Dávid R., Neckář J., Sehnálek D., (Editors). COFOLA 2009: the Conference Proceedings, 1. edition. Brno : Masaryk University, 2009, ISBN 978-80-210-4821-8

RESTRUCTURING OF COMPANIES WITH AN EMPHASIS TO THE CURRENT MARKET SITUATION

MARTINA HAVLIŠOVÁ

Masaryk University, Faculty of Law, the Czech Republic

Abstract in original language:
The article concerns with the restructuring of the non-performing loans and distressed debt trading and other questions arising in connection with the financial insolvency of the company. The means and ways of restructuring before the company is declared insolvent and presents parallels between regulation included by Czech and English law are described in more detail. As the regulatory environment visibly tightens and increasing scrutiny is placed on those taking responsibility for private investor and institutional funds the author analyzes and describes an increasing need to enhance the company's operation schemes and addressing the deficit issues. The reality of the credit crisis is that established businesses are now finding themselves on the edge of distress. The one thing that the credit crisis guarantees is change. While the current lack of liquidity presents a problem for many companies, sector consolidation is inevitability. Coming out of a soft market, also, the upsurge in insurance claims and litigation has now begun. Difficult market conditions increase the likelihood of fraudulent behavior and its detection, with several high-profile cases already making the headlines this year. While the economic downturn already puts increasing pressure on management teams, scrutiny of directors' behavior is naturally also coming under the spotlight.

Key words in original language:
Restructuring. Non-performing loans. Insolvency. Distressed debt trading. Standstill agreement. Debtor. Credit crisis. Supervisory authority.

Abstract:
The article concerns with the restructuring of the non-performing loans and distressed debt trading and other questions arising in connection with the financial insolvency of the company. The means and ways of restructuring before the company is declared insolvent and presents parallels between regulation included by Czech and English law are described in more detail. As the regulatory environment visibly tightens and increasing scrutiny is placed on those taking responsibility for private investor and institutional funds the author analyzes and describes an increasing need to enhance the company's operation schemes and addressing the deficit issues. The reality of the credit crisis is that established businesses are now finding themselves on the edge of distress. The one thing that the credit crisis guarantees is change. While the current lack of liquidity presents a problem for many companies, sector consolidation is inevitability. Coming out of a soft market, also, the upsurge in insurance claims and litigation has now begun. Difficult market conditions increase the likelihood of fraudulent behavior and its detection, with several high-profile cases already making the headlines this year. While the economic downturn already puts increasing pressure on management teams, scrutiny of directors' behavior is naturally also coming under the spotlight.

Key words:
Restructuring. Non-performing loans. Insolvency. Distressed debt trading. Standstill agreement. Debtor. Credit crisis. Supervisory authority.

1. INTRODUCTION

The restructuring of the non-performing loans and distressed debt trading and other questions arising in connection with the financial insolvency of the company or companies is a frequently discussed question currently asked by many people. The means and ways of restructuring before the company is declared insolvent and the parallels between regulations included by Czech and English law is the main subject being discussed in this article.

The reality of the credit crisis is that established businesses are now finding themselves on the edge of distress. The one thing that the credit crisis guarantees is change. While the current lack of liquidity presents a problem for many companies, sector consolidation is inevitability. Coming out of a soft market, also, the upsurge in insurance claims and litigation has now begun. Difficult market conditions increase the likelihood of fraudulent behaviour and its detection, with several high-profile cases already making the headlines this year. While the economic downturn already puts increasing pressure on management teams, scrutiny of directors' behaviour is naturally also coming under the spotlight.[1]

2. RESTRUCTURING OF COMPANIES

Each company has to address the challenges this brings the company through their knowledge of the European marketplace, the regional difficulties of cross-border mergers and the private equity space - whether they are looking at opportunities to grow or to rationalize their business. Specialist corporate restructuring officers may be appointed to assist the management of the debtor with the day-to-day burden of the restructuring process and work with other advisers to provide appropriate and co-ordinated advice to the board of the debtor. Current market conditions present opportunities and challenges for institutional investors. Restructuring investment vehicles and funds set up are complex challenges that can often take up a great deal of time. The company shall also ensure to have tax efficient structures in place and to upgrade their tax structure if needed. Furthermore, the other issues relating to restructuring, disputes, tax authorities and foreign investments shall be addressed. Nowadays, the position of the companies on the market shall be thoroughly analysed and all impacts on its proper operation and functioning shall be in deep investigated.

As the regulatory environment visibly tightens and increasing scrutiny is placed on those taking responsibility for private investor and institutional funds an increasing need to enhance the company's operation schemes and addressing the deficit issues shall be analysed and discussed. The prospect of merger or divestment activity only increases this need. Outsourcing can drive business efficiency and save costs it can also significantly increase the risk profile when not properly implemented. [2] Equally a programme embarked upon in better

[1] J. A. A. Adriaanse, E.M. Meijers Instituut, Restructuring in the shadow of the law: informal reorganisation in the Netherlands, Netherlands, Kluwer, 2005, 361 pages, ISBN 9013031560, p.305.

[2] J. A. A. Adriaanse, E.M. Meijers Instituut, Restructuring in the shadow of the law: informal reorganisation in the Netherlands, Netherlands, Kluwer, 2005, 361 pages, ISBN 9013031560, p.262.

times may not have the documentation required to safeguard the investments at this stage of the economic cycle. It is a strategic business option of particular interest to all companies in the economic downturn.

In the United Kingdom, when a debtor company is in financial difficulties and a restructuring of its debt is contemplated, the major financial creditors may agree that they will not proceed against the debtor for a specified period. This is called the „standstill period". When the financial difficulties of the debtor are first brought to the attention of such creditors, the standstill will be informal. A standstill agreement may follow such informal arrangements. The standstill agreement shall allow the debtor to have certain time to prepare the restructuring proposal to its substantial financial creditors. The general idea is, that lenders are likely to explore alternatives on enforcing their security and thereby forcing the company to start the insolvency proceedings. The initiation of the insolvency proceedings may have a substantial impact on the business value and may cause that the creditors start react negatively. This may in the end aggravate the company's financial and business situation. The lenders before they enter into the standstill agreement would like for sure to assert the viability of a restructuring proposal and compare it with an estimate what their recoveries would be in case of insolvency proceedings.

The standstill agreement would usually contain the agreement of financial creditors regarding the matters, like i.e. representation of creditors to refrain from taking any steps to enforce their claims against the debtor; consent of creditors to refrain from reducing their exposure to the debtor (otherwise than by a disposal of their debt to a third party); further to refrain from receiving or demanding prepayments or repayments unless these are pro rata (with the exception of fluctuating overdrafts and revolving lines of credit); or to place all facilities on demand such that repayment can be demanded immediately if certain newly defined events occur and if a majority of the banks agree. Furthermore, the standstill agreement might include provisions on termination of the standstill on certain defaults of the debtor, including material adverse change and an insolvency event (again, usually decided by the majority of the banks). The standstill agreement might permit a disclosure of information between individual creditors which might otherwise be in breach of confidentiality duties which such creditors owe to the debtor.

The standstill period usually commences on the date on which the financial creditors as a group were first notified by the debtor, or by another financial creditor, of a meeting with the debtor to consider the debtor's position. If the syndicate of lenders is a large one, a steering committee of lenders is likely to be set up, which will negotiate a standstill agreement with the debtor. Often either during the standstill period or on its expiry additional funding will be required by the debtor to continue its operations in the short to medium term and to get its financial accounts signed by its auditors on a "going concern" basis, etc.[3]

Specialist corporate restructuring officers may be appointed to assist the management of the debtor with the day-to-day burden of the restructuring process and work with other advisers to provide appropriate and co-ordinated advice to the board of the debtor. Debt for equity swaps are used mainly to reduce the total debt of the debtor in a tax efficient manner and to give the

---

[3] Philip R. Wood, Principles of international insolvency, London, United Kingdom, Sweet & Maxwell, 2007, 1064 pages, ISBN 1847032109, p. 400.

lenders the benefit of possible future appreciations of the debtor's shares and of share dividends when/if the debtor returns to profitability. It will be vital for the debtor's short/medium term prospects to have its accounts signed off by the auditors on a "going concern" basis. In order to prepare "going concern" accounts the debtor would normally need working capital for approximately 12 – 18 months going forward.

Apart from agreeing a standstill and setting up a steering committee (in the case of large lending syndicates) referred to above, other steps that will be taken by the lenders include appointing reporting accountants. These are typically appointed by the debtor, but report to both the debtor and the lenders.[4]

Under English law where a company is insolvent or likely to become so (unless a restructuring deal is agreed), to the extent that its creditors are at risk, the duties that the directors owe to the company are extended so as to cover the interests of the company's creditors as a whole.

3. DISCUSSION

The directors face a number of potentially tricky issues e.g. what they can do to keep the company in business without running the risk of committing an offence or incurring personal liability and therefore, they should inform thoroughly on obligations imposed upon them in connection with the distressed company's assets.

In some countries the governmental plans have been discussed in order to increase the internal bank's market operation and involve banks to push bad loans out and get cash to the bank with the aim to replace them.[5] The idea is that the bank should stop hoarding the capital as a buffer against the future write-downs, and so start lending again. The mechanics of the plan should involve banks, which will transfer toxic assets at 90 per cent of their book value into government-managed vehicles and then get government bonds of equal value in return. Banks shall pay an insurance fee for this privilege. The banks shall also compensate the government-managed vehicles for any loss suffered on toxic assets, as determined by auditors.

4. CONCLUSION

Looking in the future, as we think about what is needed in future to avoid any potential future financial crises, it becomes clear that we should have a better response and reaction to the macro-prudential problems. As the problems, which lies in between the macro-economic policy and the system of financial regulation. The regulatory bodies supervising the financial markets shall be more open and they shall be more involved in the whole process. The financial institutions, as well as the regulators, and any institution involved in the crisis, shall admit that all of them have made mistakes.

---

[4] Philip R. Wood, Principles of international insolvency, London, United Kingdom, Sweet & Maxwell, 2007, 1064 pages, ISBN 1847032109, p. 901.

[5] J. A. A. Adriaanse, E.M. Meijers Instituut, Restructuring in the shadow of the law: informal reorganisation in the Netherlands, Netherlands, Kluwer, 2005, 361 pages, ISBN 9013031560, p.300.

Regulators were too focused on the institution-by-institution supervision and the central banks were too focused on monetary policy and meeting the inflation targets. The bankers, regulators, central banks, finance ministers and academics across the world are of the opinion that the biggest problem was the failure to identify that the whole system was fraught with market-wide, systemic risk. In future, regulators need to do more sectoral analysis and be more willing to make judgements about the sustainability of whole business models, not just the quality of their execution.

Literature:

- J. A. A. Adriaanse, E.M. Meijers Instituut, Restructuring in the shadow of the law: informal reorganisation in the Netherlands, Netherlands, Kluwer, 2005, 361 pages, ISBN 9013031560.
- Philip R. Wood, Principles of international insolvency, London, United Kingdom, Sweet & Maxwell, 2007, 1064 pages, ISBN 1847032109.
- B. Wessels, Current topics of international insolvency law, Netherlands, Kluwer, 2004, 612 pages, ISBN 9013019110.

Reviewer:
Eva Tomášková

Contact – email:
martina.havlisova@post.cz