Opportunities and Pitfalls in Emerging Market Restructurings: *A Strategic Perspective*

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In many emerging market debt restructurings involving corporate debtors, creditors often find themselves at a distinct disadvantage vis-à-vis the debtors and their controlling shareholders. Indeed, in certain cases, creditors may believe that they face seemingly insurmountable obstacles in negotiating such restructurings. In some cases, foreign creditors, perhaps even more so than domestic creditors, may believe or come to realize over time that they are especially disadvantaged in such restructurings.

Creditors may be handicapped in such emerging market restructurings by several factors. In the first place, the insolvency law in certain local jurisdictions may be very unfavorable to creditors either because of the terms of the insolvency law itself or, equally important, by how the law is applied in practice by local courts. Second, in certain jurisdictions, creditors may have serious concerns regarding the fairness and independence of the local judiciary.

Third, in certain cases, the creditors may be pitted against powerful controlling shareholders of the debtor company, and such individuals or family interests may have considerable influence in the local society. As a result, in such cases, the controlling shareholders may appear to have a limited incentive to reach a timely and/or fair and reasonable restructuring with their creditors. Moreover, such controlling shareholders may be disinclined to agree to any changes in the corporate governance structure that would mean a loss of power or control for them.[1]

Certain foreign creditors, including at times major international financial players, may not always be fully aware of or focused on the extent to which they which they are seriously disadvantaged by the foregoing factors in negotiating emerging market restructurings. Some foreign creditors may believe that they can approach an emerging market restructuring in roughly the same way that they would approach a restructuring in a more developed jurisdiction. However, foreign creditors proceeding on that basis may ultimately discover to their considerable dismay and frustration that many emerging market restructurings unfold according to a very different dynamic compared with restructurings in their home jurisdictions.

Once creditors, particularly foreign creditors, realize that they are not playing on a level playing field vis-à-vis the debtor and its controlling shareholders, the question becomes: What should or can the creditors do? Specifically, what steps can they take to at least try to neutralize any inherent advantages that may be enjoyed by the debtor and its controlling shareholders? To begin with, creditors need to understand that there are not necessarily any easy or uniform answers. Instead, the optimal creditor response may vary from restructuring to restructuring depending, for example, on the local legal framework in which the restructuring is taking place.

Nevertheless, as an overarching goal, the creditors would be well advised to adopt a strategic perspective and outlook for addressing difficult and challenging emerging market restructurings. Specifically, creditors should be prepared to seize and take advantage of any opportunities that may arise in the course of the restructuring that could give the creditors additional leverage vis-à-vis the debtor and its controlling shareholders. While such opportunities may arise only from time to time and indeed may not even be readily apparent to the casual observer, the creditors should be prepared to act when they do arise. Conversely, creditors should be alert to, and take actions to avoid, pitfalls in the restructuring process that could have the effect of enhancing any existing advantages and leverage enjoyed by the debtor and its controlling shareholders.

This article presents an overview of such potential opportunities and pitfalls. It is not meant to be an exhaustive listing of such opportunities and pitfalls. Rather, it is designed to highlight certain types of selected opportunities and pitfalls that may arise in emerging market restructurings as well as some of the associated underlying strategic considerations. (It should be noted that while the article focuses on debtors that may not necessarily be models of cooperation in the restructuring process, it recognizes that there are other emerging market debtors that are more cooperative and committed to closing restructurings.)

POTENTIAL OPPORTUNITIES

During the course of a restructuring, the creditors may be faced with various situations and developments that effectively represent potential opportunities for the creditors to strengthen their hand in the restructuring process. But the creditors should not assume that such potential opportunities are presented to them on a silver platter. Instead, the creditors may need to show some savvy and initiative in recognizing and capitalizing on such potential opportunities.

Invitation to Negotiate

In a number of emerging market restructurings, it can be a fairly long period of time before the parties actually sit down and begin to have substantive discussions and negotiations regarding a restructuring deal. For months prior to that moment, the parties may be engaged in various preliminary matters, such as negotiating the parameters of a due diligence investigation, and such preliminary matters may themselves involve a fair amount of negotiating and even skirmishing between the parties. In fact, certain debtors may use these preliminary matters as a means of delaying the commencement of restructuring negotiations.

Nonetheless, at a certain point in the process, the debtor may eventually indicate that it is ready to begin negotiations with the creditors. What will prompt a decision by the debtor to extend an invitation for negotiations may vary from restructuring to restructuring. Such a decision may, for example, be prompted by a public perception that the debtor is dragging its feet, by a strong recommendation from the debtor's financial adviser, or by other similar factors. Especially if the preliminary maneuvering has gone on for an extended period of time, the creditors may be relieved that they can finally put those matters behind them and can begin to focus on what they consider to be the more substantive aspects of the restructuring. Thus, if the debtor extends to the creditors an invitation to negotiate, the creditors may be inclined to enter into the negotiating process without any hesitation and, more importantly, without any preconditions.

On the face of it, accepting an offer to negotiate without preconditions may, from a certain perspective, seem like an entirely logical and sensible approach on the part of the creditors. The creditors may be anxious to proceed in that manner, particularly if the debtor has thus far been keeping the creditors at arm's length and the creditors have begun to lose their patience for any further delay and/or obstruction on the part of the debtor. Yet if the creditors opt for such an approach, it is possible that they may be squandering a valuable opportunity to insist, for instance, upon certain protections for creditors during the course of the restructuring process itself.

Emerging market restructurings can remain unresolved for several years, and during this period, the creditors may wish to ensure that their interests are protected or at least not further disadvantaged. For example, the creditors may believe that it is important to institute a system of cash monitoring of the debtor's operations and cash flows during the restructuring process.[2] The creditors may be concerned that there will be a dissipation of debtor assets by the debtor and its controlling shareholders during the restructuring process, and the creditors may believe that a system of cash monitoring could prevent or minimize such developments.

However, the creditors may have a difficult time convincing the debtor to institute a cash monitoring system. If the creditors try to convince the debtor to do so in the opening phase of the restructuring process when preliminary matters are being addressed (i.e., prior to the commencement of actual negotiations), they may run into strong resistance. As a general matter, some debtors may object to the creditors having such oversight powers, and in particular they may view cash monitoring as an unnecessary intrusion on their business and financial affairs. For the controlling shareholders, cash monitoring may tie into their overarching fear concerning "loss of control" of the company.

Nonetheless, if for whatever reason the debtor and its controlling shareholders are prepared to begin negotiations with the creditors, the creditors may have some leverage to insist upon some form of cash monitoring being implemented. Yet even under such circumstances, it may not be easy to convince the debtor of the need for, or the merits of, cash monitoring. Assuming, however, that the debtor does finally agree to the concept of cash monitoring, there may then ensue a lengthy discussion and negotiation between the creditors and debtor regarding the precise contours of any cash monitoring system.

For instance, will the creditors have a right to review expenditures pre-disbursement or only post-disbursement, and what will be the monetary threshold or types of transactions that trigger such review? Obviously, the more rigorous a cash monitoring system that the creditors insist upon, the more resistance they are likely to encounter from the debtor. In certain cases, however, the creditors may believe that only a robust cash monitoring system will adequately protect their interests.

In short, an invitation by the debtor to negotiate may present the creditors with certain opportunities and leverage that they might not otherwise have. The creditors might try to condition their acceptance of such an invitation on certain key demands or requirements, such as implementation of a meaningful cash monitoring system. There is obviously no guarantee that by doing so the creditors will be able to achieve what they want (which itself will be a product of negotiation), but it is possible that they may have a greater likelihood of success on such issues than if they raise such issues in a vacuum.

Changes in Local Law

As a general matter, the creditors may believe in particular restructurings that the local insolvency law and the local legal system place them at a potentially serious disadvantage vis-à-vis the debtor and its controlling shareholders. In its shorthand version, the creditors may refer to lack of a "level playing field." But the local legal framework will not necessarily remain static during the course of a restructuring, especially if the restructuring process extends over a period of several years. During this time, there may be important changes in the local insolvency law or in other laws (e.g., securities/corporate laws, etc.) that could also have an impact on a restructuring in progress. (Generally, any time creditors, particularly foreign creditors, are considering these types of issues, they should consult closely with local counsel in the relevant jurisdiction since it is local counsel that will be most attuned to and familiar with the details, nuances, and implications of any changes in local law.)

Changes in law may be significant to creditors in different ways. First, the new law may introduce a new insolvency process that on its face offers more of a time-bound procedure than under the prior law, which as a practical matter may have allowed insolvency cases to drag on for many years. By way of example, the insolvency law in Mexico underwent a major reform in May 2000 when the old law, the suspension of payments law enacted in 1943, was replaced with a new law, the *Concursos Mercantiles* law.[3] (It should be noted that the new law was not made retroactive to cases that were then pending under the suspension of payments law, of which there were a few major cases.)

Under the suspension of payments law, it was not unheard of for cases to remain unresolved for a number of years, even for ten or more years in certain cases. During the period that a debtor remained in suspension of payments, no debt service was paid, interest ceased to accrue on the outstanding debt, and foreign currency debt was converted to Mexican pesos for purposes of the suspension of payments proceeding.

Under the new *Concursos Mercantiles* law in Mexico, cases are supposed to be resolved within a maximum period of twelve months after a court declares that a debtor is subject to reorganization. (If a reorganization agreement has not been achieved by the end of such twelve-month period, the court is supposed to order the liquidation of the debtor.) Thus, the new law is meant to reverse the situation that existed under the suspension of payments law where as a practical matter the debtor could effectively make a suspension of payments proceeding last for years at a time. But given that the *Concursos Mercantiles* law is still a relatively new law, creditors and their advisers are still monitoring how the new law is applied in practice.

Second, the local insolvency law may change in a way that gives the creditors greater options. For instance, an existing insolvency law may be changed in such as way as to introduce the concept of a so-called "involuntary" insolvency filing whereby the creditors, not just the debtor, can put the debtor into insolvency, whether reorganization or liquidation. Such a change may stand in contrast to the pre-existing law where only the debtor could initiate an insolvency proceeding.

However, even if creditors are able to successfully make an involuntary filing against the debtor under a new law, the debtor may find other ways to frustrate implementation of, say, an involuntary reorganization. These risks should be weighed carefully by the creditors before taking legal action against the debtor.

Third, elements of an insolvency law may change, perhaps even in very technical ways, which may make an insolvency proceeding less daunting and adverse to creditors. For instance, Brazil has recently reformed its insolvency law in a number of major respects, including, among other changes, revising the order of priority enjoyed by various classes of creditor claims.[4] Under the pre-existing law, tax claims ranked ahead of secured claims, but under the new law, the order of priority has been reversed so that secured claims rank ahead of tax claims. As one observer has noted with respect to this change in order of priority, "This represents a significant improvement in the chances of credit recovery, since tax debts are generally the bulk of the debts of a distressed company in Brazil."[5] Furthermore, whereas the old law gave labor claims an absolute priority, the new law effectively provides that the absolute priority of labor claims will be capped.[6]

Changes in local insolvency law, therefore, can perhaps change the playing field between creditors and the debtor. Such changes may give creditors new options—and potentially new leverage—that they did not enjoy under the prior law. However, new laws do not always work out as intended or as written, and thus creditors should exercise considerable caution before relying upon new provisions of law, especially if the new law is relatively untested. Again, creditors should consult with local counsel when developing a legal strategy based on local law.[7] Nonetheless, if there are changes in the local insolvency law, creditors should consider whether such changes may have the potential to alter the negotiating dynamic between themselves on the one hand and the debtor and its controlling shareholders on the other hand.

Emergence of a Strategic Investor

The creditors may have initially approached the restructuring process by pursuing (or attempting to pursue) bilateral negotiations with the debtor based on the premise that the restructuring would be a so-called "stand-alone" restructuring—i.e., a restructuring of the debtor "as is" without the involvement of a third party. However, in certain cases, such bilateral negotiations based on a stand-alone restructuring model may not necessarily yield the results that the creditors are seeking. In some situations, it may be difficult for the creditors to have successful or meaningful negotiations with the debtor if they are the only ones across the negotiating table from the debtor. Furthermore, a stand-alone restructuring based essentially on a reallocation of the debtor's existing available resources may not necessarily provide the creditors with the most attractive economic package as part of a restructuring.

The creditors may welcome the emergence of a strategic investor for several reasons.[8] First, the strategic investor might bring valuable management skills to the debtor, and it may have been the lack of such skills that contributed to the debtor's then current financial travails. Second, the strategic investor may be willing to make a significant infusion of capital to the debtor, and this may be of critical importance to the debtor, particularly if it is seriously overleveraged. Third, the strategic investor's other operations may have potential synergies with the debtor, and the creditors may believe that such synergies could help improve the longer-term profitability of the debtor's operations.

Nonetheless, a proposal for a strategic investor cannot simply be imposed on a recalcitrant debtor. But certain debtors and their controlling shareholders may be receptive to the notion of a strategic investor for their own reasons. Among other things, the debtor's controlling shareholders may believe that only a strategic investor would have the necessary resources to be able to offer them the right "exit price" in order to give up any further involvement with the company. Or, in certain cases, the controlling shareholders may believe that they can work out a deal with the strategic investor so that they can continue to play some management role in the restructured company.

Yet, even if the debtor is ultimately willing to entertain the notion of bringing in a strategic investor, the creditors will have to consider how to protect their interests in the process. A strategic investor may be able to bring considerable economic and other value to the debtor company, but the creditors cannot simply assume that their interests will be safeguarded. The creditors may need to consider how much involvement they will want to have at different stages of the process.

To begin with, the creditors may wish to consider whether the process for identifying a strategic investor is designed to attract the most attractive bids for the company. For example, is the bidding process simply an ad hoc process organized by the debtor or is it a more formal auction process overseen perhaps by a recognized financial firm? Furthermore, the creditors will have to consider whether the length of any exclusivity period granted to a potential strategic investor is reasonable or whether it is merely another means for the debtor to prolong the restructuring process.

In addition, the creditors will have to decide whether they will allow the debtor and strategic investor to work out the terms of the strategic investment strictly by themselves or whether the creditors, too, should be able to provide their input. The creditors could have a crucial stake in a number of the issues discussed by the debtor and the strategic investor. For example, the creditors will consider it important to know whether the controlling shareholders will have any continuing management role in the restructured company and how much equity the controlling shareholders will hold post-restructuring and post-strategic investment. Furthermore, the creditors will want to know whether the strategic investment is premised on any specific debt restructuring parameters, such as any proposed forgiveness of debt by the creditors.

In sum, the emergence of a strategic investor may in certain cases ultimately prove to be beneficial to the creditors and, depending on the circumstances, may yield the creditors a more favorable result than would otherwise be the case under a stand-alone restructuring. However, if the creditors want to protect their interests, they may not be able to simply sit on the sidelines and allow the debtor and its controlling shareholders to control the process vis-à-vis potential strategic investors without any involvement or participation by the creditors. Instead, the creditors may have to figure out ways to insert themselves (or at least their views) into the process involving a strategic investor.

Change in Market Conditions

During the course of the restructuring, the market conditions facing the debtor may fluctuate, sometimes for the better and other times for the worse. For instance, when the restructuring process started, the price for the debtor's products may have been in a trough. Indeed, that may have been what precipitated or contributed to a default or imminent default or other financial distress experienced by the debtor. This underlying economic reality of low or depressed prices for the debtor's products could severely constrain the options available to both the debtor and creditors in any restructuring plan. (The debtor's economics could be adversely affected by other factors, such as rising prices for inputs to its production.) Obviously, the less cash flow the debtor is generating, the less "sustainable debt" it is likely to be able to service going forward.

Where prices for the debtor's products are low, the debtor may be less likely to want to close a restructuring deal in the near term. The debtor and its controlling shareholders may be concerned that if they do close deal based on what may turn out to be somewhat optimistic assumptions, they may be setting themselves up for another payment default. As part of the restructuring plan, the creditors may be insisting upon serious consequences in the case of a subsequent default, such as a change of control of the debtor that would put the creditors in charge of the company. The controlling shareholders in particular may want to avoid putting themselves—and any continued control of the debtor company—at the mercy of market conditions when faced with such possible consequences.

Conversely, if market conditions break in the debtor's favor, the debtor and its controlling shareholders may show a greater willingness to close a restructuring deal. For instance, if the price for the debtor's products recover or even reach new highs, the debtor and its controlling shareholders may have less concern about experiencing a subsequent default. They may take additional comfort if they consider the restructuring plan's underlying economic assumptions to be realistic or conservative (i.e., targets that they can meet comfortably).

In such a rising market, the debtor may be in a better position to give the creditors a more attractive restructuring package. For one thing, at a very fundamental level, the debtor may ultimately agree that it is in a position to consider less of its debt in the restructuring plan as "unsustainable debt" and more as "sustainable debt." That result would obviously please the creditors as they seek to maximize their recovery in any given restructuring.

Moreover, a rising market may also pique the interest of strategic investors in the debtor company. Potential strategic investors may consider the debtor company a more valuable asset where, for example, the prices for the debtor's products are on the rebound. As discussed above, depending on the circumstances, the emergence of a strategic investor may in certain cases ultimately redound to the benefit of the creditors.

Thus, the dynamics of the restructuring process can be significantly affected by fluctuations in market conditions. If and when the market conditions break in a favorable way, the creditors should be prepared to try to reinvigorate the restructuring process to the extent that the process is stalled or otherwise not moving forward in a timely manner. Unlike other situations, the debtor in such circumstances may actually be receptive to moving the restructuring forward. Indeed, a rising market may in certain cases have a positive impact on the overall psychology of the restructuring process and its key participants.

POTENTIAL PITFALLS

Restructurings can present myriad potential pitfalls for creditors. The debtor and its controlling shareholders may utilize various tactics and strategies to outmaneuver or otherwise disadvantage creditors.[9] And, in some cases, the creditors may even create their own problems.

Death by a Thousand Cuts

The longer the restructuring process drags on, the more anxious the creditors may become to close a deal as soon as possible. And the debtor and its controlling shareholders may be aware of this growing anxiety on the part of the creditors. Under such circumstances, the debtor may try to extract advantage from the creditors. Thus, the debtor may present its position on a given issue as being non-negotiable or even suggest that the issue is a so-called "deal breaker." The debtor may bring or threaten to bring the negotiations to a halt unless the creditors agree with its stated position.

Faced with such a situation, the creditors will have to weigh whether the cost of making a concession on a given issue is outweighed by the benefit of possibly reaching closure on the outstanding issues. The creditors may not like to make the particular concession in issue because it may affect, for example, the underlying economics or other fundamental aspects of the overall restructuring package. However, the creditors may feel that, as a practical matter, they have very little choice if they ever want to close a restructuring deal with this particular debtor. They may believe that if they stand their ground, they may put the restructuring deal in jeopardy because they may believe that the debtor will not budge from its position.

Nonetheless, this may simply be the beginning of a slippery slope.[10] The debtor may later come back to the creditors with other issues that the debtor announces or otherwise seems to indicate are also of a "make-or-break" nature. And the creditors will be faced with the recurring dilemma of whether to stand their ground or to make further concessions supposedly in the interest of advancing the process with the ostensible aim of ultimately closing a deal. However, to the extent that the creditors have conceded on several of these types of issues, they may in effect be encouraging the debtor to continue with a pattern of trying to extract further concessions from the creditors.

Any one of the concessions made by the creditors may or may not be especially significant in its own right, although obviously some concessions may be more significant than others. However, the cumulative effect over time of a series of such concessions may be a fundamental modification or weakening of the restructuring deal that the creditors thought that they had earlier negotiated for themselves. The debtor may be prepared to wear the creditors down, and they may be counting on the creditors to offer up concessions in the interest of "saving" the deal.

In some cases, the creditors may exacerbate this problem with their own actions. At certain points in the process, the negotiations may be at an impasse, and the creditors may try to anticipate what types of concessions they could offer to the debtor in order to set the negotiations back on track. But a possible danger is that the creditors may offer concessions that even go beyond what the debtor is seeking. The risk for the creditors, therefore, is that they may end up negotiating against themselves. This would only compound the problem of the debtor seeking concessions from the creditors on a piecemeal basis, or what might be referred to as "death by a thousand cuts."

Illusion of Progress

At various times, the debtor and its controlling shareholders may be taking various steps that appear to be designed to moving the restructuring process forward. For example, among other things, the debtor may have its representatives sitting with the creditors' representatives for negotiations with respect to a term sheet. In addition, the debtor's financial adviser may be discussing and reviewing financial models with the financial adviser for the creditors, which may be viewed as an important step given that certain financial and economic assumptions are likely to play a key part in affecting or shaping the parameters of any restructuring plan. Furthermore, the debtor may be producing certain information in response to the creditors' due diligence requests. And the debtor may have even agreed with the creditors upon a detailed timeline for taking a broad range of other miscellaneous actions by specific dates.

In connection with these various activities, the debtor may be incurring considerable expenses. The debtor's outside counsel and financial adviser, each potentially with large teams of professionals and staff members devoted to the matter, may be spending a great deal of time working on the restructuring. Given the volume of work involved as well as the number of individuals that the outside advisers may have working on the restructuring, the outside advisers may in turn be submitting large invoices for fees and expenses to the debtor. In addition, in certain restructurings, the debtor may also be responsible for paying the fees and expenses of some of the creditors' legal and financial advisers, and again these bills could potentially be quite significant. (Of course, any expenditure by the debtor for the fees and expenses of outside advisers, while potentially substantial, will probably pale in comparison to the aggregate amount of money that the debtor is "saving" in debt service payments resulting from any debt standstill that may be in place.)

In short, the debtor may be taking various actions whose ostensible purpose is to advance the restructuring. And yet the restructuring process may essentially be stalled or at best advancing only in fits and starts. For a period of time, the creditors may not want to believe the worst—i.e, the debtor is deliberately holding up progress on the restructuring. The creditors may be willing to give the debtor the benefit of the doubt, especially if the debtor appears to be taking various steps such as those outlined above. In addition, the debtor may create confusion with its actions, particularly if its negotiating tactics essentially follow a pattern of "one step forward and two steps back." For example, this may be the case where the debtor appears to agree with the creditors on the resolution of a major outstanding issue and then suddenly raises a series of new issues or revisits issues that had previously been resolved. Initially, the creditors may focus on the "one step forward" and not necessarily on the "two steps back."

Nonetheless, after a certain period of time, the creditors may become frustrated if they do not see some signs of tangible progress in the restructuring. For instance, if the debtor and creditors have been negotiating a term sheet for a number of months and yet there has been no closure reached on some of the major issues to be addressed in the term sheet, then the creditors in certain cases may justifiably begin to question whether the negotiations are leading anywhere. Or if the debtor invites the creditors' financial adviser to conduct due diligence and yet provides the financial adviser only with limited information or otherwise creates roadblocks to obtaining information about the debtor, then the creditors may question the value of the debtor's cooperation in the due diligence process.

Some debtors may wish, as a deliberate strategy, to create the illusion of progress without delivering any substantive results. Such debtors can then argue in the court of public opinion and elsewhere that they are working hard to move the restructuring forward, whereas in reality they may at best simply be going through the motions. Even though the debtor may be incurring substantial expenses as a result of its various activities, this may be a small price for the debtor to pay if it serves the debtor's broader objective of forestalling a restructuring solution and if in the meantime during a debt standstill the debtor is relieved from the burden of paying debt service. However, this approach on the part of the debtor could leave the creditors in an awkward position: they may try to argue that the debtor is impeding progress in the restructuring, but to an outside observer this may not be readily apparent since the debtor may appear to be taking various actions related to the restructuring.

And yet, for their part, the creditors need to periodically apply a reality check to the restructuring process and ask themselves the following: Is genuine progress being made in the restructuring or is there simply the illusion of progress created by the debtor? If it is the latter, the creditors may need to re-evaluate their options. At the very least, the creditors under such circumstances may need to voice their concerns directly and forcefully to the debtor and its controlling shareholders. In any event, the creditors should not assume that simply because the debtor is or appears to be taking various actions related to the restructuring, that somehow represents a firm commitment on the part of the debtor to move the restructuring forward, much less close a restructuring deal.

Self-Inflicted Wounds

Often creditors may complain about the delaying and obstructionist tactics of the debtor and its controlling shareholders. But sometimes the creditors may, unwittingly or not, create problems of their own that could contribute to a lack of progress and closure in emerging market restructurings. Specifically, the creditors may create an unwieldy steering committee structure that could make it difficult to conduct effective discussions and negotiations with the debtor, or the creditors may be so riven by inter-creditor disputes that they cannot properly focus their attention on resolving issues with the debtor.

In some cases, creditors may create a steering committee that is too large to be genuinely effective.[11] There are both internal and external dimensions to this issue. From an internal perspective, the existence of a steering committee with too many members may make it difficult for the creditors to have meaningful communication and coordination among themselves regarding the broad range of issues that typically arise in a restructuring. Issues of coordination can become particularly acute where the creditor community is spread across several continents and multiple time zones—such as where creditors are from North America, Europe, and Asia—which is not uncommon in large, complex international restructuring situations. Moreover, it may be very difficult for a steering committee to reach a consensus on important issues if there are too many creditor institutions participating in discussions and meetings.

From an external perspective, an unwieldy steering committee structure may make it more complicated for the creditors to interact effectively with the debtor and its controlling shareholders. It may be difficult for the steering committee to have productive and frank discussions with the debtor and its controlling if the steering committee, together with a possible phalanx of legal and financial advisers, can only be accommodated, for example, in a large hotel meeting room. Notwithstanding any confidentiality agreements that may exist, the debtor may be reluctant to share highly sensitive business and financial information with a steering committee that it considers to be too large. Moreover, the existence of an outsized steering committee, unless it appoints a smaller working group to represent it, may make the process of negotiation with the debtor messy and inefficient.

Another way in which creditors can do very serious, if not virtually irreparable, damage to themselves is through inter-creditor disputes that are not properly handled.[12] In most creditor bodies, there will be various competing creditor interests, such as secured versus unsecured creditors, holding company creditors versus operating company creditors, original lenders versus creditors who purchased their debt in the secondary market, and so forth.[13] However, if these inter-creditor disputes become the central focus and preoccupation of the creditors, it is possible that the creditors as a whole may make limited progress in their negotiations with the debtor. Indeed, the debtor and its controlling shareholders may even be counting on this very dynamic—i.e., the creditors tearing themselves apart over inter-creditor issues so that the debtor and its controlling shareholder do not have to worry too much about reaching a restructuring deal.[14]

In short, left to their own devices, creditors can do considerable damage to themselves in ways that could impede the restructuring process. Creditors, as a general matter, may be tempted to blame the debtor and its controlling shareholders for any lack of progress in the restructuring process. However, unless creditors properly handle and address internal matters, such as forming a well-functioning steering committee and managing the process for resolving inter-creditor disputes, they may be creating their own serious obstacles to advancing the restructuring process.

Term Sheet Deal versus Completed Deal

It may take a long time—sometimes even a couple of years after the beginning of the restructuring process—for the creditors to have in hand a completed term sheet with the debtor and its controlling shareholders. Prior to that, there may have been seemingly endless wrangling and delays concerning a wide range of matters. For instance, the parties may have had protracted debates regarding the proper scope of any due diligence investigation to be conducted by a financial adviser on behalf of the creditors. And then the parties may have had sharp differences as to whether the creditors are being afforded proper access to the debtor's business in order to conduct a meaningful due diligence investigation. Furthermore, even while the parties are negotiating a term sheet itself, the creditors may find themselves frustrated by what they perceive as the debtor's unwillingness to resolve issues in a timely and forthright manner.

In light of such possible frustration, the creditors may believe they have reached a major milestone when a term sheet is finally completed and signed. They may believe that this signals that a closing of the restructuring is in the offing. The creditors may believe that the documentation process (i.e., converting the term sheet deal into the relevant restructuring agreements and related documents) will be relatively straightforward and that counsel for the respective parties should be able to draft and finalize documents in a reasonable period of time. In other words, the creditors may express considerable relief when a term sheet is finalized with the debtor—they may see this as the "beginning of the end" of the restructuring process.

However, in reality, the signing of a term sheet may simply represent the "end of the beginning," if that. The creditors may believe that the term sheet resolved all of the major business issues and that the documentation process should be a relatively mechanical, if somewhat time-consuming, exercise of translating the agreed upon terms into final deal documentation. (Of course, in so many transactions, even where the parties are working relatively cooperatively toward the same goal of closing the deal, the documentation process is rarely without its own challenges and even hiccups.) But in some cases the debtor and its controlling shareholders may view the documentation process as an opportunity to introduce new issues or revisit old issues that were already addressed in the term sheet.

Inevitably, to be sure, a term sheet may have certain gaps that need to be addressed in the documentation process. Yet the debtor may be seeking to make more than mere interstitial changes to the terms set forth in the term sheet. The debtor may look upon the documentation process as an opportunity to further delay and obstruct the overall restructuring process. If and when the debtor pursues such an approach, the documentation process may proceed at best in a desultory fashion and at worst may grind to a halt completely.

The creditors, therefore, must not be lulled into a fall sense of complacency simply because they have concluded a term sheet with the debtor. For one thing, it may be a very long and tortuous road between the signing of a term sheet and the closing of a deal. For another, the fact that the debtor has executed a term sheet may not represent a firm commitment at all on the part of the debtor that it intends to close a restructuring. Simply stated, creditors should not assume that a signed term sheet with the debtor will necessarily lead to a timely closing or perhaps any closing at all of the restructuring.

CONCLUSION

Emerging market restructurings may pose many unique challenges for creditors, particularly foreign creditors. In order to increase their chances of concluding a satisfactory restructuring or otherwise protecting their interests, creditors should be prepared to seize opportunities that may give them additional leverage in the process. At the same time, creditors should carefully avoid the many pitfalls that they may find in their way. In pursuing such an overall strategy, creditors may find that the playing field for the restructuring, which may tend to favor the debtor and its controlling shareholders, at a minimum becomes somewhat less daunting.

ENDNOTES

[1]*See, e.g.,* Asian Development Bank, *Law and Development at the Asian Development Bank (1999 edition)—Special Report: Insolvency Law Reform in the Asian and Pacific Region*, p. 16 (noting that a "principal factor that concerns 'owners' of financially troubled corporations in many of the . . . economies is the fear of loss of control of the corporation. This produces an aversion to anything that might put the corporation in a position where others might dictate its immediate and long-term future."). *See also* Samuel J. Tobing, formerly chief operating officer of the Jakarta Initiative Task Force, "The Need for a Workable Corporate Insolvency Framework for Emerging Economies," speech to APEC conference "The Second APEC Symposium on Strengthening Economic Legal Infrastructure," July 2002 (on file with author) (noting that "in certain emerging economies, corporate assets are concentrated in the hands of a small number of well-connected individuals or families. When faced with loss of ownership, these groups may seek to exert their influence to frustrate the operation of the insolvency system.").

[2]For a further discussion of cash monitoring and related issues, see Steven T. Kargman, "Tackling Restructuring in Emerging Markets (Part III), *International Financial Law Review*, August 2003, pp. 44-45.

[3]For a discussion of some of the main features of the new law, see, e.g., Eduardo Martinez R, "Mexico," in *Insolvency & Restructuring 2005*, pp. 240-245, (Law Business Research, October 2004*).* For a Spanish-language version of the law, see www.shcp.gob.mx/servs/normativ/leyes/l_cm.html. *See also generally United States-Mexico Law Journal,* Vol. 10, Spring 2002, pp. 43-60 and pp. 85-94, as well as the website of the Instituto Federal de Especialistas de Concursos Mercantiles (known as IFECOM) at www.ifecom.cjf.gob.mx.

[4]For a discussion of the changes to the Brazilian law, see generally Felsberg e Associados, "Final Text of the New Brazilian Bankruptcy Law Approved in the House of Representatives," *Restructuring Alert*, December 2004 (on file with author) and Tozzini, Freire, Teixera e Silva, "Brazil: New Bankruptcy and Restructuring Law*,"TFTS News,* February 2005 (on file with author).

[5]*See* Felsberg e Associados *supra*.

[6]*Id*. (". . . the absolute priority currently enjoyed by labor claims in bankruptcy proceedings will be limited to a cap of 150 minimum monthly wages. . .") and Tozzini *supra*.

[7]For a further discussion of litigation-related options available to creditors and the need for careful weighing of the pros and cons of pursuing legal action, see Steven T. Kargman, "Tackling Restructurings in Emerging Markets (Part III)," *International Financial Law Review*, August 2003, pp. 45-46.

[8]For a fuller discussion of the role of strategic investors in restructurings, see Steven T. Kargman, "Tackling Restructuring in Emerging Markets (Part III)," *International Financial Law Review*, August 2003, pp. 43-44.

[9]Some of the tactics employed by debtors and their controlling shareholders are discussed in Steven T. Kargman, "Negotiating Emerging Market Debt Restructurings: Recognizing the Warning Signs of a Non-Cooperative Debtor," *The Journal of Private Equity*, Summer 2004, pp. 80-86.

[10]For a discussion of what the authors refer to as the "negotiating two-step" employed by emerging market debtors, see Timothy B. DeSieno and Helder P. Pereira, "Emerging Market Debt Restructurings: Lessons for the Future," *New York Law Journal*, August 25, 2003.

[11]For a discussion of issues relating to the formation of steering committees in emerging market restructurings, see Steven T. Kargman, "Restructuring: A How-To Guide," *The International Economy*, November-December 2001, pp. 47-48, and Steven T. Kargman, "How to Tackle Debt Restructuring in Emerging Markets," *International Financial Law Review*, December 2002, pp. 41-43. For a discussion of issues relating specifically to the formation of bondholder steering committees, see, e.g., Don S. De Amicis, "Bondholder Workouts In and Outside of Bankruptcy," *Journal of Bankruptcy Law and Practice*, Vol. 12, No. 6 (2003), pp. 39-42.

[12]For a discussion of inter-creditor issues that may arise in emerging market restructurings, see Steven T. Kargman, "Tackling Restructuring in Emerging Markets (Part II)," *International Financial Law Review*, July 2003, pp. 57-59.

[13]For an overview of key participants in the restructuring process, including various creditor interests, see Peter Darrow, "Restructuring Corporate Debt in Latin America," *International Financial Law Review*, September 2003, pp. 28-29. For a discussion of creditor constituencies in the context of project finance restructurings (as to which there may be certain parallels with how creditor constituencies approach corporate debt restructurings), see Richard Cooper and Gesine Albrecht, "How to Approach the Restructuring of Problem Project Financings with Multi-Sourced Lending Arrangements," *Project Finance International*, May 19, 1999, pp. 55-56.

[14]For a discussion of "divide-and-conquer" tactics that debtors may employ to take advantage of inter-creditor divisions, see Steven T. Kargman, "Negotiating Emerging Market Debt Restructurings: Recognizing the Warning Signs of a Non-Cooperative Debtor," *The Journal of Private Equity*, Summer 2004, pp. 85-86.