Developing Extraordinary Restructuring Solutions in Response to the Global Financial Crisis: An Overview of a Project of the International Insolvency Institute

Steven T. Kargman[*]

Foreword

In the wake of the global financial crisis, it was critical for governments to infuse huge amounts of capital into the financial system and directly to financial institutions to prevent a global meltdown, but unless similar attention is devoted to the real economy, a recovery is unlikely, and a new surge in bad loans could cause a second capital crisis for financial institutions. Extraordinary measures for the real economy are as necessary as extraordinary measures for the financial system. It is unlikely that an exit from the current extraordinary support for the financial system will be successful unless industrial capacity is adjusted to the decreased and rapidly changing demand for goods and services.

> The International Insolvency Institute decided to tap the talent of the restructuring experts from throughout the world to offer suggestions on what extraordinary actions may be available to address the real economy, and that is the genesis of the III Committee on Extraordinary Restructuring Solutions and the project it has undertaken, which is described in detail in the following pages.

—Richard Gitlin (Chair, III Committee on Extraordinary Restructuring Solutions)

In response to the global finance crisis, the International

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Insolvency Institute (the III) in Spring 2009 constituted a special high-level committee, the Committee on Extraordinary Restructuring Solutions, whose mandate is to develop recommendations for addressing issues of financial distress arising in the real economies of nations. As the Committee's name suggests, the focus is on developing "extraordinary restructuring solutions," namely, innovative solutions that go beyond the conventional restructuring approaches—represented by in-court and out-of-court restructurings—to address the unique challenges posed by the global financial crisis.

The Committee was the inspiration of III Board member Richard A. Gitlin, who now serves as Committee chair, and is comprised of distinguished insolvency professionals from Asia, Europe, Latin America, and North America, including individuals from both developed economies and emerging markets.[1] The Committee is in the process of reviewing innovative approaches that so far have been embraced by national governments as a means of restructuring troubled companies and industries in the real economy. Furthermore, based on proposals and recommendations from Committee members (several of which are attached as appendices to this article and briefly discussed below), the Committee also plans to recommend additional extraordinary restructuring approaches for consideration by governments. In this article, we will briefly review some of the issues that the Committee has been considering, but this review of issues is not meant to be exhaustive nor represent a definitive or official statement of the Committee's views.

A fundamental premise of the Committee's approach has been that conventional restructuring and insolvency approaches may prove to be inadequate in addressing the impact of the global financial crisis on the real economies of nations. The global financial and economic crisis has made it much more difficult to achieve successful restructurings and reorganizations in the real economy. Specifically, the lack of liquidity hampers the ability of parties to finance restructurings and reorganizations. Furthermore, depending on the particular national economies at issue, depressed global economic activity and the lack of liquidity and timely restructurings could potentially lead to widespread corporate distress or the existence of overcapacity in certain economic sectors.

Such corporate distress or failure may have the potential,

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particularly in less-advanced economies with less well-developed insolvency systems, to overwhelm existing restructuring/insolvency institutions and processes. Economic distress may be particularly acute in certain emerging markets that do not have well-developed restructuring institutions and supporting legal frameworks. Certain regions affected by the crisis (e.g., Central and Eastern Europe) may not have recent experience dealing with restructurings in response to financial and economic crises. Moreover, there may be a serious dearth of local restructuring and turnaround expertise and experience in certain affected economies.

Fundamentally, the Committee believes that it is critically important that governments address these restructuring issues related to the real economy, particularly as much of the initial efforts by governments since the onset of the crisis have focused on repairing financial systems. The Committee also believes that if these issues in the real economy are not addressed properly and in a timely manner, there could be further serious stress placed on the global financial system.

Despite whatever improvements have taken place in the global financial system since governments began to address the serious breakdown in the financial system in fall 2008, there still remains the possibility of knock-on effects to the financial system from widespread financial distress or overcapacity in the real economy. For example, it has been widely reported in the financial press that banks in Western Europe may face further financial difficulties arising from their significant exposures in Central and Eastern Europe, especially in light of the level of financial distress and nonperforming loans that exist now or may ultimately develop in Central and Eastern Europe. Therefore, even though there may be some glimmers of improvement in the state of the global financial system and the global economy, there could nonetheless be a new round of serious pressures placed on the financial system if financial distress in the real economy is not adequately addressed.

Unfortunately, there is a tendency on the part of both banks and borrowers to delay addressing these realities. Both lenders and borrowers facing unsustainable debt burdens within affected economies do not necessarily have a clear incentive to address these issues in a timely manner. Instead, they may prefer to "wait out" the crisis in the hopes of rising asset prices and recovering demand. Yet, despite such a reaction from individual lenders and borrowers, it may not be desirable from a macroeconomic standpoint for national economies not to address these issues in a timely manner.

Thus government action in individual countries may be necessary to address this market failure and jump-start restructuring processes in their respective economies. The Committee has advocated the need for "extraordinary restructuring solutions" to fill the gap. This involves bringing to bear a broad array of restructuring resources, such as necessary financial resources and restructuring expertise, in a coordinated, timely, and efficient manner. It also involves supplementing existing restructuring processes and institutions or instituting such processes where they are not already present. Furthermore, it entails dealing in an expeditious manner with the possibility of widespread corporate distress or excess capacity in certain economic sectors where there is a misalignment of supply and demand.

The Committee has identified four core elements that could underlie a program consisting of extraordinary restructuring solutions. First, governments might consider creating some type of quasi-governmental institutional framework for coordinating restructuring expertise, restructuring capital, and expedited restructuring procedures. The Committee recognizes potential pitfalls that must be avoided, namely government bureaucracy and the potential for corruption, which may be salient concerns in some of the countries affected by the global financial crisis.

Second, governments, acting on their own or in cooperation with international organizations, might assist in providing a solution for the critical need for interim or bridge financing for restructuring solutions. This could entail developing a mechanism for providing such financing on a broad basis to deal with potential economy-wide or sector-wide situations of financial distress or overcapacity. Such government financing may be necessary because private sector lenders by themselves may not be in a position to provide financing on the scale that is required. At the same time, governments will need to take into account the role that the private sector can play in providing the necessary interim or bridge financing.

Third, governments might prepare themselves to apply professional restructuring and turnaround expertise on a large scale to the extent necessary. Drawing on expertise in the private sector, governments could be prepared to deploy experienced professionals, whether such professionals are domestic or foreign, who possess the necessary expertise to handle restructuring situations, especially restructurings arising in the context of a financial or economic crisis. However, governments need to recognize that, in certain circumstances, there could be gaps in local restructuring and turnaround expertise, and there may therefore be a need to bring in foreign experts to fill in whatever gaps exist in local expertise and experience.

Fourth, governments may wish to emphasize the critical importance of having distressed borrowers utilize expedited restructuring procedures. This may involve utilizing prepackaged reorganizations or expedited out-of-court restructurings, and in certain cases, new laws or amendments to existing laws may need to be put in place to achieve these goals. This focus on expedited restructuring procedures recognizes that normal restructuring and insolvency procedures may not move quickly enough to address situations of widespread financial distress or overcapacity in certain economic sectors.

Overall, governments must focus on addressing two overriding objectives. In the first place, they need to ensure that viable companies and industries are fixed—i.e., facilitate restructurings and reorganizations. Second, they also need to ensure that the assets of nonviable companies and industries are recycled—i.e., facilitate liquidations where appropriate.

Governments could further these objectives by taking a number of steps. They could assist in providing critical interim or bridge financing, they could help expedite restructuring of viable companies and industries, and they could help expedite liquidation of nonviable companies and industries (i.e., recycle assets). Moreover, they could condition capital solutions for their banks, such as capital infusions to troubled financial institutions, on the cooperation of banks in facilitating restructuring solutions. Specifically, banks could be encouraged to deal head-on with corporate distress and nonperforming loans among their borrowers rather than trying to postpone the resolution of these problems.

The Committee's current approach is to consider recommending a menu of possible options for governments to consider—i.e., not a "one size fits all" approach. The specific options that the government in a particular country selects may depend on a number of country-specific factors. Such factors might include the following: the capability of government institutions and the experience of such institutions in dealing with restructuring-related issues; the level of confidence of the public in government institutions; and the lack of bureaucracy and corruption in government institutions. Other factors might include the desired balance between the respective roles of government and the private sector; the level of development and the efficacy of restructuring laws and procedures; and the experience in the society, its courts, and among its insolvency and restructuring professionals in restructuring viable companies.

In deciding upon possible alternative modalities for providing restructuring assistance, governments may wish to address several issues such as the following: Is it necessary to establish a new government entity to serve as a coordinating body for the broad array of restructuring resources or can existing institutions serve this purpose? Who should provide critical interim or bridge financing to address restructuring situations—national governments, multilateral development banks, regional development banks, commercial lenders, private investors, or some combination of these parties?

How can governments catalyze action by lenders to enter into restructuring negotiations with borrowers? Can governments facilitate the restructuring of companies by facilitating the purchase of nonperforming assets whether through so-called asset management companies or through other mechanisms? How can governments develop more effective legal frameworks for facilitating reorganization of viable enterprises, especially with respect to encouraging expedited restructurings?

As noted above, the Committee is currently in the process of considering the merits of innovative restructuring approaches being taken by various governments around the world in the current crisis. The Committee is also considering whether there have been constructive approaches that were adopted by governments and other key stakeholders in previous financial and economic crises that may be applicable or useful in addressing the current crisis.

In addition, several Committee members have developed new proposals to address the impact of the financial crisis on the real economy. Three of these proposals offered by Committee members are attached as appendices to this article. Dr. Shinjiro Takagi has put forth a proposal to establish a new quasi-governmental vehicle based on the model of the Industrial Revitalization Corporation of Japan that was established by the Japanese government in 2003. Stephen Gray[2] and his colleague Marko Mitrovic[3] have put forth a proposal to establish a regional "restructuring finance agency" to deal with the problems arising in Central and Eastern Europe. Dr. Luis Manuel C. Mejan[4] and two of his colleagues, Emilio Sánchez Santiago and Dioniso Ramos, have offered a proposal for Mexico that calls for the creation of a new restructuring body to encourage out-of-court restructurings, with fresh capital for restructurings to be provided by a multisourced fund.

In the coming months, the Committee will continue to work through the issues discussed in this article with the goal of developing a final set of recommendations. Whatever the specific details and contours of any final recommendations that the Committee develops, the Committee will strive to develop recommendations that have practical value for governments and

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provide governments with useful restructuring options for addressing financial distress in the real economy in a timely and effective manner.

Appendix 1. A Restructuring Concept for Central and Eastern Europe

By Stephen Gray and Marko Mitrovic

May 2009

The Region

Although Central and Eastern Europe (CEE) is still viewed as a single region, substantial differences exist among its subregions, including European Union (EU) members, Central European non-EU members and the CIS countries.

Ten Central European countries have achieved EU membership status, with four of them (Poland, Czech Republic, Slovakia, and Slovenia) characterized as having established broad-based economies and more highly evolved legal systems. While the financial crisis has affected these countries as well, its impact is expected to be less. The Baltic States (Lithuania, Latvia, and Estonia) and Hungary, however, are countries with smaller production base, significant over-leverage and/or lack of reform implementation (e.g. tax, pension, legal etc.) Finally, the most recent EU members (Romania and Bulgaria) are considerably less developed economically, politically and legally. Second subregion consists of the former Yugoslavia (excluding Slovenia) and Albania. While there are differences within this group as well, these are all still structurally weak economies at a fairly low stage of development.

The sub-region with the largest geography and population, the CIS countries, include commodity-based economies like Russia and Kazakhstan, undeveloped and/or dysfunctional countries like Ukraine or Moldova, and politically unacceptable countries like Belarus or Turkmenistan.

The one common theme throughout the CEE region is that restructuring (operational and financial) is typically avoided. Given the relatively recent emergence of most of the countries in the region from socialism, the region has not matured to the point where governmental actions have been effective in dealing with enterprise level distress. Political purposes, cronyism, and outright corruption have typically prevented meaningful restructuring and will hinder the recovery from the current crisis.

Specifics of the Crisis in the Region

The global financial and economic crisis has affected the region severely as the countries saw huge declines in external demand. For many Central European countries, export represents over 70% of GDP, while in CIS, the decline in commodity prices has had an additional negative impact on several countries' GDPs and finances. Moreover, credit in the region, especially Central and Southeast Europe, has been dominated by Western European banks (Austrian, German, Italian, and Scandinavian), and a large percentage of both corporate and consumer debt is denominated in Euros or other foreign currencies. The collapse of local currencies combined with a decline in asset values, especially regional stock markets and real estate, has resulted in lower earnings to service foreign debt, further exacerbating the crisis. As foreign banks moved to protect domestic balance sheets and repatriate capital, a liquidity freeze has resulted in the region. Virtually all foreign direct investment (FDI) has come to a halt. This has left enterprises throughout the CEE region stranded with a mountain of debt, no liquidity, and unfunded operating losses.

Governmental Reaction to Date

Most regional governments have had few monetary or fiscal tools to try to reinvigorate their economies, and there have been more urgent issues that they have had to confront. Several local currencies were on the verge of a meltdown, including those in Russia, Hungary, and the Baltic states. The Russian Central Bank spent a third of its foreign currency reserves stabilizing the ruble. The Hungarian Central Bank was forced initially to increase interest rates to prevent massive outflow. Second, as lending ceased and rumors spread that Western banks could be pulling out of the region, preventing a run on the banks also became a priority. All regional governments at least doubled the amounts guaranteed by the state. Several countries, including the Baltic States, Hungary, Ukraine, Serbia, and Romania have received funds from IMF, EU, and/or the European Investment Bank. Funding to-date has been primarily focused on easing the liquidity crisis

What Is Needed

As a result, the corporate sector is clearly struggling, and enterprise level governmental assistance has taken a back seat to the resolution of the monetary and banking crisis. There is ample evidence that even many good companies in the region are experiencing difficulties in extending financing and rolling over lines of credit and are becoming illiquid. The most pressing need is for additional capital and the restructuring expertise to deploy it productively. Excluding fairly short-term problems in the late 1990s, the region has not experienced an economic crisis since the collapse of socialism, and the region has been growing annually at 5% to 10% for the past decade. As a consequence, the restructuring expertise is still quite underdeveloped. There are few local turnaround firms, and bank workout departments are substantially understaffed, inexperienced, or nonexistent.

While most countries in the region have passed fairly good bankruptcy legislation, often modeled on the U.S. Bankruptcy Code, its application has been very limited. Substantial effort is needed to develop the infrastructure to implement existing bankruptcy, collateral, creditors' rights, and other related laws that currently exist but are rarely used.

Proposal for the CEE Region

The issues above are interlinked and thus should be dealt with in a comprehensive manner. We propose that a pool of restructuring capital be created, with the funds initially coming from multinationals such as EBRD, IFC, IMF, the World Bank, and the European Investment Bank. To the degree possible, the funds could be matched by local governments. As the program becomes established, commercial investors could participate through the sale of credit-enhanced offerings. This capital would be deployed through a newly created Regional Restructuring Finance Agency. The Restructuring Agency would have the dual role of providing credit and deploying restructuring expertise. Local capacity building and ROI strategy and criteria development are also important objectives to create a successful and lasting impact. Given subregional differences (discussed above), the strategies should be adapted to at least three subregions: the EU members, non-EU CE countries, and the CIS.

The capital would be invested in three types of situations. First, working capital for otherwise good companies would function as a bridge until the liquidity environment is normalized. Second, it would be invested as restructuring capital contingent on fund-approved turnaround plans. Finally, the capital could be used to rationalize "bubble" debt and equity investments primarily made between 2005 and 2007. New capital would be invested as debt, possibly ahead of existing senior positions. Investment would be based on meaningful operational and financial restructuring strategies, and returns would be enhanced with PIK interest or warrants to compensate for risk. The program would be voluntary and focused on small-and medium-sized enterprises (SMEs). Large corporations would be eligible as well, provided that they are independent from political interests and can be competitive if properly restructured. Key criteria would be that the companies have a viable core business, modern management, and an ability to increase internal demand in local markets.

An alternative "entry" mode could be through nonperforming loans (NPL). By purchasing NPLs, the Restructuring Agency would provide liquidity to local and foreign banks and bring restructuring discipline and expertise to deal more effectively with debtor companies. With the Restructuring Agency in control of the debt, it can restructure for its own account.

Appendix 2. Restructuring and Funding Mechanism Proposal (A Proposal to Create a Deliberate Response to the Mexican Economic Crisis)

By Dr. Luis Manuel C. Mejan

August 2, 2009

Mexico City

The purpose of this proposal is to offer an "ad-hoc" response to the devastating effects the economic crisis has had on the Mexican economy since 2008 and to address the overwhelming concern it has instilled in the nation's organized industrial sector.

Mexico has undergone various economic crises in which the country's secondary sector, in particular the industrial sector, has faced a highly leveraged position and consequently, a high "debt-service level." Prime examples of these crises include the devaluations of the Mexican peso under President Luis Echeverria in 1976, President Miguel de la Madrid in 1985, and President Ernesto Zedillo in 1995 (also known as "December's mistake").

During these particular instances, the Mexican government employed different tools and tactics in its efforts to diminish the pernicious effects caused by these recessions, marked by long bouts of unemployment and nationwide impoverishment. What characterized these efforts was the government's focus on holding unemployment at bay and on the containment of the industrial infrastructure's erosion. The government also took diverse macroeconomic measures, such as i) stimulating public spending; ii) providing credit support; iii) providing fiscal stimulus; and iv) relaxing monetary and lending policies.

Besides the above-mentioned tools, the federal government has resorted to extraordinary mechanisms created ad-hoc in order to solve specific aspects of the crisis. Among those mechanisms the following can be considered outstanding: (i) the FICORCA program; (ii) the FOBAPROA program; (iii) the financial support programs to debtors (ADE and Punto Final (Final Period)); and (iv) the program called UCABE (Coordination Unit of the Banking-Entrepreneurial Deal).

i) FICORCA was a program designed to eliminate the foreign exchange risk that assailed the business sector from 1982–1985. A great gamut of companies within the business sector participated in this program, making it a great success.

ii) FOBABROA originated from a small financial trust, which was managed by the Central Bank of Mexico (Banco de Mexico) that aimed at protecting bank deposits. However, as a consequence of the economic crisis (1995's "December's mistake"), the banking authorities decided to utilize the fund to purchase delinquent loans and other assets that formed part of the national banking system. Eventually, FOBAPROA became the legal vehicle through which Mexico's banking rescue efforts took place.

iii) ADE and Punto Final were tools specially addressed to natural-person debtors in the mortgage and credit card areas; however, such programs also included chapters addressed to some enterprises.

iv) UCABE was the result of a collaborative effort between the Business Council (Consejo Coordinador Empresarial) and the federal government. This took shape in the form of a body headed by Eduardo Bours. This entity was made responsible for restructuring debt for a select group of Mexican companies (27 in total) on an extrajudicial level in conjunction with the banking sector.

A repetitive problem that has arisen throughout these kinds of crises is the industrial sector's difficulty in paying off banking or commercial paper debts. Consequently, many industrial companies find themselves facing a substantially high insolvency risk.

Under normal conditions, Mexican businesses use different ways to cope with these situations: i) they withhold profits and utilize them to reduce their debt; ii) they issue new shares in exchange for fresh capital; and iii) they refinance their debt through new bank loans or through new shares sold to the investment community through the Mexican Stock Exchange.

However, presently, none of these tools have been effective in allowing Mexican businesses to reduce their debt. The reasons for this are clear: i) companies are suffering large financial losses or are generating insufficient profits, making it impossible for them to reduce their debt at the necessary speed; ii) the Mexican Stock Exchange is currently unable to raise enough new capital in the large quantities needed; iii) national and foreign investors are more risk-averse and are showing a marked preference for government bonds; and finally iv) the world of banking at large is facing the same crisis, which has put some of the most recognized American and European banks to the brink of insolvency.

Given these conditions, it is evident that the recession we are undergoing is going to be of considerable length and that the effects that the current situations are having on the economy may worsen unless the Mexican federal government and the business sector take drastic measures and act swiftly in order to deflect these probable outcomes.

When dealing with an economic crisis of this nature, governments have two obvious choices. The first one is to act passively, in hopes that a failing economy recuperates relatively quickly. The second one is to act deliberately to counterattack the most damaging aspects of an economic crisis by creating mechanisms and "ad-hoc" organizations for this purpose.

Developing Extraordinary Restructuring Solutions in Response to the Global Financial Crisis

During the last 30 years or so, the Mexican government has generally responded to financial crises in a deliberate fashion. The current economic dilemma has elicited a somewhat similar response. Our government has increased public spending and resorted to countercyclical policies. According to the Ministry of Finance, it has earmarked more than 817,000 million pesos to this end.

However, in spite of these measures, there is an increasing concern amongst business owners and industrial companies with respect to: (a) their existing bank loans and their publicly-traded debt paper, and (b) their capacity to pay off their debts. Some highly visible and substantial insolvency cases have already presented themselves in which notable publicly held companies have defaulted on payments. There have also been countless instances of corporate insolvency that have been less-publicized.

It is understandable that the Mexican industrial sector is highly concerned by the difficulty that businesses are showing in fulfilling their contractual debt obligations. As long as the recession continues to batter production, and revenue continue to fall, the risk of default that companies now face will keep on rising. The loss of revenue experienced by the industrial sector is exemplified by the decreasing volume of exports. In the first five months of 2009, Mexico registered a 32.8% drop, compared to 2008's exports. Another strong indicator of revenue-loss can be observed through federal tax collections. According to the federal government, it registered a 17.4% loss in real tax revenue (i.e., revenue in constant pesos) during the first five months of this year.

Business owners are also worried about the typical terms of most loan agreements. When it becomes evident to a business that they cannot keep up with their payments as originally stipulated in their loan agreements, they soon find themselves in a weak position to bargain with their creditors, which only compounds the financial crisis and a sense of inequity.

It is necessary to recognize that the Insolvency Procedures Law (enacted in 2000) offers a useful instrument to enterprises affected by liquidity problems that enables them to achieve a restructure through orderly agreements which are carried out by a Conciliator appointed by the Mexican Federal Institute of Insolvency Practitioners (Instituto Federal de Especialistas de Concursos Mercantiles) and approved by the judicial authority. Otherwise, should a certain enterprise has lost its viability, said law is an instrument that helps to maximize, to the extent possible, the enterprise's social value during the bankruptcy stage.

Even though both the Insolvency Procedures Law and the Mexican Federal Institute of Insolvency Practitioners offer solutions, the current financial trouble is so big that it deserves such mechanisms to be strengthened with others of extraordinary nature.

If we examine the terms of typical loan agreements in Mexico, it is clear that debtors are severely penalized and are put at a negotiating disadvantage at the time of default. To begin with, penalty interest rates are applied immediately. These rates tend to be two-to-three times greater than the interest rates that are applied under normal conditions. Secondly, under Mexican law, the violation of the contract on the part of the debtor gives the creditor the right to call the loan and to demand full payment. Thirdly, Mexican law gives creditors the right to execute their guarantees as soon as there is a default. Debtors who find themselves in this precarious position have a weak bargaining position and are often forced to accept new terms and conditions that may be detrimental to them and that can even lead to bankruptcy and the loss of countless jobs.

One should note that, of course, not all creditors resolve things in this manner. They are some sophisticated creditors, experts in the financial restructuring of a company, who pursue agreements that aim to help both parties involved.

Given the scope and depth of the financial crisis that has hit our nation, organized business owners are appealing to the federal government as well as to the banking and investment community to take necessary and sufficient measures to protect employment and the industrial sector.

To achieve this, the organized business sector proposes the creation of an ad-hoc organization that would have as its mission: the extrajudicial voluntary restructuring of debt between companies and banks or between companies and stock market investors. This entity's goal would be to provide timely solutions to the debt problem and to facilitate the restructuring of debt agreements between creditors and debtors. The purpose of this entity would also be to promote the recognition of the new agreements before the judicial system.

The framework for this restructuring body would include: i) a corporate governance comprised of the business sector, the Ministry of Finance, and creditors' representatives; and ii) a staff comprised of experts in financial restructuring whose credentials demonstrate the desired level of expertise. (These experts must not have conflicts of interest with the creditors with whom they will be involved).

This body would serve as a professional, reliable forum for companies who voluntarily wish to engage in the extrajudicial restructuring of their liabilities. We recommend that the entity have a lifespan of no greater than three years.

The Ministry of Finance could also consider granting, through decrees, fiscal and federal income tax incentives for all agreements that result from the use of this forum, such as: a) reduction of tax liabilities, b) not taxing as taxable income the loan write-downs accepted by creditors, and c) not taxing as taxable income the agreed-upon debt-equity swaps.

The Ministry of Finance could also establish a "window of opportunity" for creditors and debtors to join this forum. This means that the aforementioned fiscal and tax incentives would only be available to companies that join the forum by a certain deadline. This time constraint would most likely accelerate the voluntary enlistment of debtors and creditors to this debt-restructuring body. Those who join the forum after the deadline would lose access to those benefits.

This restructuring body's activity would utilize the rules of financial arbitration. All those who join the forum would be subject to these rules. Thus participating in this forum would require voluntary consent. In addition to this, all parties would have to comply with the final decisions resulting from arbitration.

It is important to note that Mexico's past experiences with financial restructuring of this nature have always indicated an unequivocal need for fresh capital as part of the solution. This capital plays a central role in containing unemployment and preserving the industrial infrastructure. History has also shown that in order to restructure debtor's liabilities and capital, a certain amount of fresh capital is needed. As aforementioned, the role that fresh capital holds is indispensable if jobs and businesses are to be saved. Fresh capital can be injected into the restructuring company through an increase of capital, new loans, or the refinancing of pre-existing liabilities. It should be underscored that during the restructuring process, a new "valuation" of the assets would be applied to the company in question. That is to say, that they would be valued with the use of "restructuring currency," as it is referred to in the industry.

In many restructuring cases, the creditors accept a reduction in payments owed while shareholders accept a reduction in the value of their shares, that is to say, a lesser stake in the company as a result of an increase in capital, or a "dilution" of ownership as result of the conversion of debt into stocks. Those wishing to contribute "fresh capital" would be encouraged to do so after: i) writing down the value of debt and pre-existing equity, and ii) having ascertained, to the maximum extent possible, the economic and financial viability of the restructuring plan. In other words, those bringing in fresh capital would not be subject to the prices that were in place before the restructuring began; instead, they would work with "discounted" prices that would result from renegotiations between the creditors and debtors.

To reiterate, in order for this entity to be a successful tool through which jobs and industrial infrastructure may be protected, fresh capital must be brought into the picture. If not, while this may prove to be an interesting forum, it will be insufficient in resolving the financial problems that are affecting so many industrial companies. To bring all the aforementioned ideas to fruition, it will be necessary for the government to create a "fund" that will back the proposed restructuring body.

Fresh capital will be used to: i) provide fresh equity to companies that show a need for it and that can demonstrate they are financially viable; ii) refinance loans or publicly traded debt securities if debtors can demonstrate that they have a legitimate need for refinancing and can prove that they are viable; iii) guarantee the partial or complete payment of debt or the creation of an agreement between debtors and creditors, if it is justifiable; iv) concede new loans to certain companies, if they can show that the loan will permit them to regain their viability and thus enable them to engage in the repayment of their debt.

Under the present circumstances, the only possible, practical, and viable form to bring sufficient fresh capital into the restructuring process at a national level is a deliberate action by the Mexican government. Only the government has today the power to mobilize capital in the amount and timing needed to protect the industrial sector and the millions of jobs that depend from it. The organized industrial sector of Mexico proposes that the Mexican government create a new fully dedicated "Capital Fund" that utilizes both debt and equity capital.

For the proposed changes to take place, it is crucial that a simultaneous effort be made between the restructuring body and the aforementioned fund. A well-coordinated effort will improve the possibility of saving the largest possible number of companies facing insolvency and preserving and protecting the largest possible number of jobs within Mexico.

The following institutions should be considered as possible capital contributors to the "fund":

- i) Banco de Mexico (the Central Bank of Mexico): It could use a fraction of its international reserves.
- ii) Nacional Financiera (Mexico's largest development bank): It could use a fraction of its financial resources to create guarantees for companies that demonstrate that they are viable and that they are in need of such aid.
- iii) State governments: Those interested in protecting companies that are located within their territories could contribute.
- iv) World Bank: It could lend support through the IFC.
- v) U.S. Federal Reserve: It could provide financial resources through a specific line of credit.
- vi) IMF: Funds could be taken from the recent line of credit that it established with Mexico and be assigned to the fund.

vii) Inter-American Development Bank: It could lend support through its International Investment Corporation.

viii) Mexican Federal Government: It could assign a portion of the 2010 national budget.

ix) The National Association of Banks has stated that banks could use some of their liquidity to assist the program.

Contributions made by the IFC, the World Bank, the International Investment Corporation, and the Inter-American Development Bank would be "risk capital" and would not be guaranteed by the Mexican federal government, nor would they augment Mexico's external debt.

In closing, it should be noted that the lifespan of the restructuring body (three years), as well as the Fund (seven years), would be predetermined, following the example of the so-called "sunset provisions" of the U.S. Resolution Trust Corporation.

The assets accumulated by the fund would be sold at market value during the last years of its existence, and the earnings would be given to those responsible for providing the fund with capital.

Once again, the fund that we propose be created is one made up of multilateral mixed capital and is linked to a restructuring body jointly sponsored by the industrial sector and the federal government. It is conceivable that this fund go public through the Mexican stock market within three years of its creation.

Additionally, it is possible to ask for some regulatory facilities, easing some restrictions currently existing from the minister of finance in terms of taxes and requirements to financial institutions' operation.

Appendix 3. Quasi-Governmental Special Purpose Vehicle to Restructure Ailing Business Corporations in Extraordinary Times—Proposal based on Japan's Experiences[5]

By Dr. Shinjiro Takagi[6]

The downturn of real economy might have hit its bottom, but we still have some fear about sinking double-dip recession. Many

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business corporations may have to resolve excess-capacity problems to match reduced consumer demands. Under declining gross-sales conditions, some parts of existing debts owed by many business corporations may become excessive. Without revitalizing these business corporations by means of debt restructuring, another economic crisis may recur.

Insolvency Law Reforms and Expedited Practice in Japan

Significant changes in reorganization occurred in Japan between late 1990s and early 2000s. The Civil Rehabilitation Law was enacted in 1999 to replace the previous Composition Law of 1922. This was followed by series of changes in bankruptcy-related laws, such as (1) the enactment of the new Law for Recognition and Assistance for Foreign Insolvency Proceedings adopting UNCITRAL Model law in 2000; (2) the enactment of the new Corporate Reorganization Law (CRL) in 2002, replacing previous CRL of 1952; (3) the enactment of the new Bankruptcy Law (BL) in 2004, replacing previous BL of 1922; and (4) the enactment of the new Company Law, which includes many new tools to facilitate reorganization of healthy and distressed business corporations in 2005. The new Company Law also revised provisions regarding the Special Liquidation Proceeding. Chapter 4 of the Revised Act on Special Measures for Industrial Revitalization (RASMIR) of 2007 enabled to establish the Business Reorganization ADR mentioned below.

Along with the above legal reforms, the Japanese courts have opened their gates wide to rehabilitation and reorganization cases that are being handled more speedily. The handling of bankruptcy cases has been sped up. In civil rehabilitation cases in Tokyo, a plan will be generally confirmed by the court about six months after the filing of a petition to open the case. In corporate reorganization cases, which are generally larger in size than the civil rehabilitation cases, a plan will be generally confirmed within one year after the commencement of the case.

In the past 10 years, a lot of private equity funds who target distressed companies were created and advisory/consulting/turnaround firms specialized in rehabilitating distressed businesses became widespread in Japan.

2003 and Professor of Chuo University Law School from 2003 to 2006. He received his Doctor of Law (PhD) degree in 2002.

He was the Chair of the Committee for Guidelines of Multi-Creditors Out of Court Workout established by the National Bankers' Association, etc. in 2001, and also the Chairpersons of other two committees organized by Ministry of Economy, Trade and Industry from 2001 to 2003, i.e., the Advisory Committee regarding Law Reformations including Corporate Reorganization Law and the Drafting Committee of Guidelines for early business revitalization. He was the Chair of Industrial Revitalization Corporation of Japan from 2003 to 2007. He has written numerous books and articles regarding Japanese and foreign insolvency and other related matters.

The Industrial Revitalization Corporation of Japan (IRCJ)

The IRCJ was created in May 2003 by the Japanese Government to dispose of nonperforming and poorly performing loans as well as to revitalize ailing companies with excessive debts to overcome a prolonged recession that lasted over 10 years. The IRCJ rescued 41 enterprise groups consisting of nearly 200 companies by March 2005 and dissolved itself in March 2007, one year earlier than was scheduled.

Upon receiving an application made by a company and its main bank holding the biggest exposure to the debtor company, the IRCJ conducted due diligence and developed operational and financial restructuring plans. Then, the IRCJ proposed to buy debts owed to financial institutions or requested to accept the debt restructuring plan by means of partial debts forgiveness and/or debt equity swaps as stipulated by the proposed plan. After the solicitation made by the IRCJ, most financial creditors either sold their debts to the IRCJ or accepted the plan. Outstanding stocks were wiped out or diluted in most cases, and the IRCJ infused new equity into the company. The IRCJ sent hands-on turnaround managers, replacing incumbent managers, to operate the debtors' business.

Within one or two years since the opening of each case, the IRCJ sold the purchased debts and/or equities to new owners by means of M&A. The IRCJ was financed by the government guarantee and successfully closed its business with profit.

Newly Started Business Reorganization Alternative Dispute Resolution (BRADR)

The Guidelines of the Out-of-Court Workout were established in 2001 in Japan referring to the London Approach and INSOL 8 Principles by the Committee, organized by the National Bankers' Association and others for which I served as a chair. More than 40 large corporations were reorganized using the Guidelines. The Business Reorganization ADR was created by Japanese Association of Turnaround Professionals (JATP) last November with the approvals of Minister of Economy, Industry and Trade, and Ministry of Justice based on the aforementioned RASMIR. Turnaround experts, who were appointed in each case by the selection committee of JATP that is chaired by me, preside over the workout using fair rules which are similar to the Guidelines. The BRADR started its business this March and has been handling several big reorganization cases, including public companies. The government-owned organizations may guarantee substantial part of debts owed by a debtor during the workout process as DIP financing. In cases where unanimous consent could not be reached, the debtor may file a court-administered mediation proceeding, and the Court may issue an order recommending that the holdout creditors accept the proposed plan with possible amendments. If the creditors do not object to the order within two weeks, the order becomes effective to bind the relevant parties. If the creditors object to the order, the debtor should convert the case to a statutory reorganization proceeding in which the proposed plan may be treated as a prenegotiated plan.

Creation of Enterprises Turnaround Initiative Corporation of Japan (ETICJ)

The bill to establish a new quasi-governmental corporation to assist revitalization of ailing companies became a law on June 19, 2009, and the new corporation started its business on October 16, 2009. The new law is similar to the IRCJ law with minor amendments. The main targeted companies are mid-sized corporations whose failure may have adverse impact on local economies. Other small-and mid-sized companies can be reorganized assisted by SMEs Turnaround Associations that were created in 47 prefectures in 2003, the year in which the IRCJ was created. Larger corporations could be reorganized by expedited workout without the purchase of debts by the public sector, possibly assisted by the aforementioned BRADR. For the purpose of infusing new money into distressed SMEs, there are regional funds created to help revitalization of local enterprises in each prefectures as well as private-equity funds specialized to invest in distressed companies. In addition to the new ETICJ, we have several options to restructure business corporations in Japan such as 1) expedited statutory reorganization procedures supervised by courts; 2) the aforementioned new BRADR; 3) SME Turnaround Association; 4) Enterprises Restructuring Group of the Resolution & Collection Corporation; 5) local restructuring funds in every one of the 47 prefectures; and 6) private equity funds specialized in investing in distressed corporations, etc. This competitive environment might have contributed to improve professional expertise to restructure distressed corporations in Japan.

Lager corporations are going to be saved through provision of loans and/or infusion of equities by the Development Bank of Japan (DBJ), which is owned by the Japanese government, under the guarantee of the Japanese government, according to the special emergent legislation.

Japan Airlines Revitalization Taskforce

Minister of Land, Infrastructure, Transportation, and Tourism appointed five experts as members of JAL Revitalization Taskforce on September 25, 2009, and this Taskforce, which I chaired, started overall due diligence to draft operational and financial restructuring plan for JAL. Nearly 100 experts participated in doing the DD and formulating the draft plan intensively.

Discussions were held countless times with JAL's management and staff and the five major banks that own the biggest exposures in JAL, including DBJ and other key stakeholders. and the Taskforce completed the draft reorganization plan on October 26, 2009. The draft plan contemplated the solicititation of huge amount of debt forgiveness and debt equity swaps for creditor financial institutions as well as huge amounts of capital infusion as equities to DBJ and others.

The government-owned JAL started its business in 1951 and was privatized in 1987. JAL owns many obsolete huge jumbo jet aircrafts that consume a lot of fuel. JAL could not replace these old ineffective planes with smaller, more energy-efficient planes due to a cash shortage, and it sold air tickets at lower prices to fill vacant seats even as that created losses. Japanese central and municipality governments have constructed too many local airports, and JAL could not refuse to use these ineffective local airports even while accumulating huge losses. JAL also bears huge amounts of legacy costs, including pension payments to retirees, similar to GM. Our draft plan included strategies and tactics to resolve these problems—such as replacement of airplanes, closing down unprofitable local operations and cutting legacy costs mentioned above—to turn JAL profitable as early as possible. It was planned that the members of taskforce would be co-chief restructuring officers for JAL, assuming the role of negotiator with stakeholders including creditors, unions, retirees and others, soliciting them to accept the plan and consummating the plan substantially. However, the Minister of Finance and DBJ refused to infuse new money into JAL and requested us to let the newly established ETICJ take over our role on October 26. ETICJ is able to raise new money which will be infused into JAL under the guarantee of the Japanese government. I don't know the true reason why the MOF preferred the ETICJ instead of DBJ as an equity provider to JAL. Currently, the ETICJ is doing another DD in order to decide whether it will help JAL or not. JAL also filed a petition to commence BRADR on November 13. Because BRADR has convenient tools in terms of priority status of emergency loans extended during the pending case, it may be good for Japan to have so many tools to accomplish similar goals, but it also becomes difficult to choose the most appropriate ones from among them.

Proposal to Create Quasi-Governmental Organization to Revitalize Ailing Corporations

In order to save ailing business corporations that are socially useful, providing liquidity and assisting their restructuring effort is essential to restore the health of the national economy in each country. To serve that purpose, it could be effective to establish a government-backed special purpose corporation operated by private sector professionals who possess rich experience and specialized expertise in reorganizing troubled companies in each country. The corporation administers following the workout processes. Solution process is consisted of the following stages:

1. Application made by ailing companies that are useful for the national economy
2. After preliminary due diligence, a decision whether to help the applicant is made
3. Notice of standstill or stay to financial creditors (i.e., moratorium)
4. Facilitating provision of finance by financial institutions under the guarantee of governmental agencies
5. Financial and business due diligence conducted by professional experts
6. Developing business and financial restructuring plans for the companies assisted by professional experts
7. Soliciting and persuading creditors and other affected parties accept the proposed restructuring plans
8. Execution of the accepted plans
9. In some cases, purchasing debts and infusion of capital may be useful

Independence from political interference and freedom from corruption is not only critical but also essential for the effectiveness of the organization and its officers. The staffs must be consisted of professional experts recruited from the private sectors, not of government bureaucrats. Also, advanced skill of staff for turnaround management is essential. Most of team leaders of the IRCJ earned an MBA degree in business schools in U.S. or the U.K.

Until now, Japan has not been in a situation where my proposed solution above is in critical need, but some countries which are struggling with severe economic downturn a need a scheme for expedited workout solutions assisted by international organizations. We need to pay attention to the point that CDS (credit default swaps) may be an obstacle for successful workouts. In addition, obtaining unanimous consent would be very difficult in those countries where out-of-court workout solution is not usually used. The majority rule involving the courts or other appropriate authorities may be helpful in these situations.

Appendix 4. Emergent Proposal to Create Quasi-Governmental Organizations to Rescue and Revitalize Ailing Corporations

By Dr. Shinjiro Takagi

Developing Extraordinary Restructuring Solutions in Response to the Global Financial Crisis

August 2, 2009

Mexico City

Purpose

Due to unprecedented devastating drop in consumer demands, a lot of business corporations are suffering from severe financial difficulties such as a cash shortage problem caused by negative cash flow and incurring excessive amount of debts compared to their downsized operation. To save such ailing business corporations that are useful socially, providing liquidity and assisting their restructuring effort is essential to restore the health of national economy in each country. To tackle these matters in a limited period of time, it would be effective to establish a government-backed special purpose corporation operated by private sector professionals who possess rich experience and specialized expertise of reorganizing troubled companies in each country.

Organization and Outline of the Process

The corporation should be formed at the initiative of the national government and capitalized by other public sectors including the government with limited life of five years (i.e., to be formed as a sunset corporation) and operated by board members, executives, and staff recruited from the private sector who have special expertise in restructuring troubled businesses. Board members and executives are appointed by the government and must be politically independent from the government.

The corporation administers following workout processes.

Solution process is consisted of the following stages:

1. Selecting target ailing companies which are useful for the national economy
2. Notice of standstill or stay issued to financial creditors (i.e., moratorium)
3. Facilitating provision of finance by financial institutions under the guarantee of Governmental agencies
4. Financial and business due diligence conducted by professional experts
5. Drafting business and financial restructuring plans for the companies assisted by professional experts
6. Soliciting and persuading creditors and other affected parties to accept the proposed restructuring plans
7. Execution of the accepted plans

Rules

1. Troubled companies (TC) are able to apply for assistance from the corporation (CO).
2. TC must be economically useful for the country and its people.

3. CO should help only those companies whose continued operation is beneficial for the country and its people.
4. Upon the decision by the Board of Directors (BOD), the CO undertakes preliminary due diligence (DD) research on the TC's usefulness, possibility of survival, financial status, and other related matters within two weeks after the filing of the application.
5. Within a few days after the completion of the DD, the BOD must decide whether the CO will assist the TC or not.
6. Once the assisting decision (AD) is made by the BOD, the CO issues a notice of standstill (NS) immediately, by fax or other appropriate devices, to all relevant creditors of the CO.
7. The relevant creditors (RC) include banks, financial institutions, bondholders, indenture trustees, and other financial creditors to whom the CO owes debts. Trade creditors with huge claims whose participation are indispensable for sustainable restructuring of the CO could be included in the RC category.
8. Upon issuance of the NS, all RC are prohibited to take any collection actions against the CO and their codebtors, including guarantors, to maintain their exposure as of the issuing date of the NS. Prohibitions include:
   - any acts to collect or recover a claim
   - commencement or continuation of judicial or administrative action or proceeding
   - enforcement of a judgment
   - obtainment or repossession of property
   - realization of secured rights
   - any acts to create, perfect or enforce any lien or secured rights
   - setoff of any debts
9. Within a week after the NS, the CO and the TC must convene a creditors' meeting and report the present status of the TC.
10. Within two months after the NS, the CO should study the past, present, and future financial and operational status of the TC under DD, aided by external professional experts, and the TC must draft operational and financial reorganization plans (plans assisted by the CO and other professional experts.
11. When the TC is loss making and/or insolvent(ie.,liability exceeds assets), the Plans must provide appropriate means to turn to profitability and dissolve insolvency within three years.
12. The Plans must be equal, fair, equitable, and feasible.
13. When the Plans provide for debt forgiveness and/or debt

equity swap, claims should be treated on pro rata and/or pari passu principles.

14. When the Plans provide for impairment of claims by any means, equity of the TC should be wiped out or diluted, if any.
15. Should incumbent managers be responsible for the TC's difficulty, the Plans must provide for the replacement of the management of the TC.
16. Within two weeks after the Plans are completed and the BOD are satisfied that the Plans meet abovementioned requirements, the BOD should approve the Plans.
17. Within one month after the approval of the Plans by the BOD, the TC and the CO should solicit and persuade the RC to accept the Plans.
18. Within one month after the acceptance of the Plans, the TC must execute and consummate the Plans.
19. Upon the substantial consummation (SC) of the Plans, the process is completed.
20. Any time before the completion of the process, the BOD can cancel the assistance decision when the Plan does not meet the aforementioned criteria or unforeseeable changes in other circumstances occur.
21. During the period that begins with the AD and ends with the SC or the abovementioned cancellation, the CO may ask financial institutions to provide financing to the TC to defray its overhead costs under the guarantee of the governmental agency.
22. The CO is entitled to purchase and sell the TC's debts and equities. The CO is also entitled to obtain the TC's equities by other means and dispose of them.
23. When the case is converted to statutory insolvency proceedings, the loan debts owed to financial institutions by the TC which was provided under the aforementioned Rule 21 will be treated as priority debts in the same way as administration expenses.