Restructuring and Reorganization Plans
Lessons from International Experience

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Topics Covered

1. Corporate Rescue Context & Global Experience
2. Restructuring Plans: process & technique
3. Case Study: Consolidated Hydro, Inc.
4. Expedited Solutions: Prepackaged Restructuring Plans
Corporate Rescue Context

Global Experience
Corporate Workout Basics

1. **The Standstill:** formal agreement among all “relevant” creditors to refrain from exercising legal remedies for a brief period of time to gather information and evaluate proposals for restructuring.
   - All parties maintain the status quo relative to each other and to the debtor.
   - Debtor also agrees not to take actions to prejudice creditors.

2. **Creditor Coordination/Committee:** Creditors typically adopt a coordinated approach and dialogue with the debtor.

3. **Information/Disclosure:** Debtor grants reasonable and timely access to all relevant information related to its assets, liabilities, business and prospects, to allow proper evaluation of proposals. Information is treated as confidential.

4. **Proposals for restructuring:** should respect applicable law and creditor priorities.

5. **New Money/Financing:** repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.
# Corporate Rescue Continuum

<table>
<thead>
<tr>
<th>Informal Workouts</th>
<th>Formal Workouts</th>
<th>Formal Insolvency</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Forum</td>
<td>Application Court, etc.</td>
<td>Commence Insolvency</td>
</tr>
<tr>
<td>Lead/Committee</td>
<td>Lead/Committee</td>
<td>Committee nominated</td>
</tr>
<tr>
<td>Standstill</td>
<td>Stay &amp;/or Moratorium</td>
<td>Stay &amp; moratorium</td>
</tr>
<tr>
<td>Cash flow / liquidity</td>
<td>Cash flow / liquidity</td>
<td>Cash flow / financing</td>
</tr>
<tr>
<td>Information</td>
<td>Information</td>
<td>Disclosure</td>
</tr>
<tr>
<td>Evaluate Options</td>
<td>Evaluate Options</td>
<td>Evaluate Options</td>
</tr>
<tr>
<td>Plan: Negot/Agree</td>
<td>Plan: Negot/Agree/Vote</td>
<td>Plan: Negot/Agree/Vote</td>
</tr>
<tr>
<td>Binding effect limited (signatories) Non-binding on others</td>
<td>Binding effect limited (class(es) stakeholders or creditors)</td>
<td>Binding on all creditors</td>
</tr>
</tbody>
</table>

- Fewer parties, no formality, less complicated
- Fewer parties, some formality, more complicated
- Most parties, most formal, most complicated
## Formal Workout Models

<table>
<thead>
<tr>
<th>Name of arrangement</th>
<th>Indonesia</th>
<th>Republic of Korea</th>
<th>Malaysia</th>
<th>Thailand</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jakarta Initiative Task Force (JITF)</td>
<td>Corporate Restructuring Agreement</td>
<td>Corporate Restructuring Committee</td>
<td>Corporate Debt Restructuring Advisory Committee</td>
<td></td>
<td>Istanbul Approach</td>
</tr>
</tbody>
</table>

| Basic approach | Forum selected with time-bound mediation | Framework for debtor-creditor negotiations and resolution of inter-creditor differences | Forum for negotiation | Forum for facilitation; superseded by contractual approach, that is, “Debtor-Creditor Agreements” | Coordination Secretariat; Framework for debtor-creditor negotiations and resolution of inter-creditor differences |

| Default for failure to reach agreement | JITF may refer an uncooperative debtor to government for possible bankruptcy petition | Receivership or liquidation | Foreclosure, liquidation, or referral to Danaharta Asset Management Company with super-administrative powers | Less than 50% support for proposed workout, Debtor-Creditor Agreements oblige creditors to petition court for collection of debts | Less than requisite majority approval, application to Arbitration Committee; parties may pursue other rights |

| Resolution of inter-creditor disputes | No special procedures | After three failures to obtain 75% creditor support, plan goes to seven-person Coordination Committee for arbitration | Persuasion by central bank | Mediation, per inter-creditor agreement, if only 50–75% approval; but any bank with large exposure (for example, a foreign bank) could opt out | Arbitration if majority approval is not reached; large firms (55–75%); SMEs (less than 75%) |

| Role of central bank | None | None. But strong support from Financial Supervisory Committee | Secretariat support | Not mandated, but central bank can use influence | None; but strong support from BDDK which administered process |

| Support from legal system | None | Credible threat of receivership or liquidation | Credible threat of foreclosure or liquidation encourages good faith by debtors | 75% creditor threshold both for workouts and court-supervised reorganizations; cram down by court possible | Credible threat of foreclosure or enforcement; court supervised proceeding with cram-down |
Insolvency Systems - Globally

Common Law countries
- UK, Commonwealth (53) - Australia/NZ, HK, Malaysia, Singapore, South Asia, Sub-Saharan Africa, handful of LatAm & Carib

Civil Law countries
- Continental Europe, Asia, Francophone Africa (OHADA), Latin America

United States
- DIP Reorganization model

Centrally Planned
- FSU, China, Vietnam

Hybrid Models
- DIP or Trustee Supervised Reorganization (FR, GER, UK)

Sharia law countries
- Islamic & Arab nations

Concordat - unsecured creditors; high approval thresholds; inability to bind secured creditors; outmoded for larger businesses of today
European Reforms: Increasingly Support Corporate Restructuring

Traditional Restructuring Practices

- **Strategic Alliances**
  - Long-Term Perspective
  - Lifetime Employment

- **Free Markets**
  - Competition
  - Entrepreneurship

- **Protection of Creditors**
  - Accountability for Failure

Asia

United States

Europe/Latin America

- **Firm Preservation**
  - Debtor Friendly
  - Moral Suasion to Avoid Legal Crisis
  - Emphasis on Stability

- **Restructuring**
  - Market Neutral
  - Reorganization-Based Laws
  - Total Value Maximization

- **Firm Liquidation**
  - Creditor Friendly
  - Insolvency-Based Laws
  - Emphasis on Cash Recoveries

Recent Reform Revolution

1. **Rescue Culture**
   - 1980s: US, Fra, UK
   - 1990-date: Aus., Can, Arg., Ger, Jap, Mex, Kor, Fra

2. **Transition Context (1990s to date)**
   - CEE - FSU Transition & EU integration (1st, 2nd, 3rd & some 4th Gen)
   - China, Vietnam

3. **Post-1997: Crisis Driven Reforms**
   - 97-99: Asian 5 - Indonesia, S. Korea, Malaysia, Philippines, Thailand
   - Post-2000: Russia, Mexico, Turkey, Brazil, Argentina, Bolivia, others

4. **Post 2001: Standards Oriented Reforms**
   - EU – Spain (04), Portugal, Italy (05), others
   - Brazil (05), China (06), India, S. Asia, S. America (10+ countries)
   - Model Laws - EU, OHADA, UNCITRAL

5. **Post 2008: Global Financial Crisis**
   - Workout focused: Iceland, Latvia, Serbia
## Reforms in Germany

<table>
<thead>
<tr>
<th></th>
<th>US Chapter 11</th>
<th>Vergleichsordnung</th>
<th>Insolvenzplan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of Amendment</td>
<td>10/17/05</td>
<td>1935</td>
<td>1/1/99</td>
</tr>
<tr>
<td>Out-of Court Mechanism</td>
<td>Pre-Pack</td>
<td>None</td>
<td>Yes</td>
</tr>
<tr>
<td>Insolvency Requirement</td>
<td>None</td>
<td>Over-indebtedness, payment default</td>
<td>Over-indebtedness, payment default, pending inability to pay debts</td>
</tr>
<tr>
<td>Automatic Stay</td>
<td>Full</td>
<td>Partial</td>
<td>Full</td>
</tr>
<tr>
<td>Estate Management</td>
<td>DIP</td>
<td>DIP</td>
<td>DIP with Trustee monitoring (subject to Court approval)</td>
</tr>
<tr>
<td>Exclusivity Period</td>
<td>Min 120 days, Max 20 months</td>
<td>N.A.</td>
<td>3 Months</td>
</tr>
<tr>
<td>Debt Discharge</td>
<td>Full</td>
<td>Partial</td>
<td>Full</td>
</tr>
<tr>
<td>DIP Financing Seniority</td>
<td>All claims except un-primed secured</td>
<td>None</td>
<td>All claims except secured</td>
</tr>
<tr>
<td>Confirmation Procedure</td>
<td>Creditor class voting</td>
<td>Unsecured voting</td>
<td>Creditor class voting</td>
</tr>
</tbody>
</table>

= Convergence toward Chapter 11
### Reforms in France

<table>
<thead>
<tr>
<th></th>
<th>US Chapter 11</th>
<th>Redressement Judiciaire</th>
<th>Procédure de Sauvegarde</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Date of Amendment</strong></td>
<td>10/17/05</td>
<td>1/25/85</td>
<td>1/1/06</td>
</tr>
<tr>
<td><strong>Out-of Court Mechanism</strong></td>
<td>Pre-Pack</td>
<td>Règlement Amiable</td>
<td>Procédure de Reconciliation</td>
</tr>
<tr>
<td><strong>Insolvency Requirement</strong></td>
<td>None</td>
<td>Payment default</td>
<td>None</td>
</tr>
<tr>
<td><strong>Automatic Stay</strong></td>
<td>Full</td>
<td>Court discretion</td>
<td>Full</td>
</tr>
<tr>
<td><strong>Estate Management</strong></td>
<td>DIP</td>
<td>DIP with Trustee supervision</td>
<td>DIP</td>
</tr>
<tr>
<td><strong>Exclusivity Period</strong></td>
<td>Min 120 days, Max 20 months</td>
<td>Min: 6 months, Max 20 months</td>
<td>Min: 6 months, Max 20 months</td>
</tr>
<tr>
<td><strong>Debt Discharge</strong></td>
<td>Full</td>
<td>None</td>
<td>Full</td>
</tr>
<tr>
<td><strong>DIP Financing Seniority</strong></td>
<td>All claims except un-primed secured</td>
<td>All claims except accrued and post-filing wages, court costs</td>
<td>All claims except accrued and post-filing wages, court costs</td>
</tr>
<tr>
<td><strong>Confirmation Procedure</strong></td>
<td>Creditor class voting</td>
<td>Court discretion</td>
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</tr>
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☑️ = Convergence toward Chapter 11
Western Europe Adopts More Aggressive Restructuring Approaches in Mid-2000s

- Emphasized Generating Value vs. Maximizing Recoveries
- Took More Risk, Accepted Accountability
  - Acceptance of officer or “responsible person” positions at failing clients
  - Willingness to operate much deeper into the zone of insolvency
  - Confidence to request/offer rescue financing
  - Selectively tested new insolvency laws
- Discarded Cultural Bias Favoring Liquidations, Embraced Rehabilitations
  - Pursued out-of-court restructurings
  - Initiated operations improvements in addition to financial restructurings
  - Challenged unions, local authorities to accept layoffs
  - Demanded standstills from trade, institutional creditors
  - Willingly ceded some power to ad hoc committees
Restructuring Plans
Process & Technique
Informal Restructuring Considerations

1. What is the nature of the borrower’s problem/needs and what are the contributing factors? (financial / operational)

2. Who are the relevant creditors and parties to solve the problem?

3. What is the interim needs and concessions?
   1. The Standstill: Interim financing; debt relief; enforcement relief; other agreements

4. What is the current financial condition of the company, and what financial documents and due diligence is needed to assess current values and options?

5. Can the problem be resolved out-of-court or does it require a court order?

6. What will the impact of a restructuring be on other parties not involved in the restructuring agreement – e.g., general creditors, trade suppliers, customers, employees, lessors, etc.

7. What legal documents must be amended, and what will be the impact on other parties of amending such documents.

8. What are the risks involved in a restructuring: market, business, regulatory, legal, tax, etc.
Restructuring: Financial vs. Operational

**Financial restructuring**
- Term extensions
- Rate reductions
- Grace periods
- Debt > convertible bonds
- Debt > equity

➢ Address moral hazard
➢ Avoid cosmetic fixes

**Operational & ”Self Help”**
- Exit bad business
- Sales of non-core assets
- Layoffs
- Other cost cuts
- New equity

➢ Increase earnings/cash
➢ Reduce debt
Formal Reorganization Plans: Process issues

1. **Negotiation Strategies**: hinges on who the relevant parties are and their particular concerns. Bank’s may have capitalization and provisioning concerns.

2. **Plan formation**: generally works best with coordination among debtor, administrator and Creditors Committee (minimizes risk of challenges)

3. **Key Considerations**:
   - Addressing administration procedural requirements
   - Valuation of the business and business assets
   - Claims treatment, priorities & classification (based on negotiated and proposed treatment); administrative, secured, general unsecured, labor, tax, etc.
   - Treatment of executory contracts and leases
   - Asset treatment (sales, restructuring, surrender)
   - Distribution /payment provisions
   - Governance and Management of the company
   - Other provisions: releases, ongoing disputes, regulatory approvals, etc.
   - Implementation and modifications
   - Amending and developing all relevant documentation for implementation
Case Study

Consolidated Hydro, Inc.
Case Study #1: Consolidated Hydro Inc

- **Old Debt & Equity to be cancelled**
  - 12% Senior Discount: 112.1 million
  - Series H 13.50% Cum. Redeemable Exchangeable Preferred: 70.3 million
  - Series F 8% Senior Convertible Preferred and Series G 9.85% Junior: 110.2 million
  - Class A Common: 0

- **New Structure**
  - 12% Senior Discount: 100% New Common + 15 mil = 52.2%
  - H, F and G Series: Pro rated B & C Warrants = 0.7%

- **Liquidation Value**
  - Assets: 245 million
  - Liabilities: 425 million
  - Equity: <180 million>
Expedited Solutions

Prepackaged Restructuring Plans
US Experience: Historical Antecedents

- **Late 19th Century - Equity Receivership**
- **Chandler Act (1938) – Ch. X and Ch. XI**
  - Ch. X banned pre-bankruptcy acceptance
  - Ch. XI (arrangements of unsecured debt) – allowed pre-bankruptcy acceptance if it complied with non-bankruptcy law
- **Bankruptcy Code (1978)**
  - Merged Ch. X and XI under new Chapter 11
  - Removed ban against prepackaged plans
  - Policy considerations encouraged out-of-workouts
## Prepack vs. Traditional Ch 11

### Traditional Chapter 11

- **Delay (ave 2+ years)**
- **Additional Strain on distressed company**
  - Outcome in question
  - Customers may leave
- **Increased uncertainty**
  - Creditors are contentious
  - Court approval needed for most transactions
- **Expensive**
  - Multiple fees for parties

### Prepackaged Plan

- **Reduced Time in Court**
- **Stable credit relationships**
  - Suppliers & customers
  - Trade creditors support
- **Greater certainty**
  - Management
  - Outcome more assured
  - Court and creditor intervention minimized
- **Reduction in Cost**
Prepack vs. Workouts

**Out-of-Court Workouts**

- **Cost of Holdouts**
  - Debt instruments require consent for significant changes (i.e., payment)
  - Small debt holders lack incentives to respond – paid in full or as scheduled
  - Target range 90-95%

- **Tax Considerations**
  - Debt forgiveness = income to debtor
  - Net Operating Loss carry-forward more difficult

**Prepackaged Plan**

- **Easier for Holdouts**
  - Lower approval threshold --2/3 in amount and simple majority in number
  - Prospect of bankruptcy creates incentive to respond

- **Tax Considerations**
  - Debt forgiveness is not treated as income to debtor
  - More favorable tax treatment on NOL carry-forward (caveat: majority shareholder rule)
US Experience with Prepacks

- **Prepackaged Plans limited in number:**
  - 2002/40; 2003/21; 2004/14; 2005/7; 2006/10; 2007/4; 2008/4
  - 2009 Q1; numbers reached 8 year high (with bond debt totaling $16.5 billion)

- **Success Rate for Prepacks is higher**
  - 1986 to 1993 – total prepacks 49; all were confirmed
  - 32 pre-voted before petition filed; 17 voted after filing
  - Pre-voted averaged 20 months negotiating and 2 months in proceeding
  - Post-voted averaged 15 months negotiating and 6 months in proceeding
  - Traditional Chapter 11 averaged 8 months in prepetition negotiations and 23 months in court proceeding.

- **Notable Prepack Cases**
  - General Motors, Chrysler, Zenith Electronics, Ziff Davies (media); SIRVA Inc. (Allied Van Lines moving), Memorex Telex; Consolidated Hydro (electrical power), Baseline Oil & Gas; IDM Corp. (Real estate development); Blue Bird (school bus manufacturer; case confirmed in **32 hours**)
UK & French Experience with Prepacks

- **UK Prepack Experience**
  - Achieved by way of an administration proceeding
  - Sale of Distressed Business to a pre-determined buyer (e.g., Barings Bank)
  - Have been criticized for lack of transparency and insider advantage
  - In 2009, stronger safeguards introduced in the form of “Statement of Insolvency Practice 16” adopting procedures agreed with regulatory authorities

- **French Prepack Experience**
  - 2005 introduced the “Safeguard Procedure”, amended in 2008
  - Procedure is similar to pre-negotiated plan, but voted after the filing
  - Eurotunnel was first major safeguard procedure case, filed in 2006
  - Must be invoked prior to debtor encountering cash flow problems
  - Central Feature – debtor remains in control of business, can recommend administrator and draws up plan of reorganization
  - Administrator role limited to informed observer/guide, oversees management
  - Automatic stay arises on commencement of proceeding
  - Prepack arrangements must be approved by two creditors committees (financial institutions and suppliers) and a bondholder committee (if any)
Considerations

♦ Use of Prepackaged Plans have been limited:
  ➔ Mainly used for over-leveraged companies – financial, as opposed to operational, distress

♦ Need for the Automatic Stay
  ➔ Debtor generally in default on outstanding debt
  ➔ Bond holders or creditors could initiate collection actions (*race to the courthouse*)
  ➔ Out-of-court restructurings are inherently unstable
  ➔ Standstill agreement may be limited to certain creditors

♦ Need for Post-petition financing
  ➔ Existing or new lenders may be unwilling to extend new financing in the prospect of bankruptcy or without statutory priority offered by bankruptcy
Considerations

- **Executory Contracts and Leases**
  - Non-bankruptcy breach or assignment difficult and costly
  - Ch 11 provides mechanisms for this (e.g., Continental)

- **Unliquidated or Contingent Claims**
  - Prepack is not good for company with high unliquidated or contingent claims (e.g., Manville-asbestos, Dow-Corning)
  - Out-of-court procedures to resolve these issues are also cumbersome and difficult (i.e., class action lawsuits)
  - Ch 11 -- better solution; claims resolution mechanisms take time

- **Must Solicit General Unsecured Creditors**
  - Prepack requires compliance with applicable non-bankruptcy law concerning adequacy of disclosure (1126b).
  - Securities rules clear on solicitation of exchange or issuance of existing or new securities
  - Comply with Ch. 11 notice and disclosure criteria (Section 1125)
**Turkish Prepack Model**

- **Istanbul Approach**
  - Out-of-court Restructuring
- **Bank Signatories**
- **Approval by 75%**

- **Out-of-court Restructuring**
  - (prepackaged plan)
- **Affected Creditors** *
- **Majority Approval**
  - 50+ number & 2/3 amt

- **BRSA**
  - Bank Restructuring Agency

- **Commercial Court**
  - Application
  - Upon request
  - Status conference
  - Pretrial relief
  - Injunction
  - Interim Supervisor
  - Priority Financing

- **Hearing on Plan Application**
  - Within 30 days

- **Court Judgment**
  - Approved
  - Dismissed

- **Concordat**
  - Previously: 2-3 years
  - Amended: 3 mos + 2 mos extension = 5-6 mos

* Affected Creditors are those whose debts are in default or to be restructured.
Gordon W Johnson

Mr. Johnson, President and founder of EM Advisors, is one of the world’s recognized leaders in international corporate and financial restructuring, resolution and recovery, with experience in more than 50 countries. With a diverse background in banking, finance and corporate restructuring, he concentrates on national and international commercial and restructuring matters, including asset sales, distressed acquisitions, informal and formal banking and corporate insolvency; bank resolution and asset management structures; credit-risk and debt management strategies; creditor rights and debt enforcement and recovery; and sovereign and emerging market advisory services, including comprehensive privatization and investment/regulatory environment solutions.

Mr. Johnson founded EM Advisors in 2007 after nearly two decades of work as a restructuring and international commercial lawyer. From 2005 to 2007, he was a partner in the New York office of Kirkland & Ellis LLP, one of the premier corporate restructuring law firms in the United States. At Kirkland, he worked on international and cross-border restructuring and commercial matters, with a particular focus on emerging markets, including Brazil, India, China and Central and Eastern European countries. From 1998-2005, he was Lead Counsel in the Finance, Private Sector & Infrastructure Practice Group of the World Bank’s Legal Department, leading the Bank’s legal restructuring efforts and advisory assistance to governments globally. From 1988-1998, Mr. Johnson was with Weil, Gotshal & Manges LLP, including in the Firm’s London office from 1994-1995, where he worked on many leading national and international restructuring matters in virtually every industry.

Mr. Johnson holds an LL.M. in International Banking and Finance from University of London; his Juris Doctor from Pepperdine University School of Law, and a Bachelors of Science from Abilene Christian University.