Bank places paramount importance on these issues as being fundamentally important to sustain and promote effective markets and growth in developing countries and to maintain stability within financial systems. In this regard, the Bank has been working in collaboration with INSOL, the International Bar Association and international financial institutions to develop principles and guidelines for effective insolvency systems in developing countries. The INSOL *Principles* are an important complement to that broader initiative and other global efforts in this field.

INSOL is to be commended for this timely contribution to the evolving debate regarding the design and operation of insolvency systems and for its long standing commitment to the global enhancement of awareness and best practice within the international professional community.

Sincerely,



Ko-Yung Tung



The Governor  
**BANK OF ENGLAND**  
**LONDON EC2R 8AH**

5 October 2000

The Bank of England welcomes this initiative by the INSOL Lenders Group to develop a set of Principles for Global Corporate Workouts. Past experience suggests that a collective approach by creditors to a debtor company in financial difficulty can help preserve value, to the benefit of the creditors as a whole and of others with an interest in the company.

A handwritten signature in black ink, appearing to read 'R. A. V. George'.

The Rt. Hon. Sir Edward George



# BRITISH BANKERS' ASSOCIATION

**Pinners Hall  
105-108 Old Broad Street  
London EC2N 1EX**

Neil Cooper Esq  
President  
INSOL International  
2-3 Philpot Lane  
London EC3M 8AQ

**Tim Sweeney**  
*Director General*

6 October 2000

Dear Mr Cooper

## **ILG Principles for Multi-Bank Workouts**

The members of the British Bankers' Association, comprising as they do some 320 banks from more than 60 countries, have been involved in the great majority of multi-bank workouts which have been undertaken over recent decades, not just in the UK but around the world.

They recognise the value of the principles, which have now been published by INSOL. Indeed, as a member of the INSOL Lenders' Group, the BBA has been an active participant in their development.

We therefore commend them to the international community, as a statement of best practice which we believe can make a major contribution to financial stability.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Tim Sweeney', written in a cursive style.

Tim Sweeney  
Director-General

# Lovells

BINGHAM DANA  
LLP

Lovells and Bingham Dana are delighted to have been given the task of drafting the enclosed principles and commentary and working with the INSOL Lenders Group and the many institutions that have contributed their comments and thoughts to the process. It is our hope that we have produced a balanced treatment of the issues and that we have reflected faithfully the views of the many participants in the process.

Lovells

Nicholas Frome  
Chris Hanson

Bingham Dana LLP

Barry G. Russell  
Richard A. Gitlin



## ACKNOWLEDGEMENT

INSOL International would like to thank the INSOL Lenders Group and all others who have been involved in this project.

The Statement of Principles for a Global Approach to Multi-Creditor Workouts is the product of a number of meetings and conferences and much correspondence among a large group of interested persons over an extended period of time. In all, representatives from over 150 institutions have been involved in one stage or another of this project, whether as panelist, working group member, commentator or conference participant, including many of the largest banking institutions, insurance companies, institutional investors, hedge funds, secondary market and distressed debt purchasers, investment bankers and insolvency and finance professionals, plus Government representatives and regulatory authorities in many countries. The list is far too long to acknowledge each contributor individually, but suffice to say that the Principles are truly the product of a global effort by the people who deal with these issues on a daily basis.

The work of the INSOL Lenders Group has been led successively by Eddie Theobald (then of Barclays Bank Plc), David Havelock (then of National Westminster Bank Plc) and currently Adrian Marriette of HSBC and Terry Bond of Barclays Bank Plc.

They have been helped enormously by Richard Gitlin and Barry Russell of Bingham Dana LLP, New York and Nicholas Frome and Christopher Hanson of Lovells, London, who have undertaken the legal drafting of the Principles.

The INSOL Lenders Group Steering Committee has included many senior lenders in the last five years. The members of the Steering Committee as at October 2000 comprise

Adrian Marriette, Chairman	HSBC
Terry Bond, Vice Chairman	Barclays Bank Plc
Steven Barningham	Royal Bank of Scotland
Geoff Cruickshank	National Westminster Bank Plc
Rene Poisson	J P Morgan
Peter Ryan	The Industrial Bank of Japan
John Short	Deutsche Bank
Peter Stevens	Credit Agricole Indosuez
John Thirlwell	British Bankers Association

In addition, INSOL International owes a debt of gratitude to Richard Gitlin and John Lees for convening many of the meetings at which the Principles were developed.

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## INTRODUCTION

The eight principles (the “Principles”) set out in this report should be regarded as statements of best practice for all multi-creditor workouts. This document also contains a commentary on the Principles generally and on each Principle separately.

While the Principles should be equally applicable in all jurisdictions which have developed insolvency laws, the commentaries should not be taken as definitive or necessarily appropriate in all respects to all jurisdictions. They are, nevertheless, intended to help with the interpretation of the Principles and their application in practice. Both the Principles and the commentaries may be supplemented locally as circumstances dictate.

## PART I

### THE PRINCIPLES

**FIRST PRINCIPLE:** Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to co-operate with each other to give sufficient (though limited) time (a “Standstill Period”) to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case.

**SECOND PRINCIPLE:** During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.

**THIRD PRINCIPLE:** 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.

**FOURTH PRINCIPLE:** The interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty. Such co-ordination will be facilitated by the selection of one or more representative co-ordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.

**FIFTH PRINCIPLE:** During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, in order to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.

**SIXTH PRINCIPLE:** Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the Standstill Commencement Date.

**SEVENTH PRINCIPLE:** Information obtained for the purposes of the process concerning the assets, liabilities and business of the debtor and any proposals for resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential.

**EIGHTH PRINCIPLE:** If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.

## **PART II**

### **COMMENTARIES**

#### **General**

During the last thirty years there has been a growing recognition amongst the world's financial institutions that, as creditors, they can achieve better returns through supporting an orderly and expeditious rescue or workout of a business in financial difficulty than by forcing it into formal insolvency. This realisation has coincided with efforts by certain regulatory and official authorities to encourage financial institutions to co-operate with each other when dealing with debtors to whom they are collectively exposed, particularly in cases involving large exposures.

In some parts of the world, local regulatory or official authorities have, for a number of reasons, helpfully supported initiatives designed to encourage financial creditors to take a collective approach to debtors in difficulty. These include their wish to avoid the social and economic impact of major business failures where viable alternatives exist, to limit the damage to financial institutions that can result from unexpected and major debtor defaults (both directly and to lenders to those financial institutions) and generally to assist in the avoidance of more widespread economic damage.

While the advantages to be gained from a co-ordinated response by creditors to debtors in financial difficulty have been most apparent in periods of economic recession (when successive business failures can place very severe strains, not only on the financial institutions but also on the affected national economies), the methods used have gained more general acceptance. If nothing else, the co-ordinated response gives time to help manage the impact of debtor defaults, but most importantly such approaches create an opportunity to explore and evaluate the options for consensual agreement outside a formal insolvency process.

Although there is a growing international trend in the development of local insolvency laws to facilitate the rescue and rehabilitation of companies and businesses in financial difficulty (as opposed merely to closing them down through liquidation), it is a truism that, no matter how debtor-friendly and “rescue”-orientated local insolvency régimes may be, there are often material advantages for both creditors and debtors in the expeditious implementation of informal or contract-based rescues or workouts (particularly in cases of debtors having cross-border businesses or complex capital structures), compared with the unpredictable costs and uncertainties of a formal insolvency.

It should be noted that the Principles will be most successful in facilitating rescues and workouts if an appropriate legal, regulatory and governmental policy framework supports them. The existence and prospective implementation on a consistent basis of a well-designed insolvency law, by providing financial creditors with effective means of recourse against unco-operative debtors, encourages debtors to co-operate with financial creditors with a view to negotiating an agreement outside a formal insolvency in an acceptable timeframe. In addition, the effective implementation of laws that allow for the creation and enforcement of security and for priority agreements between creditors can provide an important means of encouraging the availability of new financing during the workout process. In the regulatory area in many countries, by virtue of requirements that public companies provide frequent, transparent and internationally consistent information, financial creditors are better placed to reach more rapid and sensible workout decisions.

Finally, and most importantly, time is crucial in rescues and workouts. When a debtor is experiencing financial difficulties, delay prolongs commercial uncertainty, increases the costs of the process and potentially erodes value. The Principles are designed to expedite rescues, and therefore increase the prospects for success, by providing guidance based on hard-earned experience, so that the debtor and the creditors can move the process to a resolution speedily and in a relatively structured manner.

**FIRST PRINCIPLE: Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to co-operate with each other to give sufficient (though limited) time (a “Standstill Period”) to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case.**

**Commentary:**

**All relevant creditors:** Although the main impetus and interest in developing a global approach to multi-creditor restructurings has come from the financial community, regulators and other official bodies, the approach advocated by the Principles can be applied to creditors other than financial institutions (eg, major customer or supplier creditors) in appropriate cases.

The main objective of the global approach is to assist in the process of rescue or orderly workout. Accordingly, the approach should ideally be applied to all creditors whose co-operation is needed in order to make any attempted rescue or workout succeed. On the other hand, there is usually merit in limiting the number of participants to the minimum necessary to see that objective achieved. Taking these two ideals together, it is necessary first to identify the classes of creditors which need to be included in the process and then to decide which creditors in the affected classes are to be included.

With banks and other financial institution creditors, it is usual to include all the financial creditors in the class regardless of the size of their exposure or the nature of their facilities (unless their exposure is so negligible that it is clear that their inclusion would serve no practical purpose or their position is such that they are not required to assist, and cannot frustrate, the process).



One rationale for including all financial creditors is that, even though in a particular case one financial creditor might be less exposed than others and therefore have less interest in any rescue attempt, this relative position might be reversed in another case. Accordingly, the long-term and mutually beneficial advantages to be gained by financial creditors supporting and co-operating with each other with regard to a co-ordinated approach to debtors in difficulty are reasonably clear. Financial creditors should, as a matter of principle, be prepared to support other financial creditors' attempts to rescue businesses unless it is to their commercial disadvantage to do so.

Where it is proposed to include creditors who fall outside the traditional categories of financier in the rescue process, the argument for including all creditors within a class diminishes and it is usually simply a question of deciding whether or not the particular non-financial creditor has to be included to enable the rescue to progress.

Where bonds or traded debt are involved in the rescue process it is seldom possible to involve all the bond or debt holders. Quite often ad hoc committees are formed by some of the debt holders. As these debt holders usually have the same economic interest as other holders their views are likely to be representative and they are therefore able to make an important and helpful contribution to the process. Where in the Principles or the Commentaries reference is made to "all relevant creditors", this should in the case of rescues involving bond holders or other tradable debt issues, be construed as a reference only to those of the bond or debt holders that participate actively in the rescue process.

With the increasing use of credit insurance and credit derivatives, it is not uncommon to discover that, in addition to the creditors of record, there are other parties whose consent or involvement will be necessary

for any rescue or workout proposal to succeed. Wherever practical, an early disclosure of such situations should be made by the creditors of record to the other relevant creditors.

Where the identity of relevant creditors changes during the process (eg. through the trading of debt) the successors should participate in and be included in the process in the same way as the original creditor.

**Giving time to the debtor (the Standstill Period):** Where a debtor is in financial difficulties, its creditors tend to have two main strategies. The first is to press the debtor for immediate repayment of the debt or the provision of security in the hope of removing or reducing the exposure. In some jurisdictions, attempts by a creditor to pressurise a debtor close to insolvency into giving it favourable treatment compared to other creditors can be open to legal challenge on the basis of preference. In others, however, pressurising a debtor in this way protects the creditor from a preference challenge and therefore, if a creditor is successful in persuading a debtor to pay it off or to give it security, it may well be able to keep the benefit deriving from its tactics.

The problem with the “each creditor for itself” approach is that, even if such a strategy can in theory benefit the creditor in a way which avoids subsequent legal challenge, the likelihood is that it will, either by itself or by provoking other creditors into following a similar approach, result in the debtor being forced into formal insolvency, thereby destroying any prospective advantage the creditor was seeking to gain.

This reality has caused the experienced financial creditors to conclude that their interests will usually be better served by a co-ordinated and measured response to the debtor in difficulty. It has also led debtors and their advisers to realise that giving in to pressure by one creditor usually destroys any chance of persuading the other creditors to hold off and give time for a rescue attempt.

During the Standstill Period, the creditors, with the co-operation of the debtor, should obtain and evaluate information about the debtor, its business operations and its capital structure and, if there is a commercial case for doing so on the basis of the information that has been obtained, formulate and assess proposals for resolving the debtor's financial difficulties (see commentary on the **Fifth Principle**).

**The Standstill Period - Commencement:** One of the more problematic areas is the determination of the date from which the Principles are to begin to operate and the standstill arrangements commence ("Standstill Commencement Date").

It is quite common for the relevant creditors to choose as the Standstill Commencement Date the date on which the financial creditors as a group (or at least some significant group or class of their number) were first notified by the debtor or by another financial creditor of a meeting called to allow the debtor to explain its position to the relevant creditors. Although a financial creditor has no duty to inform other financial creditors if it believes a debtor is in difficulty, it is not uncommon for this to occur and quite frequently one financial creditor will press the debtor to make a presentation to all its financial creditors so that standstill arrangements can be put into effect.

In some cases, one or more financial creditors may have anticipated the problems of the debtor and managed down their exposure to a significant extent before other creditors have realised the potential difficulties and before any meeting of financial creditors has been called. Such a creditor may well benefit in the short term, but, particularly in cases where dramatic changes have occurred in its exposure over a relatively short period, it may experience difficulty in persuading others to lend their support to a rescue.

**The Standstill Period – Duration:** The length of the Standstill Period will vary from case to case, depending on the complexity of the information to be gathered and the nature of any restructuring proposals, but should be no longer than necessary for the carrying out of the above process in each particular case, since any unnecessary delay is likely to prejudice the prospects of a successful outcome. It is customarily for an initial period of weeks or months, usually with a capacity for extension if all relevant creditors so agree. Sometimes the Standstill Period will be agreed for a period of, say, three months, but on the basis that the relevant creditors can, by a predetermined majority (eg, a majority in number or a majority in both number and value of claims) elect to terminate the Standstill Period prematurely, either at their discretion or following agreed events of default.

Although having a Standstill Period capable of premature termination at the discretion of a majority of the relevant creditors may appear to provide less assurance to the debtor, it has the advantage of flexibility and overcomes the difficulties of drafting and agreeing events of default which are suitable in a situation where the debtor is on the brink of collapse and the extent of its financial difficulties are such that “usual” event of default triggers would be inappropriate. Equally, while the relevant creditors may as a matter of principle be prepared to lend their support to the attempt at rescue or orderly workout, they will be concerned to ensure that, if the position deteriorates to their apparent disadvantage, they should be free to protect themselves and should not be locked into a deteriorating position. In practice, the approach adopted to this issue tends to depend upon the nature and degree of the difficulties facing the debtor.

**Unless such a course is inappropriate etc:** The suggested approach to multi-creditor workouts does not mean that the relevant creditors will in all cases agree to give time to a debtor to pursue the possibility of rescue or workout. Not all companies or businesses can be saved. In some cases, it may be obvious that no rescue or workout is feasible; in others, the debtor's management may have acted fraudulently and thereby have lost the trust and confidence of the relevant creditors.

If a creditor has reasonable grounds for preferring formal insolvency to any attempted rescue or workout, it is entitled, and can be expected, to elect for formal insolvency. If, however, giving time for the position to be properly evaluated has no apparent disadvantage for the creditor concerned, it should not refuse to co-operate simply to be obstructive. What will constitute reasonable grounds for a creditor refusing to give time to a debtor will depend on the circumstances of each case.

A creditor wishing to press for formal insolvency and unwilling to give time for any evaluation of the position should be encouraged to explain its reasoning to other creditors (assuming the debtor lifts any confidentiality restrictions which would otherwise prevent communication between creditors) and should at least consider representations from other financial creditors before reaching a final conclusion.

Reluctance on the part of a financial institution creditor to participate in a co-ordinated approach due to the relative size or nature of its exposure or a desire on its part to terminate the relationship with that debtor is not regarded as legitimate justification for its exclusion.

**SECOND PRINCIPLE:** During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.

**Commentary:**

**Refrain from taking any steps etc:** The initial objective of any attempted rescue or workout is to achieve stability. To attempt a rescue or restructuring against a backdrop of instability (eg, political, general economic or creditor instability) is extremely difficult. While certain jurisdictions provide for a statutory moratorium which allows “breathing space” to a debtor before the onset of formal insolvency, in many jurisdictions a statutory moratorium on creditors’ claims is available only as part of a formal insolvency process.

Even in jurisdictions which provide for a statutory pre-insolvency moratorium on creditor claims, there is often still advantage to both creditors and the debtor in adopting an informal or contract-based approach so as to avoid the costs and publicity associated with any formal process.

The confirmation of a “standstill” provides some reassurance to the debtor’s management that their attempts to achieve a rescue or orderly workout through the provision of information about the debtor to its creditors and their advisers and negotiation with them will not be immediately undermined by enforcement actions by those creditors; and also to the relevant creditors to the effect that the others of them are prepared to proceed on a co-ordinated basis while the evaluation process occurs.

In many jurisdictions, the “standstill” of the relevant creditors will be the subject of an agreement between the relevant creditors and the debtor. Typically such standstill agreements will include undertakings by the relevant creditors:-

- (a) Not to press for repayment of the amounts due to them or issue or pursue proceedings against the debtor during the Standstill Period;
- (b) Not to try to improve their individual positions relative to other creditors by obtaining or enforcing security or seeking additional financial rewards or preferential treatment during the Standstill Period; and
- (c) To continue during the Standstill Period to allow utilisation of existing credit lines and facilities, at least at the exposure levels existing at the Standstill Commencement Date.

While the continuation of facilities by relevant creditors is usually an essential feature of standstill arrangements, in some cases the termination of certain open derivative contracts may assist the rescue process by removing the volatility associated with such contracts. In other cases the continuation of swaps or hedges may be necessary to preserve value in the business concerned. Each case will need to be considered on its merits in this regard.

In certain jurisdictions, an agreement by the debtor with all or some of its creditors which provides for a moratorium on the payment of debts will itself trigger formal insolvency. In such cases it may still be possible for the creditors to agree between themselves (rather than with the debtor) to operate a moratorium

on their claims against the debtor and for the debtor separately to agree not to take steps which might prejudice the relevant creditors during an agreed period.

As stated, debt trading does not infringe this **Principle**. It is more fully discussed in the commentary on the **Seventh Principle**.

**Their position relative to other creditors and each other will not be prejudiced:** One of the main objectives of standstill arrangements is to try to ensure that, during the Standstill Period, the relevant creditors are not prejudiced relative to each other or relative to their position at the commencement of the process. While the issue of the eventual outcome for creditors may be uncertain at this stage, the standstill arrangement will usually contain a number of covenants and warranties which are designed to ensure that the position of the relevant creditors does not deteriorate, at least due to any deliberate acts or omissions on the part of the debtor during the Standstill Period (see commentary on the **Third Principle**).

Of more complexity and subtlety tend to be the arrangements between the relevant creditors themselves, which are designed to try to ensure that their relative exposures do not change during the Standstill Period. To this end, the more sophisticated standstill agreements (or separate linked inter-creditor agreements) will contain provisions which seek to address fluctuations in exposure that often occur during the Standstill Period where loan facilities provided by one or more relevant creditors are revolving or fluctuating in nature. In relation to such loan facilities, the relevant creditors may agree (under so-called “loss-sharing” provisions) to make balancing payments to each other in the event of a



collapse, such as are necessary to redress any relative gain or loss to relevant creditors resulting from such fluctuations as compared to the position at the Standstill Commencement Date.

Even greater difficulties arise in relation to facilities which are contingent in nature. There is a growing trend amongst financiers to seek to value their exposures under contingent facilities (eg, foreign exchange facilities, interest rate and currency swaps and other forms of derivatives) by means of “marking them to market”, often on a daily basis. Standstill agreements quite often seek to address the issue of fluctuations in exposure based on “marked to market” calculations under these types of facilities in a similar way to those on revolving loan facilities, although the potential volatility in exposures can require very sophisticated arrangements in order to limit the effect of such volatility on arrangements amongst the creditor group. Such loss-sharing provisions also seek to rectify variations in comparative exposure, although in many cases this issue will not be covered until a formal restructuring proposal is agreed and only limited adjustment mechanisms (if any) will be agreed at the standstill stage of the process.

Additional difficulties may arise because of the nature of the debt obligations subject to such loss-sharing arrangements. For example, where an issue of widely-held public debt is involved, it may not be practical to obtain the agreement of the requisite number of holders. All parties should recognise that efforts should be made by those parties involved in the negotiations to devise arrangements, to the extent possible, to give all holders of debt the benefit of such loss-sharing arrangements, so as to facilitate ultimate agreement on a consensual restructuring.

In certain cases, one or more of the creditors may enjoy an existing advantage compared to other participating creditors, either in the form of security or by virtue of the comparative number of companies in the debtor group against which it has recourse (whether by way of direct claims, guarantees or indemnities). Once again, the inter-creditor arrangements entered into at the standstill stage will often allow for the retention of these advantages. (Other forms of advantage which individual creditors may enjoy include set-off rights, liens, the benefit of documents of title associated with trade finance or bill purchase facilities, guarantees and insurance from third parties). The ultimate treatment of these advantages will typically be addressed in an inter-creditor agreement forming part of a contractual restructuring and is often the subject of extensive negotiation among the creditors.

When the claims of relevant creditors are denominated in a number of different currencies, movements in exchange rates during the Standstill Period can affect the relative position of creditors. Standstill arrangements often use assumed fixed exchange rates to determine certain inter-creditor issues (eg. voting and risk sharing) although realisations may still be shared by reference to actual exchange rates and end of day balancing adjustments may be required to cover exchange rate fluctuations.

**THIRD PRINCIPLE: 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.**

**Commentary:**

In return for support from the relevant creditors, the debtor should agree not to take any action which will disadvantage relevant creditors during the Standstill Period, apart from paying employees and trade and other (non-relevant) creditors in the ordinary course of business. Examples of such prejudicial action would be offering security in the form of charges, mortgages, liens, guarantees or indemnities to non-participating creditors, transferring assets or value away from the companies to which participating creditors have recourse, selling assets to third parties at an undervalue or to creditors who, because they are already owed money, will not pay for them, or otherwise running down or shifting value from its business so that the prospects of repayment to the relevant creditors are diminished. Incurring new additional borrowings or credit from persons who are not relevant creditors can also be an issue of sensitivity, as can the use of techniques such as factoring or leasing to raise new finance.

In some cases, the relevant creditors will insist that security be given to them at this stage for their collective benefit in return for their support during the Standstill Period. This is usually a topic for negotiation in connection with the standstill. If at this stage, however, additional funding (ie, in excess of existing levels) is requested by the debtor from relevant creditors, the granting of security for such additional funding would be quite usual (see commentary on the **Eighth Principle**).

**FOURTH PRINCIPLE: The interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty. Such co-ordination will be facilitated by the selection of one or more representative co-ordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.**

**Commentary:**

Although in some cases the number of relevant creditors involved in an attempted rescue is sufficiently small that a steering committee is unnecessary and a single co-ordinator may suffice, in most cases the result of a proliferation of borrowings by the debtor and/or the difficulty of identifying or making contact with, say, individual bondholders will be that the use of a co-ordination committee will greatly assist the process of attempted restructuring.

To assist with the co-ordinated approach, it is usual for the relevant creditors to appoint one or more representative committees to progress dialogue with the debtor and to help manage the evaluation process and the standstill arrangements.

Where bond or other tradable debt issues are involved, ad hoc committees are often formed by a number of bond or debt holders whose views may be expected to be representative of the bond or debt holders as a class.

Co-ordination committees (or the relevant creditors themselves) may select one of their number to act as the main co-ordinator. Such a co-ordinator will take first line responsibility for much of the administrative burden of the process and will also normally chair the meetings of the co-ordination committee.

The responsibilities and purposes of co-ordination committees and co-ordinators (hereafter together referred to as “co-ordinators”) will be determined by the relevant creditors.

Co-ordinators do not usually represent the relevant creditors in the sense of having authority to commit them to any particular course of action. Co-ordinators will also not wish to incur legal liability to the relevant creditors or to the debtor by assuming a representative role.

Co-ordinators are best described as facilitators of the negotiation process and co-ordinators of the provision of information to the relevant creditors (with appropriate professional advice). The appointment of co-ordinators should, in any case, be for the convenience of the parties and the efficiency of the process.

Co-ordinators can help resolve disputes or disagreements between the relevant creditors by facilitating discussions among those concerned. The co-ordination committees act as sounding boards, not only to the co-ordinator (if any) but also to enable the debtor to obtain an indication of the likely reaction of the relevant creditors to developments and to any proposals which the debtor may be thinking of making.

All parties should bear in mind that the role of the co-ordinator and the co-ordination committee is to facilitate the process, not to make commercial decisions on the part of others.

The advantages and efficiencies of channelling communications between the debtor and relevant creditors through co-ordinators are considerable but the process can be time-consuming, both for

the creditor representatives on the co-ordination committee and particularly for the co-ordinator. For this reason it is usual for the co-ordinator and co-ordinating committee members to receive appropriate recompense, not only to reflect the time they are likely to have to spend in discharging their role but also for travel, accommodation and other disbursements they incur. These expenses will be for the debtor's account initially, perhaps pre-funded by the debtor or covered by a loss-sharing or similar negotiated agreement among the relevant creditors as a group.

The co-ordinators are often given delegated authority to instruct outside professionals such as accountants, lawyers and valuers to provide advice for the benefit of the relevant creditors as a whole. Where practicable, the choice of such professionals will be discussed and approved with all the relevant creditors. It is important that such advisers have the relevant experience and skills and will be able to provide impartial advice for their collective benefit. Such professionals will assist in the preparation and evaluation of information and documentation relevant to the process in all its various stages. Once again the costs of such professionals will be for the account of the debtor, but pre-funding or a loss-sharing or similar negotiated agreement may be required as a back-up.

Another advantage of using co-ordinators is that it helps to ensure that all the relevant creditors receive the same information and advice during the rescue process. A single set of shared advisers for the relevant creditors as a whole is often preferable from a debtor's perspective and may work in some cases, but often creditors who are parties to different forms of credit facilities

(such as bank loans, privately-placed notes and public bonds) will require that separate legal advisers be retained to represent the interests of relevant creditors of a particular class. Because workouts often present inter-creditor issues, not just issues between the debtor and the relevant creditors as a group, and because different creditor classes typically have different legal, regulatory, policy and other issues to address, it would be unusual for a single legal adviser to be able to represent all the relevant creditors with respect to all the issues involved. Even in such cases, however, it is often possible for the main burden of information-gathering, processing, evaluation and due diligence to be borne by accountants and lawyers acting for or representing the interests of the relevant creditors as a whole. All advisers should be independent of the debtor.

Where the relevant creditors agree that there is no material difference of interest between them, but individual creditors still wish to have the benefit of separate advice (eg, on the impact of any proposals upon their individual positions in contrast to others), the cost of such separate advice will usually have to be borne by the creditor concerned and cannot be passed on either to the debtor or the other relevant creditors.

Importantly, each of the relevant creditors will be expected to make its own assessment and decisions regarding any information, advice or proposals it receives either directly or via co-ordinators with regard to matters related to the restructuring process. Co-ordinators will have no duty or liability to other creditors or the debtor with regard to the accuracy or completeness of such information or advice or with regard to any

proposals or their acceptance or rejection of them. It is important, however, that co-ordinators ensure that information they receive is disclosed to all relevant creditors and that they do not assume liability or responsibility to other relevant creditors either expressly or by any course of conduct (see commentary on **Seventh Principle**).

While co-ordinators can expect the identified costs and expenses they incur relating to the restructuring process to be recoverable from the debtor or, in the event of the debtor's default, covered by pre-funding or a loss-sharing or similar agreement with the relevant creditors as a whole, open-ended and general indemnities are likely to be resisted by the relevant creditors. It is increasingly common for co-ordinators to require that the nature of their position and role be defined in writing with the relevant creditors and the debtor.

In some cases, the differing interest groups amongst the financial creditors can be accommodated within a single co-ordination committee by ensuring that the co-ordination committee is sufficiently representative of the different interest groups within the relevant creditors as a whole. In such a case, its composition should reflect the individual types and classes of creditors and, if possible, include the true beneficial owners of the facilities involved, rather than the nominal owners or holders of legal title only. However, in situations where a relevant creditor class does not have an agent (for example, an issue of private notes or public debt securities), the representative of that class may be a designee such as an attorney or accountant who in turn has been appointed by an ad hoc group of holders of private notes or public debt securities.



In other cases, the extent and nature of the different interests can mean that a single co-ordination committee will not be appropriate and in this event, two or more co-ordination committees may be appropriate with each having its own co-ordinator who will work with the other co-ordinator(s) to progress the process while at the same time being representative of their separate constituencies.

The choice of co-ordinator is made by the constituency from which the committee is selected. Very often the co-ordinator will be a representative of the financial creditor which has the greatest or one of the greatest exposures to the debtor, and will be an individual with relevant experience, skills and seniority. In rare cases, creditors may prefer that the co-ordinator be an independent person.

The obvious advantage of the co-ordinator being a creditor with significant exposure to the debtor is that the reaction of a co-ordinator to proposals is likely to be indicative of the reaction of relevant creditors generally. On the other hand, a self-interested co-ordinator may in some cases have significant differences of view from other creditors, which may harm the process. The choice should lie with the relevant creditors.

Co-ordination committees usually operate on the basis of consensus rather than majority voting, particularly as they have no actual authority to bind the relevant creditors as a group.



**FIFTH PRINCIPLE: During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, in order to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.**

**Commentary:**

**Reasonable and timely access to all relevant information:**

During the Standstill Period, the debtor should allow relevant creditors and/or professional advisers appointed to represent them access to all relevant information regarding its assets, liabilities, business and prospects. This is important, not only to enable the relevant creditors to assess the financial position of the debtor at the Standstill Commencement Date and during the Standstill Period, but also to enable them to evaluate any proposals which the debtor may wish to make for its rescue, workout or reconstruction.

The relevant creditors will need to receive information which they can place reliance upon and have evaluated by their advisers. For this reason the information will have to be obtained, or at least be capable of due diligence, by independent advisers acting for the relevant creditors. The advisers to the relevant creditors can in some cases work from information provided by the debtor or its advisers but issues of reliance and liability can cause difficulty in this regard and, where asset valuations are needed, it will usually be necessary for the relevant creditors to commission such valuations themselves. The location and nature of assets can necessitate special due diligence techniques.

The debtor should accept that the advisers to the relevant creditors will be expected to review the accuracy of accounts, projections, forecasts and business plans related to any proposals for rescue or reconstruction and also to estimate the consequences of the relevant creditors refusing to agree to the proposals being put to them. The relevant creditors will also wish to gain reassurance that, as between themselves, their relative positions have not and will not be prejudiced by any proposals which are being made.

**Any proposals to be made to relevant creditors:** The nature of the proposals which the debtor may wish to make for its rescue, restructuring or workout will of course depend on the circumstances. They may only involve the provision of temporary additional liquidity, but in other cases debt write-offs, exchange offers for bonds, debt to equity conversions or asset for debt exchanges may be necessary to restore balance sheet solvency to the debtor. In some cases, the proposed arrangements can be effected by contractual arrangements between the debtor and the relevant creditors alone. In others, the proposals will need the sanction of the courts (eg, in the case of schemes of arrangement or chapter 11 reorganisations) and in such cases it is usual for the debtor and relevant creditors to try to ensure that, so far as practicable, the outcome of any formal procedure is known in advance.

**SIXTH PRINCIPLE: Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the Standstill Commencement Date.**

**Commentary:**

The objective of the information-gathering, due diligence and evaluation processes during the Standstill Period is to enable the relevant creditors to evaluate the debtor's position, to assess any proposals which the debtor may put to them and to satisfy themselves that they are receiving equitable treatment relative to the other relevant creditors.

Inevitably they will wish to compare what may be offered to them with what they might expect from a formal insolvency or from other options open to them (eg, the sale of their debt). This comparison may simply be based on their individual assessment of likely realisations in an insolvency or upon professional accounting and legal advice.

It is common for the accountants or other financial advisers acting for the relevant creditors to provide comparative advice of this nature and the accountants very often base their advice on insolvency models they produce in respect of the debtor or the debtor group which operate by reference to certain stated legal and accounting assumptions (eg, as to the validity of security, guarantees, rights of recourse, rights of set-off etc.) and are based on the information produced through the due diligence process.

Such insolvency models should take account of all relevant claims and entitlements (eg, the claims of the relevant creditors and other creditors, inter-company and subrogated claims and dividend entitlements) which would be counted in any insolvency of the debtor and of all relevant insolvency laws.

Insolvency models can either be used simply to identify where realisations are likely to go in the event of an insolvency (applying usual insolvency principles) or can be more sophisticated and seek to predict the likely return to creditors in an insolvency using assumed realisation values and assuming a contemporaneous liquidation and asset realisation by all companies in the debtor group. Because of the assumptions as to value and time used in these models they only serve as estimates but they are nevertheless helpful as a basis for both negotiation and evaluation.

When applied to groups of companies, insolvency models will consider the position of each debtor company separately and then aggregate the result on a group basis and by reference to each relevant creditor so that the net expected return to each relevant creditor can be determined.

In the case of larger groups, the insolvency models can be extremely complex and will need to take account of differences in the various insolvency régimes of the different jurisdictions involved.

The output from the insolvency models can, amongst other things, be used to identify the claims that relevant creditors may have against each debtor company; to estimate the likely return to such creditors from their claims and to estimate the proportion of the indebtedness due to relevant creditors which appears to be

covered by assets (as opposed to uncovered). These calculations can in turn be used when considering such issues as debt to equity conversion or debt write-offs.

Because the benchmark for the approach advocated under the Principles tends to be the position as at the Standstill Commencement Date, relevant creditors will also wish the insolvency model and the assumptions upon which it is based to have regard to issues such as the validity of claims of relevant creditors, the validity of any security they may hold, the validity of any exposure reductions which occurred in the period prior to the Standstill Commencement Date and the advantages which the holders of guarantees may enjoy by virtue of their ability to make claims against both principal debtors and guarantors. For this reason the due diligence exercise carried out on behalf of relevant creditors quite often applies not only to the debtor but also to the claims and entitlements of the relevant creditors.

**SEVENTH PRINCIPLE:** Information obtained for the purposes of the process concerning the assets, liabilities and business of the debtor and any proposals for resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential.

**Commentary:**

**Confidential Information:** It is essential that during the rescue process all relevant creditors are provided with the same information regarding the assets, liabilities and business of the debtor and see all the proposals put by the debtor. This should be so even where differing proposals are being put to differing constituencies within the relevant creditor group as a whole and even if differences in the position between the relevant creditors mean that separate professional advice is required for separate constituencies.

In the case of a group of relevant creditors that comprises only banks, it is quite common for all of them (with the agreement of the debtor) to receive the same information at the same time, even in cases where the co-ordinator first processes information so that it is put into a form suitable for evaluation by each of the relevant creditors. This is partly linked to the fact that the banks, under many legal jurisdictions, have either contractual or implied duties of confidence to their debtor customers and those banks are accustomed to receive and hold price-sensitive and confidential information. Even so, the use of formal confidentiality agreements is becoming widespread.

Where relevant creditor groups include holders of debt which either are not subject to express or implied duties of confidence or cannot accept confidential information without prejudicing their ability to trade debt (which in the case of debt-traders and many bondholders will be unacceptable except for relatively short and defined periods), the position can be more complicated and special arrangements will need to be made. If debt-traders or bondholders are involved, it is not uncommon for the confidential information to be evaluated by an ad hoc group formed from their number who are prepared to be restricted from trading and by professionals acting for them (such as their legal advisers) until proposals have been fully formulated and it is either possible to publish the information or for the information to be passed to the intended recipient on the basis that it will be published within an agreed period whether or not the rescue proposal is approved. By this method the confidential and price-sensitive information is “cleansed” in the sense that publication will enable debt-traders or professional bondholders then to trade the debt which they were not able to do while they held confidential information which was not available to the rest of the market.

**Debt Trading:** Debt trading is increasingly favoured by many financial institutions as a mechanism for managing their credit exposures and realising the values associated with their lendings. In many jurisdictions the trade in secondary debt is a well established practice and secondary debt trading has become an important feature of the financial marketplace.



The issue of debt trading in the context of multi-creditor rescues is one of complexity and, to a significant extent, linked to the issue of confidential information. The Principles neither prohibit nor prescribe rules for debt trading and leave the issue to be resolved as the relevant creditors think appropriate in each case.

The main perceived benefit of permitting relevant creditors to trade their debt is that it can provide an exit to those who, for one reason or another, do not wish to participate in the rescue process. It should also be appreciated that, where the original debt is in the form of a bond or other tradable instrument, any attempt to restrict or control the trading of that debt during the rescue process is likely to be unacceptable to the holders.

The main sensitivities associated with debt trading are that it can lead to an increase in the number of, and a change in the identity of, creditors who have to be involved in the rescue process and thereby increase the burden of co-ordinating the process. It can also allow into the process new participants who for commercial gain may seek to destabilise or block the rescue.

The use of professional advisers and co-ordinating committees to progress negotiations with the debtor and to receive and analyse confidential information relating to the debtor may reduce the sensitivity associated with debt trading by obviating the need to transmit confidential information to the main body of relevant creditors until the rescue proposal has been fully formulated and the implementation mechanism initiated. This technique tends to be of most assistance when the rescue proposal is to be implemented using some form of scheme of arrangement or

reorganisation which requires publication of the proposal and court approval. It is of less help where it is necessary to gain the voluntary agreement of each debt holder to the proposal.

Where the relevant creditor group consists only of banks and the intention is to avoid any formal procedure to implement the proposal and/or to keep the details of the proposal confidential, it is not uncommon for the relevant creditors to include in the standstill arrangements some mechanism for regulating the trading of debt during the Standstill Period.

**EIGHTH PRINCIPLE: If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.**

**Commentary:**

**If additional funding is provided:** During the Standstill Period and/or in the immediate aftermath of any rescue or restructuring, additional funding (often referred to as “New Money”) is often required. While other ways may be found of providing such funding or of easing the debtor’s financial pressures (eg, through the release of asset disposal proceeds), New Money may also be necessary to enable the debtor to overcome a temporary shortfall. The relevant creditors will normally wish to be satisfied both that any New Money funding is genuinely necessary and that repayment is adequately provided for. They may therefore be reluctant to see New Money funding of material amounts in advance of some assurance about the debtor’s financial position.

As noted in the commentary on the **Second Principle**, the standstill arrangements are intended to preserve the relative position of relevant creditors as between themselves. The benchmark for comparison will be the position as at the Standstill Commencement Date.

Where a debtor requires New Money funding, relevant creditors will be concerned that such New Money will, so far as practicable, be given priority of repayment compared with other debts in the event of the failure and insolvency of the debtor.

The simplest method of ensuring the priority of repayment for New Money is usually by the obtaining of security for its repayment over assets of the requisite value. In some cases, however, negative pledges in favour of third parties or other legal complications will either prevent the granting of security for New Money or render the benefit which will result from such security uncertain. While there are various techniques for ameliorating such problems (eg, asset purchase arrangements, placing assets into newly formed and “ring-fenced” borrowing entities and sale and leaseback arrangements) in some cases relevant creditors will have no option but to fall back on loss-sharing arrangements between themselves designed to ensure that the New Money will be accorded priority of repayment status (eg, by agreeing to “pool” recoveries from any insolvency of the debtor and to apply them in repayment of the New Money first or, in certain jurisdictions, by the use of subordination agreements).

Identifying New Money is, as indicated in the commentary on the **Second Principle**, not limited simply to the provision of additional loan facilities. It can also apply to other forms of increase in exposure levels (eg, under derivative or contingent facilities) when compared to the position as at the Standstill Commencement Date. The treatment of such increased exposure levels will be a matter for commercial negotiation among the relevant creditors.

The provision of New Money (including increases in exposure which are to receive New Money treatment) can impact upon the position of relevant creditors. This is because its priority treatment may affect the prospects of other non-prioritised debt being repaid.

Ideally, where appropriate, all relevant creditors participating in the process should be given the opportunity to participate in the provision of, and should accept the risks associated with, the provision of New Money on a proportionate basis (ie, proportionally to the perceived exposures which each of them has to the debtor as at the Standstill Commencement Date). Banks and other financial institutions may be able to provide New Money funding directly (either on a bilateral or syndicated basis) but other relevant creditors may only be able to underwrite such New Money exposures and some only to a limited degree.

Some relevant creditors may not be able to agree to any increase in their overall exposure and will only be able to support the provision of New Money either by subordinating their existing lending to its repayment (this technique may not work in all jurisdictions) or by agreeing to share dividends or other recoveries so as to give the New Money priority of repayment (ie, a form of loss-sharing provision).

The basis on which benefits associated with the provision of New Money will fall to be shared between relevant creditors where only some of them are able to provide the New Money lending to the debtor directly will be the subject of commercial negotiation between the relevant creditors.

New Money lending will generally be provided on the same basis so far as demand or cancellation is concerned as other facilities (eg, such demand may only be made during the Standstill Period with the agreement of a majority of the relevant creditors). In many jurisdictions, however, a lender of New Money (or indeed a



provider under any other facilities) should not be obliged to lend further amounts after a petition for liquidation or bankruptcy has been lodged against the debtor unless such additional lending has been approved by the courts, as otherwise it may not be recoverable in a subsequent liquidation or bankruptcy.



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