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Addressing Financial Distress in the Emerging Markets: An Overview of Key Concepts in Corporate and Sovereign Debt Restructurings

In recent years, the emerging markets have witnessed major defaults by both private and public sector borrowers. Many of these defaults have involved very large sums of money. There have been many defaults by corporate borrowers involving hundreds of million of dollars of outstanding loan obligations and in some cases even several billion dollars. In recent years, defaults by governments—so-called sovereign defaults—have in several cases involved at least several billions of dollars of indebtedness.[1] The recent sovereign default by Argentina involved outstanding indebtedness of approximately one hundred billion dollars.[2]

In this article, we will review both corporate and sovereign debt restructurings in the emerging markets. We will consider some of the key concepts that are common to both types of restructurings. In so doing, we will try to understand some of the factors

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[1] Sovereign defaults are sometimes considered to encompass not just payment defaults (or even late payments that do not technically constitute an actual payment default) but so-called "distressed exchange offers" as well. The rating agency Moody's, for example, defines a default to have occurred if "[t]here is a missed or delayed disbursement of interest and/or principal, even if the delayed payment is made within the grace period, if any" or if there has been a "distressed exchange offer." Moody's further defines a "distressed exchange offer" as follows: "1. The issuer offers bondholders a new security or package of securities that amount to a diminished financial obligation such as new debt instruments with lower coupon or par value. 2. The exchange had the apparent purpose of helping the borrower avoid a 'stronger' event of default (such as a missed interest or principal payment." Moody's Special Comment, *Sovereign Bond Defaults, Rating Transitions, and Recoveries (1985-2002),* February 2003, p. 4. (available at www.iiiglobal.org/topics/sovereign/Sovereign_Bond_Defaults_Levey.pdf).

[2] Such figure includes the amount of outstanding principal (approximately $81 billion) plus accrued interest.

that underpin or affect the dynamics of the restructuring process, whether the restructuring involves a corporate borrower or sovereign borrower. However, this article does not attempt to provide a comprehensive or exhaustive discussion of either corporate or sovereign restructurings by themselves. The article also recognizes that while there are certain commonalities between corporate and sovereign debt restructurings, obviously there are also important differences.[3]

Overview of Emerging Market Restructurings

It is not simply the sheer magnitude of the defaults discussed above that has made these defaults in the emerging markets so noteworthy. In many of these defaults, there may be a very sizeable creditor body, and it is not unusual for there to be hundreds, if not thousands, of creditors. In particular, the creditor body is likely to be very large if the borrower has issued public bonds in the capital markets. And a capital markets component has become a prominent feature in emerging market borrowings, particularly

[3] At a most fundamental level, corporate debt restructurings involve the fate of individual companies, whereas sovereign debt restructurings involve the fate of individual sovereign states. A corporate default may have an important impact on the local economy and local society where the affected company is located or where it has operations, and such a potential impact should not be discounted since the affected company may be a major employer and/or major presence in one or more regions in the host country. (If an individual corporate restructuring is particularly large or otherwise significant in the context of a specific emerging market, it is possible that certain foreign investors and/or foreign creditors may view the restructuring as perhaps a bellwether case as to how defaults and restructurings are handled in the given country.) However, the impact of a sovereign default is not likely to be restricted to a particular locale within a given country. Rather, a sovereign default can potentially have a profound impact on an entire nation and its citizens. As such, a sovereign default can become an issue of intense national political interest within the affected country and may require the active involvement of some of the most senior government officials of the host government in addressing such a situation. Sovereign defaults may also ultimately involve other foreign governments, such as G-7 nations, as well as multilateral institutions. For example, the International Monetary Fund may be a critical player in sovereign default situations. (To be sure, within a given country, corporate defaults may under certain circumstances take place in the context of a broader systemic financial or economic crisis affecting the given country, as was the case with some of the Asian economies at the time of the Asian financial crisis.)

in the sovereign debt market but also for certain emerging market corporate issuers as well.[4]

Within any given creditor body, the creditors may come in many shapes and sizes. In corporate debt restructurings, for example, the creditor body may consist of large commercial banks (foreign and domestic), foreign government lenders such as sovereign export credit agencies, multilateral agencies, trade creditors, and various types of bondholders (e.g., institutional investors, investment or hedge funds, etc.).[5] The host government in the relevant emerging market may also be involved through instrumentalities such as government-owned or controlled development banks as well as so-called "asset management companies" which are institutions whose broad mandate may include cleaning up the balance sheet of failed banks by resolving such banks' troubled loans.

Moreover, the creditors involved in emerging market restructurings may literally be spread around the globe across several continents and multiple time zones. There may be creditors in the borrower's home jurisdiction, but there may also be many major creditors that are based in North America, Europe and/or Asia. Where the creditor body is so widely dispersed, it can complicate efforts on the part of the creditors to achieve effective coordination or cohesive action. This may be the case even where the creditors have periodic face-to-face meetings or otherwise take advantage of many of the features

[4] In the sovereign context, there can potentially be a very large number of separate bond issuances by the sovereign, and this can serve to complicate the restructuring process.

[5] In the recent Argentina default, there was a large presence of retail bondholders, both domestic and foreign. Among foreigners, there were, for example, a large number of individual Italians and Germans who were holding Argentine bonds.

of modern telecommunications (e.g., multi-party conference calls, elaborate email networks and/or videoconferencing).

Furthermore, it has not been uncommon for emerging market defaults to remain unresolved for a period of several years. For instance, in the sovereign debt area, while Argentina effectively defaulted on its debt obligations in late 2001, a restructuring deal was not reached until early 2005. The restructuring discussions between Argentina and its creditors were marked by considerable acrimony.[6] Certain creditors charged that the Argentine government was not negotiating in good faith, whereas the Argentine government for its part claimed that certain creditors were unrealistic as to what type of restructuring deal Argentina could afford.[7]

Many corporate defaults in the emerging markets have also taken a minimum of several years to resolve. Indeed, certain emerging market corporate defaults have dragged on for a number of years without the closing of a restructuring deal or otherwise without any definitive resolution. In many instances, creditors in such restructurings have complained that debtors and their controlling shareholders are dragging their feet in what the creditors may view as a deliberate effort by the debtor to forestall any resolution of the debtor's financial difficulties.

During the period of negotiations with its creditors, the corporate debtor may be benefiting from a debt service moratorium, which in fact may have been unilaterally imposed by the debtor. Thus, the debtor may not be paying any debt service, whether

[6] For an overview of early reaction to the Argentina restructuring deal as well as background on the default, see, e.g., *Washington Post*, "Many View Argentina's Comeback with Skepticism," March 4, p. E1, and *New York Times*, "Argentina Announces Deal on Its Debt Default," March 4, 2005, p. C3.

[7] Even after the announcement of a restructuring deal, many creditors who did not support the final restructuring plan are apparently still pursuing or considering legal action against Argentina to recover on their loans.

interest or principal. However, in certain cases, even where the debtor has announced a general debt service moratorium, the debtor may continue to make debt service payments to a select group of creditors, such as certain domestic creditors.[8]

The creditors may believe that, where there is a general debt service moratorium in place, certain debtors may not be in any particular rush to reach a deal with their creditors as long as such debtors can continue to meet their working capital and other ongoing needs. On this view, the debtor and its controlling shareholders may simply be satisfied to live with the status quo as unsatisfactory as that may be for the debtor's creditors.[9]

To be sure, not all emerging corporate debtors act in this fashion. Certain corporate debtors will be more concerned about their long-term reputational interests and their ability to access the credit and capital markets in the future. As a result, such debtors may be more motivated to work cooperatively with their creditors and to reach a timely and/or reasonable deal with their creditors.

Out-of-Court Restructurings versus Formal Insolvency Proceedings

Faced with a payment default or the prospect of an imminent default or other payment difficulties, the debtor—whether it is a private corporation or a sovereign government—may try to resolve its financial difficulties through an out-of court "restructuring" with its creditors. Nonetheless, at least in the corporate context,

[8]In both corporate and sovereign restructurings, foreign creditors are often alert to any disparate treatment by debtors of domestic and foreign creditors (i.e., preferential treatment by debtors of domestic creditors vis-à-vis foreign creditors). Foreign creditors often propound the principle that there should be equality of treatment between domestic and foreign creditors.

[9] Such a strategy on the part of the debtor presupposes, among other things, that there is no requirement under local law for the debtor and/or its directors and officers to file for insolvency within a very short period of time after the company has become insolvent.

restructurings are not the only route for a debtor and its creditors to resolve or address a debtor's financial difficulties.

In a corporate default situation, there is always the possibility that, depending on the specific contours of the local insolvency law, the debtor or perhaps in certain instances even the creditors may resort to the local insolvency system.[10] The debtor may do so to seek protection from its creditors through provisions, if any, in the local law such as an automatic stay provision, which, broadly speaking, would prevent the creditors as of a fixed date from taking collection or enforcement actions the debtor, the debtor's property or the debtor's estate.

The creditors may also try to resort to the local insolvency law. Assuming the local insolvency law permits them to do so (which is by no means always the case), the creditors, for example, might look to the insolvency law to achieve a court-ordered reorganization or even liquidation of the debtor. However, given the state of the insolvency laws in many emerging market jurisdictions or at least how such laws may be applied in practice (which can in certain jurisdictions be equally important as what the law specifically provides as a matter of statute), certain creditors may believe that the local insolvency system is not favorable to creditor interests and thus they may be reluctant to resort to the local insolvency system. For instance, the local insolvency law may contain provisions granting creditors certain options such as filing for the liquidation

[10] In certain emerging market jurisdictions, there has been a third option—government-sponsored mediation programs which bring together the debtor and certain key creditors under the auspices of a host government agency which serves in a mediator function. For example, Indonesia established the Jakarta Initiative for this purpose, and Thailand established the so-called CDRAC program (known formally as the Corporate Debt Restructuring Advisory Committee).

of the debtor, but it is possible that as a practical matter, the local courts may rarely, if ever, order such a course of action.

A corporate debtor, on the other hand, may view the local insolvency system as a viable alternative to be considered. The debtor may view seeking insolvency protection as a way to gain some valuable breathing space while it works out a longer-term reorganization plan. But other debtors may not have such beneficent intentions—rather, they may view seeking insolvency protection in the courts as a way to keep the creditors at bay for an indefinite period of time without addressing the debtor's underlying financial difficulties or without resuming debt service payments to the creditors.

In certain emerging market jurisdictions, debtors have used the local insolvency system for that purpose. For instance, in Mexico, under the old suspension of payments law (replaced in May 2000 with the new *concurso mercantiles* law), debtors were effectively able to control when and if a suspension of payments proceeding would be lifted. Thus, suspension of payments proceedings could last for a number of years, in some cases more than ten years, where the debtor was not interested in reaching a reorganization agreement with its creditors.

Sovereign Debt Restructuring Reform Proposals

With respect to sovereign defaults, there is not yet an insolvency law applicable to sovereigns. As a result, if a sovereign defaults on its payment obligations, creditors cannot place the sovereign into insolvency and, for example, seek the court-ordered reorganization of a sovereign. Nor, conversely and quite importantly, can the sovereign count on an automatic stay to prevent creditors from exercising collection and/or enforcement remedies.

Yet, in recent years, there has been a lively debate about the possibility of establishing some type of insolvency regime for sovereigns.[11] For example, over the period 2001-2003, the International Monetary Fund (IMF) put forth proposals for a so-called "sovereign debt restructuring mechanism" (the SDRM), which is sometimes referred to as the "statutory approach" to sovereign debt restructuring.[12] In one of its final iterations in early 2003, the SDRM proposal consisted of several key elements, and among them were the following: First, a supermajority of creditors would be able to bind a minority with respect to the terms of a restructuring agreement. Second, existing creditors could by a supermajority vote agree to give priority to new lenders that provide fresh private lending to the sovereign borrower, and such new lenders would be excluded from the terms of the restructuring. Third, a dispute resolution forum would be established to resolve disputes that might arise during various votes held by creditors or when creditor claims are being verified.[13] (Unlike the earlier versions of the SDRM proposal, the later versions of the proposal did not contain a provision for an automatic stay.)

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[11] A full discussion of the competing approaches to reforming the sovereign debt restructuring process, including an evaluation of the respective merits of such approaches, is beyond the scope of this article. However, for an overview of such approaches, see the compendium of materials on this topic available on the website of the International Insolvency Institute (available at www.iiiglobal.org/topics/sovereign.html).

[12] It is referred to as a "statutory approach" because the SDRM would most likely be achieved through an amendment of the Articles of Agreement of the International Monetary Fund, which would then become binding on the IMF's member states. However, in framing its proposal, the IMF recognized that, depending on the specific requirements applicable to individual member states for making treaty obligations effective under the domestic law of its member states, individual member states might need to adopt implementing legislation to make any amendments to the IMF Articles a part of the relevant domestic law.

[13] International Monetary Fund, *Proposals for a Sovereign Debt Restructuring Mechanism (SDRM): A Factsheet*, January 2003 and *Sovereign Debt Restructuring Mechanism (SDRM): Questions and Answers*, April 2003 (both available at www.iiiglobal.org/topics/sovereign.html).

As an alternative to the SDRM approach, other actors in the emerging markets have advocated a so-called “contract-based” approach.[14] Essentially, this approach entails the use of “collective action” clauses in sovereign debt bonds.[15] In general terms, these are clauses in bond indentures that permit changes to terms of bonds, including payment terms, with supermajority approval of the bondholders (e.g., a 75 percent vote). Such collective action clauses stand in contrast to clauses in certain indentures that require unanimous approval of bondholders for any changes in payment terms. (Unanimous approval requirements are more typical of bonds issued under New York law, whereas collective action clauses are more typical of bonds issued under UK law.)

The proposed widespread adoption of collective action clauses is meant to deal with the “holdout” problem in restructurings. Where there is a unanimous approval requirement for amending payment terms, a relatively few bondholders can block the approval of a restructuring plan that may otherwise be acceptable to the vast majority of bondholders. By pursuing litigation to collect on their debt or threatening to do so, such holdouts may be seeking to obtain a more favorable settlement from the debtor than might be obtained by those bondholders who had intended to go along with the proposed restructuring plan.

The SDRM proposal generated considerable controversy among certain players in the emerging market debt world, and the proposal was effectively put on hold by the

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[14] Other approaches have also been proposed. One such approach revolves around establishing a “code of conduct” for participants in sovereign debt restructurings. The Bank of France, for instance, has proposed such an approach. See, e.g., Bertrand Couillault and Pierre-Francois Weber, “Towards a Voluntary Code of Good Conduct for Sovereign Debt Restructuring,” Banque de France, *FSR*, June 2003. For a recent version of such an approach, see Institute for International Finance et al., “Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets,” November 2004 (available at www.iif.com/data/public/principles-final_0305.pdf).

[15] For further discussion of collective action clauses and related issues, see, e.g., Anna Gelpern, “Collective Action Shows the Way Forward,” *International Financial Law Review*, May 2003.

IMF's Executive Board in the spring of 2003. In the meantime, collective action clauses have been gaining acceptance among certain sovereign issuers of debt. For instance, Mexico, Korea and other sovereign issuers have included collective action clauses in their bond offerings in recent years.

Nonetheless, some observers have argued that the adoption of collective action clauses in new bond issuances is not by itself necessarily a panacea or at least not a short-term fix, since there is currently a large stock of outstanding sovereign debt issuances that do not contain such clauses. In other words, in many outstanding sovereign bond issuances, there may still be unanimous action clauses, which can continue to complicate sovereign debt restructurings where such clauses, rather than collective action clauses, are present.[16]

Thus, notwithstanding the spirited and active debate in recent years about the best way to handled sovereign defaults, there is still no insolvency law for sovereigns. In short, while insolvency may be an option for the private sector borrower in the corporate default scenario, it is not currently an option for a sovereign in the sovereign default scenario. As a consequence, assuming that a sovereign intends to address its financial difficulties as opposed to merely allowing a default or other financial difficulties to remain unresolved, it essentially has only one choice—seeking an out-of-court restructuring with its creditors. Corporate defaults, by contrast, can be addressed through

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[16] In certain sovereign debt restructurings, some sovereigns have tried to work around unanimous action clauses through so-called "exit consents." Under this approach, the sovereign issuer amends certain non-payment terms (e.g., governing law, submission to jurisdiction, etc.) that do not require unanimous approval. This has been part of an attempt to make it less attractive for bondholders to become holdouts since the non-payment terms of their existing bonds would be amended by the exit consent in an unfavorable way. But the use of exit consents is a controversial topic. For further discussion of exit consents, see, e.g., Stephen Choi and Mitu Gulati, "Why Lawyers Need to Take a Closer Look at Exit Consents," *International Financial Law Review*, September 2003, pp. 15-18.

restructurings between the debtor and its creditors, on the one hand, or through the local insolvency system, on the other hand.[17]

Determining Sustainable Debt of the Debtor

Broadly speaking, in a restructuring, a fundamental challenge for the debtor and its creditors is to try to reconfigure the debtor's outstanding debt service obligations so that in the future the debtor can meet its reconfigured debt service obligations without triggering another payment default. Participants in debt restructurings often refer to the concept of so-called "sustainable debt," which is meant to convey the notion that there is a certain level of debt that the debtor can reasonably be expected to service in the future, presumably with some margin of comfort. Yet the concept of sustainable debt also implies that there may be a certain amount of existing outstanding debt which constitutes "unsustainable debt," i.e., debt that the debtor may not be able to service going forward.[18]

In both corporate debt restructurings and sovereign debt restructurings, the concept of sustainable debt comes into play, albeit in different ways as discussed below. Moreover, in both types of restructurings, there is not necessarily a mathematically or scientifically precise way to arrive at a sustainable debt figure. Rather, there are certain subjective judgments and assumptions that affect or enter into the parties' assessment of what constitutes the appropriate level of sustainable debt.

In the corporate restructuring context, parties may refer to what they consider to be industry norms for certain financial ratios, such as the so-called debt service coverage ratio, or what "comparable" companies achieve with respect to such ratios. (Deciding

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[17] In certain instances of corporate defaults in the emerging markets, there may be both restructuring discussions and insolvency proceedings occurring simultaneously.

[18] For further discussion of issues related to sustainable debt, see, e.g., Steven Kargman, "Tackling Restructuring in Emerging Markets (Part II)," *International Financial Law Review*, July 2003, pp. 59-60.

what constitute industry norms or even deciding what constitutes the class of "comparable" companies may not be an entirely straightforward exercise.) Fundamentally, the parties also have to make certain assumptions regarding the cash flows that the company will be able to generate in the future, and any such projections obviously involve a certain amount of conjecture based on an analysis of various factors such as the company's historical performance, future supply and demand trends for the company's product, competitive trends in the relevant industry, and so forth.

In the sovereign debt restructuring scenario, parties may refer to a different set of ratios than are used in the corporate restructuring scenario, such as the sovereign's debt as a percentage of its gross domestic product (GDP) or the sovereign's debt service obligations as a percentage of its foreign exchange earnings. Depending on the particular case, creditors may believe that the sovereign can service a higher level of debt by adjusting its fiscal or economic policies, such as by raising taxes or reducing expenditures. However, the implementation of any such changes is not simply an ivory tower exercise. Such changes can have a direct, and in certain cases an even potentially very disruptive, impact on the affected country's overall social fabric and on the daily lives of its citizens.

Moreover, as one observer has noted with respect to the options available to a sovereign, "Debt can almost always be serviced in some abstract sense, through additional taxation and through the diversion of yet more domestic production to exports to generate the revenue and foreign exchange needed to service the debt. But there is a political and social, and perhaps moral, threshold beyond which policies to force these results become unacceptable."[19]

As a general rule, the debtor, whether corporate or sovereign, will most likely strive to keep the sustainable debt figure as low as possible for purposes of the restructuring exercise. The debtor wants as conservative a figure as possible so that it does not trigger another default or otherwise have to devote too much of its resources to debt service obligations. The creditors, on the other hand, will try to argue for a higher sustainable debt figure since that will mean that more of their existing debt will potentially be repaid even if it is repaid on restructured terms pursuant to a restructuring plan.

Nonetheless, if the creditors are able to prevail with an unrealistically high sustainable debt figure, they may only be setting the stage for a subsequent default by the debtor. Such a subsequent default is a scenario that, all things being equal, the creditors may well want to avoid. For the creditors, given the potentially high transactions costs of working through a default, one default by the debtor may well be enough.[20]

However, the lower the sustainable debt figure, which may be the general preference of debtors, the greater the sacrifice the creditors may be asked to make as part of any restructuring. Specifically, a low sustainable debt figure may mean that the creditors will be asked to take a large write-off or reduction of a portion of their

[19] See Jack Boorman (then Special Advisor to the Managing Director of the IMF), "Sovereign Debt Restructuring: Where Stands the Debate?", paper presented to conference sponsored by the Cato Institute and The Economist, October 17, 2002, p. 4 (available at www.iiiglobal.org/topics/sovereign.html).

[20] Of course, in any restructuring plan, the creditors may attempt to build in certain protections upon the occurrence of a subsequent default by the debtor. For instance, the creditors may try to include restructuring provisions that give them additional equity in the debtor company, if not change of control in their favor, upon a subsequent default.

outstanding principal, which is often referred to in colloquial terms as a "haircut." In both corporate and sovereign restructurings, creditors are likely to mount a fierce struggle to limit any write-offs of their debt. As a general matter, the creditors will want as much of their then outstanding principal to continue to be serviced as part of any restructuring plan rather than simply accepting a write-off of such debt.

Role of Recovery Expectations of Creditors

Furthermore, discussions about sustainable debt may be affected by the recovery expectations of the creditors.[21] Depending on the particular restructuring, creditors may expect to recover a large portion of their outstanding debt, whereas in other cases they may be resigned to recover only a fraction of their outstanding debt. Of course, what constitutes a reasonable or realistic recovery essentially involves an evaluation of such issues as the underlying economic strength and viability of the debtor relative to its debt load and debt service obligations. Thus, a recovery of, say, forty cents on the dollar may be completely unacceptable to creditors in a given case where the creditors believe that a particular debtor has fundamentally sound prospects going forward and that the debtor's debt service obligations are not particularly unmanageable once the company gets back on the right track. Yet in another case such a projected recovery may be more acceptable if the creditors believe that the debtor in question is severely weakened from a financial and business standpoint and will continue to have significant difficulties in the future servicing its then current outstanding debt load.

Complicating matters even further, individual creditors may approach the restructuring process with recovery expectations that differ from those of their fellow

[21]For a further discussion of the issue of recovery expectations, see, e.g., Steven Kargman, "Tackling Restructuring in Emerging Markets (Part II)," *International Financial Law Review*, July 2003, pp. 60-61.

creditors. Individual creditors may form different judgments and reach different conclusions as to a company's prospects, which is perhaps not surprising given that there is a certain element of subjectivity in each creditor's evaluation of the debtor's financial and business prospects. But this can lead to differing recovery expectations on the part of individual creditors.

Furthermore, creditors who were original lenders to a particular debtor may well have different recovery expectations than those creditors who purchased their debt in the secondary market, often at distressed debt prices. The former may be measuring their recovery against the par value of their original loan, whereas the latter may be measuring any potential recovery against a much lower baseline. For instance, if a distressed debt investor has purchased debt of a company in the secondary market for, say, twenty cents on the dollar, it may, depending on the circumstances, be perfectly content with a recovery of, say, thirty cents on the dollar.[22] An original lender, on the other hand, may have serious misgivings about accepting such a projected recovery for the same company's debt.

If the restructuring process goes on for an extended period of time, the original lenders to a company may begin to lose their patience and thus begin to evaluate the alternatives available to them. Assuming that there is a relatively active secondary market in the affected debt, certain original lenders may consider selling their debt in the secondary market. Depending on the circumstances at the time, including the then prevailing price for debt in the secondary market, such original lenders may view a sale

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[22] To be sure, in considering whether a particular recovery is acceptable, distressed debt investors also take into account the timing of any recovery, or the length of time between their initial investment and their recovery.

of their debt in the secondary market as the best way to effect a reasonable or at least minimally acceptable recovery on their debt.

Correspondingly, investment fund players who specialize in distressed debt investments, sometimes referred to in colloquial terms as “vulture funds,” may begin to purchase debt in the secondary market at deeply discounted prices, including debt being sold in the secondary market by original lenders. (Over the course of a lengthy restructuring, there may be considerable turnover in the composition of the creditor body, and thus over time the same piece of debt may pass through the hands of several separate holders.) The result may be that the longer the restructuring process goes on, such distressed debt investors may become a more prominent presence in the process, and thus their recovery expectations may become more relevant to the overall dynamics of the restructuring process.[23]

Establishing Restructuring Parameters

If and when the debtor and its creditors are ultimately able to agree or otherwise reach a compromise on a sustainable debt figure, such a figure can affect the parameters and structure of any restructuring deal that is ultimately developed and/or proposed. Of course, it is possible that the parties may not be able to reach agreement on a sustainable debt figure. The result may be that each party has its own notion of what is the proper

[23] It should be noted that different distressed debt investors may have different recovery expectations depending in part on the price at which they acquired their debt. If a distressed debt investor acquired a company’s or sovereign’s debt for, say, ten cents on the dollar, it will most likely have different recovery expectations than a distressed debt investor that acquired the same company’s or sovereign’s debt at, say, fifty cents on the dollar. It is possible that over the course of a restructuring, particularly if it is a lengthy restructuring, there could be wide swings in the price of a company’s or sovereign’s debt in the secondary market. Furthermore, different distressed debt investors may have different internal rate of return (IRR) hurdles that they are trying to meet; thus, even though two such investors purchased debt at the same price in the secondary market, they may be seeking a different recovery given their differing IRR targets. Finally, not all distressed debt investors will approach restructurings in the same manner. For instance, there may be certain distressed debt investors that take, or are known for taking, a more aggressive approach in restructurings than other distressed debt investors (and certainly than original lenders).

sustainable debt figure. In that case, each party is likely to rely to one extent or another on its own respective sustainable debt analysis as a basis for developing a restructuring plan or overall restructuring concepts.

Among other things, the sustainable debt analysis can affect the level of debt write-offs that may be proposed by the debtor. The debtor may point to the gap between sustainable debt, on the one hand, and the amount of aggregate outstanding debt, on the other hand, and argue that the gap can be addressed by debt write-offs. As noted above, the creditors are likely to strongly resist proposals that they accept significant debt write-offs of their outstanding debt. In some cases, creditors will firmly oppose any proposals for debt write-offs, whatever their size.

Beyond debt write-offs, the sustainable debt analysis may also affect the use of other restructuring tools that form the basis for any restructuring plan that may ultimately be developed and/or proposed by the parties. It may play a role in the analysis, for example, as to whether to extend the tenor or final maturities of the outstanding debt, whether to reduce the interest rate on the outstanding debt and by how much, whether to provide for a grace period in the company's obligation to resume principal payments after the restructuring becomes effective, and/or whether to have to have a portion of the debt paid down or amortized at regular intervals pursuant to a fixed scheduled and/or whether to have other portions of the debt that are payable in full only on maturity (so-called "bullet" maturities).

In the corporate debt restructuring context, creditors may argue that instead of having to accept debt write-offs, there should be debt-for-equity exchanges (sometimes referred to as a "capitalization" of debt), whereby as part of the restructuring package, creditors receive a certain amount of the equity of the debtor in exchange for giving up a portion of their outstanding debt. The controlling shareholders of a debtor may be opposed to giving the creditors too much, if any, equity in the restructured company, since the controlling shareholders may be concerned with the prospect of ultimately having control of the debtor company taken away from them.[24]

Furthermore, in corporate restructurings, the sustainable debt analysis may be relevant to the analysis as whether there is a need on the part of the debtor to sell some of its so-called “non-core” assets in order to raise proceeds to pay down some of its outstanding debt. The parties may view the sale of such assets as a relatively easy and perhaps even painless way to help reduce the company’s debt load. However, even if there is agreement among the parties on the general desirability of selling “non-core” assets, the parties may have differences with respect to implementation of such a strategy. For instance, the parties may not necessarily agree on whether a particular asset is “core” versus “non-core.” In addition, the parties may disagree as to whether the sale or auction process that is proposed by one of the parties is likely to result in the company receiving the maximum possible purchase price for the assets that are being disposed of.

Conclusion

As discussed above, both corporate and sovereign debt restructurings involve developing restructuring terms and proposals that one way or another should, in an ideal situation, address or at least take into account the underlying economic and financial

[24] It has been observed that a “principal factor that concerns ‘owners’ of financially troubled corporations in many of the…economies [that were part of a study in the Asian-Pacific region] is the fear of loss of control of the corporation.” Asian Development Bank, *Law and Development at the Asian Development Bank (1999 edition)—Special Report: Insolvency Law Reform in the Asian and Pacific Region*, p. 16 (noting further that “[t]his produces an aversion to anything that might put the corporation in a position where others might dictate its immediate and long-term future.”)

realities facing the debtor—realities that are that are captured, for example, by the concept of sustainable debt. But the details and terms of any restructuring proposal or plan are not developed in a vacuum. They will be the product of negotiations, discussions and other interactions between the debtor and its creditors, although the extent and degree of any such negotiations, discussions and interactions may vary from restructuring to restructuring. Furthermore, the details and terms of any restructuring proposal will be affected by discussions that the creditors may have among themselves, particularly if the creditors are working together to develop a common negotiating position vis-à-vis the debtor.

In both corporate and sovereign debt restructurings, participants in the restructurings have complained in certain cases about the shortcomings of the process that is followed. These shortcomings have been focus of particular attention in a number of the high-profile corporate and sovereign debt restructurings, such as in the recent Argentine sovereign debt restructuring as well as in certain major corporate restructurings in the emerging markets of Asia and Latin America. Among other concerns, the parties may believe that there is no clear road map for reaching a restructuring agreement. Such parties may believe that the process tends to drag on without any clear timeline as to when a final resolution of the debtor's financial difficulties will be reached.

In addition, creditors in particular may complain about what they view as a lack of "transparency" in the restructuring processes. In certain cases, the creditors may criticize the debtor for not providing them with adequate and/or timely information to properly assess the debtor's financial condition. Before developing and/or negotiating a restructuring plan, the creditors usually want to conduct a thorough due diligence investigation with respect to the debtor. However, in certain cases, the creditors may believe that the debtor is not necessarily cooperating fully in that process.

Moreover, in some instances, the creditors in particular may believe that there is not a well-established process and/or schedule for negotiations between the debtor and the creditors, and that even if such negotiations do take place from time to time, they are not necessarily very meaningful or substantive. In some of the recent sovereign debt restructurings, the creditors have complained that the debtor was not so much engaging the creditors in negotiations as it was presenting the creditors with a restructuring deal more or less on a "take it or leave it" basis. Of course, sovereign debtors would probably have a different view of such matters as well as the other criticisms directed at them by creditors.

There are also important process issues that do not involve the relationship between debtor and creditors but involve only the creditors.[25] One of the main issues relates to how the creditors organize themselves, particularly whether they are able to form an effective coordinating mechanism and/or negotiating team, such as a creditor steering committee. However, if the creditor body is very large and consists of many diverse constituencies (which is not at all uncommon in both large-scale corporate and sovereign debt restructurings), organizing the creditors into a well-functioning steering committee or other form of creditor organization can be a formidable challenge.

But the failure to do so could have an adverse impact on the creditors' ability to engage in productive discussions and negotiations with the debtor. If the creditors are not

[25] Another critically important issue relates to the process for obtaining approval of an out-of-court restructuring plan developed by the debtor and a group of negotiating creditors. A key question is whether there is any mechanism available for binding dissenting creditors. This has been a much discussed topic in the sovereign debt restructuring context, but it is also important and relevant for corporate debt restructurings.

properly organized, the debtor, whether corporate or sovereign, may use this as a basis for criticizing the creditors for lack of progress in the restructuring process. At the very least, the debtor may use this as a basis for defending itself against criticism that it is responsible for the lack of progress.

In sum, both corporate and sovereign debt restructurings in the emerging markets raise many important issues as to how the restructuring process can and should be handled. However, such issues of process cannot be divorced from the substantive aspects of the restructuring process. Instead, such issues can have a major impact on the substantive outcomes of both corporate and sovereign debt restructurings.