

# Comment

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On behalf of INSOL International, I am honoured to congratulate Globe White Page on the second edition of the *Americas Restructuring and Insolvency Guide 2008/2009*. The book provides an excellent and timely commentary on the current restructuring and insolvency regimes in the Americas.

Since the publication of the first edition in 2004/2005, the majority of the economies in the Americas have enjoyed relative prosperity and ease of access to capital. Although not every jurisdiction has participated equally, the number of formal restructurings and insolvencies has been quite low. During this period a number of countries within the region have updated their insolvency legislation or worked to build up their infrastructure capacity. These activities are commended, particularly as insolvency legislation and capacity are not always seen by politicians as key components of a modern and progressive economic and corporate framework.

Until mid to late 2007, access to capital and financing was not an issue, particularly in the more developed countries. Debt financing had reached record levels, including the issuance of high-yield debt. In addition to the substantial liquidity, there was a dramatic reduction in the yield spreads accepted by investors, seemingly justified by the then-low default rates and high recovery rates that prevailed. The relative ease of access to financing resulted in many enterprises which might in the past have sought formal protection to carry out a restructuring, being able either to refinance at ever-increasing levels of indebtedness (in many cases with few, if any, covenants) or to sell the business to a financial buyer at a value determined by the low cost of capital as its real value. Arguably, the access to capital could have provided challenged enterprises with the opportunity to focus on fixing their operational issues rather than having to focus on the challenges of a formal financial restructuring process. Some have suggested that this window of opportunity to get the business 'right' was not seized – it being simpler and easier to engage in financial reengineering. This is not to suggest that enterprises, particularly in the manufacturing sectors, have not faced and dealt with significant challenges. Many of these enterprises were multinational and almost always operational in a number of countries within the Americas. A review of many of these proceedings suggests that they were dealt with relatively efficiently and effectively – that is, the frameworks in place do work.

The United States is, of course, the predominant economy in the Americas. So far in 2008, its economy is facing a number of significant challenges, such as the collapse of the sub-prime market. There is no doubt that the creative use of some of the new structured financial products, including securitisation programmes, resulted in investors believing that the risk of default had been either completely eliminated or at least substantially reduced. One of the characteristics of these programmes was their opaqueness and the reliance on the ratings issued by the ratings agencies. In hindsight, a number of the assumptions on which these programmes were

based were wrong. The result has been an almost complete freeze on the issuance of all structured products. On a global basis, there is a backlog of over \$160 billion in financing commitments on the originating banks' books. Until this backlog is cleared, large-scale financings are almost non-existent. For enterprises facing large refinancing commitments, it may result in more restructurings, both formal and informal.

The dominance of the US economy means that many business enterprises in the Americas have involvement with the United States. This involvement can arise in a number of ways. The United States represents a large and important market for a significant number of businesses, goods and services, and many businesses source their financing from US-based lenders. In addition, enterprises are headquartered in the United States, but have operations across the Americas. The substantial adoption of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency as Chapter 15 to the US Bankruptcy Code in late 2005 was seen as a major milestone, with a clear hope that it would encourage others to do the same.

The introduction of Chapter 15 was expressly intended to advance:

- cooperation between courts in the United States and abroad;
- greater legal certainty for trade and investment;
- fair and efficient administration of cross-border insolvencies;
- maximisation of the value of foreign debtors' assets; and
- the rescue of financially troubled business.

Although to date there has been limited application of Chapter 15, it has generally achieved its objectives. The US bankruptcy courts have a long tradition of promoting judicial cooperation. In many respects, countries such as Canada were pioneers alongside the United States in the creation of protocols. This willingness to embrace a cooperative approach created an environment where successful restructurings and insolvencies could be undertaken with the greatest efficiency and efficacy. Their approach and the development of standardised protocols helped to pave the way for others, particularly from within the Americas, to be afforded similar treatment.

One exception to the relatively flexible and cooperative environment is the recent inability of offshore funds to avail themselves of Chapter 15

and its protection. Some have asserted that the failure to achieve recognition has detracted from what was believed to have been a fairly straightforward and predictable process for offshore companies with US assets and/or creditors. There is no doubt that for these offshore funds, the recent decisions have added complexity and uncertainty as to the best way forward.

The statutory prerequisite for the court to grant the relief provided by Chapter 15 is the determination of whether the foreign proceeding is 'main' or 'non-main'. Under Chapter 15, a foreign main proceeding is a foreign proceeding in the country where the debtor has its centre of main interests. Chapter 15 presumes the centre of main interests to be located where the debtor has its registered office, unless there is evidence to the contrary. For a proceeding to be considered non-main, there must be an 'establishment' in the foreign jurisdiction, which is defined as "any place of operations where the debtor carries out a non-transitory economic activity". Time will tell whether access to Chapter 15 will be more restrictive than was the case under the previous Section 304 regime.

Another trend over the past few years in a number of the countries within the Americas has been the strategy referred to as 'buy to own'. The increasing participation of hedge funds and private equity funds in the distressed enterprise space has resulted in some novel approaches to restructurings. In a number of jurisdictions, well-established markets trading in distressed debt have developed, commencing with funds buying up debt from lenders and other creditors. Initially, the intention of the funds was not to end up owning the underlying business, but rather to make a profit on the turn, either by selling on or holding until a realisation event. Since the emergence of hedge funds (or opportunistic investors), any policy debates seem to centre around whether they would act with the same societal interest as a local financial institution or focus solely on the end reward. A number of these funds are now active in the emerging markets and their ability to transact is an area to watch, as their participation in those markets should help to create an alternate avenue for investors and lenders to redeploy their capital. Over the past few years a number of investors have taken the approach of buying up debt and, in some cases, some of the equity of enterprises either prior to or during the debtor's restructuring proceeding. Their objective has been to place themselves in a better position to acquire the business, assist in

carrying out the turnaround and capture additional reward. As might be expected, there have been challenges to such approaches. While this trend does pose some interesting issues surrounding conflicts of interest and the potential for utilisation of inside information, it may also be a relatively effective way for restructurings to be carried out where the formal restructuring framework is otherwise inadequate or ineffective. What could transpire is a series of bilateral or multilateral negotiations outside the court system, resulting in a more timely resolution of the issues.

One of the areas to watch in the near future is the increase in trading blocs. As countries within these trading blocs become more interdependent on each other and trade with other jurisdictions, the need for effective and predictable approaches to the treatment of enterprise groups in insolvency becomes greater. This is the current focus of UNCITRAL Working Group V. The UNCITRAL model law is designed to deal with a single entity, not groups of entities that form a single economic unit. Separate corporate or other entities, both within a single jurisdiction and in multiple jurisdictions, present a number of challenges, including managing local stakeholder expectations. The UNCITRAL Legislative Guide on Insolvency sets out a number of objectives that should form the basis of modern insolvency legislation. These

include that legislation should be complementary and compatible with the social, political and other policy considerations of the jurisdiction.

In some cases the countries within the Americas have widely differing political views and certainly differing social expectations. They also have a mix of common law and civil law jurisdictions. Interaction between differing legal frameworks adds additional complexity. Capital markets today, more than ever before, are global. Through the use of technology, capital can be invested virtually instantaneously anywhere in the world. If investors do not find the environment to their liking, they move to other opportunities. The growing importance of sovereign wealth funds adds another dimension. While there is no clear trend, there is a sense that various jurisdictions could become more protectionist. If so, the impact on restructurings and insolvencies will present additional challenges for insolvency professionals to tackle. All of these developments underscore the importance of the work currently being undertaken by UNCITRAL Working Group V.

For all those who participate in the Americas restructuring and insolvency markets, gaining a better understanding of the restructuring and insolvency regimes in the various jurisdictions is vital. Thus, *Globe White Page* is to be commended for its publication of this guide.