Restructuring activity in the emerging markets has been increasing sharply in recent years. In the immediate aftermath of the Asian financial crisis and in the years since, there have been a number of high-profile corporate debt restructurings in the emerging markets and several of them have involved outstanding debt amounts of more than $1 billion—in some cases significantly more. During the same period, there also have been many significant project finance restructurings in the emerging markets, particularly in several Asian countries such as Indonesia, Pakistan, and elsewhere.

Nonetheless, project finance and corporate debt restructurings in the emerging markets are not often considered to be similar undertakings. From a lender’s perspective, corporate and project finance restructurings would appear to address very different financing structures. Creditors who have loaned against the balance sheet of a going concern would appear to be in a very different situation from those who have loaned against prospective cash flows from what may be a single asset or discrete set of assets held by a special purpose vehicle that was created for the given project finance transaction (i.e., it has no prior operating history). Moreover, it is one thing to make a corporate loan to a company that has many customers, perhaps several lines of business, and possibly certain assets that can be sold off if the need arises. It is quite another thing to lend into a project finance transaction where the project may have only one customer, such as a government-owned offtaker, and where the project cannot change its line of business or the location of its assets—the so-called “stranded asset” problem.

However, while there may be many contrasts between project finance restructurings on the one hand and corporate debt restructurings on the other hand, there are also many commonalities. In this article, we will compare and contrast these two types of restructurings in the emerging market context. In considering project finance restructurings, it should be noted that we will focus on the power sector in particular and will use the restructuring of independent power producers (IPPs) based on long-term power purchase agreements (PPAs) as a paradigmatic example. Of course, there have been many other types of important project finance restructurings in diverse sectors such as telecommunications, transportation, and infrastructure, and it is certainly recognized that restructurings in these sectors may yield their own valuable lessons. But these other types of restructurings are beyond the scope of this article. In addition, even within the power sector, there are IPPs that are based on the “merchant power” model (i.e., the power is sold into a competitive market rather than sold pursuant to long-term purchase contracts) as opposed to...
the PPA model. Furthermore, in considering corporate debt restructurings in these markets, we will focus on so-called out-of-court, “consensual” restructurings as opposed to reorganizations within the judicial context.

Restructurings in the emerging markets can pose many unique challenges. In corporate restructurings, the fundamental challenge generally is the issue of how to get the debtor to begin re-servicing its debt pursuant to a consensual restructuring plan when, by virtue of the local insolvency law and local legal framework, there possibly may be limited incentive for the debtor to reach a prompt or fair restructuring with its creditors. By contrast, in the project finance restructuring context, the fundamental challenge may center on how to get the government-owned off-taker to enter into a revised long-term tariff with the affected project when, among other difficulties, demand for the project’s output may be severely depressed due to a systemic financial or economic crisis, when the local currency may have been devalued (thus making tariff payments indexed to a foreign currency more expensive), and when the transmission infrastructure may be only partially constructed.

CONTRASTS BETWEEN CORPORATE AND PROJECT FINANCE RESTRUCTURINGS IN THE EMERGING MARKETS

Timing Expectations

In corporate restructurings in the emerging markets, at the outset of the process, the parties, particularly the creditors, may believe they are about to embark on a relatively short-term exercise, one that perhaps can be concluded within, say, a period of one to two years. Although the creditors may understand intuitively that the process will not proceed as rapidly as it would in the United States or in other advanced, OECD-type economies, creditors nonetheless may have the attitude, “What can be so hard? We’ll do our due diligence on the debtor, develop some cash flow scenarios, put together a restructuring proposal, negotiate with the debtor, and then get the proposal approved by the creditors.”

By contrast, in project finance restructurings in the emerging markets, the parties may be relatively resigned to the fact that the restructuring will be a long-term process. In these restructurings, the parties may expect the restructuring process to last easily for a few years. They may come to this recognition based on the multiplicity of parties that are involved in a project finance restructuring, the array of project documents that may be implicated, and the complexity of project arrangements. In addition, the parties may realize that the structure of intercreditor arrangements, with their highly specific voting requirements among the different creditor constituencies, will not necessarily lead to a prompt resolution of outstanding issues, and that the involvement of governmental entities in the host country and the related political considerations also may serve to prolong the process.

Notwithstanding these conflicting timing expectations, both corporate and project finance restructurings can in fact turn into lengthy, protracted affairs. It is not unusual for large, complex corporate debt restructurings in the emerging markets to last several years. In certain cases, debtors have been known to use deliberate delaying tactics to prolong the process. Thus, specific phases and milestones of the restructuring process that may seem as if they should be relatively straightforward and not particularly time-consuming—for example, entering into confidentiality agreements with the debtor or performing due diligence on the debtor—can take much longer than might seem normal or reasonable. A debtor in an emerging market may use its local influence and other forms of leverage to delay the process. As the World Bank stated in a 2000 draft consultation report on insolvency law reform, “With little or no creditor protections and weak enforcement rights, management for financially distressed or willfully defaulting enterprises have no credible threat to compel them to negotiate on commercially reasonable terms.”

Even if the parties to a project finance restructuring may expect a lengthy process that will last a few years, they still may not fully expect and be prepared for some of the delays that inevitably arise.

Project finance restructurings in the emerging markets may take several years as well. Even if the parties to a project finance restructuring may expect a lengthy process that will last a few years, they still may not fully expect and be prepared for some of the delays that inevitably arise. For example, they may not be prepared for the delays that might arise when they attempt to negotiate revised tariff arrangements with host government parties such as the rel-
relevant government ministries and state-owned utilities. Such negotiations do not necessarily proceed according to a strict commercial logic and tempo, but may be significantly influenced by the political rhythm of events in the host country. Even if the project and other key project parties realize that there will be many elements that may comprise an overall project finance restructuring, they also may not fully anticipate some of the delays in reaching new, revised project arrangements among the diverse group of project parties. Such new arrangements may pertain, for example, to a restructuring of the project’s outstanding debt or a rationalization of certain project arrangements such as those relating to the supply of the project’s raw material inputs.

Central Negotiating Dynamic

In a number of corporate debt restructurings in the emerging markets, the central negotiating dynamic may revolve around the interaction between the controlling shareholder of the debtor, on the one hand, and the creditors, on the other hand. The controlling shareholders, who may hold a controlling equity stake in the debtor and also may occupy some of the key management positions of the debtor, can be a powerful force to reckon with in many emerging market debt restructurings. In particular, the controlling shareholders may represent influential family interests in the local society, which in turn may affect their eagerness or willingness to reach a timely and/or fair settlement with their creditors. They may believe they have limited incentive to reach a deal with their creditors, particularly if there are many foreign creditors involved in the restructuring. However, it should be noted that it is not just foreign creditors who may be disadvantaged by this view on the part of certain controlling shareholders; it is possible that certain significant local creditors also may be similarly disadvantaged. (To be sure, in some emerging market debt restructurings, certain local creditors, for one reason or another, may end up receiving preferential treatment.)

In project finance restructurings, the central negotiating dynamic may involve the government-owned off-taker negotiating with the project. (There may be other government entities that are project parties and therefore may be involved in restructuring negotiations, such as a government-owned fuel supplier.) Given the central position of the government-owned off-taker in the restructuring process, political issues broadly defined may assume a salient role. Government actors may strive to remain focused on how the public will react to changes flowing out of the restructuring process, such as how the revised tariff level charged by the project ultimately may affect retail tariffs that consumers will have to pay. As a result of increases in tariffs charged by IPPs as well as other factors, the host government may consider the need to raise retail tariffs. But the decision to raise retail tariffs can become a highly charged political matter, and host governments may proceed cautiously on this front.

In light of this possible political element in the restructuring process, project parties are often well advised to understand the dynamics within the relevant individual government ministries and among such government ministries. Such ministries might include, among others, a ministry of finance, a ministry with responsibility for issues relating to mines, energy, and natural resources, a ministry with responsibility for state-owned enterprises, and a ministry of foreign affairs. Within some of these government ministries, there may be individual bureaus and branches that play an influential role in the restructuring process. In certain cases, some of the bureaus and branches within a particular ministry may take different and/or opposing views and approaches to the relevant restructuring issues from other bureaus and branches within the same ministry. Thus, the project parties need to understand that the individual bureaucracies with which they are dealing may not necessarily be monolithic in their internal views on the relevant restructuring issues.

The project parties also may be interested in trying to understand and appreciate how the political leaders in the executive branch of the host government view the issues implicated by IPP restructurings. For example, it is not inconceivable that at a certain point in the process the political leadership within the executive branch of the host government ultimately may become involved in giving important direction to the relevant ministries, particularly if the restructuring issues involve high-profile projects within the host country or if these issues have broad policy and/or political ramifications for the host country. In addition to considering the views of the executive branch, the project parties also may seek to understand how the national legislature views such issues, particularly where the legislature is playing a more active role in some of the so-called “emerging democracies.”

In a federal government structure, the project parties also want to understand how the relevant state government, which may have direct jurisdiction over the project through a body such as a local electricity board, views the issues and how the state government interacts with the federal government on these issues. The views and policy
positions of the federal and state government may not necessarily be congruent, and this can become an even more complicated dynamic where the federal and relevant state government are controlled by opposing political parties.

The views and policy positions of the federal and state government may not necessarily be congruent, and this can become an even more complicated dynamic where the federal and relevant state government are controlled by opposing political parties.

Unlike project finance restructurings, corporate debt restructurings in the emerging markets typically involve less of an active and prominent role for the host government. The host government may well take the view that since the restructuring involves a private sector credit, the government should take a “hands-off” approach and leave it to the private parties, namely the creditors and the debtor, to work out their differences and reach a fair settlement. Nonetheless, in certain large-scale, private sector restructurings, the host government may become involved in the restructuring for specific reasons. For one thing, the government effectively may be, directly or indirectly, a creditor to the affected company through certain government-owned instrumentalities, such as government-owned development banks or through so-called “asset management companies” that take over failed banks in the host country. In other cases, host governments may become involved in major international debt restructurings because of broader policy interests. For instance, the host government may consider becoming involved if the government believes that the restructuring is sufficiently high-profile (e.g., it is the subject of extensive coverage in the international financial press or it involves a number of major international financial institutions). The host government also may consider becoming involved if it believes that the failure to achieve a successful debt restructuring in a particular case may have an effect on the overall perception of foreign investors with respect to the attractiveness of making future investments in the host country.

Fundamental Economic Issue

In corporate restructurings, one of the fundamental economic issues centers on what is the level of “sustainable debt,” i.e., the level of debt that the company can comfortably service on a going forward basis. In general terms, determining the level of sustainable debt is not necessarily an exact science but instead may depend on a number of financial assumptions. However, once the parties agree on the level of sustainable debt or at least agree on a compromise figure in this regard, they then can focus on how the company’s balance sheet needs to be restructured in order to fit the debtor’s outstanding debt within those sustainable debt limits. If the company’s outstanding debt exceeds its sustainable debt, the company and its creditors will have to decide what to do with the company’s so-called “unsustainable” debt, i.e., whether, as more fully discussed below, there should be debt write-offs, debt-for-equity swaps, and so forth.

In project finance restructurings, the critical economic issue may center on what is to be the level of the revised long-term tariff between the project and the off-taker. Nonetheless, this is not necessarily solely a financial or economic issue. As noted in the author’s prior article in this journal (“Restructuring Troubled Power Projects in the Emerging Markets,” *The Journal of Structured and Project Finance, Summer 2002*), the government-owned off-taker in particular may focus on what constitutes an “affordable tariff,” i.e., a tariff that the public in the host country ultimately can afford. Thus, to the extent that the new long-term tariff must represent an “affordable tariff,” this issue may take on significant political and social overtones, particularly given the role of electricity in everyday life and the visibility to the public of retail tariff changes.

Standstills

In corporate restructurings, a debt standstill or debt service moratorium may be imposed or declared unilaterally by the debtor. This is particularly true with a debt restructuring involving a multitude of creditors since it may simply be impractical for the debtor to negotiate a voluntary, contractual standstill with all, or even most, of its creditors. There may be too many creditors and there may not be enough time to do so if the debtor’s financial situation is deteriorating rapidly. In some cases where the debtor is seeking to set the proper atmosphere for the forthcoming debt restructuring exercise, it nevertheless may seek to advise the creditor body in advance that it
will be imposing a debt standstill. In other cases, whether by design or poor planning (neither of which necessarily will build much goodwill with the creditor body), the debtor may simply announce a debt standstill without any prior notice to the creditor body.

Nonetheless, whether there is advance notice or not, the creditors may not feel bound to observe the terms of a debt standstill if it has been essentially unilaterally imposed. But many creditors may observe the standstill since they may see certain advantages in temporarily relieving the debtor of its debt service obligations, albeit on a non-judicial, non-contractual basis. Specifically, they may believe that, given the presumably adverse financial circumstances of the debtor, it makes sense to provide the debtor with some breathing space in its efforts to resolve its financial problems and to work out a consensual restructuring solution with its creditors.

Other creditors, however, may choose not to observe a standstill imposed or declared by the debtor. Instead, these creditors may seek to enforce their legal rights and remedies. They may go into court in the relevant jurisdiction in an effort to recover on their defaulted loans. In addition, they may initiate insolvency proceedings that seek either the involuntary reorganization or liquidation of the debtor. Or, if they are secured creditors, they may seek to foreclose on their collateral.

Yet, to the extent that creditors choose to pursue any of these legal remedies in the local emerging market jurisdiction, they may find that, depending on the particular jurisdiction, they have significant difficulties in achieving successful outcomes because of impediments that may arise from local law or the local judicial systems. In certain jurisdictions, the creditors may believe that the local laws have a pro-debtor bias or are applied in a way that favors the debtor. In some jurisdictions, the creditors also may have questions about whether the local courts operate fairly and independently.

By contrast, in project finance restructurings, standstills are generally not such ad hoc arrangements. In some project finance restructurings, the project may seek to enter into formal, contractual standstills with its various counterparties in order to permit the restructuring process to proceed in a relatively orderly fashion. As a general matter, given the interrelated nature of the project’s contractual arrangements, a project undergoing a restructuring may desire to reduce the uncertainty that would result from having assorted parties attempting to exercise their legal rights and remedies for breach of existing contractual obligations if, at the same time, other project parties are attempting to work out a long-term restructuring solution. Of course, the process of entering into formal standstill arrangements cannot necessarily be accomplished overnight. Rather, it can be a time-consuming process given the need for the project to negotiate satisfactory terms for such standstills with the relevant project counterparties and the time involved in obtaining the necessary creditor consents for the proposed standstill arrangements.

After an extended period of time, the parties may realize that further confrontation will not necessarily yield the benefits that either side is seeking.

Furthermore, it should be noted that the parties may turn to standstill arrangements only after more confrontation-oriented alternatives have been pursued and perhaps only later abandoned. For example, the project and the state-owned offtaker may have been embroiled in a major dispute resulting from the offtaker’s repudiation of the existing power purchase agreement, which then may spill over into acrimonious litigation and arbitration in different forums both within and outside the host country. The parties even may have fought a bitter war of words in the international and local press.

In such circumstances, the government parties may well have a certain “home court” advantage vis-à-vis the project in how the dispute is portrayed in the local press. This will be particularly true if the government parties and other domestic players attempt to taint the project with allegations of corruption, whether fair or unfair, since such allegations may feed into possible nationalist sentiment against foreign-owned projects in general. However, in certain cases and perhaps only after an extended period of time, the parties may realize that further confrontation will not necessarily yield the benefits that either side is seeking.

As part of the overall standstill arrangements, the project may enter into a formal standstill with the government-owned offtaker with respect to obligations under the power purchase agreement while a new long-term tariff is negotiated. The parties may agree to forbear on
exercising any legal remedies that are available to them (e.g., the project may agree for the pendency of the standstill period not to pursue its legal remedies for the offtaker’s failure to satisfy its payment obligations under the PPA). In addition, the parties also may establish an interim tariff that would replace the tariff existing under the original power purchase agreement.

Moreover, the project may seek to enter into a formal standstill with its creditors pending the project’s overall restructuring and in particular the eventual restructuring of the project’s outstanding indebtedness. The creditors might be asked to waive existing defaults under the financing documents. Even if the project cannot service principal on its loans during the restructuring process, the creditors nevertheless may insist on being kept current on interest during this period, and that may therefore be a critical element of any standstill arrangement between the project and its creditors. Furthermore, to the extent that a project’s supply arrangements are being restructured, the project may enter into standstills with such suppliers that, for example, establish new, temporary pricing terms for such supplies.

Central Focus of Restructuring

Exercise in Practice

In corporate debt restructurings, the central focus is generally on a financial restructuring of the company’s outstanding indebtedness. The parties may consider a myriad of different ways to achieve a successful restructuring. Among other things, they may consider “capitalizing” a certain portion of the outstanding debt for an equity stake in the company, i.e., what is commonly referred to as a debtor-equity swap. They also may consider changing the terms of the outstanding debt, such as building in grace periods for principal repayment, stretching out maturities, changing interest rates, and so forth. In addition, they may consider debt buybacks and so-called “Dutch auctions” whereby the debtor seeks to retire some of its outstanding debt at substantial discounts, if possible. Or they may consider selling off certain “non-core” assets of the debtor, with the proceeds of such sales then used, for example, to pay down outstanding principal.7

Whatever techniques are used, the focus in many corporate restructurings may be largely on the financial aspects of the debtor’s operations. In some situations, this focus on a financial restructuring of the debtor may not necessarily provide an adequate basis for a long-term solution to the debtor’s problems. Rather, for the restructuring to be successful over the long term, it may be necessary, for example, to re-direct the debtor’s business strategy or to make certain corporate governance reforms with respect to the debtor’s management. The Asian Development Bank commented on this general issue in a 2001 report based on a survey of recent restructuring practices in a number of the major Asian jurisdictions. The report stated: “...very little attention is paid to addressing important and fundamental issues that would normally arise in a genuine restructuring—such as overall corporate structure, organizational structure, management, business evaluation, non-core asset shedding, and so forth.”8

In a project finance restructuring, the central focus in the first instance may be on restructuring certain key financial arrangements. The project may be forced to renegotiate the PPA and particularly the level of the revised long-term tariff that the offtaker will pay to the project. As a consequence of any renegotiation of the tariff, the project then may be forced to restructure its outstanding debt with its creditors.

Nonetheless, unlike a number of corporate restructurings in the emerging markets, a project finance restructuring does not necessarily begin and end simply with a financial restructuring. Instead, a project finance restructuring also may involve an operational and/or contractual restructuring. With respect to the renegotiation of the PPA itself, the government-owned offtaker may seek to revisit key contractual terms, such as risk allocation regarding force majeure and foreign exchange; such proposed changes will be resisted by the project. In addition, other elements of the project arrangements, such as the fuel supply chain, may require rationalization.

The process of rationalizing a fuel supply chain is not necessarily limited to strictly financial issues of what the cost of the fuel should be. Among other issues, the project may have to address the issue of whether each of the links in the fuel supply chain (shipping, storage, etc.) is necessary or whether, for example, there is too much redundancy in how the fuel supply chain is structured. In turn, this may force re-examination of issues such as security of supply. The project also may have to consider whether its contracts for fuel should be on more of a long-term or short-term basis and whether it should rely upon a few principal suppliers or whether it should have a more diversified set of suppliers. These questions also may implicate the broader issues of security and reliability of fuel supply for the project.
SIMILARITIES BETWEEN CORPORATE AND PROJECT FINANCE RESTRUCTURINGS IN THE EMERGING MARKETS

Key Role of Strategy in Managing the Restructuring Process

In both corporate and project finance restructurings in the emerging markets, the parties need to adopt a well-developed strategy if they plan on achieving a restructuring solution in a reasonable time frame. In corporate debt restructurings, the key strategic issue for the creditors is how to move the restructuring process forward in a timely manner despite some of the inherent advantages and possible leverage of the local debtor. Specifically, the creditors may be faced with the significant “home court” advantages of the debtor that arise from the local insolvency system, the local legal framework, and the local judicial system generally, and even the possible influence and prominence of the controlling shareholder in the host country.

The presence of timetables helps determine whether the debtor is demonstrating a sincere willingness to move the restructuring process forward and ultimately reach closure on a restructuring plan or whether the debtor is simply dragging its feet.

None of these advantages are easy for the creditors, particularly foreign creditors, to overcome. Nonetheless, the creditors can adopt certain strategies to attempt to make timely progress in the restructuring process. By way of illustration, as one possible strategy, the creditors may propose certain timetables for accomplishing key milestones in the restructuring process, such as how long it should take to negotiate and sign a detailed term sheet outlining the basics of a restructuring deal. Although the mere existence of timetables will by no means necessarily ensure that the debtor adheres to such timetables, at least the presence of timetables may permit the creditors to make a better determination of whether or not the debtor is negotiating in good faith. The presence of timetables also may help determine whether the debtor is demonstrating a sincere willingness to move the restructuring process forward and ultimately reach closure on a restructuring plan or whether the debtor is simply dragging its feet.

In project finance restructurings, given their inherent complexity and the multiple project parties involved, the parties may well need a strategy for keeping the process focused and on track. As a threshold matter, the project parties have to decide how to sequence the restructuring process. This involves determining the relationship between the different elements of the overall restructuring. Specifically, the overall restructuring exercise may consist of various components such as the tariff restructuring between the project and the offtaker, the debt restructuring between the project and its creditors, and any contractual restructuring of project arrangements between the project and the affected project counterparties.

As an example of the issue of how to sequence the restructuring process, the project has to decide whether it makes sense to effectively postpone the debt restructuring exercise with its creditors until the contours of the tariff restructuring are more definitively established or whether instead it makes sense to move forward on parallel tracks with both restructuring processes. For its part, the project may not want to engage its creditors in a debt restructuring negotiation until it knows what the new long-term tariff will be.

The project also may be concerned about the prospect of simultaneously entering into what may be difficult and protracted negotiations with the government parties, on the one hand, and possibly equally difficult discussions with the project’s creditors, on the other hand. The project may not wish to be distracted from what it may view as its top priority, namely reaching a new long-term deal with the government-owned offtaker. Yet the project may be very interested in knowing what its debt service requirements will be going forward so that it will know what latitude it has in negotiating a revised tariff with the offtaker.

For their part, the creditors may not be content to simply sit on the sidelines, particularly for an extended period of time, while the project works out a tariff restructuring with the offtaker. The creditors may be concerned that whatever the new tariff level is, it may necessarily imply certain consequences for how the debt has to be restructured, and the creditors may very well want to avoid being presented with what they might view as a fait accompli. For instance, the creditors will not want to accept debt write-offs or “haircuts” simply because the project has agreed upon too low a tariff with the offtaker, nor
will the creditors want to “back-load” their maturities simply because the project has agreed upon a “back-loaded” tariff schedule with the offtaker.

As a practical matter, the project and its creditors may decide that the project can go forward with its tariff restructuring with the offtaker without at the same time engaging in formal debt restructuring negotiations with its creditors so long as certain conditions are met. In particular, the creditors may insist on being kept abreast on a fairly regular basis on the status of these negotiations and any relevant developments. Moreover, the creditors may seek to have input on and be consulted on fundamental economic decisions that arise in the negotiations. Nonetheless, whether the debt restructuring awaits the outcome of the tariff renegotiation (including whether there is an ongoing process of consultation with the creditors on such negotiations) or whether the debt restructuring instead proceeds in parallel is likely to be decided by the relevant parties on a case-by-case basis depending on the particular facts and circumstances of a given restructuring.

In addition to the issue of how to sequence the individual components of the overall restructuring process, another major strategic issue in a project finance restructuring concerns how to keep the negotiations moving forward when the underlying economic circumstances may perhaps counsel delay for one of the parties to the restructuring negotiations. For example, in the tariff restructuring discussions between the project and the offtaker, the underlying supply and demand trends for electricity may make the offtaker reluctant to enter into a new, revised long-term PPA with a term of 30 years or more. In the short run, the demand for the output of the IPPs may be depressed as a result of economic recession or worse, and/or the offtaker’s ability to fully utilize the output of IPPs may be impaired in those cases where the transmission infrastructure is not fully built out.

In such a situation, the offtaker may be concerned about entering into a new long-term tariff arrangement when, at the present time, it may not need the full output of the IPP. Yet, if the offtaker were to enter into a new long-term PPA under such circumstances, assuming the PPA was of the “take or pay” variety, it would have to pay the project a fixed capacity charge as part of its tariff payment whether or not it used the project’s output. The project, on the other hand, may be seeking the certainty that will result from having a new long-term tariff. But it would not want to enter into a new long-term PPA if the restructured tariff were too low from the project’s perspective.

Therefore, the project and the offtaker would have to determine how to approach the PPA renegotiation process in general. They would have to consider questions such as the following: Does it make sense for them to focus their efforts on negotiating a new long-term PPA and new long-term tariff at a time when the offtaker may not need the full output of the IPP (which may lead the offtaker to push for a low long-term tariff)? Or should they instead develop what is effectively a stopgap approach that reinstates the PPA on an interim basis until, among other things, the supply-demand situation stabilizes and the parties are then ready to enter into a longer-term deal?

Establishing Effective Creditor Coordination

Both corporate and project finance restructurings require effective creditor coordination if the restructuring process is to proceed smoothly and if the restructuring plan ultimately agreed upon is to achieve acceptance among the creditor body at large. In corporate debt restructurings, the creditors generally attempt to form a steering committee of the major creditors. The steering committee may consist of 10 or fewer creditor institutions even though the creditor body at large may consist of a far larger number of creditors.

Essentially, the role of the steering committee is to assume a leadership role in interacting and negotiating with the debtor, and this involves attempting to develop a consensus among the steering committee members as to fundamental restructuring parameters. Particularly in large-scale restructurings, it is simply impractical to have all of the creditors actively participating in the negotiations with the debtor. While a steering committee certainly cannot bind the creditor body at large, its recommendations can carry weight with the other creditors, especially if the steering committee consists of institutions that are well respected as well as institutions that have the largest exposures to a particular debtor.

In project finance restructurings, creditor coordination tends to be slightly more informal than it is in the steering committee context, but it is not unusual for the lead creditors to form a working group. In multi-sourced project financings, this group of principal lenders may consist of agent banks for syndicated loan facilities, sovereign export credit agencies (or at least the export credit agencies with the largest exposures), bilateral and multilateral insurers, and multilateral lending agencies, among others. The principal lenders’ group may serve as a clearinghouse for information on the overall status of the restructuring. Where there is a
bank syndicate, agent banks may, in turn, inform other participating banks on the current state of play. This group of the project’s principal lenders also may play a critical role in developing positions and a consensus on the range of issues that the project brings to its lender group for consideration.

Possibility of Seeking Additional Security

In corporate debt restructurings, the creditors may seek an improvement in their security position. It is not uncommon, for example, for general unsecured creditors to demand security in the restructured company to the extent that the company has remaining unencumbered assets (i.e., assets that have not been pledged previously to other creditors). Among other things, the unsecured creditors may require that they be given liens on the company’s plant and equipment and any other valuable assets of the company. If the company defaults again, these creditors do not want to be caught again in the same relatively weak position as unsecured creditors; rather, in such a default scenario, they want to be able to foreclose on whatever security that they receive as part of the restructuring deal.

In project finance restructurings, the creditors may have far fewer opportunities to seek additional security. In the original financing, these creditors should have received a comprehensive security package providing security interests in, among other things, all of the physical assets of the project and the project’s interest in the plant site, the contract rights of the project, the project’s bank accounts and receivables, the share pledges of the sponsors, and so forth. However, there still may be a need to revisit the security package.

For instance, this may arise where the host government has provided “support” documents in connection with the project to provide a back-up to the obligations of a government-owned offtaker; this may have been an important element in the structuring of the original transaction if the offtaker is a relatively weak credit itself (a not uncommon situation in the emerging markets). In such a case, the creditors may seek to have these support documents reaffirmed or restated. The creditors may be particularly interested in such a reaffirmation or restatement if the original support documents were entered into several years earlier and/or if there have been major changes in the government of the host country since that time. (Even if the creditors do not seek any changes in the existing package, they will need to check with local counsel in the relevant local jurisdictions as to whether any elements of the security package need to re-executed and re-filed either because of any changes in law in the intervening years or because of certain structural features of the restructuring proposal itself, such as whether there is any new money going into the deal.)

Desire to Simplify Creditor Approval Process

In both corporate and project finance restructurings, there may be an effort to effectively streamline the process for gaining approval for the restructuring plan. In debt restructurings, the debtor and the steering committee may agree ultimately upon a plan and only then seek to present it for approval to the broader creditor body. As a general proposition, once they have agreed upon a restructuring plan, the debtor and the steering committee will not want then to re-negotiate the restructuring proposal with the mass of creditors that have not been involved in the actual negotiations. Some of these creditors at large may, for whatever reason, be reluctant to go along with the proposed restructuring plan and may seek to be bought out at a premium, or they may sue or threaten to sue to recover on the full value of their outstanding loan amounts. These parties may present the classic “holdout” problem.

The debtor and the principal creditors may consider the possibility of turning to the local courts in the relevant jurisdictions to seek a “cramdown” of the restructuring plan on the dissenting creditors.

However, it may be uneconomic for the debtor to pay a premium to the holdouts and, in fact, doing so might upset the whole economic framework of the restructuring plan by increasing the debt service obligations beyond the level that has been budgeted. In these circumstances, to the extent that it is available in the relevant jurisdictions (recognizing that there may be no guarantee that local law provides for such an option in the relevant jurisdictions), the debtor and the principal creditors may consider the possibility of turning to the local courts in the relevant jurisdictions to seek a “cramdown” of the restructuring plan on the dissenting creditors.
In project finance restructurings, the project, the project sponsors, and the project’s principal lenders also are interested in simplifying the creditor approval process. Accordingly, they generally try to develop a restructuring plan that does not trigger unanimous (or even supermajority percentage) approval requirements among the project’s public bondholders, if any. The project and the sponsors may be justifiably concerned that, regardless of the particular merits of any restructuring plan they develop, it will be difficult, if not impossible, to achieve unanimous or even supermajority approval among what might be a widely dispersed group of bondholders. Bearing these considerations in mind, the project, its sponsors, and its principal lenders may attempt to fashion a restructuring plan that, among other things, does not alter any of the economic and other fundamentals of the bondholder package, including such basic items as changing the repayment profile or any payment terms of the project’s outstanding bonds. During the course of the restructuring itself, the project will want to keep the bonds current on any interest or principal payments that fall due, thereby not triggering any defaults on the bonds. Thus, although a capital markets tranche may provide the project with critical financing, unless it is handled properly as the project and other key parties fashion a restructuring plan, the capital markets tranche can seriously complicate the efforts of the key project parties to achieve a successful restructuring.

**Role of Recovery Expectations of Key Parties**

In both corporate and project finance restructurings, the recovery expectations of key parties can drive how the negotiation process proceeds. In debt restructurings, the creditors may have a general sense of what constitutes an acceptable or reasonable recovery given the particular circumstances of the debtor. In some cases, they may be seeking a recovery well above 50% (perhaps even above, say, 70%-80%), whereas in other cases, they may realize that unfortunately they have to accept a recovery below 50%. Whether or not the creditors have expectations for a high recovery rate will depend on many factors, such as whether the company has reasonable prospects for a strong cash flow going forward, whether the local insolvency law effectively gives the debtor the upper hand in a restructuring situation, whether existing management (which in certain instances creditors may believe is responsible for some or even a fair amount of the company’s current travails) will stay or go in the restructured company, whether the company will have a strong competitive position in the future, and so forth.

These recovery expectations on the part of the creditor may affect how the creditors view any restructuring proposals that are put on the table. If the creditors believe that a particular restructuring proposal provides them with a projected recovery rate that is less than they have been expecting, they may be very critical of such a plan. This, among other factors, may lead them to reject the plan. Conversely, if a restructuring proposal appears to ensure the creditors of a solid recovery, then they may be more inclined to take such a proposal seriously and may be prepared to go forward with negotiations on the basis of such a proposal in the hope of eventually closing a restructuring on that basis.

Nevertheless, whether the projected recovery rates for a given corporate restructuring proposal are robust or weak, the creditors need to remember that projected recovery rates are just that—i.e., they are strictly notional amounts that are based on certain financial and other assumptions. Some of the assumptions underlying the recovery projections may not be borne out in the actual event. Moreover, some of the value that the creditors may be counting on as part of their recovery, such as what may be the imputed value of any equity that they may receive if the restructuring involves a debt-for-equity swap, may simply turn out to be overstated or otherwise incorrect. Therefore, creditors should treat recovery rate projections with a certain amount of caution. After all, for the creditors, these projections are not “money in the bank.”

In large part, restructurings involve determining how the sacrifice is to be allocated among the different parties, or what is sometimes referred to as “sharing the pain.”

In project finance restructurings, the recovery expectations of the project sponsors may be a critical driving force in determining the overall economic parameters of the restructuring. (Obviously, as discussed below, the recovery expectations of the lenders will also be critical.) The sponsors will evaluate whether a given restructuring provides them with the rate of return that they are seeking, taking all of the circumstances into account. Of course, project sponsors may be forced to lower their overall rate-of-return expectations in the restructuring context com-
pared to what those expectations were when they first invested in the project, particularly if the restructuring involves a tariff renegotiation with the prospect of less revenue coming into the project than was forecast at the time of the original project closing. Nonetheless, most restructurings, almost by definition, involve some level of sacrifice on the part of the various parties; in large part, restructurings involve determining how the sacrifice is to be allocated among the different parties, or what is sometimes referred to as “sharing the pain.”

The sponsors’ rate-of-return expectations may affect how they view tariff discussions with the offtaker as well as debt restructuring negotiations with the creditors. The sponsors may evaluate a new long-term tariff based on whether it provides the project with enough revenue so that, after covering operating expenses and debt service payments and other payments under the project’s waterfall, the sponsors can expect an adequate return and full recovery of their equity. The sponsors will not only be assessing the adequacy of the overall level of the new tariff, but also such other important issues as how the tariff is structured over time (e.g., “front-loaded,” “backloaded,” or flat), what type of financial or other consideration the project will receive for any outstanding payment arrearages from the offtaker, and whether the term of the offtake agreement will, for example, remain the same or be extended. These issues taken as whole affect the overall level of returns that the sponsors can take out of the project and, not unimportantly, how they view tariff discussions with the offtaker as well as debt restructuring negotiations with the creditors. The sponsors will not only be assessing the adequacy of the overall level of the new tariff, but also such other important issues as how the tariff is structured over time (e.g., “front-loaded,” “backloaded,” or flat), what type of financial or other consideration the project will receive for any outstanding payment arrearages from the offtaker, and whether the term of the offtake agreement will, for example, remain the same or be extended. These issues taken as whole affect the overall level of returns that the sponsors can take out of the project and, not unimportantly, from the sponsors’ perspective, the timing of such returns.

The sponsors’ rate-of-return expectations also may have a critical effect on the progress of the debt restructuring negotiations between the project and its sponsors, on the one hand, and the creditors, on the other hand. Such expectations may enter into the sponsor’s negotiations with the creditors on such issues as how quickly the principal will be amortized, what the overall contours of the amortization schedule will look like, and whether any reductions in interest rate or reductions to outstanding principal will be necessary. Of course, the lenders will likely resist any such changes in interest rate or reductions of principal, and realizing the likely opposition that they will face, the sponsors may not push too hard on such points and instead may seek flexibility from the lenders on other items such as, for instance, the final maturity of the respective debt tranches. The lenders have their own recovery expectations, and it may well be that they expect a 100% recovery, which would mean that there would be no debt write-offs. Even so, as part of the restructuring, the sponsors may try to convert certain portions of the debt from fixed rate to floating rates or vice versa.

Fundamentally, the sponsor rate-of-return expectations may create a possible tension between how quickly the lenders want to have their loans amortized and how quickly the sponsors want to take returns out of the project. If the lenders have deferred principal payments as part of standstill arrangements with the project, they may well seek “catch-up” payments as early as possible in the revised amortization schedule. The sponsors, on the other hand, may try to take returns out as early as possible with the aim, in part, of recapturing some of the additional equity that they may have invested in the project as part of the restructuring process. This tension between lenders and sponsors may exist notwithstanding the previously established priorities of payment in the project’s waterfall, which would rank debt service payments before distributions to sponsors, and basic principles of corporate finance, which would rank debt interests ahead of equity interests in a company’s capital structure. Yet the project sponsors may argue, for example, that without their efforts in negotiating with the offtaker, no restructuring could have been achieved and therefore their efforts should somehow be recognized or rewarded. Nevertheless, the extent to which the lenders will want to recognize any such arguments and allow the sponsors to take out larger-than-normal or expected distributions early in the amortization profile of the project’s restructured debt will most likely be a matter of intense negotiation and debate between the sponsors and the lenders.

Importance of Early Intervention

In corporate debt restructurings, creditors may find that it is far easier at an early stage in the process to have consultations with the borrower about developing financial difficulties and how these difficulties can be addressed rather than waiting for a widespread payment default crisis to hit. As part of their routine loan administration activities, the creditors may monitor the borrower’s financial performance and observe that the borrower is not hitting its financial covenant ratios with a comfortable margin. Or the borrower may come to the creditors seeking waivers of particular financial tests, which in itself may be an important early warning sign to the creditors.

Both the creditors and borrower generally will have greater flexibility and time to work out a solution in this context as opposed to what may well become something of a crisis atmosphere in a post-default environment. In a default situation, events can easily spin out of control, particularly if certain creditors choose to accelerate their loans or otherwise exercise creditor remedies such as attempt-
It is much easier to deal with an incipient problem than with a full-blown crisis. In a default situation, events can easily spin out of control, particularly if certain creditors choose to accelerate their loans or otherwise exercise creditor remedies.

Similarly, in project finance restructurings, it is almost certainly much easier to deal with an incipient problem than with a full-blown crisis. By way of illustration, if the project sees that there is a mounting level of payment arrearages due from the offtaker, then it may be best for some combination of the project, the project sponsors, and even key lenders to sit down with the offtaker to work out a plan to pay down the arrearages over a prescribed period of time. The existence of such a payment plan could give the project parties a benchmark to see whether the offtaker is serious about eliminating this problem or whether the offtaker is prepared to let the problem fester. If the latter is the case, the offtaker may even be willing to put the overall offtake arrangements in jeopardy, which could be a precursor to a possible repudiation or renegotiation by the offtaker of the offtake contract itself. Obviously, this is a scenario that the project and the project parties will want to avoid at virtually all costs.

In addition to the build-up of payment arrearages, project parties also may want to be alert to invoicing disputes with the offtaker that relate to payment mechanics under the offtake agreement, particularly where the disputes center on the mechanics of foreign exchange conversion from the local currency to a hard currency such as the U.S. dollar. Such disputes may arise from honest differences of interpretation of the relevant contractual provisions, which are almost of necessity highly technical. Under such circumstances, assuming that one of the parties to the dispute does not invoke any contractually available formal dispute resolution mechanisms such as arbitration, the parties may decide that it makes sense as a first step to discuss in detail their differing interpretations of the relevant provisions and then possibly seek analysis and even perhaps formal legal opinions from outside counsel.

However, such disputes also possibly could represent an opening shot by the offtaker in an attempt to revisit fundamental foreign exchange-related risk allocation issues. The offtaker may have come under serious payment pressures if the local currency has been significantly devalued and thus may use such billing disputes and the interpretation of certain contractual provisions as a way to relieve some of these currency and payment-related pressures. In those circumstances, the project will want to head off at an early stage what may possibly seem like an arcane invoicing dispute before such a dispute mushrooms into something that may call into question one of the fundamental pillars of the entire offtake arrangement, namely the allocation of foreign exchange risk.

Challenge of Arranging Interim Financing

In corporate debt restructurings in the emerging markets, there may be no good way to arrange interim financing for the debtor while the debtor is experiencing serious financial difficulties (such as debtor-in-possession financing in the United States). In many emerging market jurisdictions, the local insolvency law may not provide lenders with a special priority if they provide ongoing financing to an insolvent debtor, and in out-of-court restructurings there may be a reluctance among lenders to provide such funding absent special arrangements among the debtor’s major creditors which may be difficult to arrange. As a result, the debtor may engage in different types of uneconomic financing behavior while it sorts through its financial difficulties.

For example, the debtor may seek cash advances from some of its principal customers, but these advances may carry an interest rate that is far above market interest rates. Similarly, the debtor also may be strapped for cash for operating purposes, and it therefore may resort to heavily discounting the price at which it sells its products. But by selling its products at prices well below market prices (i.e., “fire-sale prices”) in an effort to generate
quickly available revenues for its operations, the debtor may be hurting its reputation in the marketplace and may otherwise be acting in a manner that could be inconsistent with its long-term business interests. (It should be noted that in certain cases the very suspension of debt service payments by the debtor pursuant to a debt standstill or debt service moratorium could provide the debtor with a sufficient cash cushion to cover operating costs.)

In project finance restructurings, it is virtually impossible to attract “new money” to the project. Only existing sources of finance are likely to put more money into the project. The need and uses for the additional finance may depend on whether the project is in the construction or the operations phase. The sponsors in particular may be called upon to infuse additional equity into the project or asked to agree to broaden the uses to which previously committed contingent equity may be applied. In the operating phase, such additional equity may used to cover, among other purposes, the project’s operating expenses as well as to keep the lenders current, at a minimum, on their interest payments. The sponsors may try to keep the project lenders committed to working out a consensual restructuring, and they therefore may have to provide this additional equity to help achieve that objective. Otherwise, the lenders may consider their alternatives, such as accelerating their loans, realizing on their security, or even putting the project into bankruptcy (which even the lenders may shy away from in many emerging market jurisdictions, given the nature of the local insolvency systems).

Given the dearth of possible financing sources when a project encounters financial difficulties as well as some of the well-publicized financial difficulties of certain project developers over the past year, project lenders should carefully analyze and understand the sponsors’ creditworthiness and their long-term commitment to the project. Fundamentally, the lenders need to consider the following question: Will the sponsors walk away from the project and their investment when the project encounters financial difficulties or will they be willing to put additional equity into the project to keep the project afloat and also be willing to invest the time and energy of staff and senior executives to accomplish a successful restructuring with the project parties? The lenders also may consider whether they believe the sponsors will remain committed to a troubled project to preserve their reputation in the marketplace as developers that will not abandon their troubled projects.

The project’s existing lenders also may be asked to put additional money into a troubled project. This situation could arise if a default occurs in the construction phase before the project’s construction is yet complete. Although if there is a default during the construction period the lenders may, depending on the specific provisions of the applicable loan documents, have the right, for example, to stop disbursements to the project, they may choose not to exercise such a right. Under certain circumstances, the project’s lenders may believe they have a better chance of recovering on their loans if they disburse additional funds into the project, enabling it to complete construction and begin generating revenues, rather than abandoning the project prior to project completion. The lenders will have to weigh the pros and cons of each course of action and consider, among others issues, whether, with the passage of the necessary time, there is the realistic prospect of a reasonable and satisfactory project restructuring.

ENDNOTES

1See, e.g., see George K. Miller, Chris Lin, and Alex L. Wang, “Project Documentation: Debt Finance,” 1999, p. 1 (available at www.stblaw.com/FSL5CS/articles/articles428.asp). The authors define project finance as follows: “Project (or non- or limited-recourse finance) refers to a type of debt financing (in either the private or the capital markets) that does not rely for repayment on the general corporate credit of an operating company with a financial history, but instead on dedicated, sometimes contract-based revenues from a single asset or a defined group of assets held by a special purpose entity.” See also International Finance Corporation, Project Finance in Developing Countries (1999), p. 5 (comparing project finance and corporate lending).


3World Bank, Effective Insolvency Systems: Principles and Guidelines, Consultation Draft, October 2000, p. 13. Note that the final recommendations of this World Bank task force on core insolvency principles were set forth in the World Bank report cited in note 12 below.

4For a discussion of “asset management companies” as well as other issues related to so-called “systemic insolvency” situations, see, e.g., John R. Knight, “Systemic Insolvency: A Lawyer’s Perspective,” pp. 11-12, paper presented at Organization for Economic Cooperation and Development (OECD) conference on “Insolvency Systems in Asia: An Efficiency Per-

5For a study on the relationship between local insolvency laws and creditor recovery rates, see, e.g., Fitch, “Mexican Bankruptcy and Recovery Rate Study,” December 6, 2001.

6For a discussion of arbitration in international project financings and in particular some of the obstacles faced by offshore parties, see, e.g., Mark Kantor, “The Limits of Arbitration,” The Journal of Structured and Project Finance, Fall 2002, pp. 42-51.

7For a discussion of the role that institutional bodies can play in addressing issues such as these, see, e.g., Richard A. Gitlin and Brian N. Watkins, “Institutional Alternatives to Insolvency for Developing Countries,” September 1999, paper presented to Washington, D.C. Symposium on Insolvency Alternatives (available at www.worldbank.org/legal/gild).


12See, e.g., World Bank, Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, April 2001, p. 55. (“This often results in an agreement among major creditors that emergency funding by one or more will rank for repayment in advance of their other entitlements in the event of a formal insolvency administration of the debtor.”)

13For an analysis of how lenders and sponsors from their different vantage points may view the need to provide additional financing and support to a troubled project, see George K. Miller, Chris Lin, and Alex L. Wang, “Project Documentation: Debt Finance,” 1999, pp. 47-53 (available at www.stblaw.com/FSL5CS/articles/articles428.asp).

To order reprints of this article, please contact Ajani Malik at amalik@iijournals.com or 212-224-3205.