Meeting Paper 7-C

Proposal to Formulate Cross-Border Informal Workout Rules

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PURPOSE
For consideration

ISSUE
Proposal to formulate Cross-border Informal Workout Rules for the Reorganization of troubled private multinational borrowers of multinational creditors in the Asia Pacific Region

BACKGROUND
Recently, the number of multi-national companies and their groups who owe debts to multi-national financial creditors are growing dramatically. It looks almost impossible to enact uniform insolvency and reorganization laws that could be applicable all over the world. However, global informal workout rules approved by the global financial communities may be useful even if uniformed statutes are not possible.

An informal workout is a useful tool to restructure ailing business companies with excessive debts at early stage and reorganize the debtor companies. Advantages of informal workout (as opposed to a formal court process) include cost savings, simplicity, certainty, efficiency, confidentiality, and flexibility, among others.
PROPOSAL

It is proposed to undertake work in 2013 to update and promote existing guidelines and model agreement for cross-border workout in the region, such as the ones proposed by ABAC and adopted by a regional financial industry association in 2005. The attached paper is a draft that will be discussed in consultation with industry bodies and finalized at the proposed workshop to be organized by the Advisory Group on July 9 in Kyoto, Japan.

DECISION POINT

Endorse the proposal to undertake work in 2013 on the issue.
Proposal to formulate “Cross-border Informal Workout Rules” to Reorganize Multi-national Enterprises owe to Multi-national Financial Creditors Applicable in Asia Pacific Region

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1 Existing Informal Workout Rules in Asia

“The Final Report on Promoting Regional Cooperation in the Development of Insolvency Law Reform” (Report) was presented to the Asian Development Bank in April 2005. The Report was written by a team consisted of lawyers and accountants of Blake Dawson Waldron and PricewaterhouseCoopers and co-chaired by Messrs. Ron Harmer and Richard Fisher. The “Asian Banker’s Association Informal Workout Guidelines” (GL) and the “Model Agreement to Promote Company Restructuring by Informal Workout” (MA), both of which were based on parts of the Report, were approved by the Asian Bankers’ Association (ABA) at its 22nd General Meeting held on October 2005 in Melbourne. The GA and MA are innovative, inspiring and valuable, but they have never been utilized because of several possible reasons including conflict of interests and others. Reviewing these possible reasons, it may be possible to revive the GA and the MA by correcting their defects with some amendments which may improve their usefulness and meet the needs of changing global financial and business environment. The MA is expected to be adopted for use regionally and the ABA may be agreeable to formulate Asia Pacific Regional Rules adopting the GL with some amendments.

2 Expected Global Informal Workout Rules

Recently, the number of multi-national companies and their groups who owe debts to multi-national financial creditors are growing dramatically. It looks almost impossible to enact uniform insolvency and reorganization laws that could be applicable all over the world. However, global informal workout rules approved by the global financial communities may be useful even if uniformed statutes are not possible.

Many Asian countries including Malaysia, Thailand, Indonesia, Philippines, Singapore, Hong Kong and Republic of Korea (Korea) are familiar with the informal out of court workout schemes that were used to overcome their financial difficulties following the Asian Currency Crises of late nineties. These Asian countries conducted workout through asset
management companies, which are created with a sunset clause, to purchase non- and poorly-performing loans from financial institutions. China also conducted informal workout known as Changchun approach to resolve regional financial difficulties. However, after the crisis is over, informal workout cases may have been decreasing in Asian countries except in Korea, Hong Kong and Japan.

An informal workout is a useful tool to restructure ailing business companies with excessive debts at early stage and reorganize the debtor companies. Advantages of informal workout (as opposed to a formal court process) listed in the Introduction of the GL are cost savings, simplicity, certainty, efficiency, confidentiality, and flexibility, etc.

The ABA GL and the MA are buried treasure-tools for the cross boarder workout. Let us reactivate informal workout to vitalize Asia Pacific regional economy further.

3 Possible Reasons why the existing GL and MA have not been used

Banks are usually reluctant to reduce their own loan assets. It is difficult to expect financial creditors themselves to reduce their loan assets by means of haircuts, debts equity swaps and other means of informal workouts since they have to maintain their loan assets as much as they can and they are subject to conflict of interests.

The ABA GL and the MA were disseminated only to member banks of the ABA upon its approval in 2005 and the text of the GL and MA were publicized in its periodical journal at that time. However, a few further activities have been made to promote the workout using the GL and the MA by the ABA mainly for financial institutions in some Asian countries.

Insolvency practitioners, including lawyers, accountants, consultants and investment bankers who would like to conduct informal workout using the GL and the MA, had little knowledge of the GL and the MA. Even I myself, one of the most experienced insolvency experts in Japan, came to know the existence of the ABA Guideline in last year.

4 Proposed Amendments to the GL and the MA.

Proposed amendments to the GL and the MA are only two points.

(1) Financial Creditors, who are interested parties of informal workout, may include various types of creditors such as financial institutions and banks, etc. A technical term of “Financial Institution Creditor” should be replaced by “Financial Creditor” to make the point clearer that not only financial institutions but also any type of financial creditor is able to join and participate in the informal workout under the ABA GL and
the Rules.

(2) According to the ABA GL and the MA, only a financial institutional creditor with large exposure is able to commence an informal workout process. A “Debtor Company” itself should be qualified as an applicant of the workout under the ABA GL and the MA in addition to the “Eligible Financial (Institution) Creditor” with large exposure to the Debtor Company to avoid possible conflict of interests of financial creditors.

5 Recommendations to APEC regarding formulation of informal workout rule applicable in Asia Pacific Region

The APEC should formulate the Asia Pacific regional rules (APEC Rules) adopting “Asian Banker’s Association Informal Workout Guidelines” & “Model Agreement to Promote Company Restructuring by Informal Workout” with some minor amendments mentioned above. Then,

(1) Ministries of finance, relevant governmental agencies, central banks, bankers’ associations and industrial communities of each country in APEC regions should recommend and encourage financial creditors, business corporations and relevant professionals to use the formulated APEC Rules in each home country. Professionals may include lawyers, accountants, consultants, and investment bankers, etc.

(2) The APEC should also recommend governments of member countries to enact a special statute to encourage informal workout (ex: automatic standstill with some requirements) (to be described in the next paragraph 6).

6 Possible difficulty to enter into a Standstill Agreement drafted referring the MA

Some provisions (ex: standstill, majority rule and etc.) included in the MA might not be agreed easily by some Financial Creditors. In that case some provisions of the MA could be modified or excluded.

But before commencement of an informal workout process, Financial Creditors should execute the Agreement which may be drafted referring to the MA to initiate a standstill period. During that period, Financial Creditors have to sit at the same table refraining from taking any individual collection effort of their Claims and negotiate on a possible draft Workout Agreement each other and with the Debtor Company. An Eligible Financial Creditor and/or Debtor Company, which try to apply for informal workout process, may
not be easily able to obtain consents of Financial Creditors on standstill provisions included in the Agreement drafted referring to the MA. In the workouts conducted in Asian countries immediately after the Currency Crisis, the consents for standstill or ring-fence by Financial Creditors might be induced by the government authorities in some countries to some extent. A Japanese special statute provides for the Business Reorganization ADR (alternative dispute resolution, BRADR) proceeding, which is the out of court workout operated by a certain organization licensed by Minister of Justice and Minister of Economy, Industry and Trade. The BRADR must be conducted by fair and neutral experts who are registered in a list of the licensed organization. At the commencement of the BRADR, a provisional initial standstill starts automatically under the condition that no relevant creditor objects as well as a resolution to extend the standstill period will be made at the first meeting of creditors which will be held within a week. In Korea, a statutory out of court proceeding is provided in Corporate Reorganization Promotion Act. In contrast, it is not unusual to enter into a forbearance agreement among financial creditors and a debtor company before starting pre-filing negotiation of Chapter 11 in the United States. Moreover, in many cases, reorganization plans are accepted by most of financial creditors without filing for Chapter 11. In England, Australia, Canada and some other common law countries, similar practices may be conducted. Government authorities in APEC region may be advised to enact supporting statutes for informal workout in each country. Without such kind of statutes, we can learn from reasonable practices that exist in the United States and some other common law countries.

7 Overcoming some weakness of Informal Workout

The clause 9.3 of the MA provides that at the meeting of Financial Creditors a Workout Agreement is adopted by a majority representing at least 75% of all Financial Creditors of the Debtor Company with at least 90% of the Claims of all Financial Creditors of the Debtor Company and it will bind the Financial Creditors of the Debtor Company once it has been executed by the Debtor company. But the majority rule of the clause 9.3 of the MA may be excluded in some cases intentionally. In that situation, unanimous consent of Financial Creditors to the Workout Agreement is required for the proposed Workout Agreement is accepted. When the proposed Workout Agreement was not adopted at the meeting of Financial Creditors by the majority rule or the Workout Agreement is rejected because of unanimous
consent of Financial Creditors is not obtained, the Debtor Company should file a statutory reorganization with the court of the jurisdiction where a center of main interests (COMI) is located converting the case to a statutory reorganization procedure. The reorganization plan, whose substance is similar to the proposed but not adopted Workout Agreement, may be accepted in the reorganization proceeding by a more generous majority rule under typical reorganization laws within a reasonable timeframe. Thus, the accepted plan would bind holdout creditors who did not agree to the proposed Agreement. Therefore, it may reasonable to expect even stubborn creditors may agree to proposed fair and equitable Agreements, when they come to know these consequences before the conversion of the cases to statutory proceedings.

The UNCITRAL Model Law for Cross Boarder Insolvency provides that insolvency proceedings commenced in the county where the COMI is located are effective in foreign countries. Australia, Canada, Japan, Mexico, New Zealand, Korea and the U.S.A, which are APEC countries, have adopted the UNCITRAL Model law and it is expected that some other countries may adopt the model law in the near future.

Attachment (omitted)

1 Proposed Amendments to the “Asian Bankers’ Association Informal Workout Guidelines” (with change history).
2 Proposed Amendments to the “Model Agreement to Promote Company Restructuring by Informal Workout” (with change history).
3 Proposed Amendments to Diagram (with change history).