

International Panel Discussion

Global Restructuring Roundtable

Six leaders in the Turnaround Management Association discuss recent developments and trends in the global insolvency area.



Panel:

Howard Brod Brownstein, CTP

Certified Turnaround Professional and member of TMA's Executive Committee and International Committee. He is a principal in the Philadelphia, Pennsylvania, turnaround firm of NachmanHaysBrownstein Inc.

Ward K. Mooney

Chairman of the Turnaround Management Association. He is president of Bank of America Retail Finance Group in Boston, Massachusetts.

William E. J. Skelly

Vice President of International Relations and member of TMA's Executive Committee. He is a partner in the Canadian law firm of Heenan Blaikie LLP.

Alan Tilley

President of the TMA United Kingdom Chapter and a member of TMA's Board of Directors and International Committee. He is a managing director of Glass & Associates European Division.

Jan L. van der Walt

A leader in the South Africa TMA chapter in formation. He is the managing director of Corporate Renewal Partners, a turnaround firm in Johannesburg, South Africa.

Jeffrey A. Wurst

A member of the TMA International committee, the Board of Directors and past president of the Long Island Chapter. He is a partner in the law firm of Ruskin Moscou Faltischek PC, in Uniondale, New York.

Discussion:

William E. J. Skelly: As our members have expanded into the global market, the Turnaround Management Association has also expanded its borders outside Canada and the United States. This is partially to accommodate many of our members in larger accounting, law and turnaround firms who have established offices throughout the world.

In addition, TMA has had significant new interest from various parts of the world—from India to Russia, from Finland to South Africa. Generally speaking, these people are thirsty for the knowledge and experience that the North American members have and are trying to leverage off some of this information to apply to their jurisdictions.

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Several jurisdictions like Mexico, for example, have enacted new legislation to bring their legislation in line with that of North America and Europe. What appears to be occurring is that many jurisdictions are moving toward a North American or European style of restructuring.

Very similar to the United States, Canada has had a stable and strong economy over the past couple of years, both from a financial growth and a political perspective. This has

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translated into an abundance of capital available for credit for investing in new companies and for restructuring. It has led to fewer liquidations

and encouraged more employment and more companies to stay in business.

Generally speaking, the insolvency business is somewhat slow because of a buoyant economy. Not unlike those in the States, some Canadian industries have gone through transitions. The largest airline carrier in Canada, Air Canada, restructured in the last year and a half, as well as some larger steel manufacturers.

The government has proposed some changes in legislation, mostly to protect workers in insolvent situations and also to deal with some of the more exciting financial instruments now available such as derivatives and income trusts.

Over the past year or so, Canada and the United States have entered into a protocol to deal with cases in Chapter 11 proceedings in the States. In restructurings under the CCAA (Companies' Creditors Arrangement Act) or our Bankruptcy and Insolvency Act, judges in the U.S. and Canada have agreed on how

hearings will be held, the types of orders that can be granted, and other technical and administrative matters.

Q: Has that protocol worked well? Do you anticipate any changes to that process?

Skelly: Now that there's a protocol established, there's no mystery to the process. It was established about a year and a half ago and Canada tried to model it after the UNICITRAL model for dealing with international insolvencies. We took the parts from it that made sense for our jurisdictions. I'd say we've had very good success with it for cross border insolvencies.

Ward Mooney: Certainly, what is happening in the United States is very similar to Canada. Over the past 18 months to two years, an immense amount of capital has come into market that has really focused on all aspects of restructuring corporate America.

A number of large and prominent bankruptcies—airlines, supermarkets—have immediately been able to attain the appropriate debtor in financing (DIP) to provide the necessary liquidity to restructure.

Financing for smaller transactions also has also readily available, not only from commercial but also from non regulated lenders such as hedge funds that frequently join into a restructuring financing with the bank to provide liquidity.

To the extent that money is the answer to everyone's issues, capital has been very available to allow companies to continue to operate and use either an out-of-court or in-court process to continue restructuring. It is universally accepted that we are in a frothy capital market environment, which has allowed many restructurings to occur.

Q. Do you think that this has caused more out-of-court restructurings than in-court reorganizations?

Mooney: I don't have any statistics, but my feeling is there are more out-of-court restructurings than three or four years ago.

The primary driver is intelligent capital that is unlocking liquidity for companies before going into Chapter 11 and also a desire on the part of all constituencies to avoid the expenses inherent in a bankruptcy filing. It's much more of an environment of "Let's see if we can figure out how to do it out of court and really put our capital to use."

Having said that, there's still a useful process in bankruptcy—to be able to clean up a company, restructure to its fullest extent, and then have it as an attractive investment to buy after cleanup.

Q. For those on the panel from the United States, what do you think the effect of the new Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 will be?

Mooney: The major effect we see is, given the fact that the time periods that a company in bankruptcy can now obtain exclusivity have been shortened a great deal, a company has to do a lot more planning before they go into bankruptcy—financial, strategic, operational. They'll need to have a better idea of exactly what they need achieve in the 120-160 days they'll be allowed to be in bankruptcy and obtain certain privileges. The process is going to be much more time sensitive.

Jeffrey Wurst: I do not believe that the exclusivity provision is going to be as significant. I am not anticipating many fights over competing plans. The bigger issue is retail bankruptcies, with the timing on assuming or rejecting leases.

We've learned that in retail liquidations, the most significant asset is often the value of those leases. If not assumed in a timely manner, those leases will fall back into the hands of the landlords who become the big winners. Previously, it was the reorganizing debtor who had been able to capitalize off those leases.

Mooney: I agree. The legislation is focused on quick decisions on leases and gives landlords very much of a new seat at the table in retail bankruptcies.

Howard Brod Brownstein: I would say that the pendulum definitely has taken a rightward swing, as in many areas of politics and economics in our country. Congress in its wisdom has decided to shift more of the control back in the direction of creditors. This is not a drastic change, more of a tweak.

There were some problems in the bankruptcy process that have been addressed, but others remain. In general, that's how many turnaround practitioners view the bankruptcy reform act: an unmistakably rightward shift in the policy of our country in the area of corporate renewal.

Jan L. van der Walt: I'd like to talk about driving forces in the turnaround industry in South Africa as well as the constraints it faces. The most significant influence on our turnaround industry is our government's intention to introduce new business rescue legislation. Presently our insolvency legislation is such that liquidation of distressed businesses is almost automatically guaranteed, leaving little scope for turnaround work.

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Last year I set up the so-called “task group for organizing the turnaround and business rescue industries” in response to the government announcement of plans for new business rescue legislation. The task group represented turnaround professionals from all disciplines, consisting of 20 Work Group members who met weekly for five months, supported by 80 Advisory Group members. This led directly to the formation of the South African chapter of TMA. Presently, we have 33 members and we haven’t done any marketing yet.

That’s the good news. The bad news for the turnaround industry is the present robustness of the economy. Interest rates are at an all-time low, compulsory liquidations are at a quarter to a third of the level experienced during the ‘90s, and workout activities have slowed down tremendously.

The result is that the sales funnel to the banks is pretty empty. Turnarounds are taking place in state enterprises such as the national airline carrier, but these don’t really involve private sector turnaround professionals.

To my mind, the biggest barrier to developing the turnaround industry here, and giving effect to new business rescue legislation is lack of private equity funding and a very skeptical financial sector.

Another constraint is stringent labor legislation. For instance, when a distressed business is sold, its employees form part of the deal. This was not always so.

Also the tax regime is unfriendly—not allowing past and assessed losses is a stumbling block preventing entrepreneurs and financiers from stepping forward to invest in turnarounds.

In summary, turnaround activity in South Africa is presently at a low point, and I believe it will remain so for a year or two.

Q. Then, what is driving the interest in a TMA chapter there?

Van der Walt: I do believe that the new business legislation as well as the inevitable upswing in interest rates will provide the turnaround industry with a substantial boost in the medium term.

Presently, when a company goes insolvent, we have a process called judicial management, which unfortunately in practice invariably leads to liquidation. When the government announced plans for new legislation, all our liquidators overnight claimed to be turnaround professionals. That’s why industry stepped forward and formed a local chapter of the TMA. There’s a major opportunity for the future, but it will take two years for new legislation to take effect.

Alan Tilley: In the past two to three years, Western Europe has actually seen significant developments in legislation and practice in turnarounds. It is being recognized that consensual restructuring ahead of formal process can preserve enterprise value.

Whereas historically most European regimes have been very pro-creditor, there is a drift in legislation towards more of a balance between debtor and creditor. The application of the legislation has been influenced a lot of U.S. practitioners, law firms and turnaround/workout firms coming into the marketplace and pushing the legislation.

In Germany, it’s taken industry professionals three to four years to really begin to adapt to the 1999 legislative changes. The U.K. had new legislation in 2003. Italy had the Parmalat affair that prompted pretty strict action on large company reform. Spain introduced new legislation in 2004, and France is in the process. All of it is being prompted by government recognition that they needed a better balance between creditor and debtor.

Many look to the U.S., but nobody has gone as far as Chapter 11. Nowhere is there a situation where management retains day-to-day business control once you get into formal process. In every regime there is a court-appointed administrator.

More important, there is no developed market for DIP funding, so the critical issue of liquidity ahead of insolvency is still a major factor and an impediment to the U.S. style of restructuring.

TMA has been in Europe since 2000, with the U.K. being the first chapter in 2000; France in 2002; Italy's formative meeting was last year. Germany had its first kickoff meeting in June and Spain is looking at a kickoff in 2005. Ireland has also expressed interest but will probably piggyback off the U.K. Chapter in the short term.

In other exciting developments, the U.K. Chapter launched a Certified Turnaround Professional program in July, with a lot of research and heavy lifting to make sure we have a program that will import into the U.K. We have a well-established top university director as faculty.

Q. Are those types of credentials more important there than in the U.S.?

Tilley: All professional activities are controlled or supervised by self-managed professional bodies, which all have quite challenging exam-based qualification requirements. Most professions need a bachelors' degree, then secondary professional qualifications. That's true of accounting, law, actuarial, and banking. So it is extremely important. The banks in particular are very keen to see that there is some form of accreditation.

As for the economic situation in Europe—the economy in 2003-04 has been quite benign for the restructuring industry with the exception of Germany, which is going through significant restructuring issues. Banks are addressing Basel-2 regulations and there's a lot of talk about German non-performing loans that have come onto the market. German professionals were very conservative, but the EU regulation that introduced primary and secondary jurisdictions and opened up the possibility of forum shopping saw some German administrations go into more friendly jurisdictions such as the U.K. It was a wake-up call for German professionals, who are now adapting some of the provisions. We're beginning to see prepack arrangements and better implementation of the terms of the 1999 legislation.

In terms of industries, retail in the U.K. has begun to suffer. Automobile and supply industries have seen some large restructurings and fallout from some big U.S. Chapter 11s. Those who had factories in 506 legislations, brought that difficult cross border element.

Wurst: The Russian economy continues to be very challenging. It has a high inflation rate approaching 14 percent, with low wages and low productivity.

The Yukos affair has discouraged domestic investment, yet foreign investors continue to have an interest in Russian businesses.

The ruble is appreciating against the dollar. This is not necessarily a good thing for their economy because if you're doing business in Russia, you tend to do business not in rubles but in U.S. dollars.

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This year Russia has seen a significant slowdown in industrial growth, from 8 percent to 4 percent, primarily due to the drop in exports following the Yukos crisis.

But with all this going on in the economy, Russia continues to grow on a personal level. It now has 1 percent of the world's millionaires. About 88,000 millionaires live in Russia, and that number is growing.

The banking and lending picture has been

plagued with money laundering scandals. Sodbusiness bank failed in May 2004 after it was closed down for money laundering. In

July of the same year, Guta Bank experienced significant problems and as recently as May 2005, a major bank in St. Petersburg had allegations of money laundering. In part as a result of these scandals, Alfa-Bank, one of Russia's strongest banks, had a run on the bank last year, but it seems to have gotten through it pretty well. All in all there is not a lot of confidence in the banking industry.

Russia's economy is a very young economy in comparison to other industrialized nations and is going through some growing pains. The economy had a serious downturn in 1998 with a great recovery.

In 1998, it enacted ineffective bankruptcy legislation that essentially provided the opportunity for hostile takeovers under the guise of involuntary bankruptcies. Russia had to revamp its bankruptcy law in 2002 and is relying more on the American model to provide for restructuring. Of course this is a good thing for people in our profession.

Cross border bankruptcy issues are very interesting. Yukos, a major player in the Russian economy, filed for bankruptcy in the United States and went through litigation before its case was dismissed in the Texas bankruptcy court. The court essentially said that the case did not belong in the U.S. Part of the reason was that the Russian government was a major party in the Yukos bankruptcy. It had foreclosed upon tax liens and there were issues as to the propriety of these liens.

Bankruptcy is still very volatile, but people are becoming more optimistic now that there is the opportunity for restructuring and not just liquidations. No significant turnaround management industry exists in Russia, and TMA is in early stages of investigating a possible chapter in Russia, hopefully with a late fall 2005 or early spring 2006 organizational meeting.

Q: Where is the interest in a chapter coming from?

Wurst: So far interest has come primarily from professionals in American law and accounting firms that have a presence in the Russian Federation. A U.S./Russian banking seminar held in Washington, D.C., last April discussed turnaround issues, but so far no one has rolled up his sleeves to address how to fix what is broken. With a little bit of encouragement from our colleagues there, we will be approaching Russian banks that don't know much about the turnaround industry. It's an education process and hopefully, they will see there are better options than liquidation in dealing with distressed borrowers.

Brownstein: The situation in Japan is one of progress. In the last five years, the economy has made a lot of progress toward recovery from the bursting of the economic bubble on a number of fronts: corporate initiatives

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to improve operations, and engaging in restructuring methods that until recently were unheard of in Japan, such as layoffs, closure of operations, disposal of non-core businesses. The idea of maximization of shareholder value, rather than treating a corporation as just a trust to be passed on to the next generation of managers and employees, is taking hold in Japan.

In the government and legal area, the bankruptcy laws have been somewhat modernized to make restructuring easier. New accounting rules were introduced to reflect more of a mark-to-market mentality. Some new players have emerged following the first deal that caused, pardon the expression, “ripples:” the Ripplewood deal involving the Long Term Credit Bank, now Shinsei Bank. There has been a growing acceptance of the idea that private equity and the takeover of distressed companies can be a viable alternative for corporate renewal. These are relatively new ideas in Japan.

It’s important to realize how far the Japanese economic environment has come. Historically, bank regulators did not enforce loan quality as regulators did elsewhere. If a bank got into trouble, the regulators worked with the bank behind the scenes, but the bank was rarely forced to foreclose on its borrowers.

Banks in Japan were not subject to as much of this type of discipline as banks faced in the U.S. and elsewhere, and banks therefore did not have to enforce that type of discipline upon their borrowers. As long as the economy kept improving and the tide kept rising, it didn’t matter. However, the minute when the bubble economy burst, then as in the Japanese proverb, “When you lower the water, the rocks will appear.” A Japanese version of the U.S.’s Resolution Trust Corporation was created, called the Industrial Revitalization Corporation of Japan.

It established the principle that banks have to clean up portfolios, and that distressed companies have to be restructured. The Japanese economy has come a long way.

In terms of what remains to be done, however, everything I’ve described has occurred mostly in the larger cities and the largest companies. As you move down to prefectural capitals—what we would call states or provincial capitals in North America—not much has changed for the small and middle sized banks and borrowers there, which struggle with too much debt, still suffering from the effects of the bubble economy. The government has set up some centers to assist them in the prefectural capitals.

The turnaround profession as we understand it still hardly exists in Japan. Because there was less discipline of debt, companies did not historically “get into trouble,” and a profession to help companies out of trouble had no reason to develop. Under performance was always addressed from within.

There is currently huge interest in corporate renewal in Japan, as evidenced by the meteoric rise of TMA’s Japan Chapter, now with 130 members. Its members mostly come from the accounting profession, which is where the turnaround profession in the United States had its genesis 20 to 30 years ago. TMA members in Japan are keenly interested in establishing a Japanese version of the Certified Turnaround Professional program. I think TMA as an organization is greatly appreciated by the TMA Japan Chapter for supporting the development of a distinctly Japanese chapter that everyone can be proud of.

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In China, TMA is assembling a database of likely prospective members in Hong Kong, where the first—but, we suspect, not the last—TMA chapter in China will be formed. We are planning a chapter formation meeting in Hong Kong later in 2005, and many law and accounting firms in Hong Kong that have connections to European and North American firms have already evidenced strong interest.

Q: Are there any industry sectors in Japan that are business opportunities for turnaround professionals?

Brownstein: Japanese industries that had construction or real estate components were among those with the biggest problems. The large ones have been mostly identified and addressed by now. The remaining problems span across industries, because any company that had real estate on its books probably leveraged it up too high. In general, Japan is dealing with the fact that countries in the rest of Asia are becoming lower cost producers. That's a relatively new development in the last decade or so, a problem not unlike manufacturing in the U.S.

Q: Looking into your crystal ball, where do you see the future of restructuring globally five years from now?

Wurst: I see an international trend away from what I'll refer to as the British system of having an administrator liquidate the business and more movement toward the American-type reorganization. I also suspect that we will see the insolvency business continue to grow, with more loan defaults as interest rates will come up from the present historic lows.

Brownstein: To me, corporate renewal is a process, not an event. Interest rates will go up, and they'll go down. There will be problems of an economic and political nature in various parts of the world at various times. The beauty of corporate renewal is that it's a continuous process. An analogy that I use is the Amazon rainforest: it is teeming with life, but ultimately animals and plants die. The nutrients get recycled, just as the assets of a company and the operations of a business that are worth saving, are recycled.

Much the rest the rest of the world does not yet have methods of corporate renewal as advanced as we are fortunate to have in North America, but all are interested in developing their own version. While other countries will not likely adopt methods exactly as those in North America, the fundamental principal of continuous corporate renewal will probably be developed everywhere. That is why TMA has such a huge contribution to make.

TMA is the premier corporate renewal organization in the world, and we are realizing our destiny to make a unique contribution to the world. It's a very exciting time to be involved in corporate renewal around the world today.

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