INVOLVING THE PRIVATE SECTOR in the RESOLUTION OF FINANCIAL CRISES—CORPORATE WORKOUTS

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Preface

This paper was prepared by the staff of the International Monetary Fund, for consideration by the IMF's Executive Board in the context of the Board's deliberations on the status of private sector involvement in the prevention and resolution of financial crises and standstills. The views expressed in the paper are those of the IMF staff and should not be attributed to Executive Directors or to their national authorities. The Board's views on this topic, as expressed at meetings on January 24, 2001, at which the staff's paper was discussed, are highlighted in the summing up at the front of this report.

The paper was prepared by staff from the Policy Development and Review Department under the direction of Jack Boorman, Director, and the Legal Department under the direction of François Gianviti, General Counsel. The primary contributors to the papers were Matthew Fisher (Assistant Director of the Capital Account Issues Division of the Policy Development and Review Department) and Sean Hagan (Assistant General Counsel of the Legal Department), Ms. Weeks (LEG), and Ms. Richter (PDR).

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Workshop for Executive Directors
INVOLVING THE PRIVATE SECTOR IN FORESTALLING AND RESOLVING FINANCIAL CRISES: CORPORATE WORKOUTS—PRELIMINARY CONSIDERATIONS
January 24, 2001

Workshop Summary

INTRODUCTION

The workshop for Executive Directors and staff was held to discuss corporate sector workouts, in particular their relevance for macroeconomic stability and the emergence from financial crises. The paper "Involving the Private Sector in Forestalling and Resolving Financial Crises: Corporate Workouts-Preliminary Considerations" (SM/01/8) served as the background for this discussion. The first part of the workshop entailed presentations made by the three invited outside experts (Messrs. Gitlin, Vela, and Brierley). This was followed by a question and answer session, in which the outside experts were joined on the panel by Mr. William Mako of the World Bank and Mr. Sean Hagan (LEG). The workshop was moderated by Mr. Jack Boorman, Director of PDR.

SUMMARY OF PRESENTATIONS

Richard Gitlin discussed the essential components of a proper corporate workout system, the links between a corporate workout system and other aspects of the financial system, and the importance of corporate workout systems to economic recovery. He also identified some of the key impediments that have arisen in restructuring companies in crisis economies, and presented ideas on how to address some of these problems, stressing the importance of having the appropriate workout infrastructure in place in advance of a crisis.

Abraham Vela addressed the experiences of and lessons learned from the Mexican crisis, focusing on the links between an effective formal bankruptcy system and crisis prevention and resolution; the consequences and costs involved in not having an adequate bankruptcy framework in place when a crisis hits; the importance of a bankruptcy system for economic development and modernization and financial system stability; and the role of an out-of-court corporate workout framework.

Peter Brierley expanded upon the links between company failure, financial instability, and corporate workouts, and addressed the key gains that can be derived from an effective out-of-court workout process. He also provided information on the development and evolution of the London Approach to corporate workouts; the continued role of the Bank of

England with respect to the London Approach; and the Principles for a Global Approach to Multi-Creditor Workouts recently issued by the INSOL Lenders Group, which are intended to serve as a statement of best practices for multi-creditor workouts.

OVERVIEW OF DISCUSSIONS

All participants (i.e., presenters and attendees who addressed these issues during the workshop) appeared to accept that a distressed non-financial corporate sector can have a number of significant economic consequences, including for the financial system, macroeconomic, and balance of payments stability, and sustainable economic growth. It is, therefore, important to have in place in advance of a crisis an efficient, orderly, and predictable system that allows viable businesses to be restructured and returned to sound operational footing, and—as a corollary—that allows nonviable businesses to be liquidated. More generally, as regards the Fund's private sector involvement policy, a coherent and effective corporate workout framework is an important element in the tool kit for involving private market participants in forestalling and resolving financial crises.

Participants seemed to agree that the three interconnected and complementary pillars of a corporate workout framework are (i) an out-of-court restructuring framework; (ii) an in-court insolvency system; and (iii) a financial sector restructuring and rehabilitation framework.

There appeared to be a unanimous view that a ***viable out-of-court framework*** for working out corporate sector distress is a critical component of a corporate workout system, given that the formal in-court process could not be relied on extensively especially during a systemic crisis. The principles that guide the out-of-court process must be commercially reasonable and transparent to all participants. Moreover, efforts must be made to establish familiarity with these principles in advance of a crisis. The Principles for a Global Approach to Multi-Creditor Workouts recently issued by the INSOL Lenders Group could facilitate this process, if they gain acceptance among countries as "best practices" principles for use in out-of-court workouts. Beyond this, the out-of-court framework must be supported by other measures that also can be designed in advance of a crisis, including legal provisions that do not impose tax or other regulatory impediments on workouts. Some important issues, such as the extent of governmental involvement in the framework for resolving crises, will depend upon the nature of the crisis and the particular country involved, and therefore will likely be fully elaborated only after the onset of a crisis. Other important impediments, such as political and popular resistance to workouts that give nonresident creditors equity positions in domestic companies, will need to be addressed through strong political leadership.

Participants also seemed to agree that despite the vital importance of the out-of-court system, such a framework can only be fully effective if it is supported by ***the second pillar of this framework: an orderly and predictable in-court insolvency process***. The most fundamental point here is that the rules governing the in-court insolvency system help to define the relative *leverage* the participants will possess as they begin an out-of-court

negotiation: debtors will participate in the out-of-court process if they know creditors can seek liquidation; creditors will participate if they know that debtors can obtain court protection from their creditors by filing a restructuring plan. Conversely, out-of-court negotiations are likely to be limited or even nonexistent if there is no clear and predictable in-court insolvency system to provide a backdrop for these negotiations. Substantial work has already been done in identifying the critical features of an effective insolvency law, and there was considerable support among participants in the workshop for the project that has been initiated by UNCITRAL to establish best practices in this area. The complementary task of strengthening the *institutions* that implement insolvency law is a more difficult one, as institutional reform must often address complex issues that do not lend themselves to change over the short term. By way of example, the strengthening of the capacity of the judiciary to handle complex financial issues associated with workouts in a transparent and predictable fashion may take an extended period of time.

As regards ***to the financial system restructuring framework***, the third pillar in the workout framework, the workshop did not attempt to catalyze more than a preliminary assessment of the complex and multi-dimensional issues raised by the links between corporate sector restructuring on the one hand, and financial sector restructuring and rehabilitation on the other hand. On a general level, there seemed to be little disagreement among participants about the need to design bank and corporate restructuring programs in a complementary manner, with an eye to the relationships between the two. Participants also made a number of other key observations. First, loan provisioning and write-off rules directly impact the willingness of financial institutions to engage in meaningful corporate restructuring, as financial institutions—unless required to do so—will often try to avoid the lost recognition often required to restructure a corporate borrower. Second, all creditors stand to benefit where there is a corporate workout framework that facilitates the early rehabilitation of companies, as the value of creditors' claims are likely to be maximized through preservation of the going concern value of the firms concerned. Moreover, because it enables more predictable pricing of distressed claims, a predictable corporate restructuring framework facilitates the development of a more robust secondary market in which financial institutions can trade both distressed claims and asset-backed instruments derived from distressed claims. Again, this helps to increase the value of these claims, to the benefit of all creditors. Finally, government-owned and funded-asset management companies stand at the intersection of banking and corporate sector restructuring policies and, if properly designed and empowered, can play an important role in the implementation of policies in both areas.

There appeared to be support among participants for greater familiarity with and involvement of the international financial institutions in this area. IFI involvement could arise not only in the design of economic programs supported by IFI resources, but also in other operational areas, such as surveillance discussions, FSAP and ROSC assessments, and technical assistance. Especially given the long-term timeframe of the institutional reforms often needed to support corporate restructuring, and the importance of having frameworks in place at the onset of a crisis, more involved work of the IFIs could be an important component of crisis prevention and resolution efforts.

I

Introduction

Fund-supported programs in Asia initially focused on macroeconomic stabilization and financial system reforms. Although corporate sector weaknesses were identified early in the process, comprehensive measures to facilitate orderly corporate workouts were not fully elaborated at the outset of the programs.[1] This paper provides a preliminary assessment of the need for incorporating corporate restructuring frameworks into Fund-supported programs at an early stage of a financial crisis, and attempts to identify the essential elements of such a framework. As will be discussed, putting corporations back on a sound financial footing not only helps to stabilize the financial system, but also lays the ground for a resumption of sustainable growth. A framework for normalizing relations between nonsovereign debtors and their creditors is also an important element of the tool kit for involving the private sector in the resolution of financial crises.

The paper has been prepared for a workshop for the Executive Directors. As such, it is intended to stimulate discussion, rather than to propose either concrete policy recommendations or the operational modalities for further work in this area. The paper draws on the experience of recent crisis cases and the work of INSOL (the International Federation of Insolvency Practitioners). A comprehensive discussion of some of the related issues—including financial sector stabilization and reform—is beyond the scope of this paper. For the same reason, the paper presents neither case studies, nor elaborated proposals for the ways in which the Fund and other organizations could promote corporate workouts, nor does it attempt to summarize or criticise specific policy advice provided in these areas.

The remainder of this paper is organized as follows. Section II examines the economic benefits that flow from—and the difficulties posed by the absence of—orderly mechanisms for resolving the financial difficulties of the corporate sector. Section III discusses why both a formal insolvency system and out-of-court frameworks are essential elements of the restructuring process. Section IV concludes with an assessment of some considerations for designing orderly and effective corporate restructuring frameworks as a

[1] In the case of Ecuador, in contrast, the program approved in April 2000 included specific provisions for the restructuring of corporate debt.

means of forestalling and resolving future crises. Principles prepared by the INSOL to guide multicreditor workouts are attached as Appendix I.

II

THE NEED FOR CORPORATE WORKOUTS

Recent financial crises witnessed widespread financial distress in corporate sectors. A collapse in domestic demand, sharp exchange rate depreciation, and temporarily high interest rates put severe pressure on corporate sectors, with many large companies being unable to service their debt. These problems were particularly pronounced for companies with large unhedged foreign currency positions. As a result, there was a widespread default by the corporate sector on both domestic liabilities (principally, the claims of domestic banks) and obligations to foreign creditors.[2] This fueled the growth of financial institutions' nonperforming loans which, in turn, reduced their available capital and ability to extend new loans. This may have reduced the supply of credit for even solvent corporations, though it is difficult to disentangle this effect from that of a reduction in credit demand. At the same time, arrears of some corporations to foreign creditors curtailed the ability of the corporate sector as a whole to borrow abroad.[3] Although corporate sector weaknesses were identified early in the process of designing the adjustment programs in Asia and, before that, in Mexico, in some cases corporate restructuring only became a significant focus of policy after macroeconomic stabilization and financial system reforms were being implemented, and as deepening recessions underscored the impact of the corporate sector on financial systems.[4]

[2] While some corporations borrowed in foreign currency from domestic banks, many others were able to borrow directly from abroad. In the case of Indonesia, direct lending by foreign creditors accounts for over 50 percent of aggregate corporate sector indebtedness.

[3] Payment arrears reflected borrowers' inability to pay, not the imposition of exchange controls.

[4] As discussed below, measures to facilitate corporate workouts have included bankruptcy law reforms, establishment of frameworks for out-of-court workouts, adoption of legal and regulatory reforms to eliminate obstacles to restructuring, and corporate governance reforms designed to improve management, transparency, and financial reporting in the corporate sector.

As a result of the inadequacy of the institutional framework for corporate restructuring, progress in restructuring was slow. At the onset of crises, for example, the countries concerned typically had in place neither effective formal insolvency systems, nor efficient out-of-court workout mechanisms. As a result, progress with macroeconomic stabilization and efforts to strengthen the banking system were typically not buttressed by the restructuring of corporate sector balance sheets.

Impact on the Financial System

From the perspective of the financial system, mechanisms that allow for the orderly recognition and allocation of losses should help to improve creditors' ability to assess the value of their assets, determine appropriate levels of loan loss provisions, and improve estimates of financial institutions' capital. At the same time, the availability of workout mechanisms allows banks to manage their assets better. In particular, it enables creditors to stop-loss the deterioration in the quality of their assets by organizing a corporate reorganization, or, in extreme cases, forcing a corporate liquidation so as to preserve any remaining asset value. As such, workout mechanisms can be helpful both in managing crises and in recovering from them, as well as helping ensure that, in more normal periods, emerging problems in banks' balance sheets can be dealt with as they emerge. In addition, an effective insolvency law can facilitate the development of capital markets. For example, if an insolvency law is applied with sufficient predictability, a secondary market in debt instruments can develop that, among other things, will enable financial institutions to transfer their loans to other entities that specialize in the workout process.

Impact on Corporate Sector

The ability of distressed companies to recognize and allocate losses, and, if necessary, restructure their operations, encourages them to take action to regain a sound footing. This in turn should allow such companies to maintain access to the trade credit and working capital needed to maintain operations, as well as to attract new investment capital. In this way, workouts should help to limit the degree of economic dislocation stemming from creditors' unwillingness to maintain or increase their exposure to potentially viable, but illiquid borrowers.

Incentives

Workout mechanisms could also be helpful in establishing appropriate incentives for shareholders and managers. In particular, mechanisms that encourage distressed companies to participate in workout arrangements limit the incentives for managers, in the face of a sharp decline in shareholders' equity, to gamble for resurrection by assuming inappropriately high risks. It may also help to forestall asset stripping of troubled companies.

Notwithstanding these potential benefits, both creditors and debtors may face incentives to postpone a reorganization for extended periods, and there may also be political opposition to workouts. To the extent that commercial bank creditors have inadequate loan-loss provisions and are struggling to meet capital requirements, they may be reluctant to initiate a workout that would force them to recognize actual losses. This underscores the complementarity between efforts to put in place corporate workout mechanisms with measures to reform and recapitalize the banking system, and for supervision and regulation to force recognition of losses. At the same time, managers and existing shareholders, who may stand to lose control of a company may be reluctant to participate in a purely voluntary workout. Indeed, experience suggests that managers and shareholders may be reluctant to sell assets for what they are worth, and will instead hang on in the hope that asset values will return to precrisis levels, thereby allowing an eventual restructuring to be limited to regularizing arrears and reprofiling scheduled debt-service obligations. This suggests that effective workout procedures will typically need to operate against the background of a legal or regulatory framework that can require companies that are not able to honor their obligations to participate. Moreover, experience has underscored the political and popular resistance to workout mechanisms that allow foreign creditors to acquire majority ownership positions in domestic corporations.

The establishment of a coherent workout strategy is a necessary means of involving the private sector in both forestalling and resolving financial crises. In terms of *crisis resolution*, the cost of bank restructuring has generally been borne by the fiscal accounts. Accordingly, to the extent that a corporate restructuring strategy is in place that can maximize the value of the assets of the banking system, it will contribute to easing the fiscal burden of resolving financial system crises, in part by ensuring that other creditors and shareholders share losses. In terms of *forestalling financial crises*, the effective design and implementation of the legal framework that underpins a corporate restructuring framework gives creditors the ability to predict with reasonable certainty how their claims would be treated in the event of a workout, thereby enabling the private sector to assess better the risks that they incur when extending credit. This suggests that assessments of insolvency regimes should form a part of the more general work on the assessment of vulnerabilities.

Operational Issues

In many cases, reforms to facilitate orderly corporated workouts will be an important element of Fund-supported adjustment programs. Given the World Bank's expertise in this area, and its role in promoting structural reform, the Bank would normally take the leading role in the design and monitoring of corporate workout mechanisms. In many cases, it is expected that the Bank will have a timely lending instrument to support the introduction of the reforms, and provide the necessary monitoring. In some cases, however, if the Bank is not able to address these issues in a timely fashion, assistance in the design of such reforms may have to be sought elsewhere, either within the Fund or from other sources, if corporate restructuring reforms are considered critical to the success of a Fund-supported program.

Over time, of course, it would be expected that the Bank would deepen its involvement with this element of the reform agenda, and would assume the leading role as soon as possible. In any event, staff would provide regular updates to enable Directors to assess progress and the consistency of the reforms with the objectives of the program.

III

ESTABLISHING A FRAMEWORK FOR THE RESOLUTION OF CORPORATE SECTOR CRISES

Given the impact that a distressed corporate sector can have on the financial system, macroeconomic and balance of payments stability, and economic growth generally, the establishment of a framework for resolving corporate difficulties should be a high priority, particularly for emerging markets.[5] It is important that the central elements of such a framework be established during a period of relative tranquility, as it is critical that it be in place in advance—or immediately after the start—of a crisis, so that it can help to facilitate an orderly and efficient process for working out the financial difficulties of the corporate sector.

The Role of an Orderly and Effective Insolvency System

As demonstrated recently in the context of a number of Fund-supported programs, ***an orderly and effective insolvency system forms a central component of any framework for resolving corporate sector difficulty***. Both inside and outside the context of a crisis, an effective insolvency system with well-designed rehabilitation and liquidation procedures can maximize the value of corporate sector assets for the benefit of all stakeholders (including, debtors, creditors, and employees) and the economy more generally.

Specifically, the relevant parties—including creditors—may be of the view that the assets of the enterprise (including, therefore, the value of creditors' claims) can be most efficiently maximized through the "going concern value" of the company. This will often—but not always—be the case where the inability of the company to service its debt is due to a macroeconomic/balance of payments crisis. In these circumstances, ***rehabilitation proceedings*** provide an effective means of preserving the value of a going concern, as they normally involve: (i) a stay on potentially disruptive creditor litigation during the period in which a restructuring plan is being negotiated; (ii) plan approval provisions that allow a court to approve a restructuring plan and make it binding on minority dissenting creditors; and

[5] In a similar vein, it would be important to address other sources of vulnerability that may contribute to financial crises, including, for example, corporate governance.

(iii) provisions that encourage new financing by providing a payment priority to new credits. By facilitating a restructuring that will often involve debt reduction and/or debt-for-equity conversions, an effective rehabilitation procedure helps to ensure that private creditors bear a portion of the burden of the financial crisis, thus limiting the public cost of resolving the crisis. Also, by requiring private creditors to incur the costs of the risks they have assumed, such a system generates greater stability in the financial system. More generally, effective rehabilitation systems help to limit the loss of asset value (and financial losses that may be borne by creditors) associated with excessive delays in workouts.

Where, because of the financial condition of the company, creditors are of the view that the enterprise is no longer viable, ***liquidation proceedings*** provide an effective means of maximizing the liquidation value of the company's assets through provisions that (i) prevent premature dismemberment through a "grab race" by individual creditors, (ii) provide for the appointment of an independent administrator whose duty is to maximize liquidation value (for example, through the avoidance of fraudulent and preferential transactions), and (iii) provide for equal treatment of similarly situated creditors.

Orderly and effective insolvency procedures can also achieve broader economic objectives that go beyond value maximization. For example, by establishing a mechanism that enables creditors to enforce their rights against a debtor, and establishing liquidation distribution priorities that recognize the payment seniority established in preinsolvency contracts, an effective liquidation procedure can create predictability and confidence in the credit system, to the benefit of borrowers (including through greater availability and lower cost of credit). This confidence is of particular importance in economies where alternative means of enforcing individual claims (e.g., through foreclosure on collateral) are subject to considerable uncertainty or delay. More generally, an effective insolvency law imposes discipline on the corporate sector, thereby contributing to greater competitiveness and providing a sound basis for the provision of new credit.

As discussed in a recent staff publication (*Orderly and Effective Insolvency Procedures: Key Issues)*[6] insolvency laws continue to differ in a number of respects, often reflecting diverse choices that countries make for social, cultural, and legal reasons. There are advantages and disadvantages associated with most of these choices, and competing interests to be balanced in all cases. However, in the final analysis, the most important issue is whether the law can be applied with ***adequate predictability***; i.e., whether there is sufficient capacity within the institutional infrastructure to apply the law in a manner consistent with its terms. An imperfect law applied consistently and transparently by the courts will engender more confidence within the markets than a perfect law that is improperly implemented. This infrastructure includes the court system that is responsible for applying the law and the court appointed officers (trustees and administrators) that are charged with administering the assets

[6] Legal Department (1999).

of the corporation. Unfortunately, developing this infrastructure takes considerable time and, based on experience to date, makes it difficult for a new insolvency law to be relied upon effectively in the context of a crisis. This problem is exacerbated where the local business culture lacks familiarity with the functioning (and the economic necessity) of insolvency systems.

Beyond these difficulties in implementation infrastructure, there are additional reasons—especially in the context of a crisis—why countries cannot rely exclusively on the formal insolvency system to carry out corporate sector restructuring. Where there is a systemic crisis, the sheer volume of cases would overwhelm the capacity of even the best-designed and most well-implemented legal system, if all insolvent or near-insolvent companies had to effect their restructuring through the court system. In addition, litigation is both expensive and time-consuming, factors that increase the financial burden on already distressed companies.

Out-of-court mechanisms provide one means of avoiding these difficulties in the formal insolvency system. Paradoxically, however, experience demonstrates that an out-of-court process can only be effective if it is supported by the formal insolvency system. The formal system supports the out-of-court process in two important respects.

First, by establishing a predictable set of rules that enable creditors to initiate insolvency proceedings that can eventually lead to a total transfer of a debtor's equity to creditors (in the case of rehabilitation proceedings), or to liquidation of a debtor (under liquidation proceedings), an insolvency law provides an incentive for the debtor to come to the negotiating table if it wishes to avoid the consequences of application of the law. The leverage provided by the insolvency system is of particular importance in countries where alternative enforcement proceedings (including foreclosure on collateral) are subject to considerable delays or uncertainty.

Second, the "cram down" provisions contained in the rehabilitation chapters of most modern insolvency laws enable a court-imposed rehabilitation that has support of the requisite majority of creditors to be made legally binding on all creditors. Such provisions effectively reduce the leverage of holdout creditors in the negotiating process.

The Role of an Effective Out-of-Court Restructuring Process and the Frameworks in Recent Crisis Countries

The above considerations suggest that it is important for countries to develop ***workable out-of-court proceedings*** that are designed to facilitate corporate restructuring, including in the context of a systemic crisis.[7] As discussed more specifically below, the design and implementation of out-of-court frameworks were fully incorporated at a later stage into Fund-supported programs in the context of recent financial crises. The design of these frameworks varied, depending on the structure of the debt and the particular circumstances of the country in question.[8]

In many respects, the frameworks adopted in response to recent crises are derived from collective negotiation techniques developed in the U.K. and the U.S., where—despite relatively well-functioning legal systems—considerable reliance is placed on the out-of-court approach. Indeed, out-of-court negotiations result in the vast majority of successful restructurings internationally and are generally considered more efficient than a court-supervised proceeding. Especially in developed countries, the formal insolvency system serves merely to define the leverage against which parties can reach an out-of-court restructuring agreement acceptable to all concerned.

Stated in its broadest terms, this process seeks to establish an effective collective framework for negotiations through creditor and debtor adherence to voluntary principles that provide for the formation of creditors' committees, the sharing of all relevant information between debtors and creditors, and the establishment of a voluntary "standstill" period during which creditors refrain from taking legal action against the debtor (and, if necessary, provide interim financial support), all in order to permit negotiations to proceed in an orderly and efficient manner. These principles have been developed over time and are generally viewed as the best means to rehabilitate companies and maximize recovery for creditors. In the U.K., the implementation of this process is informally guided by the Bank of England, and is often referred to as the "London Approach." As will be discussed below, although these out-of-court frameworks are often preferred to the formal insolvency system by both creditors and debtors for cost-related reasons, the effectiveness of the out-of court approach ultimately depends on the predictability of the formal insolvency system, which establishes the leverage and incentives that facilitate negotiation.

[7] The liquidation of companies normally requires a court-supervised process.

[8] These issues are discussed in the relevant staff reports and associated documents for the countries concerned.

The out-of-court frameworks of recent crisis countries have also been tailored to address the particular circumstances of each country. For example, in recognition of the shortage of local professionals with significant debt restructuring talent (discussed below), the out-of-court programs in Indonesia and Thailand make professional facilitation and mediation services available to parties in a negotiation. In Korea, given the established relationship between the public and corporate sectors and the fact that a substantial portion of the banking system is government-controlled, there is a greater degree of governmental involvement in substantive restructuring matters than in the other countries. As a further example, because most of the private foreign currency debt in Korea and Thailand was mediated through the banking system (as opposed to Indonesia, for example, where most private external debt was contracted directly with foreign lenders), the out-of-court program required local creditors—over whom the government could exercise greater moral and regulatory suasion than foreign lenders—to sign intercreditor agreements requiring specified conduct during the course of restructuring negotiations. All of these frameworks recognize the need to bring all major creditors into the collective negotiating process, including banks, bondholders and, where necessary, suppliers.

When compared to the out-of-court process in the U.S. and U.K., a distinguishing feature of the frameworks adopted in recent crisis countries has been the relatively large degree of government involvement in the process. There are several reasons for this.

First, and most generally, government involvement reflects, in part, recognition of the nation-wide nature of the problem and, therefore, the public interest in its resolution.

Second, since the legal frameworks in these countries have been too weak to give creditors effective recourse against noncooperating debtors, government-supported restructuring programs were designed to catalyze the restructuring process, as debtors would otherwise have had little immediate incentive to negotiate. Many debtors in these jurisdictions continued to hope that the local currency would appreciate close to precrisis levels, thereby reducing their foreign currency denominated debt-service requirements. These debtors can often forgo new financing—which would normally force them to the negotiating table—since the de facto moratorium on debt-service payments enables them to use income to fund working capital needs. Moreover, debtors have been unwilling to give up equity, divest favorite businesses lines, and take other difficult actions that are often necessary to effect a true operational restructuring and restore a business to viability.

Third, given the limited corporate restructuring experience in the countries concerned, the governments have also played a lead role in financing and making available professional facilitation and/or mediation services to guide parties in a restructuring. Successful restructuring negotiations depend, to a large extent, on the talent and knowledge of professionals with demonstrated experience in debt workouts.

Despite the attempts in recent crisis situations to establish effective out-of-court frameworks for corporate sector restructuring, the success of these programs has been mixed,

and it is fair to say that the pace of restructuring has been slower than expected. This appears to be attributable to at least two factors.

First, countries have found it difficult to implement the formal insolvency system in a predictable manner. As discussed above, an effective insolvency system provides the leverage necessary to support the out-of-court framework. Although problems have varied among countries, the biggest hurdle has been the establishment of the institutional framework—the judiciary and estate administrators—that is critical to implementation. In the case of the judiciary, while in some countries the problem has been training and capacity, in others, there is a strong perception of corruption within the court system. Although Fund-supported programs have included measures to address these issues, it has generally recognized that, since they touch upon broader institutional and societal issues, the corrective measures will take time to yield results. Indeed, at the core of some of these implementation problems is the reluctance of the government to challenge vested interests.

Second, it has become clear that any corporate restructuring strategy requires significant coordination with bank restructuring. In the course of containing some of the recent crises, government bank restructuring agencies and/or asset management units (AMUs) have been left holding a substantial portfolio of distressed corporate sector debt and assets, as a result of bank recapitalization or takeover programs. Indeed, government bank restructuring entities in some countries have become large creditors to the corporate sector. As a consequence, there may have been a tension between minimizing the fiscal costs of bank restructuring by maximizing the government's entity's immediate cash recovery and other objectives of corporate restructuring. For example, to the extent that the priority of the government is immediate cash recovery, it may choose to liquidate the company or, if it is a secured creditor, seize all collateral. However, to the extent that the company in question is viable, the initiation of informal or formal rehabilitation proceedings may be the most effective strategy for the company and, more generally, the economy over the longer term. As noted above, however, there is also a danger that AMUs that do not play an activist role in the workout process can allow debtors and creditors to shift the costs associated with corporate workouts to taxpayers.

The absence of effective coordination between the two policies appears attributable, in part, to the fact that the corporate restructuring strategy has been fully elaborated and implemented relatively late in the process, after most details of the bank restructuring program had already been defined and recovery targets designed to address fiscal weaknesses had already been established.

If bank and corporate restructuring strategies are effectively coordinated—both in design and implementation—they can create synergies rather than tension. To the extent that a corporate restructuring strategy facilitates the early rehabilitation of companies, all creditors—including government-owned AMUs—stand to benefit, as the value of their claims will be maximized through the going concern value of the firm. Moreover, even if a public AMU does not wish to participate in the restructuring process itself (or if it wishes to

dispose of loans after they are restructured), a predictable workout framework will enhance the AMU's ability to sell its claims through the secondary market to other investors. The more effective the framework, the easier it will be to price distressed claims, which will facilitate the development of a more robust secondary market.

IV

CONSIDERATIONS IN DESIGNING AN ORDERLY AND EFFECTIVE CORPORATE RESTRUCTURING FRAMEWORK

In light of the above, the question arises as to what steps can be taken in advance or immediately at the beginning of a crisis to bring momentum to the corporate restructuring process. The experience, to date, suggests that the following key issues would need to be addressed.

A first—almost preliminary—requirement is that the underlying legal system must be applied with a certain minimum of predictability.

In terms of its design, the insolvency law must define and balance the rights of debtors and creditors in a way that establishes the necessary incentives for out-of-court negotiations. As described in the recent staff publication mentioned above, two features are of critical importance in this regard.

First, the formal rules must make it relatively easy for creditors to commence proceedings against a defaulting debtor. A credible threat of such action provides a necessary means of bringing the debtor to the negotiating table. This is particularly important in countries where the alternative enforcement proceedings (including foreclosure on collateral) are subject to considerable delay and uncertainty. In the longer term, an improvement in these other enforcement proceedings will also be of considerable benefit.

Second, the rehabilitation provisions of the law should provide a mechanism that enables an agreement reached between a debtor and a majority of its creditors to be imposed by the court upon a dissenting minority of creditors. As discussed above, such cram down rules reduce the leverage of the hold out creditor during the negotiating process.

There are other elements of the legal framework that play a critical role in facilitating corporate restructuring. For example, an effective system for the creation and enforcement of security interests in a broad array of assets facilitates the provision of interim financing during the restructuring process. Moreover, the legal system should not impose tax and other regulatory burdens that disadvantage the types of transactions likely to arise in corporate restructuring (e.g., taxes on, or stringent regulatory approval requirements for, debt-to-equity conversions or debt write-offs).

Procedurally, it is not possible to eliminate completely the possibility of unpredictable application of a law, as legal interpretation by its very nature requires that judges and other decision-makers exercise some discretion. However, a law can be designed so as to *minimize* the chances of unpredictable application in circumstances where the institutional infrastructure is weak. For example, as discussed in the recent staff publication noted above, the law can limit the discretion of decision makers by providing for some level of automaticity in key areas (e.g., firm deadlines for court action on particular matters; firm and objective criteria for when the court must permit an insolvency proceeding to commence; objective criteria for approving or rejecting a restructuring or liquidation petition; etc.). Over the long term, these procedural safeguards are not a substitute for comprehensive judicial reform (which must proceed simultaneously); however, in the short-term, they can serve to mitigate weaknesses in the institutional infrastructure.

The above steps to improve substantive and procedural aspects of the legal system can and should be initiated far in advance of a crisis.

A second requirement is that a framework should be established for the out-of-court process. The experience to date suggests that a formal, government-led, out-of-court program is likely to be developed only after a crisis arises, or immediately prior to the outbreak of such a crisis. However, the underlying principles of commercially reasonable restructuring behavior amongst debtors and creditors can be established in advance and, as will be discussed further below, best practices are being developed in this area. A key question is the appropriate role of government in guiding this process in the context of a financial crisis. Although this role will vary depending on the circumstances of the country, experience demonstrates that it must be one which has been accepted by—rather than imposed upon—the parties to the restructuring process. Moreover, it is critical that the principles be transparent and that efforts be made to raise awareness of the importance of expeditious workouts for financial system stability and economic recovery.

Third, for the reasons discussed earlier, upon the onset of the crisis, efforts should be made to coordinate the design and implementation of banking and corporate restructuring strategies, or at least to design the bank restructuring program with consideration of its impact on corporate restructuring—and vice versa. While the precise contours of a coordinated bank and corporate restructuring program will vary depending upon the nature of the crisis and its relative impact on the two sectors, further consideration would need to be given to the design and implementation of frameworks that avoid the need for cash recovery for the benefit of the banking system or the government (in cases where a government-owned AMU owns a large amount of nonperforming loans) being pursued at the price of dismantling, or otherwise impeding the restructuring of, viable companies.

Apart from taking into consideration the above issues when designing Fund-supported programs, the question arises as to whether there are additional steps that the Fund and other international organizations could take to foster improvement in this important area. At this early stage of discussion, it is worth noting the following points.

First, given the direct impact that a system for the enforcement of creditor rights has on the financial sector, consideration could be given to including a review of these in Article IV discussions in those circumstances where the financial system in question demonstrates considerable vulnerabilities. In that regard, it should be noted that creditor rights, corporate restructuring, and loan recovery are already elements of the Financial Sector Assessment Program (FSAP), which the Fund carries out jointly with the World Bank.

Second, assessments could be conducted of the adequacy of a member's corporate restructuring system in the context of a ROSC. In this regard, it would be noted that considerable work is being undertaken in a number of fora to develop best practices and generally accepted principles in this area. With respect to the out-of-court framework, the leadership of the International Federation of Insolvency Practitioners (INSOL)—whose lenders' group includes many large international lenders—has completed work on a set of principles that are intended to guide multicreditor workouts.[9] Countries could use these principles, which are attached as Appendix I, as a starting point in establishing ex ante a framework that debtors and creditors in their own jurisdictions would be expected to follow in the event that a crisis results in systemic difficulties within the corporate sector.

Regarding the legal framework that provides the necessary underpinnings for an effective out-of-court framework, significant work has been done, or is being done, by the Bank and the Fund on identifying the critical features of an effective domestic insolvency system.[10] Building on this work, an insolvency working group established by UNCITRAL (United Nations Commission on International Trade Law) has recommended that UNCITRAL prepare a legislative guide that would provide guidance as to the design of a domestic insolvency law that would be applicable to both developed and developing countries. UNCITRAL has already completed work on a model law on cross-border insolvency. The Financial Stability Forum has identified insolvency principles as one of the 12 key standards to which countries are encouraged to accord a high priority. At such time as sufficient progress is considered to have been made in developing standards in this area, an assessment of insolvency systems against these standards by the Fund and the Bank could become part of the ROSC exercise.[11]

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[9] Upon invitation, the Fund staff has attended the working group sessions of INSOL as observers.

[10] With respect to the Fund, see *Orderly and Effective Insolvency Procedures: Key Issues*. The Bank's publication, entitled "Principles and Guidelines for Effective Insolvency Systems," is scheduled to be published shortly.

[11]Separately, the Group of 30 is leading a private sector initiative that seeks to establish methods for the better dissemination of information about legal vulnerabilities in country-specific corporate restructuring frameworks, including methods that would encourage private

(continued…)

Appendix

INSOL LENDERS GROUP

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

I. INTRODUCTION

Set out below are the eight principles (the "Principles"), which should be regarded as statements of best practice for all multi-creditor workouts. This document also contains a commentary on the Principles generally and on each Principle separately.

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

PART I
THE PRINCIPLES

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

SECOND PRINCIPLE: During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are

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investors to take insolvency and other “legal risks” into consideration when making investment decisions.

entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.

THIRD PRINCIPLE: During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date.

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

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

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

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

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

PART II

COMMENTARIES

General

During the last thirty years there has been a growing recognition amongst the world's financial institutions that, as creditors, they can achieve better returns through supporting an orderly and expeditious rescue or workout of a business in financial difficulty than by forcing it into formal insolvency. This realization has coincided with efforts by certain regulatory and

official authorities to encourage financial institutions to co-operate with each other when dealing with debtors, to whom they are collectively exposed, particularly in cases involving large exposures.

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

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

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

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

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

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

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

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

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

Where it is proposed to include creditors who fall outside the traditional categories of financier in the rescue process, the argument for including all

creditors within a class diminishes and it is usually simply a question of deciding whether or not the particular non-financial creditor has to be included to enable the rescue to progress.

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

With the increasing use of credit insurance and credit derivatives, it is not uncommon to discover that, in addition to the creditors of record, there are other parties whose consent or involvement will be necessary for any rescue or workout proposal to succeed. Wherever practical, an early disclosure of such situations should be made by the creditors of record to the other relevant creditors.

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

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

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

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

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

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

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

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

The Standstill Period – Duration: The length of the Standstill Period will vary from case to case, depending on the complexity of the information to be gathered and the nature of any restructuring proposals, but should be no longer than necessary for the carrying out of the above process in each particular case, since any unnecessary delay is likely to prejudice the prospects of a successful outcome. It is customarily for an initial period of weeks or months, usually with a capacity for extension if all relevant

creditors so agree. Sometimes the Standstill Period will be agreed for a period of, say, three months, but on the basis that the relevant creditors can, by a predetermined majority (e.g., a majority in number or a majority in both number and value of claims) elect to terminate the Standstill Period prematurely, either at their discretion or following agreed events of default.

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

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

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

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

Reluctance on the part of a financial institution creditor to participate in a coordinated approach due to the relative size or nature of its exposure or a

desire on its part to terminate the relationship with that debtor is not regarded as legitimate justification for its exclusion.

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

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

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

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

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

(a) Not to press for repayment of the amounts due to them or issue or pursue proceedings against the debtor during the Standstill Period;

(b) Not to try to improve their individual positions relative to other creditors by obtaining or enforcing security or seeking additional financial rewards or preferential treatment during the Standstill Period; and

(c) To continue during the Standstill Period to allow utilisation of existing credit lines and facilities, at least at the exposure levels existing at the Standstill Commencement Date.

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

In certain jurisdictions, an agreement by the debtor with all or some of its creditors which provides for a moratorium on the payment of debts will itself trigger formal insolvency. In such cases it may still be possible for the creditors to agree between themselves (rather than with the debtor) to operate a moratorium on their claims against the debtor and for the debtor separately to agree not to take steps which might prejudice the relevant creditors during an agreed period.

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

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

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

fluctuations as compared to the position at the Standstill Commencement Date.

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

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

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

When the claims of relevant creditors are denominated in a number of different currencies, movements in exchange rates during the Standstill Period can affect the relative position of creditors. Standstill arrangements often use assumed fixed exchange rates to determine certain inter-creditor

issues (e.g., voting and risk sharing) although realisations may still be shared by reference to actual exchange rates and end of day balancing adjustments may be required to cover exchange rate fluctuations.

THIRD PRINCIPLE: During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date.

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

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

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

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

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

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

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

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

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

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

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

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

The advantages and efficiencies of channelling communications between the debtor and relevant creditors through co-ordinators are considerable but the process can be time-consuming, both for the creditor representatives on the co-ordination committee and particularly for the co-ordinator. For this reason it is usual for the co-ordinator and co-ordinating committee

members to receive appropriate recompense, not only to reflect the time they are likely to have to spend in discharging their role but also for travel, accommodation and other disbursements they incur. These expenses will be for the debtor's account initially, perhaps pre-funded by the debtor or covered by a loss-sharing or similar negotiated agreement among the relevant creditors as a group.

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

Another advantage of using co-ordinators is that it helps to ensure that all the relevant creditors receive the same information and advice during the rescue process. A single set of shared advisers for the relevant creditors as a whole is often preferable from a debtor's perspective and may work in some cases, but often creditors who are parties to different forms of credit facilities (such as bank loans, privately-placed notes and public bonds) will require that separate legal advisers be retained to represent the interests of relevant creditors of a particular class. Because workouts often present inter-creditor issues, not just issues between the debtor and the relevant creditors as a group, and because different creditor classes typically have different legal, regulatory, policy and other issues to address, it would be unusual for a single legal adviser to be able to represent all the relevant creditors with respect to all the issues involved. Even in such cases, however, it is often possible for the main burden of information gathering, processing, evaluation and due diligence to be borne by accountants and lawyers acting for or representing the interests of the relevant creditors as a whole. All advisers should be independent of the debtor.

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

Importantly, each of the relevant creditors will be expected to make its own assessment and decisions regarding any information, advice or proposals it receives either directly or via co-ordinators with regard to matters related to the restructuring process. Co-ordinators will have no duty or liability to other creditors or the debtor with regard to the accuracy or completeness of such information or advice or with regard to any proposals or their acceptance or rejection of them. It is important, however, that co-ordinators ensure that information they receive is disclosed to all relevant creditors and that they do not assume liability or responsibility to other relevant creditors either expressly or by any course of conduct. (see commentary on **Seventh Principle** below).

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

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

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

The choice of coordinator is made by the constituency from which the committee is selected. Very often the co-ordinator will be a representative of the financial creditor, which has the greatest, or one of the greatest

exposures to the debtor, and will be an individual with relevant experience, skills and seniority. In rare cases, creditors may prefer that the co-ordinator be an independent person.

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

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

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

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

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

The debtor should accept that the advisers to the relevant creditors will be expected to review the accuracy of accounts, projections, forecasts and business plans related to any proposals for rescue or reconstruction and also to estimate the consequences of the relevant creditors refusing to agree to

the proposals being put to them. The relevant creditors will also wish to gain reassurance that, as between themselves, their relative positions have not and will not be prejudiced by any proposals which are being made.

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

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

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

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

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

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

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

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

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

The output from the insolvency models can, amongst other things, be used to identify the claims that relevant creditors may have against each debtor company; to estimate the likely return to such creditors from their claims and to estimate the proportion of the indebtedness due to relevant creditors which appears to be covered by assets (as opposed to uncovered). These calculations can in turn be used when considering such issues as debt to equity conversion or debt write-offs.

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

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

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

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

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

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

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

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

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

The use of professional advisers and co-ordinating committees to progress negotiations with the debtor and to receive and analyse confidential information relating to the debtor may reduce the sensitivity associated with debt trading by obviating the need to transmit confidential information to the main body of relevant creditors until the rescue proposal has been fully formulated and the implementation mechanism initiated. This technique tends to be of most assistance when the rescue proposal is to be implemented using some form of scheme of arrangement or reorganization, which requires publication of the proposal and court approval. It is of less help where it is necessary to gain the voluntary agreement of each debt holder to the proposal.

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

EIGHTH PRINCIPLE: If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional

funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.

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

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

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

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

Identifying New Money is, as indicated above in the commentary on the **Second Principle**, not limited simply to the provision of additional loan facilities. It can also apply to other forms of increase in exposure levels (e.g., under derivative or contingent facilities) when compared to the position as at the Standstill Commencement Date. The treatment of such

increased exposure levels will be a matter for commercial negotiation among the relevant creditors.

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

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

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

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

New Money lending will generally be provided on the same basis so far as demand or cancellation is concerned as other facilities (e.g., such demand may only be made during the Standstill Period with the agreement of a majority of the relevant creditors). In many jurisdictions, however, a lender of New Money (or indeed a provider under any other facilities) should not be obliged to lend further amounts after a petition for liquidation or bankruptcy has been lodged against the debtor unless such additional lending has been approved by the courts, as otherwise it may not be recoverable in a subsequent liquidation or bankruptcy.

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