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A Toolkit for Corporate Workouts

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A Toolkit for Corporate Workouts

WORLD BANK GROUP

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Foreword

Corporate workouts tend to generate great interest from policy makers during financial or economic crises. This has been evident during the past financial crises, including the Asian financial crisis of the 1990s, the global financial crisis of 2008–2009, and, currently, the COVID-19 pandemic. To avert unnecessary business liquidations and asset fire sales arising from the effects of the health pandemic, policy makers and the private sector are seeking fast, flexible, and cost-effective solutions to address firms' liquidity issues without overburdening the court systems.

That said, the many economic benefits of having corporate workout frameworks are also present in non-crisis times. Generally, flexible and less formal corporate workout tools complement the formal insolvency systems, facilitating faster restructurings while reducing the burden on courts. Effective corporate rescue frameworks are positively associated with increased returns to creditors, better access to credit, job preservation, and the promotion of entrepreneurship and venture capital — fundamentals that are all positive for private sector development and economic growth. Corporate workout frameworks, being key to the effective management of credit risks and insolvency risks, also play an important role in protecting the health of the financial sector. This is particularly the case in emerging markets and developing economies (EMDEs) where finance of nonfinancial corporations is predominantly provided by the banking sector.

Of course, corporate workouts do not function in a vacuum. They must be tailored to address the specific needs and challenges of the market and must be supported by an adequate and enabling legal and regulatory environment. This Toolkit helps advance the understanding of the various elements that must be present for corporate workout frameworks to be effective both "on the books" and in practice across a variety of both civil-law and common-law jurisdictions. It provides a thoroughly researched, experience-based, and practical guide on the fundamentals that need to be considered when designing and implementing a corporate workout framework.

I highly recommend this Toolkit for anyone seeking to better understand what corporate workouts are, how they can be beneficial, and the practical considerations, processes, and tools to facilitate them.

Jean Pesme
Global Director

Finance, Competitiveness & Innovation Global Practice, World Bank Group

Preface

Governments reacted quickly to blunt the effects of the COVID-19 pandemic on businesses, enacting a series of emergency measures to slow down and even prevent debt enforcement and insolvency proceedings and to ensure ongoing firm liquidity during the crisis. As these temporary measures come to an end in many economies around the world, the focus is shifting to ensuring that insolvency systems are equipped to address significant levels of corporate distress that may arise, and that supporting institutions (such as courts) do not become overwhelmed by a possible influx of increased insolvency filings.

Following the Asian financial crisis of the late 1990s and the global financial crisis of 2008–2009, policy makers have increasingly understood that there is no single, "silver-bullet" policy response to address high levels of corporate distress and related nonperforming loans (NPLs). Instead, corporate restructuring, or business restructuring, can take many forms, offering a "toolkit" of informal to formal procedures that can be used to address differing levels of financial distress. For instance, while tools may take the form of centralized responses through government involvement and sectorwide coordination (typically during a financial crisis), more informal, flexible processes may be more appropriate to work out individual NPL portfolios with minimal government or court support. These "workout" frameworks, when structured appropriately and implemented in an enabling environment, can facilitate the resolution of both high-value portfolios concentrated in a few borrowers and large-volume portfolios of low-value NPLs.

Many elements must be present to effectively restructure businesses. Firms will need to be viable, related laws must facilitate both financial and operational restructuring, and participation of stakeholders is critical. Most importantly, an economy needs a transparent legal framework and regulatory principles that provide an enabling environment for fair, good faith restructuring negotiations. Once these are in place, they must be applied consistently to ensure that the economic benefits of the workout procedures are achieved. Efficient workout tools play a vital role in allowing insolvency regimes to facilitate market stability and, by extension, crisis recovery. It is therefore important that stakeholders learn how to use such tools effectively.

This Toolkit has been updated to reflect modern restructuring tools and practices in numerous jurisdictions around the globe. It aims to assist policy makers in better understanding the intangible and tangible elements necessary for successful corporate restructuring frameworks and aims to highlight the salient features of the relevant workout models. It provides a practical case study and examples of forms to enhance stakeholders' understanding of how workouts operate in practice. Ultimately, it is hoped that this Toolkit will assist in making insolvency regimes more robust, contributing to financial stability and a stronger credit environment.

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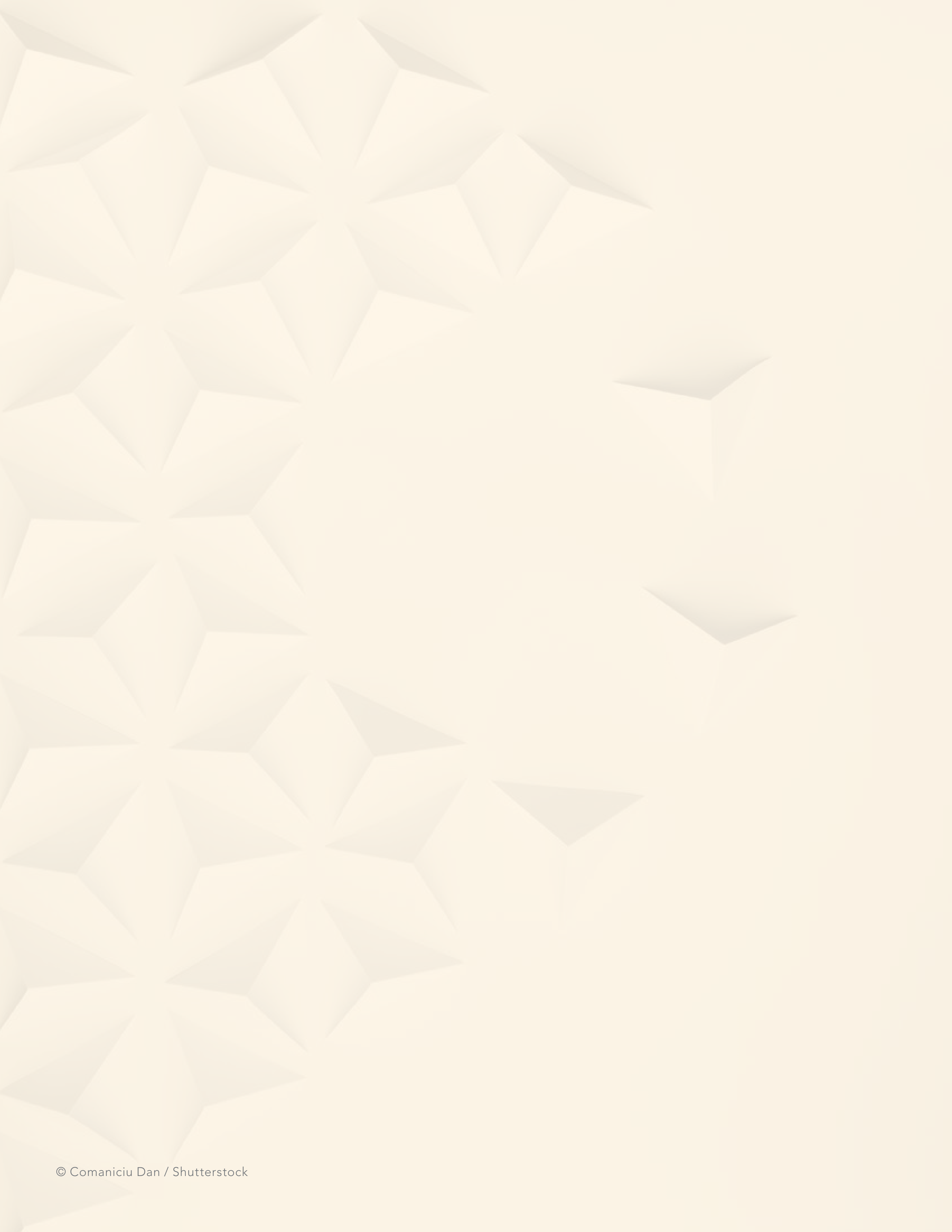

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This Toolkit also complements the foundational World Bank Group 2012 study *Out-of-Court Debt Restructuring*. The team would therefore like to acknowledge Dr. José Maria Garrido, primary author of the 2012 study, for the instructive framing of many of these issues. In addition, this publication draws on the World Bank Group Insolvency & Debt Resolution team's technical-assistance and standard-setting work in the field of insolvency, including the institution's standard-setting instrument, the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes. More information regarding the World Bank Group Insolvency & Debt Resolution work can be found at **www.worldbank.org/insolvency.**

Abbreviations

ADR	alternative dispute resolution
AMC	asset management company
CDR	Corporate Debt Restructuring
CDRAC	Corporate Debt Restructuring Advisory Committee
CDS	credit default swap
CRO	Chief Restructuring Officer
EMDEs	emerging markets and developing economies
EUR	euro
GDP	gross domestic product
IBC	Insolvency and Bankruptcy Code
INR	Indian rupee
ISK	Icelandic króna
JITF	Jakarta Initiative Task Force
MSEs	micro and small enterprises
MSMEs	micro-, small-, and medium-sized enterprises
NAMA	National Asset Management Agency
NPL	nonperforming loan
OCW	out-of-court workout
RBI	Reserve Bank of India
RP	resolution plan
SMEs	small- and medium-sized enterprises
THB	Thai baht
TL	Turkish lira
UNCITRAL	United Nations Commission on International Trade Law
USD	United States dollar
WB-ICR Principles	World Bank Principles for Effective Insolvency and Creditor/ Debtor Regimes

Glossary

Note: Definitions in this Glossary reflect the use made of the given terms in the context of this Toolkit; they do not necessarily represent accepted definitions of these terms as may be used elsewhere.

Absolute priority rule is, essentially (subject to differences between jurisdictions), a rule that the claims of creditors in a dissenting class are to be paid in full if a more junior class is to receive a distribution or retain an interest.

Ad hoc committee or **ad hoc group**, as used in the Toolkit, is a committee of certain creditors that is not an *official committee*, formed on an informal basis, with an objective of leading restructuring discussions and negotiations with the debtor. In common usage (though not in this Toolkit) the term *steering committee* may be used to refer to an ad hoc committee. See section 2.4.2; see also section 3.4.2, Fourth Principle.

Arbitration is an out-of-court dispute resolution procedure in which a dispute is submitted (by agreement of the relevant parties) to one or more independent third parties (each an *arbitrator*, often an expert on the disputed topic) who consider the opposing positions and make a binding decision.

Claim is a right to payment from the estate of a debtor, whether arising from a debt, a contract, or another type of legal obligation, whether liquidated or unliquidated, matured or unmatured, disputed or undisputed, secured or unsecured, fixed or contingent. Depending on applicable law, it may extend to an ability or right to recover assets from the debtor.[1]

Collateral is an asset that secures a payment or other obligation.

Conciliation is used synonymously with *mediation* in the Toolkit, except where it refers to a specific type of proceeding, such as in France. See sections 2.10 and 5.4.1.2.

Coordinating committee and **coordination committee** are used synonymously with *steering committee* in the Toolkit.

Cramdown is an insolvency law mechanism whereby an agreement approved by a specified majority of stakeholders — particularly creditors — or approved by one or more specified stakeholder classes, can be imposed on nonconsenting stakeholders. A cramdown of a stakeholder class by one or more other stakeholder classes is termed a *cross-class cramdown*. See section 1.4.

Creditor is a natural or legal person that has a claim against the debtor that arose on or before the commencement of an insolvency proceeding.[2]

Creditor culture, as used in the Toolkit, is a culture in which creditors readily work with each other and with debtors to obtain the best possible outcome and take the initiative to do so.

Debtor is a person that owes a debt. For simplicity, the Toolkit also uses the term to refer to multiple such persons (collectively) within a single corporate group.

Disenfranchisement is a loss by a stakeholder of its legal interest in the debtor or all or most of its economic interest in the debtor.

Distress, see **financial distress**.

Early warning tool is a mechanism that provides information to debtors that may be in financial distress, with the objective of addressing any such distress in a timely way.

Enhanced workout, as used in the Toolkit, is a restructuring in which participants are bound by law, regulation, or contract to follow restructuring-specific standards introduced by an administrative authority in accordance with an expectation or requirement set out by that authority, but where there is no provision for the court to play a role. See chapter 4.

Equity warrant, as used in the Toolkit, is an instrument that gives the holder the right to purchase shares in a company on a specified date (or in a specified period) at a specified price.

Financial distress or **distress**, as used in the Toolkit, is a situation of significant financial difficulties.

Haircut, in broad terms, means a loss incurred by a creditor in a restructuring, through receiving consideration that is less than the value of its debt. More precisely, it is the difference between the value of an instrument (on the one hand) and the (lower) value of any cash and instruments received in a restructuring in exchange for that instrument (on the other hand), where "value" may be taken to be (1) outstanding face value (plus, potentially, accrued interest), or (2) the net present value of remaining contractual payments.

Hybrid workout, as used in the Toolkit, is a restructuring involving private negotiations of restructuring terms pursuant to a procedure that provides for a court role, where this role falls short of supervision of the full procedure. See chapter 5.

Insolvency, depending on applicable law, means a debtor is unable to pay its debts as they fall due, its liabilities exceed the value of its assets, or both.

Insolvency proceeding is a collective proceeding targeted either at restructuring or liquidation, with a role for the court.

Insolvency representative is a person authorized to administer the restructuring or liquidation of a debtor's assets or affairs in an insolvency proceeding. Such a person may be known as (for example) an insolvency practitioner or trustee, depending on the jurisdiction.

Lead bank is a bank creditor designated to lead restructuring negotiations with the debtor and serve as a channel of communication between the debtor and a group of bank creditors (for example, a lender syndicate). See section 2.4.2.

Liquidation is a process in which the debtor's assets are disposed of and the disposal proceeds are distributed to creditors in accordance with insolvency law.

Lock-up agreement is a legally binding agreement under which, in essence, creditors commit to vote in favor of a restructuring plan that has certain specified terms. It may also be termed a *restructuring support agreement*.

Mediation is a flexible process, conducted in confidentiality, through which disputes can be resolved. A neutral person (the *mediator*) actively assists the parties in working toward a negotiated agreement of a dispute or difference.[3] For the purposes of the Toolkit, *mediation* and *conciliation* are used synonymously, except as specified in the definition of *conciliation*. See section 2.10.

Official committee, as used in the Toolkit, is a committee consisting generally of creditors (or parties representing creditors), the existence, constitution, and operations of which are prescribed by law or rules. In common usage (though not in the Toolkit) the term *steering committee* may be used to refer to an official committee. See section 2.4.2.

Out-of-court workout (OCW), as used in the Toolkit, is a privately negotiated restructuring where either (1) no restructuring-specific guidelines have been introduced by any administrative authority, or (2) if an administrative authority has introduced such guidelines, it has not set out an expectation or requirement that workout participants commit in a legally binding manner to follow them. In either case, there is no provision for the court to play a role. See chapter 3.

Prearranged restructuring or **prenegotiated restructuring** is a restructuring negotiated between a debtor and stakeholders of the debtor before entry into a formal proceeding, where an agreement with the requisite stakeholders with the required level of formality is solicited after entry into the formal proceeding. It is a type of hybrid workout. See chapter 5.

Pre-packaged restructuring (pre-pack) is, in essence, a restructuring negotiated out of court that is implemented quickly through a formal insolvency proceeding. An agreement with the requisite stakeholders with the required level of formality (if any) is typically solicited before entry into the formal proceeding. It is a type of hybrid workout. See chapter 5.

Pre-insolvency, as used in the Toolkit, is a state of financial distress but not technical insolvency, except where it refers to a specific procedure in Italy or Spain (for those uses, see sections 6.4.4.1 and 6.4.5).

Preventative workout is a restructuring of an enterprise that is not in a technical state of insolvency, through a broadly formal procedure with a stay on creditor action from initiation of the procedure (at least if requested by the debtor, and subject to limitations) but a limited role for the court. See chapter 6.

Receivership is a procedure for the enforcement of security over one or more of a debtor's assets, which may or may not involve a court.

Reorganization, as used in the Toolkit, is a judicial reorganization, i.e., a restructuring whose full process is subject to court supervision.

Reorganization plan is a restructuring plan in the context of reorganization proceedings.

Rescheduling is, in respect of debt, an extension of the dates on which payments are due under contractual debt terms.

Rescue is used synonymously with *restructuring* in the Toolkit.

Restructuring involves restoring a financially distressed business to a sustainable position. It consists of one or both of a *financial restructuring* (adjusting the liabilities of the enterprise in a fundamental way) and an *operational restructuring* (a significant adjustment to the assets or operations of the enterprise). It can refer to either the procedure or its outcome.

Restructuring plan, as used in the Toolkit, is an agreement (requiring court approval or otherwise) for the restructuring of a debtor. See section 2.7.

Restructuring support agreement is a legally binding agreement under which, in essence, creditors commit to vote in favor of a restructuring plan that has certain specified terms. It may also be termed a *lock-up agreement*.

Sale as a going concern is a sale or transfer of a business in whole or substantial part.[4]

Secured creditor is a creditor whose debt has the benefit of collateral in respect of one or more obligations of a debtor.

Stakeholder is a party other than the debtor that is or may be affected by a restructuring.

Standstill agreement is a contractual agreement between the debtor and some or all of its creditors that, subject to certain limitations, the creditors will refrain from exercising rights and remedies against the debtor. See section 2.4.1.

Standstill period is the period of time specified in a standstill agreement during which, subject to certain limitations, relevant parties will not exercise rights and remedies against the debtor. See section 2.4.1.

Stay is a measure that (1) prevents the commencement, or suspends the continuation, of judicial, administrative, or other individual actions concerning a debtor's assets, rights, obligations, or liabilities, including actions to make security interests effective against third parties or to enforce a security interest; (2) prevents execution against the assets of the debtor; (3) may prevent the termination of a contract with the debtor; and (4) may prevent the transfer, encumbrance, or other disposition of assets or rights of the debtor.[5]

Steering committee, as used in the Toolkit, is a committee of certain creditors that is not an *official committee*, set up by a group of creditors, with an objective of leading restructuring discussions and negotiations with the debtor. Part of its role is to serve as a channel of communication between the debtor and creditors more broadly. It may be formally appointed by the debtor. The term is used synonymously with *coordinating committee* or *coordination committee* in the Toolkit. As commonly used (though not in the Toolkit), the term may refer to an *official committee* or an *ad hoc committee*. See section 2.4.2; see also section 3.4.2, Fourth Principle.

Unsecured creditor is a creditor that is not a secured creditor.

Workout, as used in the Toolkit, is an OCW, an enhanced workout, a hybrid workout, or a preventative workout. See section 1.4.

1

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Introduction to the Toolkit

1.1 Background

The COVID-19 pandemic, first and foremost a global health crisis, has had severe economic and social impacts around the world. One of its many negative impacts has been adverse effects on firms' earnings, which have worsened the ability of firms to service debt.[6] Although economic downturns are often followed by increases in the number of insolvency filings and in NPL levels,[7] research suggests that insolvency filings remained stable during the COVID-19 crisis and in some countries declined. This is attributable, in part, to the swift action of numerous governments — injecting trillions of dollars in stimulus measures early in the crisis — and rapid adjustment by firms.[8]

This does not mean that the risk of a wave of insolvencies has been fully averted. Studies from the World Bank Group and other sources report that global financial vulnerabilities have risen since the start of the pandemic, partly because firms have borrowed to tackle liquidity shortfalls experienced during the crisis.[9] In addition, shifts in consumer preferences brought about or accelerated by the crisis may mean that the business models of certain firms will be unsustainable after the pandemic subsides. There has been, and remains, a markedly increased risk that micro-, small-, and medium-sized enterprises (MSMEs) — significant providers of employment — will be forced to close, particularly in countries where vaccines are still not widespread and lockdowns (and their resulting effects on businesses) are continuing.

Even when a crisis is not ongoing, corporate distress and firm closure are unavoidable. To a certain extent, it is a desired outcome of strong market economies. It can be seen as a process of self-cleansing and market efficiency that promotes the survival of the most competitive firms. Nonviable firms that remain in business (so-called zombies) should leave the market to make resources available for other firms; their continued existence can lead to credit misallocation and a drop in economic productivity.[10]

Where a business is viable, however, its closure is value-destructive and often leads to unnecessary job losses. In addition, where a large number of businesses are unable to meet their debt obligations, this may lead to high levels of NPLs and other nonperforming assets on banks' books, limiting credit availability, jeopardizing financial stability, and impeding economic growth. It is critically important that the rescue of viable but financially distressed enterprises be facilitated, in both crisis and noncrisis times. Specifically in the context of the COVID-19 pandemic, the Group of Thirty has noted the need for a nuanced policy response to a corporate solvency crisis.[11]

This means, in particular, ensuring that restructuring mechanisms are tailored to individual economies and that they function effectively.[12] These restructuring mechanisms may be formal and involve the courts, or they may be less formal and conducted with minor or no institutional involvement. The workout procedures described in the Toolkit sit at a point below judicial reorganization on this formality continuum. The World Bank Group has recently observed that although such procedures cannot fully replace more formal procedures, they can in principle be implemented relatively quickly and their use can reduce pressure on the court system.[13] This can be of particular value in jurisdictions where courts are at risk of being overwhelmed by numerous insolvency cases and where institutional capacity to undertake significant reforms of the insolvency system in a short period of time is limited.[14]

1.2 The Toolkit

A Toolkit for Out-of-Court Workouts, published in 2016, had two objectives: (1) to provide policy makers with tools to develop a corporate restructuring framework and culture in their economy; and (2) to help in the implementation of informal corporate restructuring principles to rescue failing enterprises.

Recent experience of the operation of corporate restructuring regimes around the world demonstrates that such regimes must appropriately account for domestic considerations, including a jurisdiction's institutional and regulatory framework. This Toolkit, a revised and updated version of the 2016 publication, incorporates wide-ranging updates that reflect this experience. As reflected in this Toolkit's revised name, it describes matters relevant to the adoption of frameworks for a broad range of types of corporate restructuring procedures, some of which provide for a role for courts throughout. This widened perspective highlights considerations of particular relevance in the context of the COVID-19 pandemic, a crisis that makes restructuring viable businesses especially important.

The Toolkit is aimed primarily at policy makers, financial institutions, and enterprises. It examines different types of restructuring procedures on the basis that one size does not fit all across jurisdictions or even within an individual jurisdiction. Box 1 outlines some of the Toolkit's key terminology. The Toolkit focuses on workouts, which for the purposes of this publication comprises four types of restructuring procedure: an out-of-court workout (OCW) procedure; an enhanced workout procedure; a hybrid workout procedure; and a preventative workout procedure.[15] These categorizations, used throughout the Toolkit, are those currently in use by the World Bank Group. They are described in section 1.4 below. For completeness, the publication also touches briefly on court-supervised restructuring procedures.

The key benefits of implementing a workout framework include the flexibility to choose from a range of possible approaches and to tailor a procedure to the specific needs of an economy. EMDEs often face challenges with respect to their institutional frameworks, and pressure on court resources may be particularly acute during the COVID-19 crisis. In that context, workout procedures can be an especially valuable means of facilitating restructuring. Provided the necessary elements of a workout framework are in place, private parties with commercial incentives to restructure financially distressed enterprises can do so effectively and efficiently, with limited or no institutional involvement.

The Toolkit addresses the financial distress of nonfinancial corporates; public policy considerations specifically regarding financial corporates (such as in relation to financial stability) require different approaches to their financial distress.[16] It does not address restructurings in which only one creditor is involved, or in which the objective is to facilitate a controlled winding down of the business of an enterprise over an extended period of time, though similar considerations to those described in the Toolkit can be expected to apply in such restructurings in many respects. Matters relating to financial collateral arrangements are outside the scope of the Toolkit; references to stays on creditor action in the Toolkit do not necessarily reflect the treatment of such arrangements. Matters relating specifically to cross-border insolvency are also outside the scope of the Toolkit. Moreover, no two situations of financial distress are identical, and the Toolkit should not be taken as suggesting that a particular approach to a restructuring or particular restructuring terms would be (or would not be) acceptable in any individual case.

Included in the Toolkit are hypothetical examples of documents commonly used in workouts. *These are included only to illustrate certain practicalities of conducting a workout. They should not be used without legal advice in the jurisdiction of their intended use and should not be used without being adapted to reflect the situation's particular circumstances.* Complex restructurings often require many different types of documents, many much more complex than these examples. Providing examples of a full range of documents is beyond the scope of the Toolkit.

BOX 1: An Outline of Key Terminology

The terms *restructuring*, *workout*, and *reorganization* are sometimes used interchangeably. The Toolkit assigns them the following specific meanings.

Restructuring, in respect of an enterprise, means one or both of a *financial restructuring*, fundamentally adjusting the liabilities of the enterprise (also referred to as a *debt restructuring* or *balance-sheet restructuring*); and an *operational restructuring*, a significant adjustment to the assets or operations of the enterprise (also referred to as a *turnaround*). It can refer to either the procedure or its outcome.

Workout encapsulates the following four types of procedure:

- Out-of-court workout (OCW)
- Enhanced workout
- Hybrid workout
- Preventative workout

As commonly used, the term *workout*, broadly speaking, can mean any of the following: (1) a synonym for "restructuring," as defined above; (2) OCWs and enhanced workouts alone; and (3) all of OCWs, enhanced workouts, hybrid workouts, and preventative workouts. As explained above, this Toolkit uses the term in sense 3.

Reorganization means "judicial reorganization," i.e., a restructuring the full process of which is subject to court supervision.

1.3 Structure of the Toolkit

The remainder of chapter 1 describes different forms of restructuring procedure and outlines how restructurings such as workouts can be beneficial. Chapter 2 addresses practical considerations relevant to workouts; it sets out aspects of the process, presents the different parties that may be involved, describes tools needed to conduct an effective workout, and outlines elements of an enabling environment that facilitates workouts.

Chapter 3 addresses OCWs, chapter 4 deals with enhanced workouts, chapter 5 covers hybrid workouts, and chapter 6 considers preventative workouts. These four chapters illustrate how different jurisdictions can develop a framework that suits their individual circumstances.

Chapter 7 examines an OCW case study, with hypothetical examples of documents relating to specific steps in the workout. They are provided to illustrate the practicalities involved in a workout. Chapter 8 offers brief concluding remarks.

1.4 Different Forms of Restructuring Procedure

A restructuring procedure is generally triggered by a debtor's financial difficulties (even if the debtor is not technically insolvent, a state that can be termed *pre-insolvency*). Such difficulties may be caused by factors internal or external to the debtor, and they may result in an actual or anticipated inability by the debtor to service its debts as they fall due. In individual cases, creditors may recognize these circumstances before the debtor's management team does (or is prepared to acknowledge that it does).

As noted, restructuring procedures can take many forms. These can (and should) be adapted to the specific needs of the jurisdiction's financial and real sectors. The World Bank Group categorizes them as follows:

- **Out-of-court workouts** are privately negotiated restructurings between the debtor and all or some of its creditors.
  - In general, the only formal requirement for restructuring by means of an OCW is that the final agreement is a valid and binding contract; insolvency legislation does not typically provide for OCWs. An OCW is only binding among (1) the parties that have voluntarily agreed to it, and (2) parties that have not voluntarily

agreed to it but are bound by amendments to debt made with the consent of a specified majority of creditors in accordance with the preexisting contractual debt terms. OCW procedures lack the cramdown features typical of reorganizations (see below).[17]

- Restructuring-specific guidelines have typically not been introduced by any administrative authority. If an administrative authority has introduced restructuring-specific guidelines, it has not set out an expectation or requirement that workout participants commit in a legally binding manner to follow them. In either case, no provision is made for the court to play a role.

- **Enhanced workouts** are restructurings in which participants are bound by law, regulation, or contract to follow restructuring-specific standards introduced by an administrative authority such as a central bank, in accordance with an expectation or requirement set out by that authority, but where no provision is made for the court to play a role.

- **Hybrid workouts** involve private negotiations of restructuring terms pursuant to a procedure that provides for the court to play a role, where this role falls short of supervision of the full procedure. A hybrid workout procedure benefits from advantageous features of both OCW procedures and reorganization procedures: it is typically a relatively inexpensive process that can make a restructuring binding on stakeholders — parties, other than the debtor, that are or may be affected by the restructuring — that do not consent to it.

- **Preventative workouts** are restructurings of enterprises that are not in a technical state of insolvency, through a broadly formal procedure with a stay on creditor action from the procedure's initiation (if requested by the debtor, and subject to limitations) but a limited role for the court.

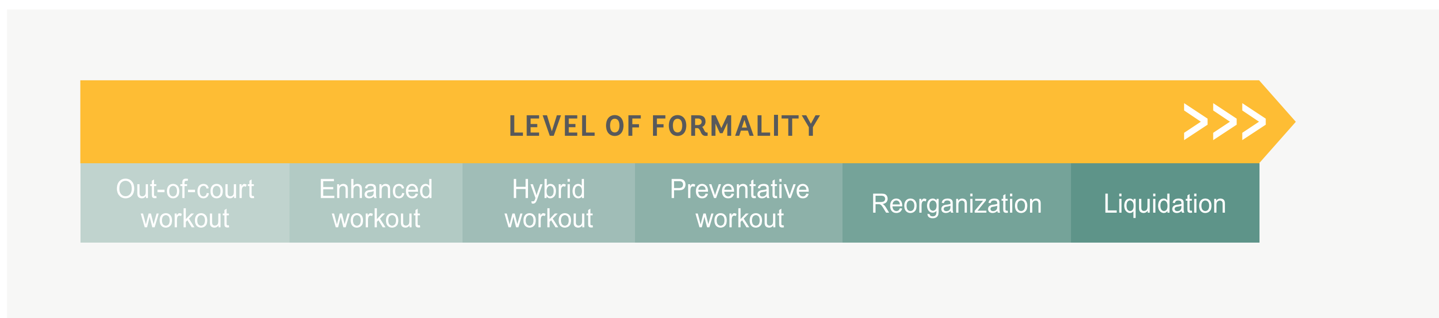
- **Reorganizations** are restructurings in which the full process is subject to court supervision, typically under insolvency legislation. Often, a jurisdiction's insolvency laws require that a specified majority of creditors agree to a reorganization plan. Typically, the court then approves the plan, and, in certain jurisdictions, it can make the plan binding on stakeholders subject to the procedure even if they have not accepted the plan's terms (i.e., a cramdown).[18] Certain stakeholders may be disenfranchised, losing their legal interest in the debtor or all or most of their economic interest in the debtor. This type of procedure is characterized by two particular features that distinguish it from OCWs: (1) the proceedings are commonly lengthier than OCWs, as all parties involved are required to follow pre-established procedures and adhere to set time intervals, and matters raised before a court are often vigorously contested; and (2) the proceedings are public and often require public disclosure of certain financial and commercial information, which may deter certain enterprises from utilizing such proceedings. Section 5.1 contains further information on reorganizations, but a detailed discussion is outside the scope of the Toolkit.

The Toolkit uses the above categories for analytical purposes. A specific procedure may be regarded as falling into a different category than that suggested by this categorization (or may not clearly fall into a particular category). A single restructuring may involve more than one procedure of the same or a different category.

As shown in Figure 1, the categories are located on a continuum ranging from informal to formal procedures, reflecting (in very broad terms) the extent to which they entail institutional involvement.

> > >

FIGURE 1 – THE FORMAL-TO-INFORMAL CONTINUUM OF RESTRUCTURING PROCEDURES



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OCWs, enhanced workouts, hybrid workouts, and preventative workouts can all be considered informal to some extent. This informality gives workouts several potential advantages over reorganizations, such as a relative lack of expense and a relative absence of confrontation between the debtor and stakeholder representatives and among stakeholder representatives.

For financially distressed MSME debtors, these potential advantages may be especially important. An MSME may have extremely limited funds available, so an inexpensive restructuring process may in practice be the only alternative to liquidation. In addition, an MSME may not have advisors through which it can communicate with its stakeholders, and if it does not, a confrontational process may be particularly problematic. Specific potential advantages of the different types of workout procedure are discussed further in corresponding chapters of the Toolkit, and the restructuring of micro and small enterprises (MSEs) specifically is addressed in chapter 2.

In many cases, policy makers choose to include several workout procedures in their jurisdiction's laws to provide stakeholders with a variety of options. This choice can (and should) reflect the requirements and strengths of an individual jurisdiction (taking into account, for example, which of its institutions are the most efficient). In addition, OCWs, enhanced workouts, and certain types of hybrid workout need not be provided for in legislation; they can arise through, and be facilitated by, market practice and institutional measures.

As discussed more fully in the following chapters, important factors relevant to each category of procedure should be considered when deciding which procedure (or procedures) to implement in a particular jurisdiction and how to implement it (or them).

In individual restructurings, it may be recognized that an enterprise is no longer viable, in which case the enterprise should exit the restructuring process and enter a liquidation proceeding to maximize creditor recoveries. In practice, if the enterprise is nonviable, this recognition commonly occurs early in the process, as it will be readily apparent that a restructuring is not feasible. An insolvency law may provide for conversion of a reorganization proceeding directly into a liquidation proceeding. Liquidation proceedings are not addressed by the Toolkit.

BOX 2: Viability

To distinguish between viable firms (which should be restructured) and nonviable firms (which should be liquidated), a possible test of viability is whether there is greater value for the firm's stakeholders from (1) its continuing to operate or (2) its liquidation.

At least in theory, restructuring can be considered the socially preferred outcome if the going-concern value of a firm (taking into account the costs of a restructuring) exceeds its liquidation value (taking into account the costs of a liquidation). Going-concern value may be assessed in several ways, including through discounting the firm's expected future cash flows of the firm. Liquidation value typically reflects the sum of the expected prices of the firm's assets on a sale within a limited time.

The question of whether a firm is nonviable is distinct from whether it is financially distressed; a firm may be financially distressed but viable. The means by which a firm's viability can or should be assessed in an insolvency system's procedures are beyond the scope of the Toolkit.

1.5 The Impact of Restructuring Frameworks

A well-functioning insolvency system seeks to sort financially distressed viable businesses from financially distressed nonviable businesses. See Box 2 for a discussion of viability in this context. The insolvency system should offer mechanisms allowing the first category of firm to be efficiently rescued and the second category to be efficiently liquidated. In a poorly designed or poorly functioning insolvency system, viable but financially distressed businesses may have to enter liquidation and close,[19] while nonviable and unproductive businesses may be more likely to stay afloat (these may be termed *zombie firms*).[20]

Restructuring enables the continued operation of a viable enterprise, preserves jobs, and ensures higher recovery rates for creditors. Restructuring frameworks help encourage domestic and foreign lending by giving financing providers assurance that, if a borrowing enterprise runs into financial difficulties, a framework is in place that will both protect creditor rights and allow a viable enterprise to resolve its indebtedness.

Because many workouts are confidential, it is difficult to obtain empirical data on their outcomes, particularly where they take place with no court involvement. Nevertheless, several studies show that insolvency regimes that include effective reorganization and out-of-court restructuring processes are associated with a lower cost and increased availability of credit, improved creditor recoveries, job preservation, increased entrepreneurship, and other economic benefits.[21] Examples include the following:

- Brazil's 2005 bankruptcy law reform aimed at improving the balance between reorganization and liquidation. It introduced a new out-of-court system for restructuring mechanisms known as *pre-packaged restructurings* (a type of hybrid workout; see chapter 5). After the reform, a statistically significant increase in the Brazilian private credit market was noted, with a 10 to 17 percent increase in total debt, and a 23 to 74 percent increase in long-term lending.[22]
- Colombia revised its corporate reorganization code in 1999, leading to dramatically improved efficiency in reorganization proceedings. The length of reorganization proceedings fell on average from 34 to 12 months. A study of the code found that, post-reform, reorganized firms achieved greater equity value than reorganized firms before the reform.[23]
- In the United Kingdom, comparisons have been undertaken of regular receivership and administration procedures with pre-packaged restructurings (see chapter 5). Studies have found that, of all sales of businesses as going concerns during receivership or administration proceedings without pre-packs, 65 percent resulted in the new owner preserving the entire workforce, whereas in pre-packaged cases, the owners preserved the entire workforce in 92 percent of cases.[24]

- A study of the Republic of Korea that quantified the benefits and costs of corporate debt restructuring concluded that corporate debt restructurings pay off with faster GDP growth due to increased corporate investment and the creation of more jobs.[25]

- It has been found that a higher number of zombie firms is associated with a lower ability to attract capital and with lower productivity growth.[26] Efficient restructuring frameworks also help foster entrepreneurship by lessening the risk an entrepreneur assumes should a venture fail. A study of the impact of procedures across the European Union that encourage early restructuring and facilitate continuation of debtors' operations found a positive correlation between such procedures and entrepreneurship.[27]

- As part of the larger insolvency and creditor/debtor rights system, restructuring can help mitigate the rise in NPLs and resolve existing NPLs, thereby strengthening overall financial sector stability and limiting credit misallocation.[28] The above study of procedures across the European Union showed that well-designed procedures that encourage early restructuring and facilitate continuation of debtors' operations help increase the speed at which NPLs return to normal levels following negative economic conditions.[29]

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2

Practical Considerations Relating to Workouts

This chapter outlines key practical considerations relating to workouts generally, whether they are OCWs, enhanced workouts, hybrid workouts, or preventative workouts. In-depth discussions of each of these types appear, respectively, in chapters 3, 4, 5, and 6.

This chapter describes the following matters commonly relevant to a workout process (the numbers refer to chapter sections):

2.1 Phases of the workout process

2.2 Relevant stakeholders in a workout

2.3 Preparing for workout negotiations

2.4 Standstill agreements and committees of creditors

2.5 Confidentiality

2.6 Financial models and valuation

2.7 The restructuring plan

2.8 The ranking of creditors' claims

2.9 Interim financing

2.10 The possible role of a mediator or conciliator

2.11 Contingency planning

2.12 The enabling environment for workouts

The chapter refers to the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes (the WB-ICR Principles).[30] These were originally developed in 2001 in response to a request from the international community in the wake of the financial crisis of the late 1990s. At that time, the WB-ICR Principles constituted the first internationally recognized benchmarks to be used to evaluate the effectiveness of creditor/debtor rights and insolvency systems. They have been periodically refined and updated since then with the guidance of the ICR Task Force.

The chapter also refers to the UNCITRAL Legislative Guide on Insolvency Law (the Legislative Guide).[31] The WB-ICR Principles and the Legislative Guide together form the Unified Insolvency and Creditor Rights Standard in insolvency law and practice.[32] This is recognized by the Financial Stability Board as one of the key standards for sound financial systems, and it represents the international consensus on best practices for evaluating and strengthening insolvency regimes.

MSEs, the majority of which are sole proprietorships and single-employee businesses, face challenges that make their restructuring particularly difficult. Among these challenges are information gaps due to their informality, inability to detect financial distress early, and social stigma.[33] Recognizing the specific challenges faced by financially distressed MSEs, the World Bank Group expanded the WB-ICR Principles to provide best-practice legislative standards for addressing the insolvency of MSEs. These principles emphasize specific features of MSE insolvency that partially modify or complement the general WB-ICR Principles. The central features of the new MSE insolvency principles include simplifying procedural formalities and reducing the cost of proceedings, using technology to support institutions, encouraging a debtor-in-possession restructuring model, promoting out-of-court solutions, and providing for automatic discharge of the good-faith, natural-person entrepreneur following liquidation. The MSE principles aim to identify aspects of insolvency regimes that impact an MSE, whether an individual person operating as an entrepreneur or an enterprise incorporated as a legal entity.

2.1 Phases of the Workout Process

A workout is likely to consist of either or both of the following (described in further detail below):

- An *operational restructuring* (also known as a *turnaround*), a significant adjustment to the assets or operations of the enterprise.
- A *financial restructuring* (also known as a *debt restructuring* or *balance-sheet restructuring*), focusing on the liabilities of the enterprise.

A financial restructuring involves adjusting the enterprise's liabilities in a fundamental way to make them sustainable for its business. This requires in-depth consideration of the enterprise's business capabilities, and for this reason, among others, some steps in an operational restructuring and a financial restructuring are similar. In addition, both types of restructuring typically seek to maintain, or restore, relevant stakeholders' confidence in the business. Section 2.2 below contains a nonexhaustive list of possible stakeholders.

Workouts take a wide variety of procedural and substantive forms, and every workout is unique in some respect. This is partly because no two financially distressed enterprises are in exactly the same situation. In very broad terms, however, a workout can be divided into the following phases:[34]

I. **Stabilizing**

II. **Analyzing**

III. **Repositioning or fundamentally changing the capital structure**

IV. **Reinforcing**

The different phases of a workout have no set order, and they frequently overlap. Actions undertaken in a restructuring process are typically time-sensitive (given the debtor's financial distress) and iterative (especially in light of the ongoing flow of information regarding the debtor and its situation).

Phase I. Stabilizing (common to an operational restructuring and a financial restructuring)

In the stabilizing phase, the focus is on identifying and reacting to the debtor's financial distress and on taking immediate action to stabilize the enterprise. The primary concern is improving the debtor's cash flow. In this way, the required "breathing space" can be created to meet critical short-term financial obligations. Some possible actions that can be taken include the following:

- Minimizing costs and potentially reducing or canceling new capital expenditure.
- Selling excess inventory.
- Reducing payment periods for customers and increasing payment periods for suppliers.

A standstill agreement (see section 2.4.1 below) can also assist in this regard. New (interim) financing from existing stakeholders or third parties (see section 2.9 below) may also be sought in this phase. It is often important that the debtor's management implement new (temporary) internal controls, including on the enterprise's cash outflows.

The governance of the enterprise may be strengthened by the temporary (interim) appointment of an experienced individual to the management team and potentially to the board of directors. Such individuals may be given the role of Chief Restructuring Officer (CRO). The CRO, typically someone with expertise in situations of financial distress, can provide a fresh perspective and a new, trusted channel of communication between the enterprise and its stakeholders. The CRO focuses full-time on the restructuring.

Phase II. Analyzing (common to an operational restructuring and a financial restructuring)

During Phase II, the enterprise (and stakeholders of the enterprise) must look at its long-term prospects. Drawing up an appropriate restructuring plan (see section 2.7 below) is of vital importance, including to maintain or restore relevant stakeholders' confidence in the enterprise. A range of measures can be taken to promote the long-term prospects of the enterprise, and those chosen will depend on the specific circumstances.

The restructuring plan must be realistic; interested parties will wish to make decisions on this basis. Financiers decide whether to maintain the financing that has been granted and to make further financing available. Suppliers of products and services decide whether to continue to supply the enterprise on credit. Due diligence by or for stakeholders (see section 2.3 below) is commonly undertaken, and an independent business review (see section 2.6 below) addressing the debtor's business and prospects may be prepared for creditors.

In parallel with or following Phase II (or both), the negotiation of a restructuring plan takes place between the debtor and at least some of its stakeholders whose economic positions are to be changed by the restructuring. In a successful workout, a restructuring plan is agreed and — subject to the necessary procedural steps — enters into effect.

Phase III. Repositioning (in an operational restructuring) or fundamentally changing the capital structure (in a financial restructuring)

Phase III consists of steps to reposition the enterprise (in an operational restructuring) or to fundamentally change its capital structure (in a financial restructuring). Certain steps cannot be categorized as clearly operational restructuring measures or as clearly financial restructuring measures; for example, a new focus on managing working capital or a revision of operational investment plans could be seen as falling into both categories.

Repositioning. The enterprise has entered into financial distress, likely with an associated loss of economic value to stakeholders (in particular, creditors and shareholders). The enterprise now needs to restore its competitive position in the market, and this is typically the aim of a new business plan (which should underpin the restructuring plan). The process of rescuing the enterprise may also require restoring confidence among stakeholders, particularly customers and suppliers, supporting its competitive position. Examples of measures that may be used in this context include (1) the divestment of noncore assets, (2) a focus on specific products, services, or customers, and (3) a cost reduction program. The process of repositioning commonly takes some time.

Fundamentally changing the capital structure. Typically, the enterprise is unable to meet its existing debt payment obligations from its actual or expected cash flows. A financial restructuring involves fundamental amendments to the agreements governing the firm's liabilities or entry into new agreements to govern those liabilities, or both, with a view to an appropriate new capital structure. Such amendments may be documented in a single contract or multiple contracts, and they are typically implemented upon the restructuring plan becoming effective (rather than over a period of time, as is common in the case of repositioning). The restructuring can include one or more of a range of possible elements, such as the following:

- *Debt rescheduling*: Extension of the dates on which payments are due under contractual debt terms.[35]
- *Release of debt (or debt forgiveness)*: Removal of an obligation by the debtor to repay an amount of debt.

- *Conversion of cash interest to payment-in-kind interest*: Making interest accrue as additional principal rather than being payable in cash, typically either (1) unconditionally, (2) automatically in certain circumstances, or (3) as elected by the debtor at the time.

- *Interest holiday*: Temporary suspension of interest payments.

- *Issuance of equity warrants or convertible debt*: Issuance to creditors of equity warrants they can exercise to obtain shares in the enterprise or debt instruments that they can convert into shares in the enterprise, in the event that it recovers and performs well.

- *Creation of guarantees*: Guarantees by a third party of creditors' claims (such that the size of the pool of available assets is increased).

- *Delivery of assets to creditors*: Payment to creditors in kind through the transfer of assets.

- *Transfer to creditors of stock in another enterprise*: Another type of payment in kind, in which the debtor transfers shares it owns in another enterprise to creditors.

- *Debt-for-equity swap (or debt-to-equity swap)*: Exchange of debt for shares in a debtor company.

- *Debt-for-debt swap (or debt-to-debt swap)*: Exchange of debt for other debt.

- *New financing*: Provision of new equity or debt financing by existing stakeholders or third parties (beyond any interim financing obtained during Phase I).

Phase IV. Reinforcing (common to an operational restructuring and a financial restructuring)

The debtor's current management team may be unable (or unlikely to be able) to complete the rescue of the enterprise, even taking into account repositioning or fundamental changes to its capital structure. Changing the management structure — including position changes, dismissal of key figures in management, or bringing in new directors — may be required. Such changes may be agreed as part of the restructuring plan, and creditors' approval of the plan may be conditional on these changes occurring shortly after it comes into effect.

2.2 Relevant Stakeholders in a Workout

The main participants in a workout process are the debtor and certain of its stakeholders (the parties, other than the debtor, that are or may be affected by the restructuring); this includes, in particular, some or all of its creditors. Not all of a debtor's stakeholders necessarily participate in the process.

Important aspects of an insolvency regime include the existence of a balance between the different interests of stakeholders, and appropriately reflecting stakeholders' interests and relevant social, political, and other policy considerations.[36]

Stakeholders may include parties such as the following:

Creditors (some or all of which are typically participants in the process):

- *Lenders* (including domestic and international banks, hedge funds, and other investment funds).

- *Bondholders* (including hedge funds and other investment funds), whose holdings may be very dispersed and whose approach may differ from that of bank lenders (particularly as they will often want to remain free to trade in the bonds (see sections 2.2.1 and 2.3) and may therefore be unwilling to receive certain nonpublic information).[37]

- *Hedge counterparties*.

- *Microfinance institutions* (including peer-to-peer lenders).

- *Trade creditors*, the enterprise's suppliers of products and services that are (at least in part) unpaid.

- *Landlords*.

- *Employees*, who may be represented by a works council or trade unions.

- *The debtor's pension scheme*.

- *The tax authority*, which often benefits from a preferential ranking ahead of certain other creditors.

Other economic stakeholders (which are sometimes participants in the process):

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- *Shareholders*.
- *Trade credit insurance providers*, as insurers of liabilities of the financially distressed enterprise to suppliers.
- *Credit default swap (CDS) protection sellers*, as providers of protection in respect of the occurrence of a specified *credit event* (such as nonpayment, insolvency, or restructuring, subject to certain criteria).[38]

Potential facilitators of the negotiations:

- *A Chief Restructuring Officer* (see section 2.1).
- *Alternative dispute resolution neutrals* (such as mediators or conciliators), as facilitators of inter-party negotiations (see section 2.10).

Guardians or promoters in a jurisdiction of institutional arrangements or restructurings in general (which are not typically participants in the process):

- *The central bank*, as the guardian of financial stability in the jurisdiction.
- *The stock exchange*, as the listing authority of the financially distressed enterprise.
- *The insolvency representative association*, as a party mandated to ensure the effectiveness and integrity of restructuring processes.
- *The pensions regulator*, as the authority responsible for ensuring protection of pension benefits.
- *The bankers' association*, as conveners of banks.
- *The chamber of commerce*, as a party interested in the sound functioning of the business environment.

The composition of the stakeholders in any given case depends on factors such as the type and size of the debtor (for example, whether it is a large, incorporated enterprise or an MSME). Support for a restructuring transaction will be needed from some or all of the stakeholders. It will be important for the debtor to identify both the stakeholders and their respective interests to be able to determine, broadly speaking, the terms of a restructuring transaction that are likely to achieve sufficient support.

As an enterprise approaches insolvency, the economic risks fall increasingly on its creditors. As such, creditors can typically be regarded as the key stakeholders in a workout. In addition, it is typically financial creditors (i.e., those with claims under financing arrangements rather than under operational or other contracts) who represent the majority of creditor claims by value and who individually have the largest outstanding claims. Given this, and supported (if applicable) by legal duties of directors of insolvent enterprises to act in creditors' interests, discussions and negotiations with financial creditors typically constitute a significant part of a workout process.

Different creditors may act in different ways, and this applies as much to financial institution creditors as to other types. Each institution will have its own approach to dealing with situations of financial distress. Nevertheless, some general points may be made. Banks with a long-term relationship with the financially distressed enterprise may focus on the continuation of that relationship. Some banks may have “workout units” — divisions specializing in situations where borrowers are in financial distress — and their restructuring negotiations may be led by those divisions; in such cases, bank relationship officers may play a secondary role. The approach of the manager of a hedge fund or other investment fund will depend in part on the mandate of the specific fund in which the debt is located, as well as on the expertise and investment objectives of the fund manager.

2.2.1 Debt Trading and Distressed Investing

Debt trading is the transfer of the benefit of a creditor’s claim to another party; that party assumes the claim, becoming the new creditor. Debt trading is one of many matters to be considered in the context of workouts; it can lead to changes in the identity of an enterprise’s stakeholders, including while a workout is under way.

Original creditors may undertake debt trades for a number of reasons — including to avoid the time commitment associated with participating in a workout process – resulting in their ceasing (of their own volition) to be creditors during workout negotiations. Certain fund managers (*distressed debt investors* or *distressed investors*) have particular expertise in situations of financial distress (sometimes referred to as *special situations*), and they may have an interest in acquiring the debt of financially distressed enterprises with a view to achieving their investment objectives. Reflecting the situation of financial distress, acquisition of such debt is generally at a discount — sometimes a very significant discount — to the par value of the debt.

The implications for an individual workout of debt trades (to distressed investors or otherwise) will depend on the specific circumstances. A small number of potential advantages and disadvantages are described below; a detailed discussion is outside the scope of the Toolkit.

Potential disadvantages include the following:

- Debt trades may lead to challenges in identifying creditors.
- The transferee of debt and the transferor of debt may differ in their views on matters relating to the workout. During negotiations on a restructuring transaction’s terms, debt trades may lead to the reopening of previously settled points or the opening of new ones.

Potential advantages include the following:

- Distressed investors are typically accustomed to taking decisions quickly on matters involving a relatively high level of risk, including in relation to providing interim financing (see section 2.9). In a workout, where the debtor is in financial difficulties and there may be no straightforward solutions, rapid decision-making on complex matters can be particularly beneficial in preserving value for all stakeholders.
- In view of particular regulatory or other standards to which existing creditors are subject, a debt trade may facilitate a restructuring. For example, a distressed investor may be more willing than an existing creditor (such as a bank) to take equity in exchange for debt.

2.3 Preparing for Workout Negotiations

As noted in section 2.1, restructuring negotiations can take place in parallel with Phase II, after Phase II, or both. Before a debtor or a stakeholder enters workout negotiations, it must prepare for these negotiations. It may retain advisors from a variety of disciplines, such as corporate finance, law, and accounting, to provide support in relation to the matters discussed in this section and the following sections.

Stakeholders commonly undertake (or instruct advisors to undertake on their behalf) an examination (*due diligence*) of the debtor’s state of affairs and financial condition. The aim is, in particular, to determine the causes of the debtor’s financial difficulties, assess its financial condition, and evaluate possible solutions. Box 3 contains a general checklist of matters to consider prior to engaging in negotiations. In many cases, information may be more readily available to a debtor than to stakeholders. In this case, a stakeholder (or its advisors) will often request the relevant information from the debtor. It may be provided during a standstill period, if there is one (see section 2.4), and will be subject to a confidentiality agreement, if appropriate (see section 2.5).

BOX 3: Considerations in Preparing for Workout Negotiations

This checklist is designed to apply to a corporate debtor that is part of a group of companies. Not all of the matters referred to here will be relevant in all circumstances, nor will it necessarily be feasible to obtain all of the listed information.

1. Group Structure

1.1 Prepare current group structure chart.

1.2 Identify the place of incorporation of each company.

1.3 Verify all shareholdings within the group.

1.4 Establish whether any companies in the group are publicly listed (and if so, where).

1.5 Establish the identity of any controlling shareholders or of identifiable groups of shareholders (e.g., family members).

1.6 Establish if there are any associated or related companies or individuals under local law.

1.7 Obtain up-to-date search information from all public registers.

1.8 Obtain copies of the constitutions of all companies.

2. Business and Assets

2.1 Identify business activities of the group.

2.2 Establish which companies in the group carry out which business activities.

2.3 Establish the level of interdependence of members of the group, such as common services or facilities, intragroup trading, and cross-ownership of assets.

2.4 Establish which companies own the operating and other assets of the group.

2.5 Establish the recent trading history of the group, including major changes in the business, acquisitions, or disposals.

2.6 Identify which assets are owned outright, and which assets are charged, leased, hired, licensed, subject to liens or retention of title, held on trust, or otherwise not subject to the claims of general creditors.

2.7 Obtain copies of any property, plant, or other asset registers of title.

2.8 Consider obtaining independent valuations of key assets likely to be essential for the business to continue or likely to need to be sold to raise finance.

3. Management

3.1 Identify current directors of all group companies.

3.2 Identify key managers and other employees who are not directors.

3.3 Identify connections, if any, between management and shareholders, including family connections.

3.4 If remuneration of management is linked to performance, establish details of the arrangements.

4. Key Contracts

4.1 Locate all key contracts.

4.2 Establish whether valuable contracts may be terminated by the counterparty or might automatically be terminated on an "insolvency." Determine whether "insolvency" includes restructuring, and whether it might make a difference if a restructuring does not involve a court proceeding.

4.3 Establish the consequences of termination by the debtor of key contracts, including claims for damages or contingent liabilities.

4.4 Establish the implications of a restructuring under contracts with customers and suppliers, information technology and intellectual property licenses, and property and other operating leases.

5. Financial Information

5.1 Obtain copies of the latest management accounts.

5.2 Obtain copies of recent audited accounts.

5.3 Identify the auditors of each company.

5.4 Obtain individual accounts as well as consolidated accounts.

5.5 Obtain or produce up-to-date cash flow statements and forecasts.

5.6 Obtain or produce budgets, forecasts, and other financial planning information.

6. Cash Flows

6.1 Identify all bank accounts of each company, including bank, location, currency, purpose, and current balance.

6.2 Describe cash flow patterns: which company receives and pays, how much it receives and pays, in which currency, and when.

6.3 Identify all intragroup payments and payment patterns.

6.4 Identify any intragroup loans and their terms.

6.5 Identify key cash flow dates, such as for payment of wages, rent, and other periodic sums.

7. Financing Arrangements

7.1 Identify all sources of financing used by the group, including intragroup loans (see point 6.4).

7.2 Obtain copies of all loan, bond, and finance lease documentation, and identify:

- Agents and trustees
- Amount and type of financing
- Current level of drawdown
- Repayment profile
- Currencies involved
- Interest rates and margins, both normal and default
- Fees and expenses
- Events of default and potential events of default
- Termination and acceleration rights
- Financial and other covenants
- Negative pledges
- Provisions allowing transfer of the debt
- Majority creditor voting thresholds
- Pro-rata sharing provisions
- Confidentiality provisions
- Governing law

7.3 Establish if there are any existing defaults. Have any default notices been served or rights reserved? Are there any letters extending or varying facilities?

7.4 Obtain copies of documents relating to all other facilities, such as:

- Overdrafts
- Letters of credit
- Bonding lines
- Bills of exchange
- Currency facilities

7.5 Identify any foreign exchange contracts, swaps, options, or other derivative contracts, and obtain copies of relevant ISDA Master Agreements and Schedules. Establish current mark-to-market values, close-out exposures, and the grounds on which termination may be permitted.

8. Guarantees and Security

8.1 Identify all guarantees given by or to members of the group, and note the following in each case:

- Identity of guarantor
- Beneficiary of guarantee
- Persons or entities whose liabilities are guaranteed
- Liabilities guaranteed
- Date of guarantee
- Purpose or benefit to the guarantor in providing the guarantee
- Enforceability of the guarantee under its governing law
- Risk that payment under the guarantee will be required

8.2 Identify all security given, and by which company to which creditor, including the following:

- Mortgages on land
- Debentures
- Charges or pledges over shares
- Charges by deposit of title deeds
- Charges on bank accounts
- Charges over movable or personal property, e.g., ships or aircraft
- Cash held as collateral, and its location
- Other collateral, type and location

8.3 Identify all creditors who may be able to assert liens, retention of title claims, trusts, or other proprietary (*in rem*) or security rights.

8.4 Check whether all security subject to a perfection requirement has been perfected; if not, assess the consequences of this.

9. Regulation

9.1 Establish whether the activities of the group are subject to regulation in any way. If so, identify the applicable regulators.

9.2 Establish whether the group holds licenses that permit its activities and whether these licenses may be affected by an "insolvency." Determine whether "insolvency" may include a restructuring, and whether it might make a difference if a restructuring does not involve a court proceeding.

9.3 Establish whether there are obligations to disclose insolvency-related events to regulators. If so, consider how this obligation is to be discharged, and when this must or should be done.

9.4 Establish whether any public announcements may be required, e.g., through a stock exchange.

10. Litigation

10.1 Obtain details of all material litigation against the group, including:

- Parties
- Nature and amount of claim
- Legal advisors
- Stage reached in the proceeding
- Advice received on likely outcome
- Insurance cover
- Settlement prospects

10.2 Obtain details of any claims or threats of litigation.

10.3 Establish if there are any significant overdue payments to suppliers, or to tax authorities or other governmental authorities. Determine whether any enforcement action has been threatened or commenced.

11. Stakeholders

11.1 Identify all relevant stakeholders, including creditors, shareholders, and governmental authorities, and determine their likely interests (see section 2.2).

12. Advisors

12.1 Obtain contact details for:

- Legal advisors to the group in the jurisdiction
- Legal advisors to the group in other jurisdictions
- Financial advisors to the group
- Any other relevant advisors to the group

12.2 Obtain contact details for any legal, financial, and other advisors to other relevant parties.

A stakeholder may not wish to receive nonpublic information during a workout for the following reason. Insider trading or market abuse laws or regulations, or market conduct rules, may prevent parties from trading debt if they hold nonpublic information (of a prescribed nature) relating to the debt or debtor, at least where the debt is traded on a regulated market or other multilateral system (as is common in the case of bonds; the issue may or may not arise in other contexts).[39] In the case of a workout, this may apply both to information regarding the debtor's business and financial condition and to information regarding potential restructuring terms. Certain creditors may wish to remain free to trade in the debt of the enterprise during a workout — i.e., to be "unrestricted" rather than "restricted" — and they may therefore (as a general matter) not want to receive nonpublic information as the workout progresses. A common means of facilitating a workout in these circumstances is for the debtor to disclose nonpublic information to these creditors' advisors, and for these creditors themselves to receive nonpublic information only at certain critical stages of a workout and for a limited period of time, at the end of which the significant elements of that information are disclosed publicly by the debtor ("cleansing").

2.4 Standstill Agreements and Committees of Creditors

2.4.1 Standstill Agreements

Creating a *standstill agreement* (also known as a *forbearance agreement*) is one of the typical first steps involved in a workout once creditors have convened. It is an agreement (either formal or informal) between the debtor and relevant creditors that the creditors will refrain from exercising rights and remedies against the debtor in respect of certain defaults for a specified period (the *standstill period*), subject to certain termination triggers. Alternatively, temporary waivers of creditors' contractual rights may be put in place to similar effect.

Some standstill agreements provide that creditors must keep open any existing lines of credit to the debtor or postpone any principal or interest payments falling due. Insolvent debtors do not necessarily fail to pay under all debt at the same time, but only under the facility whose payment comes due just as the debtor's financial condition becomes so acute that it cannot (or legally should not) make the next payment. As such, the burden of default commonly falls disproportionately on a subset of the creditors.[40] Creditors may agree to share the losses from a debtor default.

It should be emphasized that in certain hybrid workout procedures and in preventative workout procedures, a formal stay to prevent enforcement actions by creditors may be imposed by the court or come into effect automatically. However, in OCWs and in at least certain enhanced workouts, a standstill agreement would have to be negotiated with relevant parties. More generally, any successful financial restructuring generally requires involvement of the debtor's major financial creditors and their agreement not to take enforcement action, as their cooperation is needed to amend the capital structure. Typically, payments continue to be made to trade creditors, who are often unaware that the debtor is pursuing a restructuring.

The debtor is granted a reprieve from enforcement actions for the standstill period. In exchange, the debtor uses this time to prepare a restructuring plan and to provide creditors with relevant information on the enterprise and its financial condition, so that creditors can assess the causes of the financial difficulties, the appropriateness of the proposed restructuring plan, and potential alternatives to the proposed plan. Standstill periods vary in length. They often do not exceed several weeks, at least initially, though they may be extended by agreement among relevant parties.

2.4.2 Committees of Creditors

In individual cases, the number of creditors, or the range of types of creditors, may be such that coordination with and among them is not straightforward. In a reorganization procedure, a consultative function may be performed by a committee consisting generally of creditors (or parties representing creditors), the existence, constitution, and operations of which are prescribed by law or rules. The name of such a committee will depend on the jurisdiction; examples include *official committee* and simply *creditors' committee*, and the term *official committee* will be used here.

In a workout, a committee of creditors (commonly financial creditors) may be formed *other than* as an official committee. An objective of such a committee is to lead restructuring discussions and negotiations with the debtor. Although practice in connection with the formation of a committee (and associated terminology) will depend on the jurisdiction, the following points in this regard apply broadly:

- A group of certain creditors may coalesce informally, in which case it is known as an *ad hoc committee* or *ad hoc group*.

- A committee of certain creditors may be set up by a group of creditors, in which case it is known as a *steering committee* or *coordinating committee*.[41] Such a committee may be formally appointed by the debtor.

The constitution of a steering committee and its operations (for example, the responsibilities of its members and coverage of expenses such as advisors' fees) are typically governed by an agreement between the committee and the creditor group and, if applicable, a separate agreement between the committee and the debtor. Part of the role of a steering committee is to serve as a channel of communication between the debtor and creditors more broadly; an ad hoc committee may also serve as an informal channel of communication.

A designated leader of a steering committee or ad hoc committee may be referred to as a *committee chair*. Whether or not there is a committee, where a single bank out of multiple bank creditors (for example, a lender syndicate) is designated to lead restructuring discussions and negotiations with the debtor and to serve as a channel of communication between the debtor and the bank group, it is known as the *lead bank*.

If there are multiple groups of creditors, there may be multiple committees, committee chairs, and lead banks, as applicable.

2.5 Confidentiality

A level of confidentiality may be especially important in a workout to protect the debtor's business. In particular, the management of a struggling enterprise will commonly wish it not to be widely known that the enterprise is insolvent (or close to insolvency) or in restructuring discussions and negotiations with its creditors. This is commonly out of a concern that customers may walk away or that suppliers may terminate supply agreements (on the grounds of insolvency) or use a termination right as leverage in renegotiating the terms of supply agreements. In addition, if certain information (such as trade secrets) relating to the debtor's business becomes known to competitors, this may be damaging to the business. However, certain sensitive information will typically need to be provided to creditors (or their advisors) for creditors to be able to assess the debtor's financial condition and decide what restructuring terms may be appropriate. For this reason, confidentiality agreements are often used in a workout process.

In certain hybrid workout and preventative workout procedures, the level of confidentiality may be limited, at least where a court proceeding is under way. For instance, a stay on creditor enforcement action would likely entail giving all creditors notice and the court proceeding becoming public knowledge. There may therefore be a tradeoff between the advantages of a hybrid workout or preventative workout procedure and the disadvantages of associated publicity. An absence of publicity is a typical advantage of an OCW procedure or enhanced workout procedure as compared with other workout procedures (though in some hybrid workout procedures the likelihood of publicity may be mitigated, at least until relatively late in the process).

2.6 Financial Models and Valuation

Financial models (in spreadsheet form) are commonly used in workouts to facilitate financial analysis. Financial advisors retained by the debtor may prepare a financial model, a version of which may be shared with creditors. Creditors, and financial advisors to creditors, may also prepare their own financial model or models once they have sufficient information to do so. Commonly incorporating different scenarios (*sensitivities*) reflecting different risks or risk levels attached to the debtor's financial projections, such models are intended to assist (among other things) in reaching decisions on what would be a sustainable level of debt and, more broadly, an appropriate capital structure for the business. In addition, creditors (particularly financial creditors) may request that accountants prepare a report (an independent business review) discussing in detail the enterprise's financial condition and prospects.

Properly valuing a financially distressed debtor's business or assets is often important for an efficient restructuring, especially a financial restructuring. Creditors and their advisors commonly undertake valuations in order to estimate their recoveries in different scenarios and make informed decisions on the course of action to pursue. These decisions feed into restructuring negotiations. Valuations may also be required as part of a formal proceeding. In individual cases, valuations may be undertaken in a number of ways, including one or more of the following: through physical inspection of assets (especially in the case of real estate); via market testing (inviting indications of interest in all or part of the debtor's business from market participants); and on a desktop basis (i.e., without physical inspection or market testing).[42]

Reasonable valuations can be expected to produce a range of plausible values. In addition, different creditors may have different incentives in the context of valuation. Individual creditors may have commercial incentives to minimize the

losses they recognize (and in turn may adopt an optimistic position on the debtor's prospects). In addition, if the law allows disenfranchisement in the restructuring of out-of-the-money creditors (being, typically, those who would have no recoveries in an alternative scenario such as a liquidation), junior creditors may be financially incentivized to argue that the debtor's business has sufficient value that they are not out of the money.

2.7 The Restructuring Plan

A key responsibility of the debtor — by law or in practice — is to prepare and present to its creditors proposed terms of a restructuring (*a restructuring plan*), potentially via an insolvency representative. This would typically be during a standstill period, if there is one.

The restructuring plan is typically negotiated with representatives of creditors. Financial and legal advisors to the debtor and to the creditors may provide input on negotiating strategy, undertake negotiations, and advise on the substance and means of implementing possible restructuring plans. An insolvency representative may also provide input to the debtor in connection with the procedure's requirements or perform a role prescribed by law, or both, and may retain its own advisors to support it in this role. For practical reasons, summaries of proposed plans' key terms (known as *term sheets* or *heads of terms*) may be produced.

Once it appears that there is sufficient agreement on a particular proposal, and depending on the nature of the restructuring procedure, the restructuring plan may be formally voted on, submitted to the court for approval, or effected by an insolvency representative. The details of the plan depend mainly on the needs of the business and the willingness of creditors to make concessions to avoid a liquidation of the debtor and the risk of even lower recoveries. The workout can be completed preemptively, in an attempt to avoid default by the debtor under a payment obligation, or after such a default has taken place.

A debtor seeking to achieve a workout may have a number of different creditors to whom it owes various sums pursuant to different types of transactions and under different legal structures. In such a context, a restructuring will be assisted through the coordination of these different groups of creditors, straightforward voting, as applicable, and equitable treatment of claims. Creditors are often divided into separate classes for voting purposes, based on their preexisting rights or their rights under the proposed restructuring plan (or both).

2.8 The Ranking of Creditors' Claims

An *order of priorities* means that some creditors would have precedence over others in a distribution of the proceeds of the sale of the debtor's assets, if liquidation were to take place. There is no standardized order of priorities across jurisdictions; modern thinking suggests, however, that an order of priorities in an insolvency proceeding should generally reflect the priorities of claims established prior to the insolvency proceeding and that deviations from this general rule should occur only where necessary to promote other compelling policies. This is reflected in WB-ICR Principle C12.1. The applicable priorities on liquidation constitute part of the background against which workout negotiations take place, and the treatment of stakeholders in a workout typically (either consensually or as a matter of law, depending on the procedure) takes these priorities into account; see also section 3.4.2 below, Sixth Principle, regarding recoveries.

2.9 Interim Financing

A debtor may not be able to remain in business through a restructuring without additional financing, which would commonly be in the form of (1) debt (termed *interim financing, post-commencement financing, post-petition financing,* or *debtor-in-possession financing*, depending on the nature of the procedure), (2) new equity, or (3) proceeds from the sale of noncore assets. Such financing may be needed for operational purposes or (to keep restructuring negotiations to a readily manageable number of parties) to satisfy the claims of smaller creditors. If interim financing is unavailable, the debtor may experience liquidity problems (beyond any it is already experiencing). If the debtor is undergoing a workout, it may be forced to enter a reorganization proceeding or liquidation; if it is in a reorganization proceeding, it may be forced to enter liquidation. Given this, additional financing is often an important prerequisite of a successful and efficient restructuring.

The prospects of rescue for a financially distressed enterprise may be highly uncertain. The provision of new debt to such an enterprise, without some special protection being granted to that debt, would entail a level of counterparty risk that a potential debt financing provider may be unwilling to assume – either for a feasible interest rate (or other compensation) or at all. This is especially the case if the enterprise's financial condition is deteriorating rapidly, such that the time available for due diligence of its affairs is very limited.

BOX 4: Provision for Super Priority of Interim Financing in Singapore

Singapore's Insolvency, Restructuring and Dissolution Act 2018 provides that a court can grant super priority to interim financing provided during a scheme of arrangement or judicial management proceeding, subject to certain statutory criteria. One of these criteria is that the financing is necessary for the survival of the company as a going concern or necessary to achieve a more advantageous realization of the assets of the company than on a liquidation. The court may order the interim financing to be treated (1) as if it were part of the costs and expenses of a liquidation; (2) as having priority over all preferential and unsecured debts; (3) as secured over property that is not otherwise subject to any security, or by a subordinate security interest on property that is subject to an existing security interest; or (4) as secured by a security interest on property that is subject to an existing security, and the security interest ordered ranks *pari passu* with or higher in priority than the existing security interest, if there is adequate protection for the interests of the holder of the existing security interest.[45]

Given the potential importance of interim financing to the enterprise's survival, and consequently the potential benefit for creditors as a whole, it may be appropriate for such financing to be capable of benefiting from priority over existing debt of the debtor in the event of a subsequent formal insolvency proceeding. Such "super priority"[43] would be expected to have a positive impact in potential financiers' risk assessments, and thereby encourage the provision of interim financing. For instance, in the context of stabilizing and sustaining business operations of an insolvent enterprise, WB-ICR Principle C9.2 states: "Subject to appropriate safeguards, the business should have access to commercially sound forms of financing, including on terms that afford a repayment priority under exceptional circumstances, to enable the debtor to meet its ongoing business needs."

Where the granting of super priority for interim financing is not agreed to by all stakeholders who would be adversely affected by it, it may be appropriate for it to be imposed by law, subject to certain conditions. However, this is only feasible in the context of a formal proceeding — such as a reorganization or, potentially, during a hybrid workout or a preventative workout — where appropriate stakeholder protection can be ensured. See Box 4 for an example of a law providing for super priority in the context of formal proceedings. A detailed discussion of super priority in formal proceedings is outside the scope of the Toolkit; for considerations that may arise, reference should be made to the Legislative Guide.[44]

Outside a formal proceeding, super priority would typically involve granting consensual security over assets. In this situation, the following considerations may arise: (1) granting security may be prohibited by contractual terms of the firm's existing debt (such as a "negative pledge" clause); and (2) the debtor may have (i) limited unencumbered assets over which security could be granted, or (ii) limited excess value in encumbered assets (or both). In addition, the assumption of new debt in the amount required by the debtor may — even if unsecured — be prohibited by a contractual term of the firm's existing debt. Waiving a contractual prohibition would require creditor consent.

For these reasons, the potential availability of interim financing in a workout generally depends, in the first instance, on the prior consent of creditors under the debtor's existing financing arrangements. Such consent may or may not be forthcoming. Where it is not forthcoming, it may be appropriate for the debtor to use a formal proceeding — by way of a hybrid workout, preventative workout, or reorganization — with consequential advantages (potentially including super priority by law for interim financing) and disadvantages. On the other hand, where the granting of super priority for interim financing is agreed to by all stakeholders who would be adversely affected by it, it should as a general rule (1) be permitted, and (2) not be nullified in the event of a subsequent formal insolvency proceeding. Insolvency law in some jurisdictions may provide that super priority of interim financing can be nullified in a subsequent insolvency proceeding, and it may also entail liability for delaying the commencement of an insolvency proceeding and damaging creditors' interests; this may inhibit the achievability of workouts.[46]

2.10 The Possible Role of a Mediator or Conciliator

Workouts succeed when there is open dialogue and good-faith negotiation between the debtor and its creditors. At times, these elements may be missing. Alternative dispute resolution (ADR) neutrals (more specifically, mediators and conciliators) can be a means of support to facilitate negotiations. They can be used in a variety of restructuring procedures, and they are particularly beneficial in workouts.

Mediators and conciliators, for example, assist the parties by operating like intermediaries or referees, in that they facilitate an agreement between disputing parties. However, they are not authorized to make binding decisions for the parties. Instead, the goal is to guide the disputing parties to reach their own resolution (through a variety of techniques for which they must be specially trained). They are independent and objective third parties, and they frequently have vast experience in facilitating agreements, as well as substantive knowledge of the relevant topic. In addition, they may be aware of market-standard approaches to resolving issues that arise in workouts in a particular jurisdiction, and they may be familiar with common approaches to handling certain issues in a reorganization. These may serve as useful benchmarks for the parties when negotiating a workout. It can be particularly useful for mediators with specialized knowledge to facilitate negotiations involving small businesses, which may not have the knowledge and capacity to successfully negotiate agreements with creditors to relieve financial difficulties.[47] Ultimately, mediators and conciliators may help avoid recourse to litigation.

Mediation is also developing in light of emerging technologies. Online dispute resolution, particularly with the constraints faced in the COVID-19 pandemic, is rapidly developing in many economies.[48] It provides online technologies to digitize ADR and provides a potentially useful platform for pre-insolvency negotiation and restructurings.

WB-ICR Principle B4.1 (set out in full in section 2.12.1) notes that a workout process may function better if it enables the use of techniques such as mediation. The new WB-ICR Principle D5.4, in relation to the insolvency of MSEs, provides that the legal system should support and encourage the use of mediation, conciliation, and other ADR tools in simplified procedures. The use of mediation has been growing in both common law and civil law jurisdictions. The insolvency laws typically expressly include the use of these ADR mechanisms to overcome differences between parties. One of the available ADR schemes in Japan is described in Box 5.

2.11 Contingency Planning

The debtor may not be certain that it will be able to obtain, on a purely consensual basis, the necessary approvals from creditors or other stakeholders for its preferred restructuring plan, in particular approvals required under the preexisting contractual debt terms. The debtor and advisors to the debtor may therefore carry out contingency planning (also known as *Plan B planning*) in which one or more alternative means of implementation are prepared. These alternatives would generally involve a hybrid workout procedure or preventative workout procedure, or otherwise involve a formal proceeding, that would subject certain stakeholders to a cramdown (see section 3.3). To encourage approval of the debtor's preferred

BOX 5: Japan's Turnaround ADR Scheme

In 2007, Japan established a scheme called Turnaround ADR to facilitate the rescue of companies in financial distress through OCWs. Only financial creditors are involved, protecting the trade creditors and the debtor's relationship with them. The procedure is managed by a private sector institution, the Japan Association of Turnaround Professionals, which is both certified under the 2004 Act on Promotion of Use of Alternative Dispute Resolution under the Ministry of Justice of Japan and qualified as a certified dispute resolution business operator under the Industrial Competitiveness Enhancement Act under the Ministry of Economy, Trade, and Industry.[49] Under this procedure, the debtor in financial distress must prepare a restructuring plan, obtain the unanimous consent of its financial creditors, and implement the plan with the guidance of the Association. Reportedly, OCWs are increasingly preferred over the procedures provided for in the Japanese insolvency law.

restructuring plan and avoid needing to undertake the restructuring by the contingency plan route, the debtor may offer stakeholder classes more favorable terms for approval than would otherwise be available, and the debtor and advisors to the debtor may disclose details of (and potentially take steps under) the contingency plan.

2.12 The Enabling Environment for Workouts

Many factors determine the achievability and efficiency of workouts. These include legal matters, specifically related to insolvency and otherwise. They also include intangible elements, for example in relation to parties' willingness to enter into discussions regarding financial problems. This section addresses these considerations. After looking at the WB-ICR Principles (in section 2.12.1), the section addresses laws not specifically related to insolvency (in section 2.12.2) and concludes by addressing intangible elements (in section 2.12.3).

2.12.1 Workouts in the World Bank Group Principles for Effective Insolvency and Creditor/Debtor Regimes

Sections B3, B4, and B5 of the WB-ICR Principles set out best-practice guidance for restructurings.

PRINCIPLE B3: ENABLING LEGISLATIVE FRAMEWORK

SUMMARY

WB-ICR Principle B3 contains core criteria for establishing an enabling legislative framework — one conducive to conducting negotiations and undertaking analysis to preserve viable businesses in the economy. Such a framework should include the following:

- The availability of accurate and reliable information.
- A range of restructuring tools that stakeholders can use.
- Effective debt enforcement and insolvency procedures; restructuring negotiations conducted outside the context of formal proceedings (and, to an extent, those conducted within the framework of formal proceedings) take place in the "shadow of the law," i.e., against the backdrop of the applicable legal norms.
- Incentives to invest in or recapitalize viable financially distressed enterprises.
- Tax treatment that facilitates debt restructurings (expanded on in section 2.12.2 below).

In addition, WB-ICR Principle B3 states that regulatory impediments should be addressed.

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TEXT OF WB-ICR PRINCIPLE B3

B3	ENABLING LEGISLATIVE FRAMEWORK
	Corporate workouts and restructurings should be supported by an enabling environment, one that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An environment that enables debt and enterprise restructuring includes laws and procedures that:
B3.1	Require disclosure of or ensure access to timely, reliable, and accurate financial information on the distressed enterprise;
B3.2	Encourage lending to, investment in, or recapitalization of viable financially distressed enterprises;
B3.3	Flexibly accommodate a broad range of restructuring activities, involving asset sales, discounted debt sales, debt write-offs, debt reschedulings, debt and enterprise restructurings, and exchange offerings (debt-to-debt and debt-to-equity exchanges);
B3.4	Provide favorable or neutral tax treatment with respect to losses or write-offs that are necessary to achieve a debt restructuring based on the real market value of the assets subject to the transaction;
B3.5	Address regulatory impediments that may affect enterprise reorganizations; and
B3.6	Give creditors reliable recourse to enforcement, as outlined in Section A, and to liquidation and/or reorganization proceedings, as outlined in Section C.

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TEXT OF WB-ICR PRINCIPLE B4

B4	INFORMAL WORKOUT PROCEDURES	
	B4.1	An informal workout process may work better if it enables creditors and debtors to use informal techniques, such as voluntary negotiation or mediation or informal dispute resolution. While a reliable method for timely resolution of inter-creditor differences is important, the financial supervisor should play a facilitating role consistent with its regulatory duties as opposed to actively participating in the resolution of inter-creditor differences.
	B4.2	Where the informal procedure relies on a formal reorganization, the formal proceeding should be able to quickly process the informal, pre-negotiated agreement.
	B4.3	In the context of a systemic crisis, or where levels of corporate insolvency have reached systemic levels, informal rules and procedures may need to be supplemented by interim framework enhancement measures in order to address the special needs and circumstances encountered with a view to encouraging restructuring. Such interim measures are typically designed to cover the crisis and resolution period without undermining the conventional proceedings and systems.

PRINCIPLE B4: INFORMAL WORKOUT PROCEDURES

SUMMARY

WB-ICR Principle B4.1 encourages a facilitating role on the part of the financial supervisor; such a role may be most prominent in the context of enhanced workouts (addressed in chapter 4). In addition, it notes that the use of mediation may be beneficial; see section 2.10.

WB-ICR Principle B4.2 promotes the use of a formal proceeding to process a prenegotiated restructuring plan; this is a form of hybrid workout, covered in chapter 5.

WB-ICR Principle B4.3 states that in a systemic crisis, framework enhancement measures may need to be put in place. This may be through introducing an enhanced workout procedure; see chapter 4.

PRINCIPLE B5: REGULATION OF WORKOUT AND RISK MANAGEMENT PRACTICES

SUMMARY

WB-ICR Principle B5 recommends the development of a code of conduct on a voluntary procedure for dealing with cases of corporate financial difficulty in which financial institutions have a significant exposure. Such a code of conduct may take the form of guidelines for OCWs, which are covered in chapter 4.

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TEXT OF WB-ICR PRINCIPLE B5

B5	**Regulation of Workout and Risk Management Practices**	
	B5.1	A country's financial sector (possibly with the informal endorsement and assistance of the central bank, finance ministry, or bankers' association) should promote the development of a code of conduct on a voluntary, consensual procedure for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure, especially in markets where corporate insolvency has reached systemic levels.
	B5.2	In addition, good risk-management practices should be encouraged by regulators of financial institutions and supported by norms that facilitate effective internal procedures and practices supporting the prompt and efficient recovery and resolution of nonperforming loans and distressed assets.

2.12.2 Potential Impediments in Other Laws

Beyond the considerations outlined in section 2.12.1, laws not specifically related to insolvency may constrain the achievability and efficiency of workouts. Examples of the potential impact of such laws are as follows:

- Data privacy laws may restrict financial institutions from sharing information relating to a financially distressed debtor. This may impede the ability of creditors to work together to design an appropriate restructuring plan.[50]
- Public creditors such as tax authorities may not be permitted to release debt and accept a "haircut" on the principal, penalties, or interest (see section 2.1, Phase III). This may impede the process of reaching an agreement on a restructuring plan.
- Tax laws may give rise to difficulties in implementing workouts, including for the reasons described in Box 6.

Although the above list is not exhaustive, it shows that a broad range of legal considerations can be important for ensuring a sound enabling environment for workouts generally. In relation to the enabling environment for individual types of workout, certain further legal considerations are outlined in section 3.5 (OCWs), section 4.6 (enhanced workouts), section 5.7 (hybrid workouts), and section 6.5 (preventative workouts).

2.12.3 Establishing Intangible Elements of a Successful Framework

If certain intangible elements are not present, an economy may fail to reap the benefits of a workout framework, for example if private parties are not motivated to engage fully in discussions and negotiations. Such intangible elements include:

- A *willingness* on the part of creditors to proactively encourage debtors to seek help if they are facing financial difficulties.
- A *business culture* where debtors feel comfortable approaching creditors with financial problems in a timely way, i.e., at a minimum, while debtors' businesses are still viable.
- A *creditor culture*, where creditors readily work with each other and with debtors to obtain the best possible outcome in a difficult situation and take the initiative to do so.
- A *rescue culture*, where creditors recognize that restructurings can be in their best interest, compared to refusing to negotiate, enforcing security, or pursuing liquidation.
- *Good faith* on the part of debtors and creditors.
- *Commercial sensibility* on the part of debtors and creditors, including an awareness of the commercial realities arising from a situation of financial distress and a willingness to reach commercially reasonable and practical solutions.

BOX 6: Tax Considerations in Workouts

Tax policy plays a key role in creating adequate incentives for parties to agree to financial restructurings via workouts. While restructuring transactions that occur within formal insolvency proceedings are usually exempt from taxation, this is often not the case for identical transactions negotiated out of court. In fact, many aspects of restructurings — such as releases of debt, debt-for-equity swaps, and sales of assets — commonly result in a tax liability for debtors or creditors.

Two typical impediments that arise relate to (1) income recognition for debtors, and (2) the deductibility of losses for creditors. Both occur, for instance, in the context of net present value reductions in financial restructurings. In the case of the first impediment, any amount released by creditors is sometimes considered extraordinary income or a "gift" received by the debtor and is therefore treated as taxable income. This classification creates a new tax burden on a debtor already in financial distress. The second impediment arises from the inability of a creditor to deduct the losses incurred in a workout, including any amounts it has released. Although these amounts are typically regarded as losses under applicable accounting standards, before allowing their deductibility for tax purposes tax laws may impose additional stringent requirements, for example that collection efforts be exhausted. This requirement would not typically be met in workouts, where creditors do not generally undertake collection efforts. This restrictive interpretation of losses may significantly discourage creditors from engaging in workouts.

- An *understanding* by creditors of applicable methods and principles of workouts.
- A *setting* in which debtors and creditors feel they can and should engage in dialogue.

Governments can facilitate the existence of these intangible elements in various ways. For example:

- Governments can provide for "early warning tools." These mechanisms provide information to individual debtors that may be financially distressed (even if not technically insolvent), with the objective of addressing any such distress in a timely way. These mechanisms may encourage and assist near-insolvent debtors to take appropriate action, including approaching creditors. The earlier financial difficulties are tackled by a debtor and its creditors, the easier it may be to resolve them. Box 7 describes a European Union requirement for early warning tools, and Box 8 describes an early warning tool in Denmark (which has been in place since before the requirement was introduced).
- Governments can ensure that the directors of an insolvent entity have a legal duty to act in the interests of the entity's creditors. This may encourage the directors of insolvent entities to engage constructively with creditors to resolve financial difficulties.
- Governments can ensure that insolvency representatives are trained, regulated, and supervised. This may encourage (well-placed) trust by creditors in insolvency representatives, encouraging them to seek advice from insolvency representatives in dealing with financial distress, particularly regarding methods and principles for conducting workouts.
- Governments can ensure that laws on insolvency and the enforcement of security are clear and undertake efforts to ensure commercial parties are aware of them. Workout negotiations take place in the shadow of the law (see section 2.12.1). Clear laws, combined with awareness of them, encourage dialogue between stakeholders as opposed to litigation, in turn facilitating the achievement of workouts.

BOX 7: Early Warning Tools in the European Union

The Restructuring and Second Chance Directive[51] in the European Union requires member states to "ensure that debtors have access to one or more clear and transparent early warning tools which can detect circumstances that could give rise to a likelihood of insolvency and can signal to them the need to act without delay" (Article 3(1)).

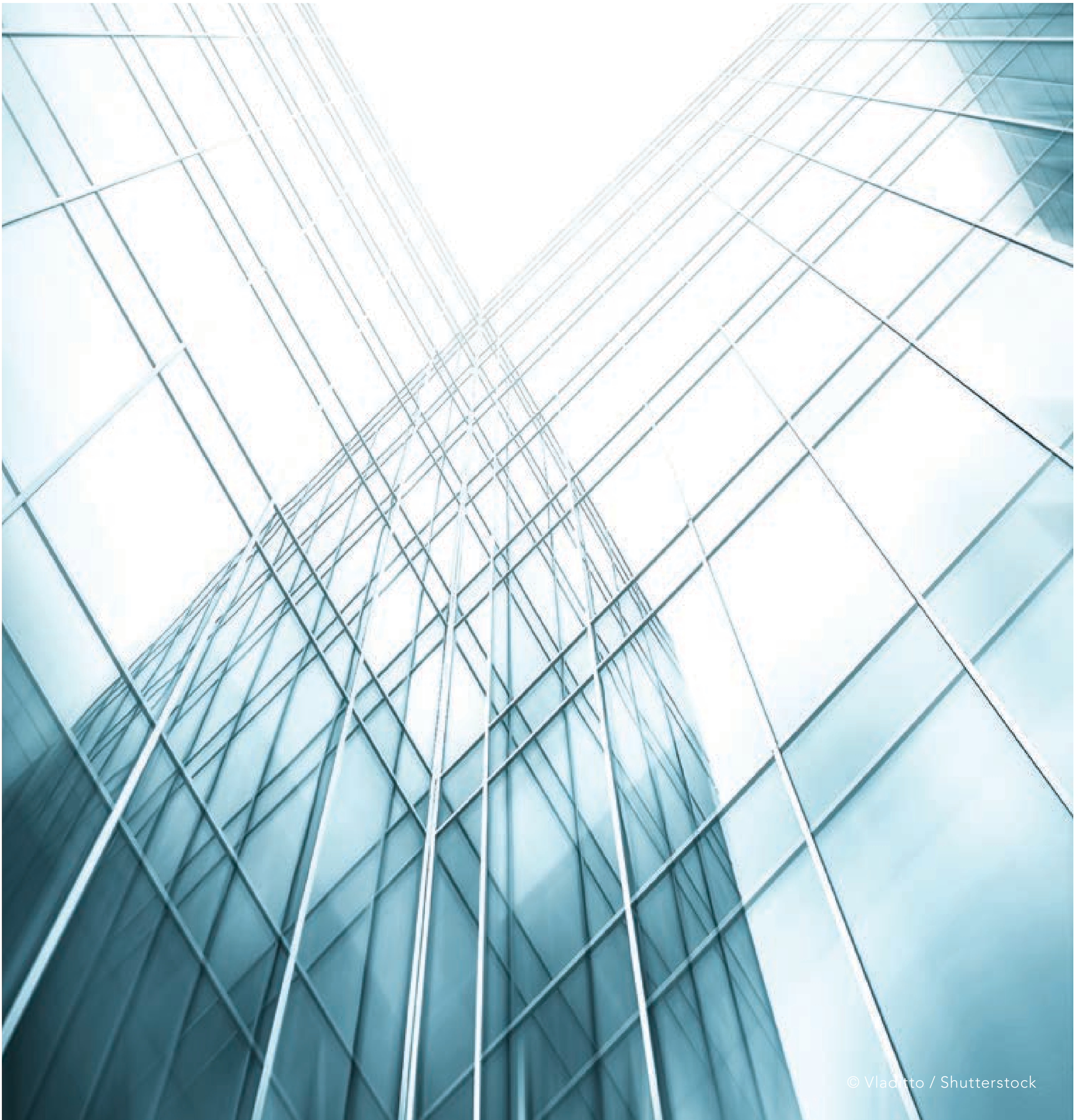
Early warning tools may include the following: (1) alert mechanisms when the debtor has not made certain types of payments; (2) advisory services provided by public or private organizations; and (3) incentives under national law for third parties with relevant information about the debtor, such as accountants and tax and social security authorities, to flag to the debtor a negative development (Article 3(2)).

BOX 8: Early Warning Tool in Denmark

In Denmark, an early warning tool has been providing free, impartial, and confidential assistance to small- and medium-sized enterprises, with the goal of avoiding insolvency on the part of such companies and improving their position. The system uses financial information provided by the Danish Business Registrar to detect potential distress and generates a list of potentially distressed companies. The list is then filtered. Relevant companies are contacted and invited to initiate a process that may include (among other things) defining their problems, matching them with expert legal advisors, coaching, action planning, and assistance with financial restructuring.[52]

In addition to intangible elements such as these, a strong institutional framework — and institutional capacity in practice — is critical for an effective insolvency system and in turn an effective workout framework. An important part of the framework consists of the institutions and participants with ultimate authority regarding matters arising in workouts, which may include courts, central banks, and insolvency representatives. Institutional and legal mechanisms must appropriately align incentives and disincentives across commercial, corporate, financial, and social systems;[53] laws on matters not specifically related to insolvency are relevant here (see section 2.12.2).

Other nonlegal factors can also have a significant impact on the achievability and efficiency of workouts. These include prudential standards, accounting standards, and macroeconomic conditions. Such factors are beyond the scope of the Toolkit.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Out-of-Court Workouts

3.1 What Are Out-of-Court Workouts?

An OCW is a privately negotiated restructuring. Such workouts also have the following characteristics:

- Typically, no administrative authority has introduced any restructuring-specific guidelines.
- If an administrative authority has introduced restructuring-specific guidelines, it has not set out an expectation or requirement that workout participants commit in a legally binding manner to follow them. In these cases, either the guidelines are not binding on workout participants or workout participants agree purely voluntarily to be bound by them.
- There is no provision for the court to play a role.

An OCW procedure is thus not structured by formal norms or formal modes of participation. The process is moved forward by the parties, to the extent there is sufficient willingness among them for this to happen. Broadly speaking, all stakeholders to be bound by the terms of a restructuring plan must be persuaded that the plan is in their best commercial interests.[54]

3.2 Advantages of Out-of-Court Workouts

Advantages of OCWs include the following attributes:

- OCWs are *fast*, as there are no procedures with preestablished time frames to follow. If negotiations with creditors are properly conducted, and the right incentives are in place, the process can be highly efficient.[55]
- OCWs are *inexpensive*, as the absence of court proceedings means that the expense associated with court filings and attending court hearings can be avoided.[56]
- OCWs are *flexible*, in two respects. First, parties can agree to restructuring terms in the way most convenient for them (for example, parties are free to decide on the manner in which information is shared during the process). Second, subject only to requirements of general law (see the next point), parties can tailor restructuring plans to individual situations; this may or may not be the case in other types of procedure.

- OCWs are *informal*. Restructuring negotiations are not subject to specific requirements, and restructuring terms — embodied in a contract or contracts — are subject only to requirements under applicable governing law for a contract of this nature to be binding. Among other things, this informality may avoid termination of licenses or authorizations of the debtor that would be triggered by a formal proceeding.

- OCWs are *confidential*, since the negotiations and their outcome are generally not publicly disseminated (except where the debtor has securities traded on a regulated market or other multilateral system, in which case public reporting may be required or beneficial; see section 2.3). In many economies, a stigma attaches to insolvency proceedings. OCWs are less prone to adverse publicity than insolvency proceedings, perhaps especially where confidentiality agreements have been entered into (see section 2.5). An OCW may therefore be more helpful than an insolvency proceeding in preventing reputational damage to the debtor and in turn a loss of value in its business.

3.3 Disadvantages of Out-of-Court Workouts

Potential disadvantages of OCWs include the following:

- *Purely voluntary nature*. An OCW is only possible if the enterprise's key creditors are willing voluntarily to explore it as a viable option. Key creditors commonly act as a driving force; their choice to either agree or not agree to pursue a restructuring plan through an OCW may induce others to follow suit, even in the absence of deliberate coordination.

- *Absence of a stay*. An OCW can only be successful where relevant parties share a real willingness to reach a consensual agreement, either due to an underlying wish to do so or simply by necessity. OCWs offer no statutory stays; therefore the status quo can be altered at any time by a creditor's unilateral action (such as security enforcement or the initiation of an insolvency proceeding). A contractual stay can mitigate this, but it requires agreement by at least a significant proportion of creditors to be effective. The lack of a formal stay while resolving the enterprise's problems represents a disadvantage of OCWs. Creditors may simply not consent to refrain from unilateral action while waiting for a privately negotiated agreement to be reached, and there is a risk that individual creditors will race to grab assets of the debtor in their own self-interest.

- *Nonalignment of interests*. There are frequently different types of creditors with distinct interests (for example, secured and unsecured), so it may be difficult to engage in meaningful negotiations if various classes of creditors are all present. It may make negotiations easier to separate them into groups and have separate negotiations with each group. Where such an approach is pursued, the debtor will need to consider both the sequencing of the negotiations and appropriate interconditionality between concessions requested of different groups.

- *Requirement for coordination*. Negotiations may be challenging unless an ad hoc committee or steering committee facilitates discussions among participants, especially where there is a large number of creditors or a broad range of disparate creditors. (See section 2.4.2.)

- *"Holding out."* Very significantly, given the contractual nature of OCWs, they are binding only through contractual terms and are therefore commonly binding only on signatories. The fundamental changes to a debtor's capital structure involved in a successful financial restructuring (see section 2.1) are commonly not permitted by the pre-existing contractual debt terms without unanimous creditor consent; they typically fall outside the scope of contractual debt terms that allow changes with the consent of a specified majority of creditors. There may therefore be a particular risk of a creditor or shareholder "holding out."

  - In the case of a creditor, this commonly involves the creditor not pursuing a consensual restructuring but instead seeking repayment of the debt owed to it at par or close to par. The creditor may litigate to this end, potentially in parallel with negotiating.

  - A debtor's financial condition may mean that it is not readily able to satisfy the demands of a holdout stakeholder, and other stakeholders may also be prompted not to make concessions unless the holdout stakeholder does so. As such, holding out can impede the achievement of a restructuring.

  - The holdout problem may be avoided with a hybrid workout procedure or a formal proceeding in which the terms of a restructuring plan can be crammed down on nonconsenting creditors and shareholders (see section 5.2).

- *Information asymmetry*. Imbalances in information available to a debtor and its creditors can lead to suboptimal outcomes (including the liquidation of viable firms).[57] To minimize this issue, the debtor can provide creditors with all information material to the decisions the creditors are

being asked to make. However, such disclosure will need to be subject to appropriate confidentiality protections (see section 2.5) and limited vis-à-vis particular creditors where requested by or on behalf of those creditors.[58]

- *Nullification of agreements, or liability, under insolvency law*. Subject to certain conditions, legislative provisions may (1) nullify the creation of additional security or preferences entered into within a particular period of time prior to insolvency, and (2) entail liability for delaying the commencement of an insolvency proceeding and damaging creditors' interests. If not appropriately limited, such provisions may impede OCWs because parties may be reluctant to enter into agreements that involve a significant risk of nullification or liability in a downside scenario. Agreements relevant in this context include those granting super priority to interim financing (see section 2.9).

- *Absence of formal scrutiny*. An OCW does not allow for formal scrutiny of the pre-restructuring conduct of directors or others involved in the management of the debtor. To promote responsible corporate governance and allow remedies in instances of inappropriate conduct, such scrutiny may form an integral part of a formal insolvency proceeding.

- *Requirement of a highly developed creditor culture*. An OCW requires creditors that readily work flexibly and efficiently with each other and with debtors to obtain the best possible outcome in a difficult situation, and take the initiative to do so; see also section 3.5 below regarding *negotiation culture*.

- *Possible lack of foreign recognition*. In the absence of a formal proceeding, restructuring terms may not be recognized in all jurisdictions relevant to the debtor's business.

3.4 Examples of Guidelines

As stated in section 3.1, participants in an OCW may be subject to nonbinding restructuring-specific guidelines or to ones to which they have agreed purely voluntarily to be bound. Such guidelines will be of limited value if a significant proportion of stakeholders do not follow them: they depend on a collective approach. Examples of guidelines, together with certain observations that apply to OCWs in general, are described in sections 3.4.1 and 3.4.2.

3.4.1 London Approach[59]

The London Approach was one of the earliest widely followed OCW models. It deals with situations in which a company is in serious financial difficulties and consists of certain general, nonbinding principles describing how creditors should respond. Its guiding objective is to facilitate the restructuring of viable firms.

The London Approach was developed in the London corporate banking market from the 1970s onwards, and it was in wide use in the United Kingdom. It evolved with encouragement from the Bank of England, which played a critical role in individual workouts. The Bank of England's main aim was to bring negotiations to a satisfactory conclusion, and its position in the banking system allowed it to exert considerable moral suasion vis-à-vis bank creditors.

The main tenets of the London Approach are summarized in Box 9. Since the 1990s, the use of the London Approach in practice in the United Kingdom has been more limited. This may reflect factors such as increased fragmentation and diversity of creditor groups and increased complexity of debtors' capital structures.[60]

BOX 9: The Main Tenets of the London Approach

1. Bank creditors should be supportive when they receive information that a borrower is in financial difficulties.
2. Decisions about the debtor's longer-term future should only be made on the basis of comprehensive information that is shared among all bank creditors and other relevant parties.
3. Banks should work together to reach a collective view on whether, and if so, on what terms, the debtor should be given a financial lifeline.
4. The seniority of claims should be recognized, but there should be equal treatment for all creditors of a single category.

3.4.2 INSOL Principles for Workouts

Published by INSOL International and now in their second edition, the "Statement of Principles for a Global Approach to Multi-Creditor Workouts" (the INSOL Principles) are a further example of OCW guidelines. The INSOL Principles were designed to facilitate the restructuring of debtors through a coordinated and cooperative approach.

The eight INSOL Principles are listed here, followed by commentary on the most salient aspects of their envisaged operation. The INSOL Principles bring out many considerations that apply to workouts generally (at least in respect of private negotiations), and the commentary should be read with this in mind.

FIRST PRINCIPLE: Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to co-operate with each other to give sufficient (though limited) time (a "Standstill Period") to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor's financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case.[61]

COMMENTARY

1. No enterprise has a right to breathing space to conduct an OCW: the granting of a standstill period is a concession by creditors and not a right of the debtor. The debtor (together with, if applicable, its advisors) should assess whether there is a realistic possibility that its financial difficulties can be resolved and the enterprise's sustainability restored. If a realistic possibility does not exist, liquidation of the enterprise through a formal insolvency proceeding should be considered.

2. The standstill period allows the debtor time to prepare a restructuring plan. The plan should show how the business is capable of operating profitably and that there is, essentially, a reasonable prospect that a restructuring will return the debtor to a sustainable position.

3. The support of relevant creditors is essential to the restructuring's success. The identities of the creditors from whom concessions are sought should be strategically determined to minimize the complexity of the negotiations as far as possible. If there is insufficient creditor support for granting the debtor a reprieve to find a solution to its financial difficulties, an OCW will in almost all cases be either unable to proceed or unsuccessful. That said, enterprises commonly get into trouble, and creditors' interests may be served by the pursuit of a restructuring.

4. The initial standstill period will often not exceed several weeks, though this will depend on the circumstances of the individual case.[62]

5. During the standstill period, it is important that creditors continue to receive sufficient current and reliable information to enable them to determine the causes of the debtor's financial difficulties, assess its financial condition, and evaluate possible solutions.

6. An ever-present challenge for the debtor is the natural tendency of many creditors to adopt an "each creditor for itself" approach and to pressure the debtor for payment on an individual basis. The effectiveness of such a strategy will depend in part on the provisions of domestic insolvency law dealing with transactions undertaken on the eve of a debtor's insolvency. For example, in some jurisdictions, the application of such pressure can be a defense to a claim brought by a subsequent liquidator to challenge the validity of the transaction as a preference.

SECOND PRINCIPLE: During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.[63] Conflicts of interest in the creditor group should be identified early and dealt with appropriately.

COMMENTARY

1. The objective of this principle is to achieve stability and to maintain the pre-standstill status quo among relevant existing creditors.

2. Creditors typically wish to be confident that, in deciding not to pursue their individual rights and remedies, they would not be prejudiced vis-à-vis other creditors if a consensual way forward for the restructuring of the debtor cannot be found. Each creditor's relative ranking should be neither worsened nor improved during the OCW process unless this is voluntarily agreed to by or on behalf of the relevant creditor or creditors.

THIRD PRINCIPLE: During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date.[64]

COMMENTARY

1. Standstill Commencement Date is when the principles start to operate and the standstill arrangements commence.

2. If the creditors are to expressly or tacitly agree that they will not take any steps intended to enable one (or one group of them) to gain an advantage over other creditors, it follows that the debtor should also agree not to undertake any activities or transactions that would be detrimental to the interests of any creditor or class of creditors or alter their respective priority positions.

3. An important exception to this principle is an ability of the debtor to continue to make payments in what is commonly referred to as "the ordinary course of business," as otherwise the debtor would not be able to continue to trade while attempts are made to agree to the terms of an OCW. However, the following should not be undertaken: transactions not for full value; preferential payments; granting security for past debts; and, without appropriate creditor consent, incurring new debt (at least other than to suppliers in the ordinary way).

FOURTH PRINCIPLE: The interests of relevant creditors are best served by coordinating their response to a debtor in financial difficulty. Such coordination will be facilitated by the selection of one or more representative coordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.[65]

COMMENTARY

1. All negotiations between the debtor and relevant creditors should be conducted in good faith, in an atmosphere of honesty and frankness, and with the objective of finding a constructive solution. If any parties lose confidence that their counterparts are negotiating in good faith, the negotiations are likely to fail and creditors will tend to fall back on their legal rights and remedies, initiating enforcement proceedings, insolvency proceedings, or both.

2. The number of creditor groups that can be involved in an OCW, their different priority positions in the event of liquidation, and differing views within those creditor groups, mean that it is often advisable for ad hoc committees or steering committees (termed "coordination committees" in the INSOL Principles) to be formed and for external advisors to play a part in achieving a consensus. Such committees, generally including the largest or most representative creditors, lead restructuring discussions and negotiations with the debtor and may serve as a channel of communication between the debtor and creditors. (See section 2.4.2.)

3. It may be appropriate for the costs of external advisors (perhaps within specified limits) to be for the account of the debtor. This should be agreed in advance with the debtor.

FIFTH PRINCIPLE: During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, in order to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.[66]

COMMENTARY

1. The integrity of the process depends on creditors receiving good-quality information. Although time in most cases is of the essence — and, indeed, the tension of deadlines serves a valuable purpose in reaching agreement — the standstill period should be sufficiently long to enable information gathering, dissemination, and analysis.

2. It is in the debtor's interests to disclose all required information to all counterparties involved in the restructuring negotiations (subject to appropriate confidentiality protections, as noted in section 2.5, and unless otherwise requested by or on behalf of creditors).[67] At the very least, this information should include full details of the debtor's assets and liabilities, information on its trading relationships, and information relating to its future business prospects. Full disclosure may mean provision by the debtor of (1) accounts beyond those it is contractually obliged to supply, and (2) forecasts and projections more detailed than those it would normally prepare.

3. The creditors should be given sufficient time to consider the details of the proposed OCW solution.

SIXTH PRINCIPLE: Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the Standstill Commencement Date.[68]

COMMENTARY

1. Absent special circumstances, creditors will wish to be assured that the debtor will treat similarly situated creditors alike, both throughout the OCW process and in any proposed restructuring plan.

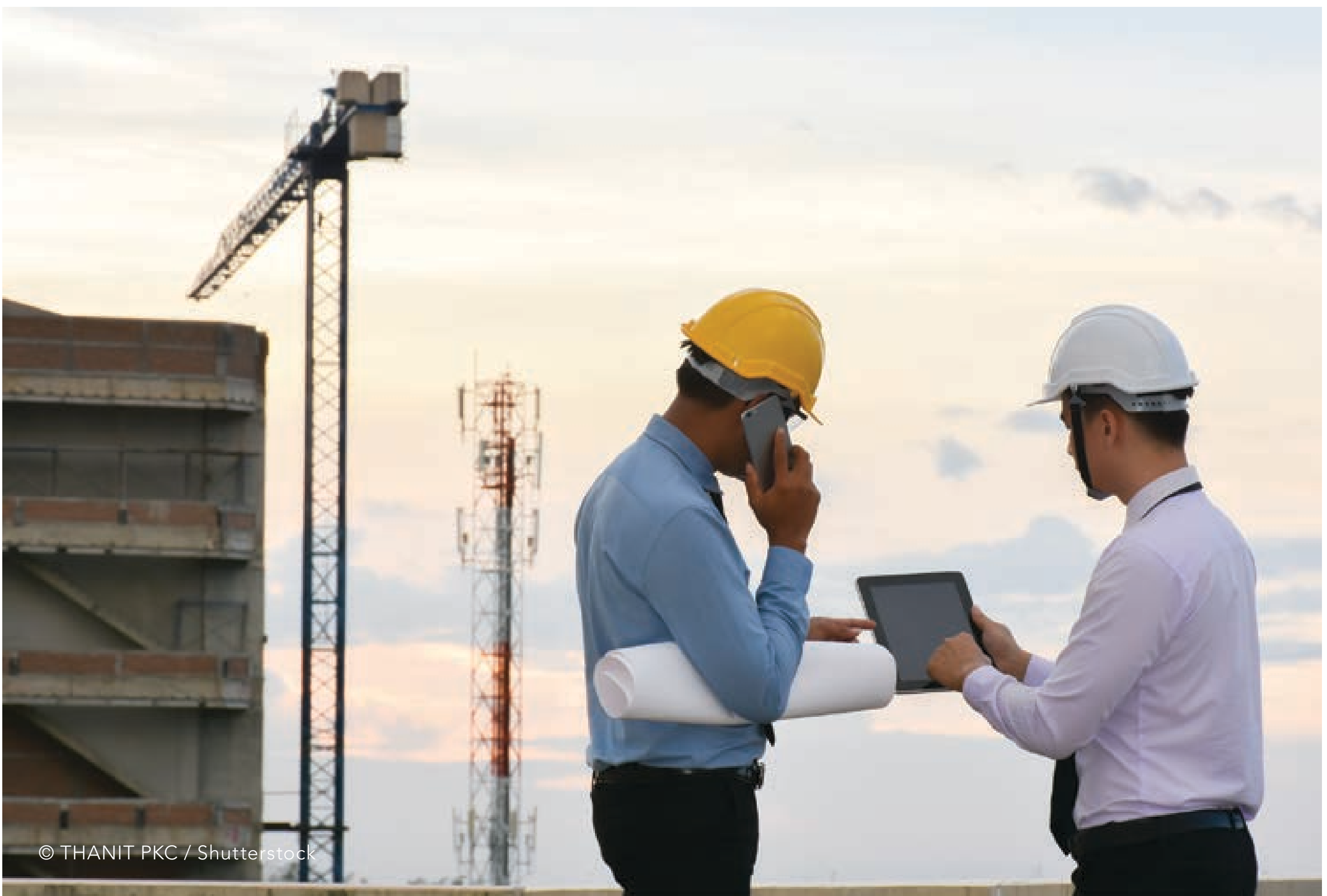
2. The provisions of applicable insolvency law typically guide determinations of the relative priority positions of stakeholders.

3. Creditors will typically analyze their positions under different scenarios (for example, in a liquidation or in a judicial reorganization) in deciding their position on a proposed restructuring plan. That said, creditors may appreciate that it may be necessary for trade creditors owed small amounts to be paid in full to achieve greater consensus and to facilitate continuation of the debtor's enterprise.

SEVENTH PRINCIPLE: Information obtained for the purposes of the process concerning the assets, liabilities and business of the debtor and any proposals for resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential.[69]

COMMENTARY

1. All relevant creditors should, ideally, be provided with the same information, subject to points 2 and 3 below. Information should be as detailed as the circumstances of the case require and should in any event be sufficiently detailed to permit creditors to form their own views of the merits of the proposal put forward by the debtor. New and updated information should be provided by the debtor during the OCW, including regarding significant events affecting it.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2. Information may be the subject of legitimate confidentiality concerns, in which case entry into confidentiality agreements by creditors (and, if applicable, advisors to creditors) may be necessary before the information is made available. Where the proposed recipients of information concerning the debtor are lenders, they may have legal duties to treat such information in confidence even in the absence of a confidentiality agreement, though the debtor may consider it nevertheless prudent for them to enter into a confidentiality agreement covering the specific circumstances.

3. Certain creditors may (as a general matter) not want to receive nonpublic information as the workout progresses; see section 2.3.

EIGHTH PRINCIPLE: If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.[70]

COMMENTARY

1. The debtor's ability to continue in business during a period of private negotiations is required for an OCW to be feasible, and a debtor may need to raise funds in order to do so. Potential sources include the proceeds of the sale of noncore assets, new equity from existing shareholders, and interim financing (see section 2.9) from existing creditors or third parties.

2. Unless a certain degree of priority is accorded to additional debt financing, it is highly unlikely that it will be made available, and the OCW may fail to survive long enough to permit a restructuring plan to be fully developed and considered by creditors. In practice, however, the requisite priority may not be available (see section 2.9).

3.5 The Enabling Environment for Out-of-Court Workouts

In addition to the considerations described in section 2.12 (regarding the enabling environment for workouts generally), the following considerations apply to OCWs in particular:

- A broad range of restructuring transactions should be permissible under contract law, such that (from a legal perspective) formal proceedings are not required to achieve them. These include debt reschedulings and debt-for-equity swaps (see section 2.1, Phase III).

- There should be a strong *negotiation culture* among debtors and creditors: they should be willing and able to engage cooperatively in informal negotiations with each other. Where they are not, for example, because of insufficient trust or lack of experience in resolving difficult issues outside a formal framework, OCWs may not be achievable.

- As noted in section 2.12.1, OCW negotiations take place in the shadow of the law. As such, formal insolvency and enforcement procedures should be available for use where appropriate and necessary, and the laws on such procedures should be clear and known to commercial parties to facilitate workouts (see section 2.12.3).

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Enhanced Workouts

4.1 What Are Enhanced Workouts?

An OCW is not structured using formal norms or formal modes of participation but is entirely driven by the players and their needs. Broadly speaking, all stakeholders who are to be bound by the terms of the restructuring plan must be persuaded that the plan is in their best commercial interests (see section 3.3). Such a procedure can be enhanced through the involvement of an administrative authority (such as a central bank or insolvency regulator) to seek to encourage stakeholders to enter into restructuring plans.

Enhanced workouts are restructurings in which participants are bound by law, regulation, or contract to follow restructuring-specific standards introduced by an administrative authority such as a central bank, in accordance with an expectation or requirement set out by that authority, but where there is no provision for the court to play a role.

By way of example, standards may take the form of accords, intercreditor agreements, or central bank circulars. These may provide fiscal and regulatory incentives for creditors to take particular types of action during workouts. Moreover, they may legally bind workout participants (under contract law, commercial law, or otherwise) to procedural elements such as (1) a mechanism under which agreements reached among a specified majority of financial institutions can be imposed on nonconsenting financial institutions; (2) use of formal arbitration to resolve disputes; and (3) penalties for failure to meet deadlines.[71]

Policy makers have focused particularly on the advantages of enhanced workout procedures in the aftermath of crises, especially when large stocks of NPLs require resolution. Although enhanced workout procedures depend on an administrative authority's involvement at least for their introduction, they do not provide for a role for the court. They may be particularly advantageous during the COVID-19 crisis, when pressure on court resources around the world is acute.

In certain cases, restructuring participants may not commit in a legally binding manner to follow restructuring-specific standards, even if they are expected or required to do so. There are several potential impediments. First, legal matters not specifically related to insolvency may interfere with use of such standards (see section 2.12). Second, participants may not recognize that conducting a workout, or conducting a workout within the framework of such standards, would serve their collective interests. Third, individual creditors may not follow such standards

if they are not satisfied that all (relevant) creditors will do so. Communications efforts and capacity-building may assist in addressing the second and third impediments; these matters are addressed in section 4.5.3 below.

For completeness, public asset management companies (AMCs) should be borne in mind in this context. These are entities established by governments to acquire nonperforming assets from financial institutions to enhance both recoveries from those assets and the lending capacity of the financial institutions. They usually incorporate an enhanced workout procedure. Examples are described in Box 10. AMCs are outside the scope of the Toolkit; regarding their effectiveness and issues relating to their establishment and operation, refer to *Public Asset Management Companies: A Toolkit*.[72]

4.2 Advantages of Enhanced Workouts

Potential advantages of enhanced workouts include the following:

- *Relative lack of expense*. The absence of court proceedings means that the expense associated with court filings and attending court hearings can be avoided.
- *Confidentiality*. The negotiations and their outcome are generally not publicly disseminated (except where the debtor has securities traded on a regulated market or other multilateral system, in which case public reporting

BOX 10: Asset Management Companies

AMC with a restructuring mandate

- **Malaysia's Danaharta** was a government-owned AMC set up in 1998 with a projected lifespan of seven years. Danaharta was given special powers, such as to transfer loans in and out of the AMC without debtor consent or to appoint a special administrator over debtor companies without the need for judicial approval in order to speed up restructuring.[73] It engaged in both restructuring and asset sales.[74] Danaharta acquired about 70 percent of banking sector NPLs with only 3,000 loans. By 2005, it had recovered approximately 58 percent of the book value of its total NPL portfolio.[75]

AMCs with a mandate for rapid asset disposal

- **Ireland's National Asset Management Agency (NAMA)** was established in December 2009 as a statutory body[76] with an objective of purchasing distressed real estate assets from the banking sector and disposing of them. By the end of 2011, a total of EUR 74 billion in loans had been transferred to NAMA by five participating institutions and EUR 32 billion had been paid as consideration to the institutions, an overall discount of 57 percent. As payment, NAMA issued EUR 32 billion of government-guaranteed senior bonds (95 percent) and subordinated debt (5 percent). By October 2017, NAMA had redeemed all the government-guaranteed senior bonds.[77] By 2019, it had also redeemed the subordinated debt, which at the time of NAMA's creation was not expected to be redeemed. Key factors behind NAMA's success included a small number of assets (3,000); broad political support; purchases of all loans (NPLs and performing loans) from individual debtors, which provided much-needed cash at inception; an asset portfolio in the United Kingdom that provided NAMA with cash in the early years; and a strong governance and reporting framework.
- **Spain's Sareb**[78] was created in November 2012 as a private for-profit company with a public mandate to acquire, manage, and dispose of real estate assets transferred from distressed banks. The majority of Sareb's share capital (55 percent) is owned by private shareholders, while the main shareholder is a public fund owning the rest of Sareb's equity. Article 3 of the Royal Decree of November 15, 2012,[79] gave wide discretion to Sareb to maximize value recovery during its maximum 15 years of operation. Between its inception and December 31, 2020, Sareb had reduced its portfolio from approximately EUR 50.8 billion to approximately EUR 31.5 billion (i.e., by approximately 38 percent). As compared with NAMA, Sareb took on a higher number of assets (approximately 200,000). It also had issues at inception with servicing loans, as the transferring banks were not interested in continuing such servicing.

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may be required or beneficial; see section 2.3). In many economies, a stigma attaches to insolvency proceedings (as noted in section 3.2). Enhanced workouts are less prone to adverse publicity than insolvency proceedings and therefore can help prevent reputational damage to the debtor and in turn a loss of value in its business.

- *Cooperation*. The standards introduced by the administrative authority can provide incentives for creditors to seek to reach agreement on restructuring terms expeditiously. These can include, for example, fiscal incentives or penalties for failure to meet deadlines.

- *Cramdown of the agreement on nonconsenting stakeholders*. Depending on the type of standards introduced by the administrative authority, it may be possible for nonconsenting stakeholders to be bound by a restructuring plan. This may be the case, for example, where stakeholders adhere to an accord under which agreements reached among a specified majority of financial institutions can be imposed on nonconsenting financial institutions.

4.3 Disadvantages of Enhanced Workouts

Potential disadvantages of enhanced workouts include the following:

- Typically, not all types of creditor are subject to the standards. Trade creditors, tax authorities, and labor claims are generally excluded. In these cases, the standards do not incentivize cooperation among all creditors.

- Where standards provide fiscal and regulatory incentives, these incentives may have an inappropriate distorting effect on creditor behavior and financial markets. Although they may facilitate workouts, in individual cases they may have the effect of keeping nonviable enterprises in business.

- Where standards provide fiscal incentives, these have a cost that is typically borne by the taxpayer. Although it is possible that the existence of such standards is associated with benefits at a macro level (see section 1.5), such costs should be taken into account in their design.

4.4 Enhanced Workout Frameworks in Practice

This section sets out examples of enhanced workout frameworks, in the order in which they were introduced into practice. Examples in section 4.4.1 are from the Asian financial crisis of the late 1990s and those in section 4.4.2 are from the global financial crisis of 2008–2009; section 4.4.3 presents more recent examples together with background information on them.

4.4.1 Asian Financial Crisis

4.4.1.1 Indonesia

In 1997–1998, Indonesia faced widespread corporate defaults threatening the collapse of the entire banking system. Recognizing an urgent need for a financial restructuring mechanism, the government of Indonesia amended its insolvency law in 1998 with the objective of providing a structure for informal workouts.[80]

Although a new commercial court was established, subsequent experience with financial restructuring suggests that the insolvency law amendments were not as effectively implemented by the courts as they might have been, which ultimately hampered the financial restructuring efforts.[81]

The Jakarta Initiative, a framework to facilitate and encourage voluntary corporate workouts, was announced on September 9, 1998. The Jakarta Initiative Task Force (JITF), a government entity, was established to facilitate financial restructuring in accordance with certain principles, rules, and mediation procedures. The JITF was originally designed as a voluntary program, and its ultimate objective was to guide debtors through an OCW.

The JITF's initial success was limited, however, and in April 2000 it was given powers to direct the negotiation process, including a mandate to refer uncooperative parties (those in breach of deadlines or otherwise in breach of good faith) to a supervising government institution for possible sanctions,[82] as well as the ability to apply for regulatory relief in certain cases. To accelerate negotiations, a time-bound mediation process was also adopted, which included the following features:[83]

- The debtor and creditors were given an opportunity to agree on a mediation schedule.
- Failing such agreement, a mediation schedule would be set by the JITF.
- The JITF would monitor the progress of a case relative to its schedule and mediate disputes as appropriate.
- On determining that a party was behaving uncooperatively or that progress could not be made for other reasons, the JITF could terminate the mediation and file a report with the government's Financial Sector Policy Committee.

Despite multiple institutional challenges the JITF faced during the five years of its operation (1998–2003), the JITF mediated over 100 cases involving approximately USD 30 billion of debt.[84] About 70 percent of that debt was restructured under the JITF framework.[85]

4.4.1.2 Republic of Korea

In the Republic of Korea in 1998, banks entered into a voluntary agreement among financial institutions on corporate restructuring (the Financial Institutions' Agreement for Promotion of Company Restructuring, the "Agreement").

The Agreement committed creditors to the use of specific workout procedures. The state incentivized workouts with tax exemptions and reductions, modified labor standards, and greater protections for minority shareholders. However, the implementation of workouts under the Agreement entailed collective action problems; not all financial institutions participated in it. The government therefore codified the Agreement in law in 2001, in the form of a Corporate Restructuring Promotion Act (CRPA). Further CRPAs, enacted between 2001 and 2018, made it obligatory for all financial institutions to participate in workouts.[86] Financial institutions may now opt out of workouts by selling debt to the assenting creditors.

4.4.1.3 Thailand

In 1999, the Bank of Thailand, together with domestic and foreign financial institutions, formulated a framework of debtor-creditor and intercreditor agreements.

The Bank of Thailand established the Corporate Debt Restructuring Advisory Committee (CDRAC) to monitor processes conducted within the framework and to facilitate negotiations among parties. The CDRAC framework modified the "Bangkok rules," a framework for voluntary workouts modeled on the London Approach (see section 3.4.1). The new framework reinforced the existing elements of the Bangkok rules through a contractual approach, after it became clear that the nonbinding, consensual approach of the Bangkok rules was not producing sufficient progress.[87]

Creditors taking part in CDRAC agreements agreed to abide by the CDRAC framework in their negotiations with debtors and not to seek recourse to the bankruptcy courts until the avenue of negotiations provided by the CDRAC closed. The agreements introduced mechanisms for dealing with breaches of the agreed process, such as warnings and fines imposed by the Bank of Thailand for noncompliant creditors. Debt restructuring cases under the framework qualified for prearranged tax benefits, stamp duty exemptions, and reductions in land transfer fees. The framework also gained credibility because of the threat of loan collection, liquidation, or reorganization if a restructuring plan was not adopted.[88] The framework introduced firm timetables with the threat of fines in cases of noncompliance, mediation to resolve disputes between debtors and creditors, and arbitration to resolve disputes between creditors.

By April 2002, a reported 10,109 cases with debt of THB 1.3 trillion had concluded with a restructuring plan under the CDRAC framework.[89] Alongside the CDRAC framework, Thai insolvency laws were amended to facilitate reorganizations, and a Central Bankruptcy Court was established in 1999.[90]

4.4.2 Global Financial Crisis

4.4.2.1 Iceland

Following the onset of the global financial crisis, Iceland restructured its financial sector through the Emergency Act, passed in October 2008, pursuant to which the Financial Supervisory Authority took over the operations of banks. The restructuring of the nonfinancial corporate sector followed.

In 2010, the government, banks, and social partners (trade unions) entered a voluntary (nonbinding) debt restructuring scheme of "joint rules on the financial restructuring of companies," specifically targeting small- and medium-sized enterprises (SMEs) with less than ISK 1 billion (approximately USD 8 million) of liabilities.[91] The joint rules on the financial restructuring resembled a reinforced London Approach (see section 3.4.1) and included guidelines designed to foster creditor coordination.

Under the agreement, all SMEs were to be reviewed by July 2011 and loans to viable SMEs would be written down to the net present value of their cash flows as estimated by the corresponding lender.[92] Lenders received equity stakes in exchange for writing down debt, reducing the incentive for solvent SMEs to take advantage of the system.[93]

The scheme included an arbitration committee to resolve disputes among parties involved. The government supported the scheme by requiring banks to distinguish between viable and nonviable firms, introducing various tax incentives (for example, exemption from taxation of gains from debt write-downs and restructuring of tax arrears like other debts), and subjecting banks to monthly targets for SME restructurings.[94]

4.4.2.2 Latvia

A financial crisis affected Latvia in early 2009. Latvia saw a double-digit percentage decline in gross domestic product, plummeting real estate property values, and a threefold increase in NPLs.

A World Bank Group team assisted the Latvian government in improving the insolvency framework by implementing the Latvian Corporate Debt Restructuring Guidelines. The Guidelines were a series of principles promulgated by the Ministry of Justice for improving the effectiveness of workouts. They were released in August 2009, coinciding with the early stages of development of restructuring and corporate recovery divisions in the major commercial financial institutions in Latvia. Their release was followed by a public-private sector workshop, cohosted by the World Bank Group and the Latvian government, on out-of-court debt negotiations.

Coupled with proactive risk management tools, the largest commercial banks developed a restructuring culture by applying principles contained in the Guidelines to foster the use of workouts. This provided viable enterprises with an opportunity to weather the crisis and continue operating.[95]

4.4.3 Recent Examples and Background Information

4.4.3.1 Albania

Albania has adopted a resolution framework for NPLs that facilitates a coordinated settlement when a large borrower with exposure to multiple lenders faces current or imminent financial distress.

This framework enables the Albanian regulator to use heightened prudential measures on banks that opt out of such a framework, incentivizing restructuring agreements.

The Bank of Albania issued an instruction for such a framework in Decision No. 51, published in the Official Gazette on July 24, 2019, and amended by Decision No. 34 published in the Official Gazette on June 4, 2020.[96] This was followed by an Interbank Cooperation Agreement on treatment of distressed borrowers signed by most Albanian banks in October 2019, and the handling of the first cases started. To deal with the consequences of the COVID-19 crisis (which may result in a surge of new NPLs), the Bank of Albania extended the framework from the end of 2020 to the end of 2021.

The implementation of the framework serves to establish a platform of cooperation, among banks and with debtors, aimed at facilitating a solution accepted by a majority of creditors in each case. Under the guidance and leadership of the Bank of Albania, negotiations have already started on several large legacy multilender exposures.

The World Bank and other international organizations supported the Bank of Albania in preparing the framework, which comes shortly after a complete overhaul of the Albanian insolvency system in 2016.

4.4.3.2 India

In 2001, the Reserve Bank of India (the RBI), India's central bank, introduced the Corporate Debt Restructuring (CDR) scheme. This was a voluntary method of restructuring corporate debts by banks without court involvement.

Banks and financial institutions that took part in the CDR scheme were required to sign an intercreditor agreement in which they agreed that if at least 75 percent of creditors by value approved a restructuring package, the other creditors were bound by it.

While the scheme worked to a limited extent in the initial years, subsequent years saw repeated failure by borrowers to adhere to the CDR restructuring documents, with criticisms being raised regarding the use of the CDR mechanism by banks for evergreening loans (the extension of new loans to repay previous loans). To complement the CDR scheme, the RBI introduced other voluntary restructuring mechanisms between 2014 and 2016, namely Strategic Debt Restructuring, the Scheme for Sustainable Structuring of Stressed Assets, the Joint Lenders' Forum, the Corrective Action Plan mechanism, and Flexible Structuring of Long-Term Project Loans to Infrastructure and Core Industries (the 5:25 Scheme).

India cont...

The corporate debt restructuring landscape in India underwent fundamental changes with the introduction of the Insolvency and Bankruptcy Code (the IBC) in December 2016.[97] This established a new architecture for handling insolvency cases, including a new, dedicated adjudicating authority and an insolvency regulator, the Insolvency and Bankruptcy Board of India. The IBC provided for a corporate reorganization proceeding that could be initiated by a debtor or a creditor in the event of a default. There was a big push by policy makers for restructuring to be undertaken under the aegis of the IBC, and on February 12, 2018, the RBI withdrew all existing voluntary restructuring mechanisms and replaced them with a simplified generic restructuring framework. Under the new framework, banks were required to finalize a resolution plan (RP) for stressed borrowers within a 180-day timeline. Unless a reorganization proceeding in respect of debts with an aggregate exposure of over INR 2,000 was fully implemented on or before 180 days from the reference date (i.e., March 1, 2018) or date of first default, banks were mandated to file for formal restructuring under the IBC, within a period of 15 days thereafter.

This framework was struck down by the Indian Supreme Court primarily on the ground that the RBI did not have the power under the Banking Regulation Act 1949 to give general directions for mandatory reference to the IBC in respect of debtors generally. Following this, on June 7, 2019, the RBI published a new circular (the June 7 Circular)[98] for early recognition, reporting, and time-bound resolution of stressed assets by banks and financial institutions without involving the court. The circular was issued in the form of prudential regulation guidelines to banks and certain nonbanking financial institutions (classified as systemically important) and required them to put in place policies for resolution of stressed assets, including timelines for resolution. Lenders are expected to initiate the process of implementing an RP even before a default. In any case, once a borrower is reported to be in default by any of the lenders falling in categories specified in the circular,[99] the lenders must undertake a prima facie review of the borrower's account within 30 days of the default (the review period). During the review period, lenders may decide on the resolution strategy, including, for example, the nature of the RP, change in ownership, and the manner of implementing the RP.

To implement the RP, lenders are required to sign an inter-creditor agreement in which they agree that if 75 percent of creditors by value and 60 percent of lenders by number approve the restructuring package, the others are bound to accept the package. Dissenting creditors are protected by the offer of an exit at liquidation value. The RP is required to be implemented within 180 days of the end of the review period.

The prudential framework stipulates additional punitive provisioning of 20 to 35 percent in a phased manner beyond existing provisions, where implementation of the RP is delayed. The additional punitive provisioning may be subsequently reversed by a lender in certain circumstances including on implementation of the RP, if the RP involves a restructuring or change in ownership of the borrower outside the IBC, or where resolution of the borrower is pursued under the IBC, or where assignment of debt recovery proceedings are initiated and completed by the lender.

There are no publicly available statistics from the RBI measuring the success of the June 7 Circular. Anecdotal information, however, indicates that it has had limited success. While a model intercreditor agreement has been developed by the Indian Banks Association, in many cases not all banks or financial institutions have signed up to it, and the enforceability of such an agreement qua such banks or institutions remains uncertain. Further, the June 7 Circular applies only to banks and certain financial institutions governed by the RBI, but most large cases involve loans, credit, or deposits from other institutions/individuals, including from investors in debt securities, life insurance companies, mutual funds, and pension funds. While some of the regulators have issued enabling guidelines allowing such investors or creditors to sign the intercreditor agreement, since the Circular is not applicable to them, no uniform approach has been adopted. Further, unlike the IBC, which deals with resolution of both financial and operational liabilities, the June 7 Circular addresses only resolution of stress by banks and financial institutions. The dues of nonfinancial creditors (such as trade creditors and statutory dues) are not addressed through this mechanism, making the IBC a more attractive alternative for holistic resolution.

4.4.3.3 Turkey

In 2000, a financial crisis hit Turkey, leaving a large number of enterprises insolvent. Financial institutions realized initiating an insolvency procedure or foreclosing on a secured asset was not always the optimal solution from a commercial point of view and that participating in a restructuring might prove more beneficial.

As a result of this change in attitude, a large number of Turkish financial institutions entered into a consensual framework agreement (the Istanbul Approach) to restructure the debts of large enterprises. The agreement was approved by the Banking Regulatory and Supervision Agency in 2002. The main objective was to address the widespread corporate distress and to resolve the escalating levels of NPLs.

The Istanbul Approach followed models of workout procedures adopted in Asia. At its heart was a framework agreement signed by 34 financial institutions, including commercial banks, financial intermediaries, intervened banks, and state banks. The framework agreement addressed terms for selecting firms to participate or benefit from financial restructuring, deferment of credits, granting of new loans and related matters, and enabled creditors to participate in nonjudicial resolution procedures. During the negotiation period, a stay was imposed on actions by creditors to collect their debts or enforce against collateral.

Individual workouts were managed by creditors' committees led by the bank holding the largest share of the debt. If creditors holding 55 to 75 percent of the debt agreed to a restructuring plan, the plan could be submitted to an arbitration panel that had a mandate to approve it and cram down the other creditors that were part of the framework agreement. If more than 75 percent of creditors agreed, an arbitration panel was not needed to approve the plan.

The Istanbul Approach lasted for only three years and was not replaced by a permanent enhanced workout framework. While the Istanbul Approach was highly useful to facilitate multibank restructurings, it is important to note that it was not used in cases involving large single exposures or cases involving related-party lending. However, it was particularly instrumental in helping to facilitate a resolution of corporate distress, especially in the first 18 to 24 months following its adoption, when most banks lacked adequate internal risk management and restructuring teams to address the problems of corporate distress.

While no assessments have been conducted to determine the status and success of enterprises that went through the process, some banks estimate that 55 to 60 percent of the loans were recovered or became performing. It has been reported that most agreements reached under the Istanbul Approach were debt rescheduling transactions, and that in most of these cases, the rescheduling was for up to 15 years.[100] In the period 2002 to 2005, a total of 322 firms participated in the program. The principal amount of loans dealt with under the program was approximately USD 6 billion, of which USD 5.4 billion was owed by large conglomerates.[101]

During the currency crisis experienced by Turkey almost 15 years later, the Banks Association revisited this temporary framework and published two new framework agreements: a Framework Agreement on Financial Restructuring (large-scale implementation for companies with financial indebtedness of TL 25 million and over) and a Framework Agreement on Financial Restructuring (small-scale implementation for companies with financial indebtedness of less than TL 25 million).[102] Forty-nine banks and other financial institutions signed up to the large-scale framework agreement and 53 to the small-scale framework agreement. The Framework Agreements set out a contractual basis for financial restructurings and echo the Istanbul Approach.

4.5 Implementing an Enhanced Workout Framework

The specific steps required to put in place a framework for enhanced workouts, in the form of accords or other standards, include the following:

- Understanding the existing insolvency framework.
- Designing and issuing standards.
- Communicating the standards to relevant stakeholders, and building capacity as necessary.

These steps can also be applied in the context of guidelines for OCWs (see section 3.1), substituting "guidelines" for "standards," and they may serve to increase the effectiveness of such guidelines. However, they are particularly important in relation to enhanced workouts, given that restructuring participants will be expected or required to commit in a legally binding manner to follow the standards. The Toolkit therefore addresses them in this context.

4.5.1 The Existing Framework

The first step of any workout procedure implementation program is to understand the policy objectives and the enabling insolvency system, including related laws and supporting institutions. This includes a review of how creditors currently work with debtors and other creditors to resolve debtors' financial difficulties. This review is key to designing an appropriate enhanced workout framework. For instance, while certain economies may already have a highly developed creditor culture — perhaps aided by the presence of foreign financial institutions familiar with workout practices in other economies in which they do business — other economies may not have such a creditor culture. Other constraints may also affect restructuring negotiations (as discussed in relation to taxes in section 2.12.2, for example). Extensive discussions must be undertaken with all relevant stakeholders and any such factors must be reflected in the design of the standards.

4.5.2 Designing and Issuing Standards

The second step is designing and issuing standards for stakeholders to follow in negotiating workouts. The form of the standards need not adhere to any particular template. However, they should include such tools as the authority considers appropriate to encourage their use (potentially, for example, intercreditor agreements). They should also set out basic tenets for workouts and should be accompanied by commentary on how they can be used.

Standards should be designed such that they take into account domestic considerations. For example, there may be differences in practice between the treatment of financial creditors' claims and the treatment of trade creditors' claims, and this may call for a particular approach to sharing losses among creditors, either to facilitate the customary differentiation in treatment (if it is conducive to achieving restructurings) or to encourage stakeholders to move away from existing practice (if it is not).

Before standards are issued, a draft should be reviewed by relevant authorities and stakeholder representatives, such as the central bank, bankers' association, and local legal advisors. The issuing institution is typically a body such as the insolvency regulator or the central bank.

4.5.3 Communication and Capacity-Building

The finalized standards must be communicated to stakeholders in a manner sensitive to the domestic context. Capacity-building is also particularly important.

Direct communications with individual banks and other financial institutions can be supplemented by disseminating the standards through other interested bodies, such as bankers' associations and chambers of commerce. Insolvency representatives might also appropriately disseminate them.

Less intense communications efforts may be needed in jurisdictions with more developed insolvency systems, greater cultural acceptance of the rescue of financially distressed but viable enterprises, a more developed creditor culture, and a higher level of commercial sensibility on the part of debtors and creditors. In jurisdictions where such conditions do not exist, it will likely be helpful to discuss the value of workouts with stakeholders. If creditors and debtors are not persuaded that workouts (as opposed to enforcement, liquidation, or reorganization) can produce optimal outcomes for them, the standards will be unlikely to facilitate the rescue of viable businesses or a reduction in the volume of nonperforming assets in the banking sector. In any event, conveying the specific benefits of conducting workouts within the framework of the standards can be helpful.

Specific communications and capacity-building that may be appropriate on a case-by-case basis include the following:

- Speeches and articles by government and bank officials promoting workouts and the standards.
- Simulations of workouts with application of the standards.
- Roundtable discussions to examine issues that arise during workouts and the manner in which they are addressed by the standards.
- Capacity-building seminars on specific topics, such as:
  - Issues faced by lead banks
  - How to coordinate steering committees
  - Engaging insolvency representatives
  - Negotiation techniques
  - Loss-sharing among creditors
  - How to determine a sustainable level of debt and, more broadly, an appropriate capital structure, for a business
  - Possible elements of financial restructurings, such as debt reschedulings and debt-for-equity swaps
  - Using unresolved workout negotiations as the basis for a pre-packaged restructuring (see chapter 5) or other expedited process
  - MSME debt resolution
  - Conflicts of interest

4.6 The Enabling Environment for Enhanced Workouts

In addition to the considerations described in section 2.12 (regarding the enabling environment for workouts generally), the following considerations apply to enhanced workouts in particular:

- The standards should apply broadly to financial institution creditors. Their applicability to a financial institution may depend on the nature of the institution's relationship with a debtor, but it should not depend on the specific nature of the financial institution.
- The administrative authority that introduced the standards should seek to ensure that they encourage cooperation among creditors. It may be helpful for the administrative authority to play an ongoing coordinating role in the use of the standards in practice, though importantly, it should facilitate coordination and not encourage specific outcomes in individual cases (see section 2.12.1, Principle B4).
- As noted in section 2.12.1, negotiations in enhanced workouts take place in the shadow of the law. As such, formal insolvency and enforcement procedures should be available for use where appropriate and necessary, and the laws on such procedures should be clear and known to commercial parties to facilitate achievement of workouts (see section 2.12.3).

5

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Hybrid Workouts

5.1 What Are Hybrid Workouts?

At some point during some workout processes, circumstances may require the debtor to have access to a court proceeding to develop or implement a restructuring plan. Commonly this occurs when the debtor cannot continue to operate without the benefit of a stay on creditor action or when certain stakeholders are (1) unwilling to vote in favor of a plan's terms, and (2) not bound by majority creditor consent to the plan in accordance with the preexisting contractual debt terms (see section 3.3). To address such issues, a restructuring may combine negotiations using the OCW approach with elements of a (court-supervised) reorganization. This is a "hybrid workout," that is, a restructuring involving private negotiations of restructuring terms pursuant to a procedure that provides for a court role, where this role falls short of supervision of the full procedure.

To fully understand what a hybrid workout involves, it is necessary to understand judicial reorganization. Where such a formal restructuring procedure is available, it is usually found in a jurisdiction's insolvency legislation (although in some jurisdictions it may be found in companies' legislation, as in the case of schemes of arrangement and similar procedures). Restructuring commonly takes place under the supervision of a court with the assistance of an insolvency representative. The procedure typically facilitates a restructuring through (1) an agreement reached with a specified majority of creditors, and (2) implementation by an insolvency representative or sanction by a court. Reorganizations are discussed further in Box 11.

Hybrid workout procedures have generally arisen by market practice rather than by legislation and in ways designed to address the particular context and the specific objectives sought (for example, to deal with a financial crisis). Court involvement is less extensive in a hybrid workout than in a reorganization, and this may be particularly advantageous during the COVID-19 crisis given pressure on court resources.

Hybrid workouts in different jurisdictions can take very different forms. Two specific categories, "pre-packaged restructurings" and "prearranged restructurings," are addressed in section 5.5 below.

BOX 11: A Generalized Description of Judicial Reorganization

Judicial reorganization procedures differ depending, among other things, on individual jurisdictions' insolvency legislation, but this box sets out a general description.

The initial step is the submission to a court of a formal request to commence the procedure. In the process, the court will require information about the enterprise, including the state of its affairs and its financial condition. Based on the information presented to it, the court may assist the debtor by imposing a time-bound stay on enforcement of creditors' claims. Throughout this process and until a restructuring plan (a "reorganization plan") is implemented, the debtor is under the supervision of the court.

In some jurisdictions (for example, the United States), a stay is imposed automatically, without any intervention or decision by the court or any administrative authority. Rather, the debtor obtains a stay simply by opening an insolvency proceeding, and the stay arises by statute. Stays can be varied or eliminated if creditors can successfully challenge them or their scope.

The laws of some jurisdictions include requirements that a proposed reorganization plan meet (1) a "best interest" criterion, in that the plan is better for creditors than alternatives such as liquidation; and (2) a "feasibility" criterion, in that the debtor will be able to meet its obligations under the plan. The plan typically must be accepted by a specified majority of creditors, after which the court is often empowered to cram down the plan on nonconsenting creditors.

The debtor and creditors may be unable to reach an agreement to which a sufficient majority of creditors agree. In such circumstances, a judicial reorganization allows for orderly liquidation; the enterprise continues operating until the last possible moment and under the supervision of a court to preserve its value.

Factors influencing the extent to which judicial reorganization proceedings are pursued by debtors in practice may include the following:

1. Whether, in a reorganization proceeding, a third-party insolvency representative has control of the debtor's business in place of the debtor's management (i.e., the procedure is not a debtor-in-possession procedure).
2. Whether it is compulsory for the debtor's management to apply for a formal proceeding if it is insolvent.
3. The possibility of management liability in relation to debt incurred while the debtor is insolvent.[103]

A decision on whether to pursue a reorganization (and if so, what terms are appropriate) may be particularly challenging given considerations such as the following:

1. Differences between the interests of shareholders and those of creditors.[104]
2. The desirability of avoiding a lengthy process in which delays are risky for the survival of the enterprise, combined with uncertainty as to which process will be most lengthy.

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5.2 Advantages of Hybrid Workouts

The hybrid workout brings together key benefits of an OCW and key benefits of a reorganization. The following advantages that hybrid workouts tend to provide are particularly notable:

- *Relative lack of expense from court process*. The relatively limited involvement of a court mitigates the expense associated with court filings and attending court hearings.

- *Confidentiality*. It is often possible or legally required for the content of negotiations to be kept confidential, at least prior to the court proceeding. This can assist in limiting reputational damage to the debtor and in turn a loss of value in its business.

- *Cramdown of the agreement on nonconsenting stakeholders*. If the agreement is implemented by an insolvency representative or sanctioned by a court, it can often be made binding on minority creditors and other stakeholders (such as shareholders) that did not approve the agreement. Such an attribute makes a hybrid workout procedure a powerful tool of persuasion that may facilitate a workout (see section 2.11, in relation to contingency planning).

- *Fairness*. The insolvency representative or court is (or at least should be) independent and objective. In certain procedures it will assess the restructuring terms or the process for compliance with legal requirements. This can assist in ensuring that the agreement that was reached is fair and seen to be fair.

- *Certainty*. Court involvement provides certainty regarding the validity and inviolable nature of the agreement (at least once any challenge has been heard).

5.3 Disadvantages of Hybrid Workouts

Potential disadvantages of hybrid workouts include the following:

- *Publicity*. As and when court review is required, if not earlier, the process may lose its confidential nature.

- *Possible challenges*. Where a proposed restructuring plan is presented to a court for sanction, it may be possible for dissenting stakeholders or other parties to challenge the outcome. This may lead to the overturning of a proposed restructuring plan relatively late in the process.

- *Temporary uncertainty*. Judicial review required to sanction a proposed restructuring plan may take some time, regardless of whether there are challenges. The window during which the status of the plan is under review can entail uncertainty.

5.4 Examples of Hybrid Workout Procedures

This section discusses specific examples of hybrid workout procedures. Temporary measures put in place in response to the COVID-19 crisis are not reflected unless otherwise stated.

5.4.1 France

France has two hybrid workout procedures:

- The *special mediation procedure (mandat ad hoc)* can be requested by a debtor after financial difficulties have materialized but before cash flow insolvency (*cessation de paiements*).
- The *conciliation procedure (conciliation)* can be commenced either before the debtor is in cash flow insolvency or when the debtor has been in cash flow insolvency for less than 45 days.

In the context of the COVID-19 crisis, the number of special mediation and conciliation proceedings opened in the Île-de-France (Paris) in 2020 was 601, a number 13 percent higher than in 2019. In particular, although the total number of collective proceedings opened dropped due to government measures relating to the pandemic, recourse to the conciliation procedure increased by 35 percent year on year.[105]

5.4.1.1 Mandat Ad Hoc

The special mediation procedure — which existed in practice for many years — was formally introduced into the restructuring and insolvency legislation in July 2005. The management of an enterprise can request that the president of the commercial court appoint a preselected special mediator (the *mandataire ad hoc*), provided that the enterprise is not in cash flow insolvency (*cessation de paiements*). The appointment will usually last three months and can be renewed; the law does not provide for any specific time limit. The process includes a phase of private negotiation of a restructuring with the debtor's main creditors, under the aegis of the *mandataire ad hoc*.

The rights and judicial remedies of creditors remain unimpaired, and it is common practice for the *mandataire ad hoc* to request a contractual standstill during which no creditor can enforce its claims and undermine negotiations. If agreement on a restructuring is reached, it can be presented to the court for approval (*homologué*) through a *conciliation* proceeding. If no agreement is reached, there is a serious chance that the enterprise will be put into an insolvency procedure and subsequently liquidated.

5.4.1.2 Conciliation

The *conciliation* procedure was introduced in 2005. It is available to any enterprise that faces actual or foreseeable legal, economic, or financial difficulties and has not been in default for more than 45 days.

Similar to *mandat ad hoc* proceedings, the purpose of a *conciliation* proceeding is to facilitate an agreement between an enterprise and its main creditors, as selected by a court-appointed conciliator. There is a private negotiation phase under the aegis of the conciliator. The proceeding normally has a time frame of four months, with a one-month extension available.

On commencement of *conciliation*, the enterprise must provide details of its financial, economic, and social situation, including its future financial needs. As in a *mandat ad hoc*, the rights and judicial remedies of creditors remain unimpaired, and a creditor can make a formal claim on its debt (*mise en demeure*) during the *conciliation* proceeding. If that occurs, the debtor can apply to the court for a grace period under Article 1343-5 of the French Civil Code.[106] It is market practice for the conciliator to ask all participants to enter into a standstill, although doing so is voluntary. The legislation relating to COVID-19 has reinforced the position of the debtor until December 31, 2021, allowing it to go to court to obtain a standstill for the duration of the *conciliation* with respect to all creditors the conciliator has invited to participate in the proceedings.

To be binding, a restructuring agreement negotiated during *conciliation* needs the unanimous consent of all affected parties and must be sanctioned by the court at the end of the proceeding. Court sanctioned requires the following three conditions to be met: (1) the debtor is not in cash flow insolvency (*cessation de paiements*) or will no longer be in this state as a result of the agreement; (2) the agreement allows the business to continue; and (3) the agreement does not affect the interests of the creditors that did not participate in the agreement.

New debt financing obtained within the framework of the agreement will have priority, although subordinated to court fees and labor claims. This is similar for suppliers of new products and services.

5.4.2 Egypt

In 2018, Egypt introduced major reforms in its insolvency regime by enacting Law No. 11 of 2018 Promulgating the Law Regulating Restructuring, Preventive Composition and Bankruptcy (the 2018 Insolvency Law).[107]

Among other matters, the 2018 Insolvency Law led to the creation of a new group of Restructuring Experts at the new specialized Bankruptcy Departments of the Economic Courts in Egypt, in addition to the existing groups of bankruptcy trustees. The 2018 Insolvency Law also introduced two new restructuring tools: mediation as a restructuring tool (available in all insolvency procedures for the purposes of achieving settlement), and a new insolvency procedure called restructuring.[108]

The procedures of preventive composition and bankruptcy liquidation already existed prior to the enactment of the 2018 Insolvency Law, but both procedures were amended and supplemented with the new restructuring procedure to fulfill the government's goal of better facilitating the restructuring of enterprises facing financial distress. The new restructuring procedure was inspired by (but is in no way identical to) the French *mandat ad hoc* procedure (described in section 5.4.1), while the preventive composition procedure was originally inspired by the French *sauvegarde* procedure (described in section 6.4.2 below). With support from the World Bank Group, in 2021, Egypt adjusted the restructuring and preventive composition procedures by enacting a law amending some provisions of Law No. 11 of 2018 concerning Regulating Restructuring, Preventive Composition and Bankruptcy (the 2021 amendments). The 2021 amendments explicitly provide for the possibility of obtaining financing as part of a restructuring plan and granting it priority in the event of subsequent liquidation; allowing individual creditors to request and obtain information on an insolvent enterprise through the process; and introducing a system of classes of creditors for the purposes of voting on a preventive composition plan. The 2021 amendments also allow creditors to file for preventive composition of defaulted debtors and to vote on important issues such as continuing the business in bankruptcy liquidation; assignment of restructuring experts to develop a restructuring plan in bankruptcy liquidation; commencing procedures for the sale of the bankruptcy assets as a going concern; and liquidation of core assets of the bankrupt business and other bankruptcy assets, provided that any decision on these matters is taken by a simple majority in number of creditors.

Perhaps the most innovative feature of the recent Egyptian reforms concerning pre-insolvency restructuring is the introduction of mediation as a tool to negotiate a settlement with creditors. Only the debtor has the right to request mediation after filing for one of the three available procedures: restructuring, preventive composition, or bankruptcy liquidation (Article 4(a) of the Insolvency Law). Once this has been done, a confidential (Article 6) initial mediation lasting a maximum of 60 days can commence immediately, with an appointed bankruptcy judge acting as mediator (Article 5). The judge mediator has significant discretion to conduct the mediation as he or she deems appropriate (Article 7) and is entitled to seek the assistance of whomever he or she deems necessary (Article 8), including a restructuring expert from the "Bankruptcy Department Experts Roster" (Article 13), to assist the judge mediator with specific tasks (i.e., expert advice on technical issues if the judge mediator lacks such expertise). Unanimity of all parties involved is required to reach a settlement (Article 9). There is no moratorium (although a de facto or contractual standstill may be agreed with the participating parties). A ratified settlement decision has executory effect (Article 9) and is final (unless the judge has exceeded his or her jurisdiction; Article 12). When the debtor is a company, settlement proposals require cooperation of the shareholders (Article 202), and if the debtor has a judgment against it imposing a penalty for bankruptcy by fraud, settlement is not available (Article 181).

Given that mediation in the context of commercial litigation has been available in Egypt's Economic Courts[109] since 2008 and has gained particular traction in recent years after focused training of Economic Court judge mediators, it is expected that the tool will have a positive impact on reaching settlements in the present context as well. With its recent legal reforms, Egypt has clearly taken meaningful steps in the right direction for making tools and processes available for enterprises facing financial distress. However, whether this will also make an impact in practice depends largely on how effectively the market and businesses are made aware of these new tools and processes, and how they will be applied by the relevant institutions.

5.4.3 Ethiopia

Ethiopia's Book III (Article 617 et seq.) of its new Commercial Code of 2021 outlines a key reform of a hybrid workout procedure called preventive restructuring.[110] This is inspired by the successful French model of *conciliation* (described in section 5.4.1).

Preventive restructuring proceedings in the new Ethiopian insolvency law are confidential and have the duration of four months, renewable once if the debtor can demonstrate that it is likely that a restructuring plan will be accepted unanimously by all affected creditors. The procedure is initiated on the sole application of the debtor, which is not yet in cessation of payments or has been in cessation of payments for less than 45 days. On the debtor's request, the court will appoint a restructuring expert to facilitate a restructuring agreement. However, the court may replace the expert at the request of a creditor at any time during the proceedings. If such a request is made by creditors holding two-thirds of the claims, the court will appoint the expert suggested by the creditors. During the proceedings, the debtor remains in possession, but any decision outside the ordinary course of business requires the prior approval of the expert. To support the negotiation of a restructuring plan, the debtor may apply for a single stay against a creditor that has requested payment of its claim or has started enforcement action.

The restructuring plan, if accepted by all affected creditors, needs to be confirmed by the court to verify that third-party interests are protected and the restructuring plan has a reasonable prospect of preventing insolvency and assuring the viability of the business. Any new financing is also subject to the confirmation by the court in approving (homologating) the restructuring plan.

If the restructuring plan is not accepted by all affected creditors or not confirmed by the court, preventive restructuring proceedings may be converted to reorganization proceedings or bankruptcy proceedings at the request of the debtor or on the court's own motion.

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5.4.4 Poland[111]

In June 2020, the Polish government introduced a temporary simplified restructuring procedure, known as "proceedings for the approval of arrangement."

The new procedure is a simplified version of the existing "arrangement sanctioning proceeding" that has been available in Poland since 2016, and it aims to reduce reliance on courts constrained by the COVID-19 crisis.

The new simplified procedure permits any enterprise facing the risk of insolvency (not necessarily related to the COVID-19 pandemic) to enter into an agreement with a restructuring advisor and commence a simplified restructuring proceeding through an announcement in the Court and Commercial Gazette. After conclusion of the agreement with the restructuring advisor,[112] and from the time of the announcement, an automatic four-month stay applies to all enforcement actions against the debtor, although creditors may apply to court for a lifting of the stay with respect to their claim on very limited grounds. The debtor continues to manage its assets but under the supervision of the restructuring advisor. The advisor formally acts as an arrangement supervisor; it works with the debtor to prepare a list of creditors, collects and counts votes in favor of a restructuring plan, and determines whether the plan has been accepted.

Unlike the arrangement sanctioning proceeding, the simplified procedure allows restructuring of all secured debt without the secured creditors' consent, as long as the new payment terms provide that such creditors receive 100 percent of their principal debt, interest, and other ancillary claims at a future date or that the proposed repayment level is not less than could have been obtained from enforcement of collateral. The restructuring plan can be approved by more than half of all voting creditors holding at least two-thirds of all voting claims.

The court involvement in the procedure is limited to hearing motions to lift the automatic stay for cause, approving the restructuring plan following voting by creditors, or dismissing the proceeding if four months have elapsed without a motion to approve the arrangement.

The simplified restructuring procedure is intended to be temporary and is set to expire by June 30, 2021. In the first six months following its adoption, at least 60 cases were processed through it. Based on a report prepared by Poland's Central Economic Information Centre on restructuring proceedings,[113] the simplified restructuring procedure was the most common form of court restructuring in 2020, accounting for nearly 50 percent of all restructuring proceedings opened: 392 simplified restructuring proceedings were opened, with the highest monthly figure — 118 proceedings — occurring in December.[114]

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5.4.5 Tunisia

Tunisia's insolvency law (dated April 29, 2016, and effective May 17, 2016) gives debtors facing financial difficulties but not yet insolvent the option to request the opening of an amicable settlement proceeding. It is a voluntary process that can be initiated only by the debtor through the court. Negotiations between the debtor and its creditors are facilitated by a court-appointed conciliator. The agreement should be reached within a period of three months, renewable for one month by decision of the president of the court.

Information on the financially troubled enterprise can be requested by the conciliator and the court from the debtor itself, any public administration, any financial institutions, and the Follow-up Committee on Economic Entities. The court can also request from the committee a review and diagnosis of the debtor's situation within one month.

A stay of execution can be ordered by the court on a debt recovery proceeding initiated prior to the opening of the amicable settlement proceeding or related to the payment of wages, if it appears that debt recovery could worsen the business's situation and jeopardize its rescue. The stay of execution ends automatically when a decision on the amicable settlement request is made.

Parties are not subject to any constraint on or requirements for reaching a settlement agreement. Such an agreement could include (but is not limited to) a debt rescheduling, a write-down, and suspension of interest. The settlement agreement is validated by the court if it is agreed to by creditors holding claims equivalent to two-thirds of total claims. The court also provides, for a period not exceeding the shorter of the duration of the agreement and three years, for rescheduling of the remaining claims held by other creditors (with the exception of debts owed to workers, employees, sailors, travelers, and sales representatives; funeral expenses; debts owed to doctors, pharmacists, and nurses in the preceding six months; legal costs incurred in the common interest of all creditors for the preservation and realization of the "common pledge"; amounts owed for living expenses of the debtor and the debtor's family as well as the debtor's alimony for the preceding six months; and certain small claims up to a limit of 5 percent of total claims and with a value not exceeding 0.5 percent of total claims). Creditors involved in the agreement must suspend (for the period of the agreement) any debt recovery proceeding.

If a judicial settlement proceeding or bankruptcy proceeding commences, fresh money provided in the context of the amicable settlement agreement will be given priority ahead of other creditors except those with a super privilege (the part of wages that is exempted from collection; the debts of the preceding six months of other workers, sailors, and travelers and sales representatives; funeral expenses; debts owed to doctors, pharmacists, and nurses in the preceding six months; and legal costs incurred in the common interest of all creditors for the preservation and realization of the "common pledge").

If the debtor breaches its obligations under the settlement agreement, the agreement can be terminated by the court at the request of any relevant party, and the pre-settlement situation will be restored, unless the debt has been repaid.

If the conclusion of an amicable settlement within the fixed time limit fails, or if the debtor knowingly fails to appear before the conciliator despite having been duly summoned, or if the enterprise becomes insolvent, the conciliator, the debtor, the creditor, or any relevant party must immediately inform the president of the court, who must terminate the mission of the conciliator and the amicable settlement proceeding. After summoning and hearing the debtor, the president must order the opening of a judicial settlement proceeding if it is established that the debtor is insolvent, and must inform the debtor, the creditors, and the Follow-up Committee on Economic Entities of that decision.

5.5 Pre-Packaged and Prearranged Restructurings

The term *pre-packaged restructuring*, or *pre-pack,* refers to different types of procedure in different jurisdictions, largely due to differences between national insolvency proceedings. In essence, a pre-pack is a restructuring negotiated out of court that is implemented quickly through a formal insolvency proceeding. For a more technical description, see Box 12. Pre-packs are often used in practice even where they are not specifically provided for in legislation.

The first part of a pre-pack procedure is essentially the same as that of an OCW, that is, it involves private negotiations in pursuit of a consensual agreement. In respect of this part of the procedure, a pre-pack shares with an OCW the advantages of speed, low expense, and confidentiality (see section 3.2). As compared with an OCW, a key potential benefit is the ability to deal with creditor holdouts and nonconsenting shareholders through mechanisms prescribed by insolvency law (see section 3.3).

Moreover, a pre-pack procedure may have a number of benefits compared with a formal proceeding for an entire workout process or a hybrid workout in which a formal proceeding is under way for a longer time prior to a restructuring plan taking effect. Potential benefits include (1) lower expense; (2) less adverse publicity resulting from stigma or uncertainty associated with a formal proceeding (which may have negative consequences for the debtor's business); and (3) more limited loss of value occurring through, for example, opportunistic termination of contracts by the debtor's counterparties on the grounds of insolvency (where this would not be prevented in a formal proceeding by a stay). In addition, particular speed may be possible where court review of the substance of the restructuring plan does not take place (see point (2) of the second bullet point in Box 12).

However, in some cases pre-packs may be undertaken to the detriment of certain stakeholders not involved in the negotiations, who may have different views on the approach that should be pursued to resolve a debtor's financial distress. In particular, the interests of unsecured creditors may be adversely impacted if they are unable to object effectively to unfavorable options proposed by secured creditors. Safeguards should be considered that protect a debtor's stakeholders. The appropriate nature of safeguards will depend, among other things, on the nature of the relevant insolvency proceeding; they may include both legal requirements and professional standards for insolvency representatives. If there are effective safeguards in place, pre-packs may play a valuable and effective role in achieving workouts.

In individual cases, a pre-pack may be prepared by a debtor for contingency planning purposes (see section 2.11). Indeed, the possibility of, and preparation for, a pre-pack may be used by a debtor as a bargaining tool in workout negotiations, especially with those stakeholders who would or might receive limited value in a pre-pack (as an outcome of the formal insolvency proceeding). In such cases, a workout may ultimately be achieved through either an OCW or a pre-pack.

A *prearranged restructuring* (also known as a *prenegotiated restructuring*) is similar to a pre-packaged restructuring. In both cases, a restructuring plan is negotiated between a debtor and stakeholders before entry into a formal proceeding. However, in a prearranged restructuring, an agreement with the requisite stakeholders with the required level of formality is solicited after entry into the formal proceeding (and not before as in the case of a typical pre-pack). As with pre-packs, prearranged restructurings need not be specifically provided for in legislation. In a prearranged restructuring, approval of a restructuring plan occurs through a procedure initiated by an insolvency representative or governed by the court. The outcome of a creditors' meeting held within this framework is commonly determinative. Creditors may enter into an agreement under which, in essence, they commit to vote in favor of a restructuring plan with certain terms, known as a *lock-up agreement* or *restructuring support agreement*. If and when such a plan is formally put forward by the debtor, these creditors (and potentially other creditors) vote in favor of it.

As such, elements of pre-packaged and prearranged processes occur prior to the commencement of formal proceedings. In both cases the debtor is essentially seeking to ensure, prior to entry into a formal proceeding, that the proceeding will be orderly and as swift as possible.

Examples of pre-packaged and prearranged restructuring procedures follow.

BOX 12: Understanding the Term *Pre-Pack*

The following description captures the features of many, if not all, pre-pack procedures used around the world:

- A formal insolvency proceeding is used to implement a restructuring plan among stakeholders.
- There is a two-stage process in which (broadly speaking) (1) a restructuring is negotiated and agreed with the required level of formality (if any) by the requisite stakeholders, and then (2) the formal proceeding is opened, and the plan is brought into effect shortly afterwards, without prior substantive examination of the plan by a court necessarily being required.
- Regarding the level of formality referred to in point (1), specific formality requirements may be prescribed by law, regulation, or rules (for example, as to the form of a ballot).

5.5.1 Colombia

Colombia's Law 1116 of 2016 on Corporate Insolvency Regime[115] provides for a pre-packaged arrangement procedure. Under the procedure, the debtor and its creditors can reach agreement on a restructuring and request that the court confirm it.

The agreement can be confirmed if it is approved by the requisite majority of creditors. The court confirms the agreement if (1) the negotiations were open and had sufficient publicity; (2) all creditors of the same class have the same rights; and (3) the agreement is not abusive and is subject to the rule of law.

Once the agreement is confirmed by the court, it has the same effect as a settlement executed after a judicial reorganization proceeding: it binds the debtor and its creditors, including those that did not participate in the negotiation or voted against it. The pre-packaged arrangement procedure is considerably shorter than the judicial reorganization procedure, which may last about 14 to 18 months.

On April 15, 2020, Colombia partially amended Law 1116 of 2016 by introducing a temporary (two-year) insolvency regime to aid the rescue of businesses affected by COVID-19. The Government Decree of April 15, 2020,[116] established two new out-of-court procedures: (1) extrajudicial emergency restructuring; and (2) a business recovery proceeding before the Chamber of Commerce.

In *an extrajudicial emergency restructuring*, the debtor may apply to the judge for an emergency negotiation of up to three months of a reorganization agreement if it is in default or has an imminent inability to pay. During the negotiation, processes of execution, coercive collection, restitution of possession, and execution of guarantees against the debtor are suspended. Payments of obligations for administrative expenses that the debtor deems necessary may be deferred, except for payment of salaries, tax contributions, and obligations to the social security system. The agreement can be confirmed by the judge, subject to the majority requirements of Law 1116 of 2016. In a *business recovery proceeding*, negotiations are facilitated through mediation under the framework of rules created by the Chamber of Commerce. Mediators must be trained in insolvency. An agreement reached through mediation can be validated by the Superintendence of Commerce or the civil court through an expedited confirmation procedure.[117]

5.5.2 England and Wales

In England and Wales, legislation does not provide specifically for pre-packs as a possible route. However, a market practice has developed in which pre-packs are commonly used to achieve restructurings. They generally involve sale transactions conducted in insolvency proceedings, and the usual insolvency procedure for this purpose is administration under the Insolvency Act 1986.[118] Administration can be combined with another formal procedure (such as a scheme of arrangement under the Companies Act 2006) to achieve an outcome not possible through administration alone.

An administrator can be appointed out of court by a certain type of secured creditor (specifically, a creditor with a qualifying floating security interest), the debtor, or its directors, or appointed by order of the court. The out-of-court route in particular can provide a quick entry into administration to facilitate the delivery of a pre-pack.

The pre-pack procedure is commonly, in outline, as follows.[119] A restructuring plan is negotiated out of court by key stakeholders and is agreed by them. In parallel with the negotiations, an insolvency practitioner examines the feasibility and potential structuring of a pre-pack and undertakes necessary preparatory steps. The debtor enters into administration, with the insolvency practitioner appointed as administrator, and the debtor's business is forthwith sold by the administrator as a going concern to an acquiring entity newly incorporated for the purpose. Certain claims against the debtor — such as senior debt claims — are swapped for equity, debt, or both, in the acquiring entity, in line with the agreed restructuring terms. Out-of-the-money creditors (see section 2.6) receive no interest in the acquiring entity (and, assuming no material assets remain in the original debtor, their claims against the original debtor have minimal value).[120] As such, the restructuring is achieved through the sale.

A major advantage of such pre-packs is that they mitigate the risk that the enterprise loses material contracts. In an ordinary case, an announcement that a company is in administration can generate uncertainty for counterparties, employees, and other stakeholders. With a pre-pack, this is commonly avoided because by the time news of the administration is made public, a solution will have been agreed among key stakeholders and a financial restructuring implemented. Pre-packs can preserve the reputation of the business in the market, and in turn the value of the enterprise, thereby maximizing the recoveries of creditors as a whole.

The time it takes to move from a pre-pack proposal as a potential means of achieving a restructuring to a sale of the business depends on numerous factors, including the size and complexity of the business. It could take anywhere from a matter of days to weeks or months.

A number of criticisms have been expressed with respect to such pre-packs, particularly in the context of sales to connected parties, including that not all creditors are necessarily given an opportunity to influence the restructuring. Restructuring terms are essentially finalized before the statutory administration procedure commences, and unsecured creditors commonly find out about the pre-pack only after the sale has taken place. A further concern that has been expressed is the risk of "phoenix" trading, whereby a debtor's business is transferred at an undervalue to a party connected with its management, with an inappropriate disregard for creditor claims.[121]

A variety of safeguards were introduced through a professional standard applicable to insolvency practitioners.[122] The safeguards include that, after a sale, an administrator should provide creditors with information such that a reasonable and informed third party would conclude that the sale was appropriate and that the administrator has acted with due regard for the creditors' interests.[123] Additional, statutory safeguards[124] have recently been introduced that apply to pre-pack sales by administrators to connected parties, requiring a report from an independent evaluator if creditor approval is not obtained. The report must include (among other things) a statement of whether the evaluator is satisfied that the consideration and grounds for the disposal are reasonable in the circumstances. If the evaluator states dissatisfaction on these matters, the administrator must, if proceeding with the sale, provide a statement setting out the reasons for doing so.

5.5.3 The Netherlands

A new pre-pack procedure has been in place in the Netherlands since January 1, 2021, following the entry into force of the Act on the Confirmation of Extra-Judicial Restructuring Plans.[125]

The new procedure constitutes an alternative to the practice of asset deals, which are the customary means of restructuring in the Netherlands.

The scheme enables debtors to offer their creditors and shareholders tailor-made restructuring plans outside a formal insolvency procedure and to have the plans later confirmed by the court in a formal proceeding. Creditors and shareholders whose rights are affected by a restructuring plan are entitled to vote on it. If all classes accept the plan, the court confirms it unless there are other grounds to refuse confirmation (for example, if certain creditors or shareholders would be worse off under the plan than in the event of liquidation in bankruptcy). Confirmation by the court makes the plan binding on all affected parties.

The plan may affect secured creditors, creditors with priority rights, unsecured creditors, and shareholders. This is the key feature of the new restructuring framework because in the preexisting debt restructuring law, only the rights of unsecured creditors could be impaired. Minority opposing parties (including all creditors and shareholders) can be bound to accept a discount on their claims; only employee rights cannot be modified. If one or more classes of creditors reject the plan, judicial confirmation of the plan requires its acceptance by at least one class of creditors expected to receive a distribution, at least in part, in the event of insolvency. In general, cramming down a dissenting class requires an absolute priority rule to be observed.

The procedure can be used to terminate onerous contracts (except for employment contracts), although such termination is subject to judicial consent on confirmation of the plan. One flexible element of the new procedure is that it provides an option to choose between a public and a private (confidential) approach. The public procedure involves publication in the public Insolvency Register, the Government Gazette, and the Trade Register. The private procedure involves only a private court hearing, without any publication, and better suits situations in which the creditor group is small. A court order can be requested to support the out-of-court process on any procedural or substantive matter.[126]

5.5.4 Peru

In Peru, the insolvency framework is regulated by Law No. 27809 ("Ley General del Sistema Concursal").[127] Enterprises undergoing restructuring can choose from two procedures (*concursos*): preventive or ordinary.

In either case, only creditors at a creditors' meeting can approve a restructuring plan. Debtors and creditors often meet before entering the formal procedure to create a prenegotiated restructuring plan, so that when they enter the formal procedure, the process is easier and more predictable (though prenegotiated restructuring plans are neither required nor endorsed by the legislation). The resolution approving a restructuring plan (and amendments to it) requires more than 66.6 percent of recognized credits (in the first call) or more than 66.6 percent of recognized credits represented in the creditors' meeting (in the second call). Each creditor has a vote proportionate to its share of the debt (see Article 53.1, Law No. 27809).

The preventive restructuring procedure is designed for debtors anticipating a financial crisis and willing to adopt measures to avoid it. The preventive restructuring procedure may only be initiated by debtors not subject to an insolvency situation as defined by Law No. 27809. When applying for a preventive restructuring, the debtor may request an automatic stay from commencement of the procedure. If a restructuring plan does not obtain the majority required for approval in the creditors' meeting, creditors representing 50 percent of those recognized or present at the creditors' meeting are entitled to resolve to submit the debtor to an ordinary procedure in which liquidation can later be opened.

5.5.5 The United States

PRE-PACKAGED RESTRUCTURINGS IN THE UNITED STATES

A pre-packaged case is permitted under provisions of the United States Bankruptcy Code.[128] In a pre-packaged case, unlike in regular bankruptcy proceedings under Chapter 11, a debtor files for bankruptcy after having already negotiated a Chapter 11 reorganization plan and solicited votes for the acceptance of the plan by the requisite majority of its creditors. In a typical pre-packaged case, prior to filing its petition for bankruptcy, the debtor negotiates with creditors (at least its main creditors) and prepares a reorganization plan, which is circulated to creditors together with a disclosure statement and a ballot as part of the plan solicitation process. After the creditors review the plan and cast their ballots, and if the plan receives sufficient support, the debtor will simultaneously file its petition for bankruptcy and submit its Chapter 11 plan. The court will then initiate a plan confirmation process, which can often be completed in a matter of a few months. It is not uncommon for cases to last only 30 to 45 days or even much shorter periods of time. An example of a completed pre-packaged case is outlined in Box 13.

A pre-packaged case enables a debtor to restructure quickly; it is less costly than a regular Chapter 11 case; it may avoid significant disruption to the debtor's business operations; and it can bind nonconsenting creditors. However, the success of a pre-packaged case depends on various factors. For example, as part of the plan confirmation process, the court will review the adequacy of the disclosure provided by the debtor in the disclosure statement furnished to creditors in the pre-petition period and will consider whether the solicitation process was conducted properly.[129] In the event that the court finds the disclosure inadequate or that the solicitation process was not conducted properly, the court will require the debtor to repeat the solicitation process. Furthermore, as there is no automatic stay in place in the pre-petition period, unless the debtor has managed to enter into a standstill agreement with its creditors, it runs the risk of creditor enforcement actions while it undertakes negotiations. Finally, a rule requires that creditors receive adequate time during the pre-petition period to review the plan before voting.[130]

PREARRANGED RESTRUCTURINGS IN THE UNITED STATES

A prearranged bankruptcy proceeding shares many similarities with a pre-packaged case. However, unlike in the latter, the enterprise and key creditors (potentially via their representatives) in a prearranged case both agree on and contractually bind themselves to the terms of a restructuring without engaging in the formal plan approval process mandated by the Bankruptcy Code. Prior to a filing, no disclosure statement is circulated and no solicitation of votes takes place. However, creditors are contractually bound to vote in the manner they have agreed on. After agreement with creditors is reached, the debtor initiates a Chapter 11 case, a disclosure statement is filed, court approval is sought, and the actual solicitation commences. This process usually proves to be less time consuming than a regular bankruptcy case, as most creditors have typically already consented to the restructuring, although it is not as expeditious as a pre-packaged case.

A prearranged restructuring plan may be useful in cases where the debtor does not wish to deal with or comply with nonbankruptcy requirements that govern some pre-packaged plans — such as securities laws — but still wishes to ensure that there will be sufficient creditor support for a plan following entry into Chapter 11. A prearranged plan may also be appropriate when creditors are "knocking at the door" and the debtor does not have time to negotiate each point of a pre-packaged plan but can only agree on the principal terms of a deal with its major creditors and work through the remainder in the Chapter 11 process.

Box 13: FullBeauty Brands Holdings Corp.

FullBeauty Brands Holdings Corp. (together with nine affiliated debtors, the "Debtors"), a leading U.S. retailer in the plus-size apparel market, was confronted with the challenges of a depressed retail apparel market, lower consumer engagement, and reduced revenues and profit margins.

Additionally, the Debtors had a highly leveraged capital structure. After hiring a new executive team and engaging advisors, FullBeauty considered a comprehensive restructuring, a financing transaction, or both.[131]

After several months of negotiations, on December 18, 2018, FullBeauty entered into a restructuring support agreement with all its major stakeholders, including its equity holders, holders of its first-in last-out loan facility (a type of asset-based lending), and holders of its first-lien and second-lien credit facilities.[132] The terms of the proposed restructuring included a debt reduction by lenders of about USD 900 million (approximately 70 percent of the Debtors' funded debt obligations) in exchange for equity, and USD 35 million in new financing.[133] Creditors that did not vote for the plan — holders of administrative claims, priority tax claims, and general unsecured claims — would remain unimpaired by the plan.[134]

About two weeks later, the Debtors distributed the plan to the creditors with voting rights. On January 24, 2019, all the creditors with voting rights voted in favor of the plan.[135] On February 3, 2019, FullBeauty filed in the U.S. Bankruptcy Court for the Southern District of New York a petition for Chapter 11 protection along with a reorganization plan implementing the terms of the restructuring agreed on December 18, 2018.[136]

The U.S. Trustee filed an objection, arguing that confirmation of a plan in less than 24 hours would "enable [the Debtors] to race through the Chapter 11 too quickly" and not "provide any time for parties-in-interest, governmental agencies, and the Court sufficient time to evaluate — let alone respond or object to — the Plan."[137] The court rejected the objection, explaining that "Congress clearly had in mind the prospect of confirming plans at the 'very initial stages' of a Chapter 11 case if a company is able to meet all of the confirmation requirements."[138] The court confirmed the plan on the record at a hearing the following day, February 4, 2019, setting the record for the fastest Chapter 11 case from filing to confirmation at the time.[139] The confirmation order was entered the next day, February 5, 2019.[140] In its order, the court noted that the plan did not impair the general unsecured claims and that there was unanimous acceptance by all creditors in all voting classes, and it noted the "Debtors' need to normalize trade credit as quickly as possible."[141] FullBeauty Brands Holdings Corp. emerged from bankruptcy three days after the plan was confirmed, on February 7, 2019.[142]

5.6 Implementing Hybrid Workout Frameworks

This section discusses considerations policy makers should bear in mind when considering implementing frameworks for hybrid workouts.

Notably, the involvement of an insolvency representative or the court in hybrid workouts almost inevitably requires that some statutory condition be met to enable the debtor to use the procedure. This is so even though there need be no legal regime specifically for hybrid workouts (which can arise and evolve through market practice).

To develop new, effective hybrid workout procedures, therefore, some domestic insolvency legislation will be necessary as a foundation. In addition, safeguards (in the form of legal requirements, professional standards, or both) may be required to protect stakeholders against misuse of hybrid workout procedures. When policy makers consider putting in place hybrid workout frameworks, they should start by reviewing the existing legislative position.

In many cases, domestic laws already allow for effective hybrid workouts, but domestic practice has never developed. In such jurisdictions, it is possible that law reform is unnecessary, and that policy makers should instead focus on information dissemination, training, and promotion.

No two hybrid workout procedures are exactly alike. In introducing one, policy makers have a menu of possible types to consider as a starting point; they will then need to tailor the procedure to their specific domestic circumstances. In the context of the COVID-19 crisis, for instance, one relevant factor may be the extent to which courts are permitted (and able) to operate electronically. A physical hearing required to initiate an insolvency proceeding as part of a hybrid workout could be an impediment when travel restrictions make it difficult for the parties to attend. In some jurisdictions, mediators or conciliators may not have been trained in the specific context of financially distressed enterprises, making it difficult for them to facilitate agreement on restructuring plans. As in the case of other workout procedures, capacity-building may be key.

The following represents a simplified implementation framework. The specific process appropriate in a particular jurisdiction will depend on domestic policy considerations and other factors.

5.6.1 Steps in Implementing Frameworks for Hybrid Workouts such as Pre-Packs

The first step for policy makers is to consider the state of development of the relevant insolvency system and its most important characteristics.

If the relevant jurisdiction has a functioning reorganization procedure but does not (yet) have a cadre of competent insolvency representatives in whom the public has confidence, experience suggests that one of the more effective hybrid workout procedures to be introduced early may be a pre-pack effected through reorganization. The potential advantages of this approach include the following:

- It permits development of a confidential, privately negotiated solution that the court can approve if appropriate.
- Debtors may be incentivized to ensure that creditor voting protections already provided for in the formal proceeding will be respected when the pre-pack is put to the court for approval.
- Cramdown is possible.

A jurisdiction with both a functioning reorganization procedure and a cadre of competent insolvency representatives in whom the public has confidence may have additional options.

- A pre-pack approach may still be suitable.
- Provision can be made for the appointment of an insolvency representative to assist the debtor in developing a restructuring plan; this could be followed (where appropriate in individual cases) by a restructuring transaction effected by the insolvency representative or sanctioned by the court.

Once there is clarity on these matters, the appropriate characteristics of a hybrid workout procedure can be determined, as explored in the next section.

5.6.2 Specific Considerations

When making policy decisions and enacting implementing legislation, and in relation to the characteristics of a procedure, the following questions (among others) may need to be addressed:

- Should it be necessary for the debtor to open an insolvency proceeding to benefit from the assistance of an insolvency representative, or should this only be necessary if the debtor is to have the benefit of a stay?
- What should be the required financial condition of the debtor for a formal proceeding to be opened or a stay to be imposed?
- Where a stay applies, what should be the scope of the stay?
- If an insolvency representative is appointed, what title should be used (e.g., facilitator or administrator)? What role should the representative have, and should that role be set out in statute or in court orders in individual cases?
- What are the appropriate time limits?
- How is potential interim financing addressed, including in terms of the priority it would receive (see section 2.9)?

5.7 The Enabling Environment for Hybrid Workouts

In addition to the considerations described in section 2.12 (regarding the enabling environment for workouts generally), the following considerations apply to hybrid workouts in particular:

- In respect of the involvement of an insolvency representative or court, expertise in restructuring-related issues and sufficient capacity are required. These matters are addressed in Part D of the WB-ICR Principles. Regarding capacity, and as noted in section 5.1, court involvement is less extensive in a hybrid workout than in a reorganization, a feature that may be particularly advantageous during the COVID-19 crisis.
- A formal procedure should be able to quickly process a prenegotiated restructuring plan, assuming all procedural and other legal requirements of the formal procedure are complied with (see section 2.12.1, Principle B4).

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Preventative Workouts

6.1 What Are Preventative Workouts?

In recent years, there has been a focus on preventative workout procedures, also known as *early intervention* procedures. These can be defined as broadly formal procedures for the restructuring of enterprises that are not in a technical state of insolvency, with a stay on creditor action from initiation of the procedure (at least if requested by the debtor, and subject to limitations) but — significantly — a limited role for the court. This definition frames preventative workout procedures as formal procedures with a certain level of informality; it may also be possible to view them as informal procedures with a certain level of formality.

A 2014 recommendation by the European Commission[143] encouraged member states to establish frameworks that enable efficient restructuring of viable enterprises in financial difficulties and give honest entrepreneurs a second chance. In 2019, the Restructuring and Second Chance Directive[144] was adopted. It aimed, among other things, to ensure that viable enterprises and entrepreneurs in financial difficulties have access to effective national preventative workout frameworks that enable them to continue operating.[145] See Box 14 for details.

Box 14: The European Restructuring and Second Chance Directive

The Restructuring and Second Chance Directive was adopted in July 2019. It is aimed at harmonizing restructuring and insolvency laws of European Union member states ("Member States") with regard to "preventive restructuring" (preventative workout) frameworks for debtors in financial distress and procedures leading to discharge of debt incurred by insolvent entrepreneurs (Article 1). The Directive establishes the key features of the preventative workout frameworks and requires Member States to establish early warning tools to detect potential distress (see Box 7).

The Directive establishes that "Member States shall ensure that, where there is a likelihood of insolvency, debtors have access to a preventive restructuring framework that enables them to restructure, with a view to preventing insolvency and ensuring their viability, without prejudice to other solutions for avoiding insolvency, thereby protecting jobs and maintaining business activity" (Article 4(1)). The key features of the preventative workout procedures required by the Directive are summarized below.

- *Possibility of filing early*. The debtor is to be able to file as soon as it is in financial difficulties with the objective of avoiding insolvency. Member States are to impose specific duties on directors where there is a likelihood of insolvency, to incentivize them to pursue early restructuring when a business is viable.

- *Debtor-in-possession proceedings*. The debtor is to remain in control of the day-to-day operation of its business during the negotiation and implementation of a restructuring plan. The rationale is that the debtor's current management knows the enterprise best and displacing it would interrupt operations and make rescue unlikely. Practitioners in the field of restructuring may have a role, but such practitioners are not to be mandatory in every case.

- *Availability of stay*. The debtor is to be able to request a temporary stay of individual enforcement actions. This would be granted by a judicial or administrative authority for a maximum of four months, extendable to a total of 12 months. Member States may provide that judicial or administrative authorities can refuse to grant a stay of individual enforcement actions where it is unnecessary or would not fulfill the objective of supporting restructuring negotiations.

- *Plan approval by majority*. A restructuring plan adopted by the majority prescribed by national law is to be binding on all creditors provided that the plan is confirmed by a judicial or administrative authority.

- *Cross-class cramdown*. A restructuring plan not approved by affected parties in every voting class is to be capable of confirmation by a judicial or administrative authority on the proposal of a debtor, or with the debtor's agreement, and become binding on dissenting voting classes. In general, where there is a dissenting voting class of affected creditors, either: (1) it is generally to be treated at least as favorably as any other class of the same rank and more favorably than any junior class; or (2) the claims of affected creditors in the dissenting voting class are to be paid in full if a more junior class receives a distribution or keeps an interest (an *absolute priority rule*).

- *Best-interest-of-creditors test*. Where a restructuring plan must be confirmed by a judicial or administrative authority, dissenting creditors are not to be worse off under the plan than if the normal ranking of liquidation priorities were applied, in the event of liquidation or the next-best-alternative scenario if the plan were not confirmed.

- *Safe harbor: protection of new financing*. New financing (i.e., financial assistance provided to implement a restructuring plan, and included in that plan) and interim financing are to be adequately protected; at a minimum they are (subject to potential exceptions) to be exempt from avoidance actions. Member States may provide that grantors of new financing or interim financing are entitled to a repayment priority in subsequent insolvency proceedings.

- *Limited court involvement*. Any court involvement is to be limited to appointing an insolvency representative and confirming the plan. The rationale is that recourse to an authority should be available to ensure creditors' rights are protected but should not drive the process. The negotiation is to be largely driven by the debtor and creditors.

6.2 Advantages of Preventative Workouts

Advantages of preventative workouts include the following (the first four of which are shared with hybrid workouts):

- *Relative lack of expense from court process*. The relatively limited involvement of a court mitigates the expense associated with court filings and attending court hearings.
- *Cramdown of the agreement on nonconsenting stakeholders*. If the agreement is implemented by an insolvency representative or sanctioned by a court, it can often be made binding on minority creditors and other stakeholders (such as shareholders) that did not approve the agreement. Such an attribute makes a preventative workout procedure a powerful tool of persuasion that may facilitate a workout (see section 2.11, in relation to contingency planning).
- *Fairness*. The insolvency representative or court is (or at least should be) independent and objective. In certain procedures it will assess the restructuring terms or the process for compliance with legal requirements. This can assist in ensuring that the agreement that was reached is fair and seen to be fair.
- *Certainty*. Court involvement provides certainty regarding the validity and inviolable nature of the agreement (at least once any challenge has been heard).
- *Stay*. The debtor is able to benefit from a stay from initiation of the procedure, preventing at least certain types of unilateral action by a creditor (such as security enforcement or the initiation of an insolvency proceeding).
- *Interim financing*. Special protection is typically accorded to interim financing provided within the framework of the procedure (see section 2.9 regarding the potential importance of such protection).

6.3 Disadvantages of Preventative Workouts

Preventative workouts have several potential disadvantages, including the following (the first of which is shared with hybrid workouts):

- *Temporary uncertainty*. Judicial review required to sanction a proposed restructuring plan may take some time, regardless of whether there are challenges. The window during which the status of the plan is under review can entail uncertainty.
- *Publicity*. Disclosure of the existence of the process is a tradeoff of a stay, and public disclosures are typically required throughout the process. This may discourage its use.
- *Cost*. Although court involvement is relatively limited, it is more extensive than in a hybrid workout. In addition, an insolvency representative may have a relatively extensive role. These factors entail costs.

6.4 Examples of Preventative Workout Procedures

This section contains examples of preventative workout procedures. Temporary measures put in place in response to the COVID-19 crisis are not reflected unless otherwise stated.

6.4.1 Croatia

The purpose of pre-bankruptcy proceedings in Croatia is to regulate the legal position of the debtor and its creditors and to preserve the debtor's business operations. The procedure is regulated by the Bankruptcy Act.[146]

Subject matter and territorial jurisdiction in pre-bankruptcy proceedings is exercised by the commercial court with jurisdiction in the territory in which the debtor, as a legal person, has its registered office. A petition to open pre-bankruptcy proceedings may be filed by the debtor or by a creditor subject to the debtor's consent to such petition. Pre-bankruptcy proceedings may be opened if the court establishes the existence of imminent insolvency. Imminent insolvency is deemed to exist if the person filing for the opening of pre-bankruptcy proceedings shows probable cause that the debtor will not be able to meet its existing obligations as they become due.

A decision to open pre-bankruptcy proceedings must be published on the court's e-notice board.[147] If it considers it necessary, the court nominates a commissioner, whose roles include examining and overseeing the business of the debtor. During the pre-bankruptcy proceedings, the debtor may only make payments essential for regular business. The debtor may alienate or encumber its property only with the prior approval of the commissioner or of the court if a commissioner is not appointed. No litigation, enforcement, or administrative procedure against the debtor may be initiated.

Each group of eligible creditors votes on a restructuring plan separately. Rules on formation of creditor groups (classification of creditors) that apply in bankruptcy also apply in pre-bankruptcy proceedings. The restructuring plan is deemed accepted if the majority of all creditors voted in favor of the plan and if in each group the sum of the claims of creditors that voted in favor of the plan exceeds twice the sum of the claims of creditors that voted against the plan (Article 59, para. 2, Bankruptcy Act). The Bankruptcy Act does not foresee the application of cross-class cramdown rules to the restructuring plan in pre-bankruptcy proceedings, but only to the bankruptcy plan in bankruptcy proceedings. A bankruptcy plan in bankruptcy proceedings can also be a restructuring plan.

A confirmed restructuring plan is binding on all creditors, regardless of whether they participated in the procedure, save that it has no effect on (1) the right to separate satisfaction of secured creditors and rights of creditors who are entitled to claim certain items that are in the debtor's possession, (2) claims of the debtor's current and former employees arising from employment relations, (3) preventive measures in criminal proceedings, (4) tax procedures for establishing the misuse of rights, or (5) qualified financial contracts related to netting. Tax authorities may not seek enforcement of tax debts during pre-bankruptcy proceedings because their claims are not excluded from the restructuring plan. Only fines imposed for the misuse of rights regarding taxes are excluded from the restructuring plan.

The Working Group of the Croatian Ministry of Justice and Administration has been preparing changes and amendments to the Croatian Bankruptcy Act to transpose the Restructuring and Second Chance Directive (see section 6.1).

6.4.2 France

The law on companies' safeguard (Loi No. 2005-845 de sauvegarde des entreprises, dated July 26, 2005) provides a court-supervised restructuring procedure, the safeguard procedure, to enterprises in distress but not yet in cash flow insolvency (*cessation des paiements*).[148]

The safeguard procedure is a debtor-in-possession procedure that is more formal than the *mandat ad hoc* and *conciliation* procedures (described in section 5.4.1). It is not confidential, and it must involve all creditors.

Following the opening of a safeguard proceeding, an automatic stay on individual creditor enforcement actions is triggered, and an insolvency administrator is appointed by the court to supervise and assist management in preparing a plan. A debtor has a period of six months, extendable to a total of 18 months (an "observation period"), to negotiate with creditors and prepare a restructuring plan.

Creditors are consulted individually, or where creditors' committees are constituted, approval is required by two-thirds in value of each of the following: a creditors' committee of financial institutions, a creditors' committee of major trade creditors, and (if applicable) bondholders. The constitution of creditors' committees is only mandatory where the debtor has more than 150 employees or an annual turnover of more than EUR 20 million, though the insolvency administrator can voluntarily request it in other cases.

The approach using creditors' committees will be replaced by one involving classes of creditor, after the entry into force of the reform transposing the Restructuring and Second Chance Directive (see section 6.1). This is scheduled to occur in 2021. The court approves the restructuring plan following review of the plan, assessment of the administrator, and verification that the interests of all the creditors are sufficiently protected.

Overall, 64 percent of companies entering into a safeguard proceeding have implemented a plan. Sixty-two percent of companies that have concluded a safeguard plan have remained a going concern five years after its implementation.[149]

On October 22, 2010, the French legislature created a subcategory of safeguard procedure: the accelerated financial safeguard procedure (*sauvegarde financière accélérée*), with the objective of providing an option for fast-track restructuring of financial liabilities. It was also designed to allow a cramdown of minority creditors that did not consent to a restructuring agreement negotiated during a *conciliation* proceeding. The debtor can request an accelerated financial safeguard proceeding provided certain conditions are met, including that the restructuring plan is likely to obtain the support of creditors representing two-thirds of the debtor's total financial indebtedness. The restructuring plan requires approval by two-thirds in value of each of a creditors' committee of financial institutions and (if applicable) bondholders. The maximum duration of the proceeding is two months.

On March 12, 2014, the French legislature created another subcategory of safeguard procedure: the accelerated safeguard procedure (*sauvegarde accélérée*). This is similar to the accelerated financial safeguard procedure, but it is not limited to financial creditors. Instead, it extends to all creditors except employees. The maximum duration of the proceeding is three months. An example of a completed accelerated financial safeguard procedure is outlined in Box 15.

In both the accelerated financial safeguard procedure and the accelerated safeguard procedure, an agreement is negotiated prior to applying for the proceeding, and the proceeding allows quick conversion of the agreement into a court-approved restructuring plan.

The transposition of the Restructuring and Second Chance Directive (see Box 14) will occur at the level of the accelerated safeguard procedure, which is to be merged with the accelerated financial safeguard procedure. The new restructuring procedure will be available to all types of debtors, including small and medium-sized enterprises.[150]

BOX 15: Europcar Mobility Group

On February 3, 2021, the accelerated financial safeguard plan of the Europcar Mobility Group, a multinational mobility services company, was approved by the Paris Commercial Court.[151] The plan was negotiated and agreed with creditors within the framework of the *mandat ad hoc* and *conciliation* procedures in approximately two months, prior to the opening of the accelerated financial safeguard procedure in the court on December 14, 2020.[152] The effects of the restructuring procedures commenced in France were recognized in the United States through the Chapter 15 bankruptcy procedure.[153]

In the years preceding the restructuring, the Group had been experiencing financial difficulties. The financial restructuring of the Group's balance sheet involved a capital increase of EUR 250 million, new fleet financing of EUR 225 million, and a refinancing of its revolving credit facility through a EUR 170 million cash line and a EUR 500 million term loan.[154] The restructuring also involved changes to the Group's governance, which came into effect on February 26, 2021, the date of the closing of its financial restructuring.[155]

6.4.3 Germany

On January 1, 2021, Germany introduced a new preventative restructuring procedure (Stabilization and Restructuring Framework),[156] which allows a financial restructuring of the debtor on a majority-vote basis before an insolvency filing.

The procedure is available to debtors facing imminent cash flow insolvency and seeking financial restructuring at an early stage. It provides for a stay, suspension of contractual provisions that give a party a right to terminate or modify the operation of a contract in the case of default by the debtor, a cross-class cramdown[157] (without affecting employee claims), and court confirmation of a restructuring plan. The appointment of a restructuring practitioner is optional. However, rejection of burdensome contracts, for example with suppliers or landlords, is not possible under the framework.

During the procedure, the current management remains in charge. However, the procedure includes a shift of fiduciary duties toward the creditors affected by the restructuring plan. The plan can be confirmed by the court if the majority of creditor classes voted in favor of the plan, the plan complies with an absolute priority rule (with limited exceptions), and no creditors or shareholders would be worse off under the plan than in the most likely alternative scenario in a formal insolvency proceeding (although other scenarios are also possible, e.g., liquidation or sale of the business as a going concern). Voting rights are determined by the value of claims affected by the plan; the number of creditors is irrelevant.

To date, a limited number of cases have fallen under the Stabilization and Restructuring Framework.

6.4.4 Italy

6.4.4.1 Concordato preventivo

In Italy, a debtor in financial difficulties may file with the competent court for a pre-insolvency procedure (*concordato preventivo*)[158] even when it is only in a crisis situation (*stato di crisi*) and not technically insolvent. The Italian Bankruptcy Law does not define *crisis*,[159] but it will generally be recognized when there are financial difficulties (not necessarily reaching insolvency).[160]

The debtor must file a petition with the competent court, accompanied by a proposal to the creditors to (contractually) resolve the crisis situation by entering into a debt restructuring agreement under court supervision. Together with the proposal, the debtor files with the court a plan that reflects the operational architecture and financial conditions for implementing the restructuring proposal. The plan must be certified by an expert opinion confirming its feasibility and the truthfulness of the accounting data. The bankruptcy court does not have the power to examine the expert's opinion on the economic feasibility of the plan; it can only check if the procedure has been fulfilled and if classes of creditors have been formed according to the law.[161] In the event of a proposal aimed at liquidating the business of the debtor, the court verifies that the proposal ensures payment of at least 20 percent of the amount of unsecured claims. The debtor may ask for authorization to obtain interim financing, with first priority to the party offering it.[162]

Only the debtor is entitled to submit a petition to request the opening of a *concordato preventivo*. Nevertheless, after the most recent amendments to the Italian Bankruptcy Law,[163] creditors holding at least 10 percent of the debt may propose competing proposals (and related plans). After the publication on the Companies' Registry of the petition, the creditors are subject to a stay.

A debt restructuring agreement proposed by the debtor must be approved by creditors representing a simple majority of the claims eligible to vote. Where the plan has divided creditors into classes, a twofold majority is required for approval: (1) an absolute majority of all claims admitted to the vote; and (2) in a simple majority of classes, an absolute majority of the claims entitled to vote within the class.

After approval of the proposal, dissenting creditors (or creditors belonging to a dissenting class) representing 20 percent or more of the liabilities may file an opposition. The court can nevertheless sanction the plan if it is ascertained that dissenting creditors would not receive better treatment under the available alternative (i.e., *fallimento*, a formal insolvency procedure). The proceeding must be concluded within six months of the date of filing the petition, which can be extended by the competent court for an additional two months.

6.4.4.2 Accordo di ristrutturazione

The Debt Restructuring Agreement (*accordo di ristrutturazione*), pursuant to Article 182 of the Italian Bankruptcy Law, is an out-of-court procedure that allows the debtor to negotiate with its creditors. A debt restructuring agreement must be concluded with one or more creditors representing a significant portion (60 percent) of the total debt. A debtor may file with the competent court for a stay while a debt restructuring agreement is negotiated. Unlike the pre-bankruptcy settlement agreement in *concordato preventivo*, a debt restructuring agreement only applies to the parties to the agreement. The competent court can grant judicial approval (homologation) of the agreement once it has ruled on any opposing actions. The court's decree of approval is then published in the Companies' Registry.

Article 182-*septies* of the Italian Bankruptcy Law[164] provides for a specific procedure regarding debt restructuring agreements involving mainly financial intermediaries. Where the debt restructuring agreement includes one or more categories of banks or financial intermediaries with the same economic interests and legal position, under certain conditions the debtor can request an extension of the effects of the debt restructuring agreement to the minority of nonadhering financial creditors belonging to the same category.

6.4.5 Spain

Article 5 of the Spanish Insolvency Law 22/2003[165] requires a debtor to file for insolvency within two months of the date on which it became aware or should have become aware of its insolvency. In 2011, a new Article 5 bis was introduced allowing the debtor to postpone the insolvency filing by an additional four months: three months to negotiate a restructuring agreement with creditors and one month to file for insolvency if negotiations fail.[166]

In 2020, Article 5 bis was replaced by a new section (Articles 583–595) on pre-insolvency proceedings.[167] The amendments maintained the debtor's right to postpone an insolvency filing by four months by notifying the court of the opening of negotiations with creditors. All enforcement and insolvency actions against the debtor are suspended during this period, and the debtor and creditors may pursue an ordinary refinancing agreement, a court-approved (homologated) restructuring plan, or an out-of-court payment (mediation) agreement subject to provisions specifically applicable to each.[168] Although the court is involved at commencement, formal institutional involvement during the negotiation process is very limited, with the exception of out-of-court payment agreement negotiations (facilitated by an insolvency mediator (*mediador concursal*), which are designed to meet the needs of small- and medium-sized enterprises). Pre-insolvency proceedings have been gaining popularity in Spain, which has seen some high-profile restructuring cases.[169]

6.5 The Enabling Environment for Preventative Workouts

In addition to the considerations described in section 2.12 (regarding the enabling environment for workouts generally), the following considerations apply to preventative workouts in particular:

- Where an insolvency representative or the court is involved, expertise in restructuring-related issues and sufficient capacity are required. This is addressed in Part D of the WB-ICR Principles. Specifically, in relation to insolvency representatives, WB-ICR Principle D8 states that the creditor/debtor rights and insolvency system should ensure the following:
  - Criteria as to who may be an insolvency representative should be objective, clearly established, and publicly available.
  - Insolvency representatives are competent to undertake the work to which they are appointed and to exercise the powers given to them.
  - Insolvency representatives act with integrity, impartiality, and independence.
  - Insolvency representatives, where acting as managers, are held to director and officer standards of accountability and are subject to removal for incompetence, negligence, fraud, or other wrongful conduct.

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Practical Case Study

7.1 Introduction to the Case[170]

A hotel group (the "Hotel Group") is in a challenging financial situation. Because of changing market dynamics, the Hotel Group's assets — its three hotels — are losing market share and have started to experience substantial losses. Limited financial resources have prevented the Hotel Group from making the large-scale renovations necessary to compete for customers with new hotels emerging throughout the region. As a result, the Hotel Group is in financial distress and does not have sufficient funds to cover current and future obligations. The enterprise is owned by a family of three (father, son, and daughter), who chose the Hotel Group's management including its Chief Financial Officer, a close associate of the family.

7.1.1 The Problem

The earnings of the Hotel Group are down, and it has a high level of debt. It is not generating sufficient cash to service its debt, which is inconsistent with the positive outlook conveyed to creditors by its Chief Financial Officer as recently as three months ago. However, an underlying assumption in the Hotel Group's projections is that the management team will be able to make headway in reviving the Hotel Group's operational and financial health. As such, the projections show gradual operational improvements in the Hotel Group's performance. Specifically, these estimates assume greater efficiency and profitability in day-to-day hotel operations and a positive impact from property renovations.

7.1.2 A Restructuring

The Hotel Group is not able to meet its interest payment and principal repayment obligations to lenders; certain payments are already overdue. This means prompt action is necessary. If the Hotel Group does not effect a restructuring in short order, some of the secured creditors may start a judicial enforcement proceeding to seize secured assets (the hotels) and have them sold.

7.1.3 Current Debt Structure

This table shows the current debt structure of the Hotel Group.

STAKEHOLDER	CURRENTLY OUTSTANDING ('000)	MATURITY DATE	ARREARS IN INTEREST PAYMENTS	ARREARS IN PRINCIPAL REPAYMENT
Senior secured debt Lender A	6,937	Matures in several months	Yes	No
Senior secured debt Lender B	5,946	Matures in several months	Yes	No
Unsecured debt (working capital) Lender C	991	Matured	No	Yes
Unsecured debt Lender D	793	Matures in several years	No	No
Shareholder loans	2,000	No maturity date	N/A	N/A
Trade creditors (unsecured)	4,851	The Hotel Group currently pays on average after 90 days.	Payment is net 30 days from date of invoice according to contract terms.	
	Two trade creditors are crucial for the Hotel Group's operations, as they supply food and beverages and daily cleaning and housekeeping services. It is not possible to switch to other suppliers in short order, as the current suppliers (which represent about 50 percent of the current trade debt) are monopolists in the high-end hotel industry. Also, new suppliers would probably demand substantial guarantees or cash on delivery.			

Lender A and Lender B have senior debt that is secured over the same assets. There is an intercreditor agreement between them to split the proceeds of the collateral pro rata following an enforcement or an insolvency event.

7.1.4 Valuation of the Hotel Group's Business and Assets

Valuations of the Hotel Group's business and main assets are set out below. The restructuring valuations are based on the assumption that the Hotel Group's properties could be sold as a going concern relatively quickly to a strategic (i.e., an industry competitor) or a financial investor, for example.

Each property has its own license to operate. In the valuation, it is assumed that the licenses will remain; however, this is subject to some risk (each license can be withdrawn at the discretion of the relevant public authority).

7.1.5 Case Study Analysis Guidance

1. *What are the parties' interests?* Each stakeholder involved has different interests. Two of them (Lender A and Lender B) are relatively safe because they have senior secured debt. Lender C and Lender D are less safe; in a worst-case scenario, their recoveries may be zero. The trade creditors have a large outstanding amount of debt, and no collateral, but two of them have a strong commercial position.
2. *Is there consensus on a possible solution?* Do all the parties in this case understand that a workout probably maximizes recoveries for stakeholders?
3. *How should a workout be structured?* How should a workout be designed so that it serves the interests of stakeholders?

BEST-CASE SCENARIO	OCW (GOING-CONCERN SCENARIO)	REORGANIZATION PROCEEDING (GOING-CONCERN SCENARIO)	LIQUIDATION (SALE OF ALL ASSETS TOGETHER)	LIQUIDATION (PIECEMEAL SALE OF ASSETS)
('000)				
Total Hotel Group	27,000	21,600	17,550	13,500
Hotel Master	16,546	13,236	10,755	8,273
Hotel Oak	7,560	6,048	4,914	3,780
Hotel Gold	1,123	899	730	562

WORST-CASE SCENARIO	OCW (GOING-CONCERN SCENARIO)	REORGANIZATION PROCEEDING (GOING-CONCERN SCENARIO)	LIQUIDATION (SALE OF ALL ASSETS TOGETHER)	LIQUIDATION (PIECEMEAL SALE OF ASSETS)
('000)				
Total Hotel Group	20,250	16,200	13,163	10,125
Hotel Master	12,409	9,927	8,066	6,205
Hotel Oak	5,670	4,536	3,686	2,835
Hotel Gold	842	674	548	421

7.2 Phases in the Restructuring Process

Section 2.1 discussed four phases of a workout. They are as follows:

I. **Stabilizing**

II. **Analyzing**

III. **Repositioning or fundamentally changing the capital structure**

IV. **Reinforcing**

This case study works through the phases in practice for the Hotel Group. All forms are set out at the end of this chapter.

7.2.1 Phase I: Stabilizing

Phase I focuses primarily on how to improve the Hotel Group's cash flow. Minimizing operational expenses, and where appropriate capital expenditure, is necessary. The sale of assets and other initiatives can assist. To effectively minimize expenses, the Hotel Group's management must have a clear overview of payments to be made in the coming weeks. Management naturally has concerns about its ability to pay employees, trade creditors, and tax authorities, and a failure to make these payments could cripple the enterprise. Creditors, in turn, are concerned about the stability of the Hotel Group since they have limited faith in the reliability of the reporting by the Chief Financial Officer. At this stage, creditors may also focus on what management considers drastic means of generating cash (for example, some creditors may push for the sale of assets, such as artwork, to alleviate some liquidity concerns).

In Phase I, key stakeholders of the Hotel Group are identified, and their commercial interests are mapped out (**Form 1**); meetings with them are scheduled. Management draws up a timeline setting out milestones and a communication framework (**Form 2**), and the Hotel Group's owners and the lenders and key trade creditors agree on guidelines for the workout (**Form 3**).

Especially as trust in the Hotel Group's management is already lacking, a Chief Restructuring Officer (CRO) is appointed for Phases I to III of the process. To provide a basis for open dialogue, creditors agree to keep disclosed information confidential (**Form 4**). Sharing financial data (**Form 5**) is key, as is a clear action plan setting out how the enterprise is to be stabilized to prevent further deterioration of its financial condition (**Form 6**). A standstill agreement is entered into (**Form 7**) and interim financing is provided (**Form 8**).

The following sections describe the elements of Phase I in more detail.

7.2.1.1 Identifying Stakeholders

The management of the Hotel Group first identifies key stakeholders in the workout, including lenders and key trade creditors, and maps out their commercial interests (**Form 1**).

In the case of the Hotel Group, the primary stakeholders are the following:

- The owners
- Lender A
- Lender B
- Lender C
- Lender D
- Two trade creditors

Other stakeholders include the following:

- Other trade creditors
- Employees
- Tax authorities

If stakeholders not yet involved in the workout are identified, the management team will consider whether and when those stakeholders should be contacted and invited to participate in the process. Broad disclosure of the Hotel Group's financial difficulties at too early a stage may lead to a (further) loss of confidence in the Hotel Group, with negative consequences for its business. Partly for this reason, if certain stakeholders will not be asked to make concessions, it may be appropriate not to involve them in restructuring negotiations but rather to inform them of the conclusion of a workout once it has taken place.

To make the workout process as efficient as possible, relevant stakeholders elect representatives to participate in the negotiations, in the form of a steering committee. In the case of the Hotel Group, continuity of its operations will be at risk if the trade creditors decide to stop supplying the Hotel Group. The Hotel Group may also need them to make concessions. While the trade creditors' legal position is not strong, two of them have extensive commercial power. Management asks those two trade creditors to participate in the workout process.

7.2.1.2 Adoption of OCW Guidelines

To have a clear overview of the standstill period and roles, responsibilities, and deliverables, as well as the overall time frame of the process, a detailed timeline setting out milestones and a communication plan is drawn up by management; **Form 2** shows the initial part of this. It describes the intended structure of communications and meetings with all relevant stakeholders, and addresses the following questions:

- When are important deadlines for the owners, the lenders, and the trade creditors?
- What type of information will be disclosed and at what time?
- In what respects will stakeholders participate in the process?

The timing in Form 2 reflects the typically time-sensitive nature of actions in a restructuring (see section 2.1). However, especially if a debtor's business is sizable and complex, the steps described in Form 2 may take substantially longer than is described there.

The relevant stakeholders of the Hotel Group agree (voluntarily) that the workout process will follow a framework of OCW guidelines. A letter setting out the framework is entered into (**Form 3**).

Management of the Hotel Group has not been able to consistently generate positive cash flow, despite past promises to creditors. The creditors also have serious doubts about the current positive forecasts of the Chief Financial Officer. Management must ensure appropriate and timely communication with stakeholders, and this is likely to go beyond the contractual commitments contained in the terms of its loans. Trust in the enterprise will otherwise be further reduced, while (on the other hand) restoring faith in the enterprise by the lenders and trade creditors is important for a successful OCW. The CRO may play a critical role in this respect.

7.2.1.3 Confidentiality Agreement

Management requires that a confidentiality agreement (**Form 4**) be entered into by any creditor receiving information not already publicly available. Information, concepts, and ideas shared by the debtor within the context of the OCW should be treated as confidential by creditors. An approach based on confidentiality may help generate an open relationship among participants, which in turn can be expected to lead to a more efficient and effective workout process.

7.2.1.4 Financial Data

It is necessary for management of the Hotel Group to provide financial information to relevant stakeholders. This information will include the following:

- The latest audited financial statement, including a balance sheet, income statement, and cash flow statement with disclosures.
- Management reports per business unit per month over the past 24 months (including a reconciliation to the audited financial statements).
- A short-term cash flow forecast, updated weekly (a "rolling" cash flow forecast covering the following 13 weeks), highlighting immediate cash needs of the business (**Form 5** contains an excerpt of such a forecast).
- Longer-term projections, if any have been prepared.

7.2.1.5 Short-term Stabilizing Plan

Preferably before the start of the standstill period (see section 7.2.1.6 below), a short-term stabilizing plan (**Form 6**) is prepared and implemented.

Such a plan is helpful in enabling the Hotel Group to finalize a standstill agreement in short order, which will help it achieve its primary function of permitting the Hotel Group to trade

while developing a restructuring plan. The stabilizing plan must make clear what cash requirements of the Hotel Group need to be met to permit it to carry on with the restructuring. It must be credible and capable of being presented to groups of creditors.

Topics in the stabilizing plan include the following:

- An assessment of the causes of the enterprise's decline.
- An overview of projected cash needs (based on the short-term cash flow forecast referred to in section 7.2.1.4).
- An overview of initiatives to improve cash flow (e.g., the sale of assets, increased or faster collection of accounts receivable, postponement of payments to trade creditors).
- An overview of new internal controls over the cash outflow of the enterprise (e.g., payment controls, controls regarding forecasting and reporting, restrictions on capital expenditure, employment-related controls).

The stabilizing plan also notes the appointment of the CRO and lists the other members of the management team that will be involved in the day-to-day management of the OCW process. Roles and responsibilities in this regard are also summarized.

7.2.1.6 Standstill Agreement

The stakeholders of the Hotel Group agree on the standstill period and enter into a standstill agreement (**Form 7**). The following matters are addressed in the Hotel Group's standstill agreement (with additional points as set out in **Form 7**):

- The time frame of the standstill period, including a specified end date and the circumstances in which the standstill would terminate earlier.
- An obligation of the Hotel Group to submit a restructuring plan to creditors during the standstill period.
- A commitment of the lenders and trade creditors not to enforce their claims against the Hotel Group during the standstill period.

7.2.1.7 New Financing

The trade creditors of the Hotel Group need to be at least partially paid during the OCW process to ensure that the Hotel Group can continue to receive key supplies of food and beverages, laundry services, housekeeping, and transport services. If these cease to be provided, the Hotel Group will cease to remain operational and a restructuring may not be achievable. The Hotel Group will need to determine how such payments will be made, and this requires it to identify a provider of interim financing.

A letter of intent on the part of the Hotel Group's creditors and owners regarding the provision of interim financing by Lender D to the Hotel Group is set out in **Form 8**. Express consent by the creditors is likely to be required for the interim financing to have super priority over other Hotel Group debt. In the absence of super priority, interim financing may not be forthcoming.

7.2.2 Phase II: Analyzing

When entering Phase II of the OCW process, the Hotel Group's management and the relevant stakeholders shift focus from a short-term to a longer-term perspective. The phases overlap: Phase I is still in progress when Phase II starts; management must endeavor to stabilize the enterprise while at the same time assessing what the enterprise could and should look like in the longer term.

Ultimately, the best outcome of the Hotel Group's OCW for its stakeholders as a whole is an agreement among owners, lenders, and key trade creditors to support the enterprise so it can survive and succeed in the long term. This will take the form of a restructuring plan, the goal of Phase II. This plan represents an all-encompassing and legally binding summary of what is agreed among the parties.

7.2.3 Phase III: Repositioning; Fundamentally Changing the Capital Structure

The OCW of the Hotel Group is partly an operational restructuring and partly a financial restructuring. In Phase III, steps are taken to reposition the Hotel Group and fundamentally change its capital structure to make it appropriate.

Form 9 sets out key issues addressed in the Hotel Group's restructuring plan, including:

- Enterprise profile and causes of decline
- Restructuring vision
- New members of management
- Operational action plan
- Information on the financial restructuring
- Long-term financial projections

The Hotel Group's restructuring plan is disseminated to the lenders, key trade creditors, and owners and is approved by them. As the OCW involves a financial restructuring, appended to the restructuring plan are contracts that amend the terms of the lenders' debt and specify the amended terms. These contracts are entered into when the restructuring plan is formally approved.

7.2.4 Phase IV: Reinforcing

Following formal approval of the restructuring plan, which marks the end of Phase III, the CRO steps down. During Phase IV, the leadership team is strengthened for the longer term. A Chief Marketing Officer is added to the management team, and the Chief Financial Officer is replaced by an independent (not family-related) individual. Creditor consent to the restructuring plan is conditional on such changes, which form part of the restructuring plan.

7.3 Example Documents

DISCLAIMER

The documents included in this section are intended to serve as examples solely in the context of the case study in this chapter. While they represent examples of the types of documentation that might be used in such a case, they are in no way intended to serve as models for actual transactions. Rather, they are intended to give users of this publication an idea of the types of issues that may arise in the context of an out-of-court workout and the types of documents that participants in such a workout may need to produce. All documents in relation to a restructuring should be subject to the necessary legal and financial advice and nothing in this publication is intended to serve as a substitute for, or supplement to, such advice.

> > >

FORM 1 – STAKEHOLDER MAP

NAME OF STAKEHOLDER	Family Y
CONTACT PERSON	Father
POSITION	Joint owner
EMAIL	family@hotelgroup.com
TYPE OF STAKEHOLDER	Shareholders
SHORT DESCRIPTION OF THE POSITION	100% owner of the business
COMMERCIAL INTERESTS	Wish to retain control of the business
NAME OF STAKEHOLDER	Lender A
CONTACT PERSON	Mr. X
POSITION	Senior Account Manager, Large Clients
EMAIL	x@lender-a.com
TYPE OF STAKEHOLDER	Bank
SHORT DESCRIPTION OF THE POSITION	Senior debt, collateral
COMMERCIAL INTERESTS	Hotel lending business is now noncore, so likely to want to reduce exposure
NAME OF STAKEHOLDER	Lender B
CONTACT PERSON	Ms. Z
POSITION	Vice President, Corporate Clients
EMAIL	z@lender-b.com
TYPE OF STAKEHOLDER	Bank
SHORT DESCRIPTION OF THE POSITION	Senior debt, collateral
COMMERCIAL INTERESTS	Longstanding lender to the enterprise; likely to want to maintain good relations with it
NAME OF STAKEHOLDER	Lender C
CONTACT PERSON	Mr. A
POSITION	Account Manager, Hospitality
EMAIL	a@lender-c.com
TYPE OF STAKEHOLDER	Bank
SHORT DESCRIPTION OF THE POSITION	Junior debt, no collateral
COMMERCIAL INTERESTS	Relatively limited exposure, and likely to follow the approach taken by other lenders
NAME OF STAKEHOLDER	Lender D
CONTACT PERSON	Mr. F
POSITION	Account Manager, Hospitality
EMAIL	f@lender-d.com
TYPE OF STAKEHOLDER	Bank
SHORT DESCRIPTION OF THE POSITION	Junior debt, no collateral
COMMERCIAL INTERESTS	Relatively limited exposure, and likely to follow the approach taken by other lenders
NAME OF STAKEHOLDER	Trade Creditors 1 and 2
CONTACT PERSON	Mr. R and Ms. T
POSITION	Trade creditors
EMAIL	r@tradecreditor1.com and t@tradecreditor2.com
TYPE OF STAKEHOLDER	Trade creditors
SHORT DESCRIPTION OF THE POSITION	Supply required in order for enterprise to remain operational; current trade creditors not easy to replace; weak legal position but strong commercial position
COMMERCIAL INTERESTS	Keen to maintain good relations with the enterprise, but limited ability to defer receivables owing to their own working capital positions

SAMPLE

> > >

FORM 2 – TIMELINE: MILESTONES AND COMMUNICATION FRAMEWORK

WORKOUT MILESTONES AND COMMUNICATION FRAMEWORK	SUN 22 MAY	MON 23 MAY	TUE 24 MAY	WED 25 MAY	THU 26 MAY	FRI 27 MAY	SAT 28 MAY	SUN 29 MAY	MON 30 MAY	TUE 31 MAY	WED 1 JUN	THU 2 JUN	FRI 3 JUN	SAT 4 JUN	...
Overall process															
• setup of team for day-to-day management of restructuring	x														
• standstill period										Start					
Meetings															
• meetings with all key stakeholders			x						x						
• meetings with all key creditors									x						
• bilateral meetings with lenders						x							x		
• bilateral meetings with certain trade creditors						x							x		
Workout deliverables															
• draft letter of adoption of workout guidelines			x												
• draft confidentiality agreement			x												
• executed letter of adoption of workout guidelines						x									
• executed confidentiality agreement						x									
• draft standstill agreement						x									
• stabilizing plan									x						
• executed standstill agreement										x					
• draft restructuring plan															
• approval of restructuring plan and execution of associated documents															
Distribution of information (subject to entry into confidentiality agreements)															
• financial statements							x								
• management information							x								
• short-term cash flow forecast							x								
• further information as requested and appropriate										x	x	x	x	x	

SAMPLE

> > >

FORM 3 – LETTER OF ADOPTION OF WORKOUT GUIDELINES

Parties to this letter agreement:

- Creditors: Lender A, Lender B, Lender C, Lender D, Trade Creditor 1, and Trade Creditor 2
- Debtor: Hotel Group

It is generally accepted around the world that privately negotiated restructurings can yield higher stakeholder recoveries than court proceedings.

It is generally accepted that such restructurings (which can, broadly speaking, be termed out-of-court workouts) can:

- Allow viable businesses to continue to operate and to emerge successfully from financial distress.
- Allow creditors generally, and lenders specifically, to reduce losses.
- Serve the interests of other key stakeholders, such as customers, employees, suppliers, and investors, since businesses subject to out-of-court workouts can continue to trade.
- Be more efficient and effective than court procedures due to shorter time frames and higher recovery rates.
- Reduce pressure on courts.
- Avoid, to a large extent, the social and economic impact of major business failures.
- Apply to any form of enterprise.

The approach taken in this letter agreement reflects INSOL International's "Statement of Principles for a Global Approach to Multi-Creditor Workouts II."

The eight principles adopted under this letter agreement are as follows:

FIRST PRINCIPLE

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

Creditors agree with Debtor a Standstill Period of one month. Within this Standstill Period, Debtor will produce (in cooperation with Creditors) a restructuring plan.

SECOND PRINCIPLE

During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced. Conflicts of interest in the creditor group should be identified early and dealt with appropriately.

Creditors acknowledge that their positions are best served by Debtor remaining in business. An interruption of the operations of the hotels would seriously damage the reputation of Debtor and the insolvency concerns will become a self-fulfilling prophecy.

SAMPLE

THIRD PRINCIPLE

During the Standstill Period, Debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date (being the date on which the Standstill Period commences).

Payments to any Creditor are subject to approval of all Creditors. Repayment of outstanding loans will not take place during the Standstill Period. Payments to trade creditors can take place, but payments of amounts that are currently overdue are not allowed. Payments to a Creditor that exceed 100,000 currency units in total in the Standstill Period need express approval of all Creditors.

Debtor will not take action to file for an insolvency proceeding, other than as required by directors' duties, without the approval of all Creditors.

FOURTH PRINCIPLE

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

Creditors have appointed a coordination committee (the "Committee") comprising Mr. X (Lender A), Ms. Z (Lender B), and Ms. T (Trade Creditor 2). The Committee's role includes responsibility (alongside Debtor) for managing the process of the workout, including scheduling meetings and disseminating information to stakeholders as appropriate.

FIFTH PRINCIPLE

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

Creditors will enter into confidentiality agreements in a form to be agreed. Debtor will create a detailed package of information (to be specified) and will set up a virtual data room (an online repository of documents) with access granted to all Creditors. New information provided by Debtor will only be distributed via the data room. A Creditor wishing to receive additional information will submit a written information request to Debtor specifying in reasonable detail the nature of the information sought.

SIXTH PRINCIPLE

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

Debtor and all Creditors are located in country ABC, and the governing law of all Debtor's liabilities is that of country ABC. As such, legally binding agreements entered into in connection with the workout will follow the laws of country ABC. The Creditors' positions at the Standstill Commencement Date are as follows:

SAMPLE

	CURRENTLY OUTSTANDING ('000)	MATURITY DATE	ARREARS IN INTEREST PAYMENTS	ARREARS IN DEBT REPAYMENT
Senior secured debt **Lender A**	6,937	Matures in several months	Yes	No
Senior secured debt **Lender B**	5,946	Matures in several months	Yes	No
Unsecured debt (working capital) **Lender C**	991	Matured	No	Yes
Unsecured debt **Lender D**	793	Matures in several years	No	No
Shareholder loans	2,000	No maturity date	N/A	N/A
Trade creditors (unsecured)	4,851	The Hotel Group currently pays on average after 90 days.	Payment is net 30 days from date of invoice according to contract terms.	

SAMPLE

SEVENTH PRINCIPLE

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

All written information provided by Debtor to Creditors will be made available through the virtual data room so that all Creditors can access it. Proposals from a Creditor will be discussed during meetings between Debtor and Creditors.

EIGHTH PRINCIPLE

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

Both Lender B and Lender D have indicated that they are willing in principle to provide additional funding to the Hotel Group. Debtor needs to provide an overview of the necessary funding for the next six months. Lender A, Lender C, Trade Creditor 1, and Trade Creditor 2 have indicated that they are willing to discuss the possibility of super priority of the new financing.

This letter agreement is made under and shall be construed according to the laws of country ABC. In the event that this letter agreement is breached, any and all disputes must be settled in a court of competent jurisdiction in country ABC.

The parties acknowledge that they have read and understand this letter agreement and accept the obligations set forth herein.

Signed on [*date*] by:

....

Hotel Group

....

Lender A

....

Lender B

....

Lender C

....

Lender D

....

Trade Creditor 1

....

Trade Creditor 2

FORM 4 – CONFIDENTIALITY AGREEMENT

Parties to this agreement:

- Creditor: [Lender A / Lender B / Lender C / Lender D / Trade Creditor 1 / Trade Creditor 2]
- Debtor: Hotel Group

It is understood and agreed that the Debtor would like to provide the Creditor with certain information that may be considered confidential. To ensure the protection of such information and in consideration of the Agreement to disclose said information, the parties agree as follows:

1. The confidential information to be disclosed under this Agreement ("Confidential Information") can be described as and includes:

   Financial information about the Debtor, budgets, financial projections, forecasts, business plans, information about customers and suppliers, information about liabilities, proposed or actual restructuring plans, and all other information regardless of whether such information is designated as Confidential Information at the time of its disclosure.

   In addition to the above, Confidential Information shall also include, and the Creditor shall have a duty to protect, other confidential and/or sensitive information which is (a) disclosed in writing and marked as confidential (or with other similar designation) at the time of disclosure; and/or (b) disclosed in any other manner and identified as confidential at the time of disclosure and is also summarized and designated as confidential in a written memorandum delivered within thirty (30) days of the disclosure.

2. The Creditor shall use the Confidential Information only for the purpose of trying to reach an out-of-court workout agreement.

3. The Creditor shall limit disclosure of Confidential Information within its own organization to its directors, officers, partners, members, and/or employees having a need to know it and shall not disclose Confidential Information to any third party (whether an individual, corporation, or other entity) without the prior written consent of the Debtor. The Creditor shall take affirmative measures to ensure compliance with these confidentiality obligations by its employees, agents, consultants, and others who are permitted access to or use of the Confidential Information.

4. This Agreement imposes no obligation on the Creditor with respect to any Confidential Information (a) that was possessed or known by the Creditor before receipt; (b) that is or becomes a matter of public knowledge through no fault of the Creditor; (c) that is rightfully received from a third party not owing a duty of confidentiality; (d) that is disclosed without a duty of confidentiality to a third party by, or with the authorization of, the Debtor; (e) that is independently developed by the Creditor; or (f) to the extent that disclosure is required by law.

5. This Agreement shall not be construed as creating, conveying, transferring, granting, or conferring on the Creditor any rights, license, or authority in or to the information disclosed, except the limited right to use Confidential Information specified in paragraph 2. Furthermore, and specifically, no license or conveyance of any intellectual property rights is granted or implied by this Agreement.

6. In disclosing information under this Agreement, the Debtor is not giving any representations or warranties to the Creditor as to the accuracy or completeness of such information.

SAMPLE

7. Each party acknowledges and agrees that the disclosure of information under this Agreement shall not commit or bind either party to any present or future contractual relationship (except as specifically provided for in this Agreement), nor shall the disclosure of information be construed as an inducement to act or not to act in any given manner.

8. Neither party shall be liable to the other in any manner whatsoever for any decisions, obligations, costs or expenses incurred, changes in business practices, plans, organization, products, services, or otherwise, based on either party's decision to use or rely on any information disclosed under this Agreement.

9. If there is a breach or threatened breach by the Creditor of any provision of this Agreement, it is agreed and understood that the Debtor shall have no adequate remedy in money or other damages and accordingly shall be entitled to seek injunctive relief, provided, however, no specification in this Agreement of a remedy shall be construed as a waiver or prohibition of any other remedies in the event of a breach or threatened breach of this Agreement.

10. This Agreement states the entire agreement between the parties concerning the disclosure of Confidential Information and supersedes any prior agreements, understandings, or representations with respect thereto. Any addition or modification to this Agreement must be made in writing and signed by authorized representatives of both parties.

11. If any of the provisions of this Agreement are found to be unenforceable, the remainder shall be enforced as fully as possible and the unenforceable provision(s) shall be deemed modified to the limited extent required to permit enforcement of the Agreement as a whole.

12. This Agreement is made under and shall be construed according to the laws of country ABC. In the event that this agreement is breached, any and all disputes must be settled in a court of competent jurisdiction in country ABC.

The parties acknowledge that they have read and understand this Agreement and voluntarily accept the obligations set forth herein.

Signed on [*date*] by:

SAMPLE

....

Hotel Group

....

[Lender A / Lender B / Lender C / Lender D / Trade Creditor 1 / Trade Creditor 2]

> > >

FORM 5 – EXCERPT FROM SHORT-TERM CASH FLOW STATEMENT

(CASH RECEIPT AND DISBURSEMENT METHOD) ('000)							
	29/05	30/05	31/05	01/06	02/06	03/06	04/06
Cash Inflow							
Sales	24	25	21	19	23	24	18
Additional loans						125	
...							
...							
...							
...							
...							
Total cash inflow	24	25	21	19	23	149	18
Cash Outflow							
Disbursement for cost of sales	–	–	(3)	–	–	(3)	–
Disbursement for payroll	–	–	(101)	–	–	–	–
Disbursement for other operating expenses			(36)			(36)	
Disbursement for financial expenses	–	–	–	–	–	–	–
Disbursement for maintenance		(124)					
Total cash outflow	–	(124)	(140)	–	–	(39)	–
Total change	24	(99)	(119)	19	23	110	18
Cash & bank: beginning of day	5	29	(70)	(189)	(170)	(147)	(37)
Total change	24	(99)	(119)	19	23	110	18
Cash & bank: end of day	29	(70)	(189)	(170)	(147)	(37)	(19)

SAMPLE

> > >

FORM 6 – STABILIZING PLAN

The stabilizing plan contains the following items:

1. Preliminary analysis of causes of decline:
    - Description of the strategy that led to the financial distress
2. Immediate cash requirements:
    - Further information on the short-term cash flow forecast
    - Based on reliable starting position
    - Indication of whether amount or timing of individual items can be changed
3. Overview of cash-generating activities:
    - Description of each initiative to generate additional cash or generate cash more quickly, including benefits and costs of the initiative
    - Examples:
        - Sale of assets
        - Increased or faster collection of accounts receivable
        - Postponement of payments to trade creditors
4. Emergency cash-management controls:
    - Description of payment controls, including list of cash management team members
    - Description of forecasting and reporting controls
    - Examples:
        - Restrictions on capital expenditure
        - No new employment contracts
        - No payroll increases or promotions
5. Out-of-court workout management team:
    - Chief Restructuring Officer
    - List of other team members
    - Roles and responsibilities

SAMPLE

> > >

FORM 7 – STANDSTILL AGREEMENT

Parties to this agreement:

- Creditors: Lender A, Lender B, Lender C, Lender D, Trade Creditor 1, and Trade Creditor 2
- Debtor: Hotel Group

All parties involved acknowledge that the parties should be provided sufficient time for information about the Debtor to be obtained and evaluated and for proposals for resolving the Debtor's financial difficulties to be formulated and assessed.

1. The standstill period is effective as of [*date*].

2. During the standstill period, the Debtor:

    a. Has the obligation to provide all relevant Creditors with adequate and reliable information to enable them to assess the Debtor's financial condition, to understand the causes of its financial difficulties, and to evaluate any proposed solutions that are put forward.

    b. Has the obligation to prepare and submit to the Creditors a restructuring plan that is intended to resolve the Debtor's financial difficulties. The restructuring plan should show how the distressed business is capable of operating profitably and should set out a proposed capital structure that is appropriate.

    c. Shall not take any action, other than as required by directors' duties, that would adversely affect the prospective recoveries of the relevant Creditors on a collective or individual basis, as compared to their position at the commencement of the standstill period.

3. During the standstill period, the Creditors:

    a. Are entitled to expect that their positions relative to other creditors will not be prejudiced during the standstill period;

    b. Will not try to improve their positions relative to other creditors;

    c. Will not declare outstanding amounts to be due and payable or demand payment of such amounts;

    d. Will not initiate security enforcement, or liquidation proceedings;

    e. Will allow existing credit lines and facilities to be used; and

    f. Will allow the Debtor to continue to make payments in what is commonly referred to as "the ordinary course of business."

4. The standstill period ends on [*date*] at 12:00 GMT or, if earlier, upon (a) a breach by the Debtor of any of its obligations under this Agreement or (b) an event of default under one of the Debtor's loans other than (i) a failure to pay, (ii) a breach of a financial covenant, or (iii) a cross-default triggered by (i) or (ii) (which are all covered by the standstill). Extension of the standstill period is only possible if all Creditors and the Debtor agree.

5. This Agreement is made under and shall be construed according to the laws of country ABC. In the event that this Agreement is breached, any and all disputes must be settled in a court of competent jurisdiction in country ABC.

SAMPLE

The parties acknowledge that they have read and understand this Agreement and voluntarily accept the obligations set forth herein.

Signed on [*date*] by:

....
Hotel Group

....
Lender A

....
Lender B

....
Lender C

....
Lender D

....
Trade Creditor 1

....
Trade Creditor 2

SAMPLE

> > >

FORM 8 – LETTER OF INTENT TO ENTER INTO INTERIM FINANCING ARRANGEMENTS

Parties to this letter of intent:

- Creditors: Lender A, Lender B, Lender C, Lender D, Trade Creditor 1, and Trade Creditor 2
- Owners

The parties acknowledge that the Debtor needs additional financing during the out-of-court workout process to be able to restructure the enterprise and avoid insolvency proceedings.

More specifically, the Debtor needs interim financing to reduce the outstanding amount to trade creditors to ensure continuation of the supply of food and beverages and certain services. Without such continued supply, the going-concern position of the Debtor is not guaranteed.

Lender D has expressed an interest in providing interim financing to the Debtor in the form of senior secured debt. In exchange for the interim financing by Lender D, it is envisaged that the following would be required:

1. An agreement among the current creditors to provide Lender D with the highest priority with respect to repayment of the interim financing. Lender D would be repaid first in the case of an insolvency event of the Debtor.
2. An agreement to change the security rights of Lender A and Lender B and involve Lender D. Lender A and Lender B would (a) give up a proportional part of their rights to the collateral in favor of Lender D, and (b) waive their negative pledge protections to a corresponding extent.
3. A share pledge agreement, under which Lender D would be granted a pledge over the shares in the Debtor.
4. Personal guarantees by the shareholders of the Debtor in favor of Lender D, on which Lender D would be able to call if its collateral were insufficient to repay the interim financing.

The parties will use reasonable endeavors to finalize the above in the next week.

SAMPLE

Signed on [*date*] by:

....	....	....
Hotel Group	**Lender A**	**Lender B**
....	....	....
Lender C	**Lender D**	**Trade Creditor 1**
....		
Trade Creditor 2		

> > >

FORM 9 – RESTRUCTURING PLAN

1. Enterprise profile and causes of decline:

    - Profile of the enterprise
    - Description of the causes of the financial distress

2. Restructuring vision:

    - Target customers and the channels that will be used to target them
    - Revenue streams and cost structure
    - Structure of the organization
    - Use of new technology
    - New corporate partners

3. New members of management

4. Operational action plan:

    - The agreed operational restructuring measures (for each of the parts of the organization in which specific actions are to be taken)
    - A detailed timeline setting out the milestones of the operational restructuring

5. Information on the financial restructuring:

    - Information on amendments to the existing instruments held by stakeholders, including whether interim financing is to be refinanced
    - Details of the new capital structure, containing key terms of the new debt instruments (e.g., maturity dates and interest rates) and new holdings of shareholders

6. Long-term financial projections

SAMPLE

8

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Conclusion

In the context of the COVID-19 crisis, the risk has significantly increased that when government stimulus and forbearance measures end, fundamentally viable businesses will be forced to close, with associated job losses. Even in noncrisis times, corporate distress is unavoidable. However, systemic corporate distress can lead to high levels of nonperforming assets. This can have adverse effects across both the financial sector and the real economy, such as increased inflation and reduced GDP growth. Preventing and resolving nonperforming assets, through sound insolvency and debt resolution regimes, goes a long way toward ensuring the stability of the financial sector. Such regimes also promote access to credit and in turn facilitate economic growth by ensuring that nonviable businesses are liquidated efficiently, unproductive zombie firms can exit the market, and viable businesses are restructured.

While ensuring efficient and orderly liquidation has always been a challenge for policy makers, for most jurisdictions the larger challenge has been on the restructuring front. International experience tells us that there is no one-size-fits-all solution to the challenge of developing effective restructuring frameworks. Best practices require that a restructuring system provide debtors and creditors with a range of tools to restructure troubled companies. Formal reorganization proceedings must be supplemented with other options. This is what makes frameworks for workouts particularly important.

Workout frameworks of many different types can be put in place. This Toolkit provides a broad understanding of the different frameworks that can be deployed: OCWs, enhanced workouts, hybrid workouts, and preventative workouts. Some of these involve courts or administrative authorities — to varying degrees — and others are purely driven by commercial parties. Some frameworks rely heavily on a strong cadre of insolvency representatives, others less so. In all cases, debtors and creditors must be willing to drive workout processes forward. There must be a workout culture, with certain intangible elements present, and there is much that policy makers can do to facilitate this. Ultimately, stakeholders themselves need to take a pragmatic, commercial approach to workouts and understand the potential for maximizing recovery through a collective restructuring (as opposed to using debt enforcement tools, for instance). This Toolkit provides policy makers and stakeholders with tools to develop both workout frameworks and a workout culture, as well as a practical understanding, via the case study, of how workouts operate in practice. Through a discussion of potential approaches, it aims to illustrate how individual EMDEs can select the right model (or models) to suit their specific needs and institutional fabric.

While the formal legal framework for corporate reorganization (and, indeed, liquidation) will always provide a "backstop" if workout negotiations fail, decades of experience in insolvency cases tell us that consensus-driven solutions can provide better outcomes for all stakeholders. The goal of this Toolkit is for such solutions to become commonplace, during the COVID-19 crisis and beyond.

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Endnotes

1. UNCITRAL 2005, 4.
2. UNCITRAL 2005, 4.
3. World Bank Group 2011, 63.
4. UNCITRAL 2005, 7.
5. This definition is based on the definition of stay of proceedings in UNCITRAL 2005, 7.
6. World Bank Group 2021b, citing International Monetary Fund 2020 and International Monetary Fund 2021.
7. See Muro 2021.
8. Muro 2021.
9. Apedo-Amah et al. 2020.
10. Laeven, Schepens, and Schnabel 2020.
11. Group of Thirty 2020, 57.
12. See World Bank 2020.
13. Dancausa, Muro, and Uttamchandani 2020.
14. See Menezes and Gropper 2021.
15. Compare Garrido 2012.
16. See Čihák and Nier 2012.
17. A *cramdown* is an insolvency law mechanism whereby an agreement approved by a specified majority of stakeholders (or of stakeholder classes) can be imposed on nonconsenting stakeholders, even in the absence of (or with an effect beyond that of) a provision in the preexisting contractual debt terms allowing amendments with the consent of a specified majority of creditors.
18. The law of the relevant jurisdiction establishes the scope of a cramdown. A cramdown of a stakeholder class by one or more other stakeholder classes is termed a *cross-class cramdown*.
19. See Armour et al. 2015, 10.
20. McGowan, Andrews, and Millot 2017. See also Andrews and Petroulakis 2019.
21. Menezes 2014. (Updated version forthcoming in 2021.)
22. Araujo, Ferreira, and Funchal 2012 and Funchal and Clovis 2009.
23. Giné and Love 2010.
24. Frisby 2007; Polo 2011.
25. Chung and Ratnovski 2016.
26. See McGowan, Andrews, and Millot 2017 and Andrews and Petroulakis 2019.
27. Carpus Carcea et al. 2015.
28. Menezes et al. 2021.
29. Carpus Carcea et al. 2015.
30. World Bank Group 2021a.
31. UNCITRAL 2005.
32. See Financial Stability Board 2011.
33. See Martinez and Uttamchandani 2017.
34. In line with the 2016 version of the Toolkit, this part of the revised Toolkit draws on Jan Adriaanse and Arnoud Griffioen 2015. See also International Finance Corporation 2011.
35. A debt rescheduling (without more) is akin to an amend-and-extend. This involves an extension of the maturity of debt and relatively limited amendments to other contractual debt terms, and it is typically seen as a transaction that is short of a restructuring, as it is not a fundamental change to the capital structure.
36. UNCITRAL 2005, Part One, Ch. I, para. 1.
37. For further differences between bonds and loans and related considerations in the design of restructuring frameworks, see Brodie 2017.
38. See INSOL International 2006. The CDS market has changed in certain respects since 2006; in connection with restructurings, changes include the incorporation of auction settlement in standardized CDS documentation and the introduction of committees to determine (among other things) whether or not a credit event has occurred.
39. The detail of the laws, regulations, and rules referred to in the main text is beyond the scope of the Toolkit. The wording in the main text is intended to encompass, among other things, a prohibition in the United States on purchasing or selling a security on the basis of material nonpublic information, under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder (17 CFR § 240.10b-5).
40. For completeness, it should be noted that the terms of debt may contain (a) a cross-default provision, pursuant to which a nonpayment event of default under other debt constitutes an event of default under this debt; or (b) a cross-acceleration provision, pursuant to which the declaration of outstanding amounts under other debt as due and payable constitutes an event of default under this debt.
41. In common usage, the term *steering committee* may also be used to refer to an *official committee* or an *ad hoc committee*. This is not the sense in which it is used in the Toolkit.
42. The detail of different valuation methodologies is beyond the scope of the Toolkit.
43. Depending on its nature, it may be termed *priority*, *super priority*, or a *priming lien*.
44. UNCITRAL 2005, Part Two, Ch. II, paras. 94–107.
45. See sections 67 (Scheme of Arrangement) and 101 (Judicial Management) of the Insolvency, Restructuring and Dissolution Act 2018.
46. Compare UNCITRAL 2005, Part Two, Ch. II, para. 107. It may be appropriate for a grant of super priority in respect of *preexisting* financing (i.e., where no new financing is provided by the creditor in return for the super priority) to be nullified in a subsequent insolvency proceeding.
47. See Mocheva and Shah 2017.
48. See Menezes, Mocheva, and Shankar 2020.
49. Abe 2017.
50. Insider trading and market abuse laws or regulations, and market conduct rules, are also potentially relevant in the context of sharing information (see section 2.3).
51. Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency, and discharge of debt, and amending Directive (EU) 2017/1132.
52. Adapted from Menezes, Mocheva, and Shankar 2020, citing Introduction to Early Warning Europe: Early Warning, Denmark (July 8, 2019), https://www.earlywarningeurope.eu/about/best-practices/early-warning-denmark. As described on the website, Early Warning, Denmark "is a national programme providing free, impartial and confidential counselling to Danish SMEs facing the risk of bankruptcy."
53. WB-ICR Principles at 3.
54. Certain creditors may be bound through the application of a provision in the preexisting contractual debt terms allowing amendments with the consent of a specified majority of creditors (see text at note 17).
55. On the other hand, the absence of formal deadlines may be unhelpful (at least if the debtor's financial condition is not deteriorating rapidly), by not encouraging an agreement between relevant parties.

56. If an OCW takes longer than another form of restructuring would take, owing to the point made in note 55, this could offset the cost advantage described in the text.

57. See Clementi 2001. The existence of CDSs can also affect creditors' financial incentives; see generally INSOL International 2006 and note 38.

58. See text at note 37 and section 2.3 of this Toolkit in connection with trading in bonds.

59. See, generally, Kent 1993 and 1997; and Garrido 2012, paras. 82–84.

60. See Finch and Milman 2017, 258 et seq.

61. INSOL International 2017, II: 2.

62. The reference is to an "initial" standstill period; the standstill period may be extended. Indeed, as noted in section 3.2, an advantage of an OCW is its flexibility.

63. INSOL International 2017, II: 2.

64. INSOL International 2017, II: 2.

65. INSOL International 2017, II: 2.

66. INSOL International 2017, II: 3.

67. See text at note 37 and section 2.3 of this Toolkit in connection with trading in bonds.

68. INSOL International 2017, II: 3.

69. INSOL International 2017, II: 3.

70. INSOL International 2017, II: 3.

71. See Claessens 2005.

72. Cerruti and Neyens 2016.

73. Cerruti 2018.

74. See Fung et al. 2004.

75. Cerruti 2018.

76. Its powers, functions, and governance arrangements derive from the National Asset Management Agency Act No. 34 of 2009.

77. This paragraph is based on the information provided on NAMA's website and in the NAMA 10-Year Overview of January 9, 2020; available at https://www.nama.ie.

78. This paragraph draws in part on information on Sareb's website (https://www.sareb.es) and *Annual Activity Report 2020*. See Sareb 2020.

79. Spain 2012.

80. Tobing 2002.

81. Ogada 2008.

82. Ogada 2008.

83. Mako 2003.

84. Ogada 2008.

85. Ogada 2008.

86. See Mako 2005; Kwon 2016; Bae Kim & Lee 2016.

87. Mako 2003.

88. DLA Piper 2012.

89. Charoenseang and Manakit 2002.

90. Charoenseang and Manakit 2002. See also Dasri 2013; Garrido 2012; International Monetary Fund 2000.

91. See Bergthaler et al. 2015.

92. OECD 2011.

93. OECD 2011.

94. International Monetary Fund 2011 and 2012; see also Bergthaler et al. 2015.

95. The Corporate Debt Restructuring Guidelines were reapproved by the Consultative Council on Insolvency Issues on February 12, 2018.

96. Bank of Albania 2020.

97. India 2016.

98. Reserve Bank of India 2019.

99. Scheduled Commercial Banks (excluding Regional Rural Banks), India Term Financial Institutions (NABARD, NHB, EXIM Bank, and SIDBI), and Small Finance Banks.

100. World Bank Group 2003.

101. Kardayi N.D.

102. These frameworks can be consulted via the Banks Association of Turkey website; see https://www.tbb.org.tr/fyyen/Framework%20Agreement%20on%20Financial%20Restructuring-Large%20Scale.pdf and https://www.tbb.org.tr/fyyen/Framework%20Agreement%20on%20Financial%20Restructuring-Small%20Scale.pdf. Links to other relevant documents can be found at https://www.tbb.org.tr/en/banking-legislation/professional-codes-/91.

103. See Wood 2007, 36 et seq.

104. In England and Wales, once a company is insolvent or bordering on insolvency, the focus of directors' duties to the company shifts from shareholders' interests to creditors' interests. This is commonly referred to as the rule in *West Mercia Safetywear v. Dodd* [1988] BCLC 250. The basis of this approach can be seen as the following: (a) once a company is insolvent or almost insolvent, its primary economic stakeholders are its creditors; (b) the interests of creditors are not aligned with the interests of shareholders regarding the level of risks that should be taken by such a company; and (c) creditors may not be well placed to protect their interests.

105. Figures from the Consular Observatory of Companies in Difficulty (*Observatoire consulaire des entreprises en difficulté*) on January 1, 2021, in the region Île-de-France (commercial courts of Paris, Meaux, Melun, Versailles, Évry, Nanterre, Bobigny, Créteil, and Pontoise). Available at: https://www.entreprises.cci-paris-idf.fr/documents/20152/6283288/FlashOCED-BulletinSanteEntreprises-France-IdF-janv2021.pdf/a25ef700-889e-5325-4c53-4458f6690851.

106. France 1804 (amended 2020).

107. Egypt 2018.

108. The 2018 Insolvency Law includes three main bankruptcy procedures: restructuring, which is available only to debtors who are not yet insolvent; preventive composition, which is available to debtors whose "financial works are distressed in a way that can lead to ceasing payments," as well as to a debtor "who ceases honoring his debts" if "he submits the bankruptcy application within fifteen days as of the date of cessation of payments"; and bankruptcy liquidation, which can be declared against a debtor who "ceases paying his commercial debts following distress of his financial affairs."

109. As part of the Economic Courts preparatory panels, based on the 2008 Economic Court Law. See https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/ifc+backs+mediation+in+egypt%2C+helps+expedite+commercial+justice.

110. Ethiopia 2020.

111. Section 5.4.4 is based on information collected through the World Bank Group project work in Poland (contributions by Nina Mocheva, EFNFI) and on Squire Patton Boggs 2020.

112. The restructuring advisor must be chosen from the official list of insolvency administrators provided by the Ministry of Justice.

113. Central Economic Information Centre 2020.

114. Central Economic Information Centre 2020.

115. Law 1116 of 2006 of Colombia, Official Gazette No. 46.494.

116. Decree No. 560 of the Ministry of Justice of Colombia, April 20, 2020.

117. The information in this paragraph is based on contributions by Susana Hidvegi Arango, Superintendent of Insolvency Proceedings, Colombia (based on interview conducted on November 2, 2020), and Brigard Urrutia 2020.

118. Administration is a procedure that allows the reorganization or realization of assets of a company — typically an insolvent one — with the protection of a stay.

119. Discussion of the range of possible transaction structures is outside the scope of the Toolkit.

120. Certain claims of senior creditors against the original debtor may be left there, so that if the asset value of the debtor turns out to be above zero, it may be recovered by those senior creditors.

121. See Frisby 2007, 9.

122. ICAEW 2021.

123. ICAEW 2021, para. 8.

124. United Kingdom 2021.

125. The Netherlands 2021.

[126] For further information, see Galen 2020.

[127] Peru 2002.

[128] Post-petition Disclosure and Solicitation, United States, Title 11 U.S. Code, Sec. 1125(g): "Notwithstanding subsection (b) [pre-approval by the Bankruptcy Court of disclosure statements when solicitation is done *after* the commencement of the Chapter 11 case], an acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law and if such holder was solicited *before the commencement of the case* in a manner complying with applicable nonbankruptcy law" (emphasis added).

[129] Title 11 U.S. Code, Sec. 1126(b).

[130] Federal Rules of Bankruptcy Procedure, United States, Part III — Claims and Distribution to Creditors and Equity Interest Holders; Plans. Rule 3018(b): Acceptance or Rejection of Plan in a Chapter 9 Municipality or a Chapter 11 Reorganization Case: Acceptances or Rejections Obtained Before Petition.

[131] Declaration of Robert J. Riesbeck, Chief Financial Officer of FullBeauty Brands Holdings Corp., In Support of Debtors' Chapter 11 Petitions and First Day Motions, *In re FullBeauty Brands Holdings Corp., et al*., Case No. 19-22185 (RDD) (Bankr. S.D.N.Y.).

[132] Declaration of Robert J. Riesbeck, *In re FullBeauty Brands*.

[133] Declaration of Robert J. Riesbeck, *In re FullBeauty Brands*.

[134] Declaration of Robert J. Riesbeck, *In re FullBeauty Brands*.

[135] Declaration of Robert J. Riesbeck, *In re FullBeauty Brands*.

[136] Declaration of Robert J. Riesbeck, *In re FullBeauty Brands*.

[137] Objection of the United States Trustee to Confirmation of the Plan and Related Relief, *In re FullBeauty Brands Holdings Corp., et al*., Case No.19-22185 (RDD) (Bankr. S.D.N.Y.).

[138] Confirmation Hearing Transcript, *In re FullBeauty Brands Holdings Corp., et al.*, Case No.19-22185 (RDD) (Bankr. S.D.N.Y.).

[139] Order (I) Approving the Disclosure Statement and Confirming the First Amended Joint Prepackaged Chapter 11 Plan of Reorganization of FullBeauty Brands Holdings Corp and Its Debtor Affiliates and (II) Granting Related Relief, *In re FullBeauty Brands Holdings Corp., et al*., Case No. 19-22185 (RDD) (Bankr. S.D.N.Y.).

[140] Notice of (I) Entry of Order Approving Disclosure Statement and Confirming the Debtors' First Amended Joint Prepackaged Chapter 11 Plan of Reorganization and (II) Occurrence of Effective Date, *In re FullBeauty Brands Holdings Corp., et al*., Case No.19-22185 (RDD) (Bankr. S.D.N.Y.).

[141] Order (I) Approving the Disclosure Statement, *In re FullBeauty Brands*.

[142] Notice of (I) Entry of Order Approving Disclosure Statement and Confirming the Debtors' First Amended Joint Prepackaged Chapter 11 Plan of Reorganization and (II) Occurrence of Effective Date, *In re FullBeauty Brands Holdings Corp., et al.*, Case No. 19-22185 (RDD) (Bankr. S.D.N.Y.).

[143] European Commission 2014.

[144] European Union 2019.

[145] European Union 2019, preamble, para. 1.

[146] Official Gazette Narodne novine, nos 71/2015, 104/2017.

[147] https://e-oglasna.pravosudje.hr.

[148] France 2005.

[149] Figures for the period 2010–2016, extracted from Epaulard and Zapha 2020.

[150] Since their implementation, and until the transposition of the Directive, accelerated financial safeguard and accelerated safeguard proceedings are only accessible to companies that meet certain thresholds (20 employees, EUR 3 million turnover, and EUR 1.5 million balance sheet total).

[151] Europcar Mobility Group 2021.

[152] Europcar Mobility Group 2020.

[153] See Europcar Mobility Group S.A. and Luc Peligry Bankruptcy (1:20-bk-12878), Southern District of New York, Bankruptcy Court, file December 17, 2020.

[154] Europcar Mobility Group 2021.

[155] Europcar Mobility Group 2021.

[156] Act for a Stabilization and Restructuring Framework for Businesses (Gesetz über den Stabilisierungs und Restrukturierungsrahmen für Unternehmen, Unternehmensstabilisierungs- und –restrukturierungsgesetz – StaRUG), December 17, 2020.

[157] If the required majority (75 percent of voting rights) is not achieved in every class, the plan will be deemed approved if certain other conditions are met, in particular that a majority of voting classes has accepted the plan.

[158] See Article 160 of the Italian Bankruptcy Law (r.d. 16-3-1942, n. 267), "Legge fallimentare."

[159] The debate concerning the definition of "crisis" was partially settled by the reform of 2005, whereby the Italian legislature specified in the text of Article 160, para. 2 of the Italian Bankruptcy Law that "a state of crisis also includes a state of [technical] insolvency" (see r.d. 30-12-2005, n. 273, converted into r.d. 23-2-2006, n. 51).

[160] Ambrosini 2019.

[161] Concerning judicial review of the "feasibility" of the plan in the context of the *concordato preventivo*, in 2017, the Italian Supreme Court extended the review performed by the competent court to "economic feasibility" in the presence of a project manifestly unfit to be realized (Cass., April 7, 2017, decision no. 9061).

[162] See Articles 182 *quater* and *quinquies* of the Italian Bankruptcy Law.

[163] See Law Decree dated June 27, 2015, no. 83, converted into Law August 6, 2015, no. 132.

[164] Introduced by law decree dated June 27, 2015, no. 83.

[165] Insolvency Law of 22/2003, July 9, 2003, effective January 1, 2004.

[166] Royal Decree Law 38/2011, October 10, 2011.

[167] Royal Decree Law 1/2020, May 5, 2020.

[168] Articles 596–694, Royal Decree Law 1/2020.

[169] International Monetary Fund 2017.

[170] In line with the 2016 version of the Toolkit, this part of the revised Toolkit draws on Jan Adriaanse and Arnoud Griffioen 2015.

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Notes

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