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Stabilising Corporate Workouts (Out- of-Court Restructurings) in
Times of the COVID 19-Pandemic and Beyond:
The Case for Creditor Cooperation Duties

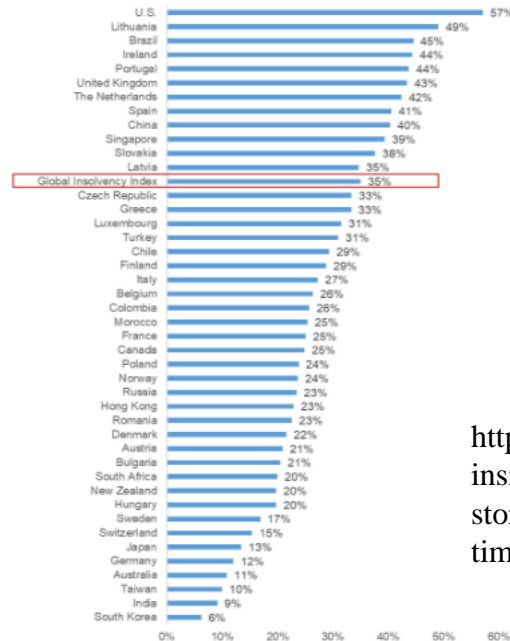
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The global policy problem

- Financial distress by (economically) viable firms on an unprecedented scale as a result of the pandemic (→ slide 3)
- Policy options
 - Bankruptcy
 - Bail-outs (tax-funded)
 - Bail-ins (private sector claims)
- “Bail-outs and Bail-ins are better than Bankruptcy”
 - Van Zwieten, Eidenmueller, Sussman (2020),
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3669541
- Many firms will need a (financial) restructuring despite bail-out/bail-in measures

Predicted 35% rise in global insolvencies in 2021 (compared to 2019)

Figure 1: Changes in insolvencies by 2021 (2021 level compared to 2019 level in %)



- US 57%
- Brazil 45%
- UK 43%
- The Netherlands 42%
- Spain 41%
- China 40%
- Global 35%
- Italy 27%
- France 25%
- Germany 12%
- India 9%

https://www.eulerhermes.com/en_global/news-insights/economic-insights/Calm-before-the-storm-Covid19-and-the-business-insolvency-time-bomb.html

Sources: National Statistics, Solunion, Euler Hermes, Allianz Research

The workout problem

- Corporate workouts are more efficient than bankruptcy (lower direct and indirect bankruptcy costs)
- But workouts are fragile because of free rider problems: creditors face a multi-party prisoners' dilemma
- Private contracting / informal restructuring principles cannot solve these problems
 - Private contracting, e.g. collective action clauses in bond indentures or syndicated loans
 - Legal barriers, e.g. Sec. 316(b) of the Trust Indenture Act in the US
 - Does not “solve” coordination problem between different creditor groups
 - Informal rules and business practices, e.g. London Approach, INSOL Principle
 - Lost their function already before the pandemic: dispersed debt-holders, heterogeneous interests, unstable composition of the creditor body

The Free Rider Problem in Corporate Workouts



Cooperation duties: function – content – trigger*

- **Function:** replicate contours of *hypothetical* inter-creditor agreement
- **Content**
 - Guiding principle: proportionality (duties necessary? fair?)
 - Negotiate in good faith (creditors and debtor)
 - If restructuring necessary and feasible
 - Agree to a proposed workout arrangement (bridging loan, debt restructuring, long-term credit facility etc.)
 - If Pareto-efficient compared to bankruptcy and ranking of claims respected
- **Trigger:** workout is initiated by one of the firm’s stakeholders
 - “Subjective” test, avoids publicity, easy to ascertain, good indicator of restructuring need, firm-specific, utilises information advantage of management
 - Good fit with “wrongful trading” rules/regimes

Cooperation duties: doctrine

- German Federal Supreme Court denied cooperation duties in a 1991 landmark decision: “Nach geltendem Recht entfaltet ein außergerichtlicher Sanierungsvergleich eine Bindungswirkung nur für diejenigen Gläubiger, die ihn geschlossen haben. Sogenannte Akkordstörer sind grundsätzlich auch dann nicht gehindert, ihre Ansprüche gegen den Schuldner uneingeschränkt durchzusetzen, wenn eine ganz überwiegende Mehrheit der Gläubiger einen derartigen Vergleich befürwortet.“

Bundesgerichtshof, Judgment of 12 December 1991, *Entscheidungen des Bundesgerichtshofes in Zivilsachen* (BGHZ) Vol. 116, at 319

- Legal position in other countries (e.g. UK, US) is similar
- Is this correct as a matter of doctrinal analysis?

Cooperation duties: doctrine

- Indirect inference (creditor-debtor)
 - Duty to perform in good faith (implied term)
- Direct inference (creditor-creditor)
 - Extension of negligence principles
 - Law of partnership (creditors and debtor are “in this together”)
- Private International Law
 - Center of restructuring efforts (→ COMI)
- Overregulation (→ satellite disputes) to be avoided
 - Precise formulation of cooperation duties
 - Judicial restraint

Conclusion

“In any event, these are extraordinary times, which arguably demand extraordinarily creative legal thinking. The task is to prevent debt gamblers from turning a global human tragedy into more of an economic nightmare. Creditor cooperation duties in a corporate workout could be a way to do that.”

(Eidenmüller/van Zwieten, CLS Blue Sky Blog May 13, 2020,

<https://clsbluesky.law.columbia.edu/2020/05/13/the-case-for-creditor-cooperation-duties-in-corporate-workouts/>)