Proposed Framework For
Expedited Insolvency Procedures to Facilitate Cross-Border Restructurings

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The recent work of the Insolvency Working Group of the United Nations Commission on International Trade Law (UNCITRAL) highlights the growing international consensus that an effective national insolvency system is critical to access of domestic businesses to the international capital and credit markets and to reducing the adverse impact of business failures on a nation's economy. Most nations participating in UNCITRAL's Insolvency Working Group also appear to agree that an essential feature of an effective national insolvency system is a cost effective method of rescuing troubled businesses.

The growing consensus that rescue is an essential alternative to liquidation of troubled businesses is understandable. Rescues involve, in various combinations, the postponement, adjustment or refinancing of existing debt obligations, the infusion of new capital, the sale of assets, and even the exchange of existing debt for equity. However, despite the diversity of rescue techniques, the goals of all successful rescues are the same. They preserve an ongoing business enterprise, they preserve employment and, by preserving the going concern value of the business, they typically maximize the value available to satisfy claims. These common features strongly favor structuring national insolvency systems to facilitate rescue.

Rescues generally take one of two forms: voluntary restructurings with little or no court involvement ("out-of-court restructurings") and restructurings under formal judicial supervision ("court supervised restructurings"). Voluntary out-of court restructurings often are the lowest cost way of resolving an insolvent company's financial difficulties. They involve the voluntary, negotiated resolution of financial difficulties and can avoid many of the costs, delays and difficult distributional issues faced in the context of plenary, court supervised, insolvency proceedings.

Voluntary out-of-court restructurings typically are less comprehensive than plenary, court supervised restructurings. Often they affect only lenders, bondholders and shareholders. This makes them easier to accomplish than court supervised restructurings, which typically affect all claims, including trade, employee and governmental claims.[1] In spite of the advantages afforded the holders of claims that are not affected by a voluntary out-of-court restructuring, lenders and bondholders find it in their interest to participate in voluntary out-of-court restructurings because they often will suffer even greater losses if plenary insolvency proceedings are commenced. Voluntary out-of-court restructurings also

[1] It has proved exceedingly difficult to accomplish out-of-court restructurings that affect classes of creditors other than lenders and bondholders. This is due to the large number of parties whose participation would have to be solicited and to the complexities involved in trying to address vendor and employee claims outside of formal insolvency proceedings.

accommodate the need for prompt resolution that is essential for successful rescues but not always possible in plenary insolvency proceedings.

Because of the importance of voluntary out-of-court restructurings to a properly functioning insolvency system, this paper proposes that UNCITRAL explore how national insolvency systems might be restructured to facilitate such restructurings.[2]

The Need For Expedited Insolvency Procedures to Facilitate Restructurings

Voluntary restructurings are often impeded by the ability of individual creditors to take enforcement action and by the need for unanimous creditor consent to alter the repayment terms of existing classes of debt. These problems are magnified in the context of complex, multi-national businesses, where it is especially difficult to obtain consents from all relevant parties. It is critical, therefore, that a "rescue" culture evolve that encourages voluntary cooperation and participation by creditors and other participants in out-of-court restructurings. Among other things, creditors should be encouraged to conduct themselves in accordance with principles like those proposed in the "Global Approach to Multi-Creditor Workouts" currently being considered by the Lenders Group of INSOL International.

Even, however, where an effective rescue culture is in place, it is often difficult to obtain the necessary support to complete a restructuring due to the need to persuade large numbers of creditors of varying types and dispositions (i.e., banks, bondholders and debt traders). This is due in part to the "hold out" problem, where a few small creditors try to take advantage of their blocking position by refusing to agree to a restructuring that most creditors believe is in the best interests of all concerned. These creditors hope to extract better terms for themselves at the expense of other parties. In response, other creditors may refuse to agree and the entire restructuring may fail. This problem is even greater where creditors come from many different countries and commercial cultures.

[2] A mechanism to accomplish voluntary restructurings is especially useful in the case of substantial international borrowings by a large company with multinational interests. Thus, the model legislation proposed in this paper is specifically designed to address such complex cross border situations. The concepts could, of course, be applied equally to purely domestic situations.

Accordingly, to facilitate restructurings and support an effective rescue culture, there is a need for a legal mechanism that makes it possible to bind the dissident minority of creditors to go along with the great majority who wish to settle with the debtor and keep its business alive, so long as a threshold standard of treatment that appropriately protects the interests of the dissenting minority is achieved by a restructuring. Such mechanisms are found within many countries' insolvency laws, but are not readily applied to cross-border situations.[3]

Domestic insolvency laws that require a minority of creditors to accept majority rule typically provide for independent review of the restructuring to assure that the minority is not being abused. International creditors may, however, be reluctant to accept a mechanism that subjects them to inconsistent rulings by local courts in various affected countries. They may also be hesitant to accept a given country's standard of review. On the other hand, if international creditors are assured that the mechanism to bind "hold outs" also provides for a single, independent review under an acceptable international standard, they will be much more comfortable making loans to or buying bonds from borrowers who are in jurisdictions that provide such assurance.

A Model Voluntary Cross Border Restructuring Statute would provide for an expedited, statutory procedure for implementing a voluntary restructuring of borrowed money indebtedness (institutional lender debt and bonds) of insolvent international business enterprises based upon:

(i) approval of the restructuring by a requisite ***supermajority*** of each affected class, and

(ii) ***independent judicial review*** of the adequacy of the restructuring applying ***appropriate international restructuring standards***.

Eligible Debtors

The procedures under the Model Statute would be available to any insolvent or defaulting business enterprise with substantial borrowings from foreign persons. Size criteria, criteria for proving insolvency/default status,[4] and criteria for establishing that sufficient amounts of debt held by foreigners would have to be established in the Model Statute. Different countries might decide to adopt different criteria in this regard.

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[3] A legal procedure for dealing with hold outs such as the one described in this paper is an adjunct to and not a substitute for an effective rescue culture. It complements and supports such a rescue culture by dealing with the small minority of parties who might otherwise seek to disrupt the restructuring process.

[4] For example, the criteria for eligibility might be a declaration by the company of a current or prospective inability to pay its debts when due.

Certain types of regulated debtors (for example, financial institutions and insurance companies) might be made ineligible for restructuring under the Model Statute.

Parties Affected

Under the Model Statute, restructurings would be accomplished by a supermajority vote of each affected class of claimants. However, only borrowed money indebtedness (institutional and public, whether secured or unsecured) and other similar financial obligations could be adjusted by such a vote.[5] Indebtedness held by other creditors could not be affected unless such creditors individually agreed to adjustment of their claims. Thus, indebtedness to trade creditors, employees, taxing authorities, etc., would "ride through" (i.e., not be affected by) restructurings under the Model Statute. Absent consent from each claimant, these liabilities could be affected only in domestic insolvency proceedings to the extent permitted under local law.

Common stockholders and other equity holders could, however, be affected by a restructuring under the Model Statute (for example by dilution of their equity position if debt were exchanged for equity as part of the restructuring).[6]

Temporary Moratorium

In many instances, restructurings can be accomplished, even after a default, as a result of the voluntary agreement of creditors to delay collection actions. However, in order to facilitate restructuring efforts, it may be advisable to include in the Model Statute an appropriately limited statutory moratorium on such actions, so that the actions of individual creditors do not prematurely precipitate insolvency proceedings, thereby thwarting restructuring efforts.

The Model Statute could provide that, in connection with making a bona fide restructuring proposal, an eligible company could declare a brief temporary moratorium that would suspend collection activities by affected classes. As noted above, only lenders, bondholders and shareholders, not vendors or employees, would be affected. The declaration of the moratorium would be publicly filed in the appropriate court and would specify whether all, or only certain, creditors and shareholders are subject to the moratorium.

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[5] In some countries it may be controversial to adjust the rights of secured creditors in this manner.

[6] In some cases, the vote of shareholders might have to be solicited under applicable law to, among other things, increase the authorized capital stock of the corporation if necessary to consummate the restructuring.

The moratorium would be solely for the purpose of permitting the orderly proposal, negotiation and solicitation of approval of a restructuring. To be palatable, the initial moratorium period would have to be relatively short (e.g., 15 days), but might be subject to extension with the consent of holders of a material portion of creditors in affected classes (e.g., a further 30-60 days with the written approval of a majority in principal amount of each affected class of unsecured creditors).[7] In addition, to protect affected parties, the moratorium could be designed to terminate if the debtor seeks to effect transactions (e.g., terminates its business or engages in substantial asset transfers) outside the ordinary course of business or seeks, outside of an approved restructuring, to afford preferential treatment to a subset of creditors.

Solicitation of Acceptances

After proposal of a restructuring and informal negotiations with representatives of affected creditors and shareholders[8], the company would solicit acceptances of the negotiated restructuring proposal from affected creditors and equity security holders in accordance with otherwise applicable law.

Requisite Vote

The Model Statute would require that claims and interests be appropriately classified for voting purposes, and would establish requisite majorities in amount and number of claims of each class for approval of the restructuring.

It may be appropriate to require a substantial supermajority vote of each affected class (for example, 75% in number and face amount of those voting in each class) for approval of a restructuring.

Independent Determination of Adequacy of Restructuring Under International Criteria

Because the dissenting minority of creditors in each class would be bound by a restructuring under the Model Statute, it should be required that an independent determination be made regarding the adequacy of the restructuring to the dissenting minority of creditors applying appropriate international restructuring criteria. **Under the Model**

[7] A further extension of the moratorium might be permitted (with the written consent of a specified percentage of creditors in affected classes) to allow completion of the solicitation of votes for a restructuring.

[8] It is typical in out-of-court restructurings for large claim holders to form informal negotiating committees. In order to facilitate the formation of such committees, the debtor company will often offer to pay their expenses. Although the Model Statute need not refer to such committees, they can be expected to form as part of the restructuring process.

Statute, such criteria would be established and effectiveness of a restructuring would be conditioned upon a determination of adequacy by an independent expert, subject to final approval by an appropriate court.

An independent expert meeting explicit eligibility criteria would be identified.[9] The expert, who would be compensated by the debtor company, would review the restructuring proposal, make findings regarding whether the international restructuring criteria had been met, and issue a report containing such findings. The proposal, together with the expert's report, would then be submitted for approval by an appropriate local court.

Notice and Criteria for Approval

The Model Statute would require publication or other appropriate notice to affected parties of completion of solicitation procedures and submission of the restructuring for review by the independent expert and final court approval. The Model Statute would contemplate expedited procedures for submissions to the independent expert in support of and in opposition to the restructuring. Copies of these submissions would be filed with the Court. Presumably there would be a deadline for submissions (e.g., 20 days after publication of notice) and perhaps even a deadline for a qualifying report (e.g., 30 days after completion of submissions to the independent fact finder).[10]

Upon completion of the independent expert's report, proceedings would be commenced in an appropriate local court (the "Court") to obtain approval of the restructuring. In order to approve a restructuring over the vote of dissenting creditors in each affected class, the Model Statute would require that the Court make certain findings of fact and law to establish the adequacy of the restructuring under appropriate international restructuring criteria, based upon the recommendations contained in the expert's report. For example, the international restructuring criteria might require the Court to conclude that:

(i) the company is eligible to implement a restructuring under the Model Statute;

(ii) the restructuring was proposed, negotiated and solicited in good faith;

(iii) disclosure to each affected class was adequate;[11]

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[9] Appropriate criteria and procedures for selecting a qualified independent expert would have to be included in the Model Statute.

[10] This period will have to be relatively short, as the Model Statute will presumably require the moratorium to continue while the independent expert is in the process of reviewing the submissions and the Court is making its final determination.

[11] Such disclosure would presumably be required to include a valuation of the distributions to affected parties in connection with the restructuring and a comparison of such amounts to the value that would be realized by claimants in the affected classes if the debtor were liquidated.

(iv) creditors and shareholders in affected classes were properly classified, and the requisite supermajorities of each affected class of creditors have agreed to the restructuring;

(v) claims in affected classes having the same status and priority are receiving comparable treatment in connection with the restructuring (except to the extent they have expressly agreed otherwise);

(vi) each non-assenting creditor in an affected class will receive in the restructuring property having a value at least equal to what it would receive if the Company were liquidated in plenary insolvency proceedings under local law;

(vii) after effectuating the restructuring, the company is likely to meet its obligations when due; and

(viii) in the event any class of affected equity holders fails to accept the plan, the aggregate indebtedness of the company exceeds the (debt free) value of its business as a going concern (i.e., the enterprise is insolvent).

The Court would be required to adopt the findings in the independent expert's report absent manifest error.

Declaration of Effectiveness

Upon approval of a restructuring by the Court and satisfaction of all conditions to effectiveness of the restructuring, notice to affected creditors would be published in accordance with procedures prescribed under the Model Statute, whereupon the Court would issue a "Declaration of Effectiveness," declaring the restructuring effective.

Under the Model Statute, the Declaration of Effectiveness would be given the effect of a binding judicial decree.

Discharge and Enforceability

The Declaration of Effectiveness would discharge any indebtedness extinguished under the terms of the restructuring, and local courts would be bound to enforce the restructuring in accordance with its terms.

Alternatives to Judicial Approval

The objective of the Model Statute is to permit the voluntary restructuring of claims in a cost effective and expeditious manner. Some states' judicial systems may afford the type of cost effective expedited review of restructuring proposals required under the Model Statute. In many states, however, it may be desirable to avoid the more cumbersome judicial process to enhance the potential for successful rescue, to preserve value, to prevent the loss

of employment and production, and to lessen the systemic impact of failing enterprises. Accordingly, options should be considered, drawing upon already established practice, to validate restructurings utilizing non-judicial private ordering methods. In considering such alternatives reference can be made to existing structures. Such alternative procedures should be considered because approval procedures that foster expeditious and equitable voluntary out-of-court restructurings are critical to upgrading country risk factors and lessening systemic financial risk, as well as to facilitating both investment and the restructuring of invested capital when that is required.[12]

Necessary Adjustments to Local Law

Local laws, if any, requiring unanimous agreement to adjust indebtedness outside of insolvency would have to be modified so that adjustments of indebtedness in restructurings approved in accordance with the proposed Model Statute would be permitted.

If local law causes directors or officers of a local business enterprise to be liable for trading while insolvent, it may also be appropriate to modify local law to provide for some form of relief, after appropriate disclosure, to allow ongoing trading while bona fide efforts to restructure under the Model Statute are under way.

International Recognition

In order to enhance the likelihood that the restructurings under a home country's Model Statute will be honored by courts both at home and abroad, commercial parties could

[12] A common dispute resolution mechanism included in modern bilateral and multilateral investment treaties and other related multilateral documents is binding international commercial arbitration. Such a system would need to be adjusted to accommodate decisions on a rapid basis and to provide dissenting claimants with an appropriate opportunity to be heard. Another possibility would be the establishment, with the imprimatur of recognized governmental or private sector international bodies, of pre-qualified panels of experts knowledgeable in the appropriate economic, industry and insolvency matters, and with appropriate knowledge of regional circumstances. For example, a large majority of countries (including many current members of UNCITRAL) are party to existing international arbitration award treaty systems, such as the New York and Panama Conventions, which provide for enforcement of international commercial arbitration awards, and the International Center for the Settlement of Investment Disputes (ICSID) arbitration system, which allows investors and other designated parties to resolve issues within states that are members of the ICSID treaty system. Reference might also be made to the UNCITRAL arbitration rules or other appropriate international arbitration rules for evaluation of private ordering plans on an ad hoc arbitration basis.

be encouraged to adopt a practice of expressly incorporating the applicability of the Model Statute into the terms of companies' debt obligations. The Model Statute could also provide that the right to restructure indebtedness after insolvency under the Model Statute is an implied term of each obligation incurred by a local debtor unless expressly disclaimed.

To the extent issues arise relating to the binding effect or enforceability of a restructuring under the Model Statute in courts of another jurisdiction, such issues should be addressed consistent with the notions of coordination, cooperation and recognition embodied in UNCITRAL's Model Law on Cross-Border Insolvency. To facilitate this, it may be desirable to provide in the Model Statute for a procedure whereby a debtor restructured under the Model Statute can obtain the appointment of a foreign representative who could be recognized in other countries for purposes of seeking enforcement of the terms of the restructuring.

Finally, the proposed Model Statute would also contain provisions granting recognition in local courts to restructurings of foreign debtors accomplished under the Model Statute as enacted in other countries.