Comments on Corporate Restructuring in Japan, Korea and the US

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Comments on Tomoo Tasaku

- Refinancing Tools
- Restructuring Vehicles
- Bankruptcy Law
- The RCC and IRCJ
Refinancing Tools

- Refinancing for debtors
  - Debt forgiveness
  - DES
  - Quasi Debtor-in-possession finance (under Civil Rehabilitation or Corporate Reorganisation Laws – in fact trustees are appointed)
  - Vehicle: Restructuring Advisory Services, now independent advice is available

- Refinancing/asset management for creditors
  - Bulk sales of loans in market
  - DES and sale to Private Equity Funds
  - RCC
Corporate Restructuring Vehicles

- M & A
  - have been growing generally
  - For distressed companies helped by possibility of “pre-negotiated filing” under Civil Rehabilitation Law and Corporate Reorganisation Law

- Turnaround management companies

- METI Guidelines
  - suggest use of financial covenant style early distress indicators and cash-flow based lending practices
  - recommend pre-packaged or pre-negotiated filing (Tasaku prefers “court supervised business revitalisation”)

- IRCJ
  - Is this the restructuring vehicle that the RCC was not?
Bankruptcy Laws

- Liquidation
  - Bankruptcy Law and Special Liquidation within Commercial Code

- Reorganisation
  - Corporate Reorganization and Civil Rehabilitation Law (to replace also Company Resolution?)

- Problems?
  - Too complex (is it worse than others?)
  - “Debtor in Possession”
    - New Civil Rehabilitation Law allows debtor to stay in control (not previously possible because of difficulty of DIP finance?) and revitalize more quickly (isn’t that likely to worsen the zombie firm problem? Incentive to preserve firm value too long)
Bankruptcy Laws

- Too many out-of-court workouts in past?
  - They lack transparency
  - Main banks tended to forgive too little debt so restructuring plans difficult because junior creditors are suspicious of deals between main banks and borrowers
  - Now more will be dealt with by legal procedures and should encourage genuine restructuring.
What is the role of Guidelines?

- Guidelines for Out-of-Court Workouts
  - Aimed at increasing transparency of out-of-court settlements and seem to want stronger protection for non-main banks in multi-bank finance cases.
  - They seem unrealistically strong but the fact they were needed points to problems:
    - Creditor coordination is not happening
    - Transparency of valuation is a problem.
What is the function of the IRCJ?

- RCC was set up as a debt collection agency
  - This is similar to AMCs in other countries
  - They are NOT the same as restructuring agencies but expectations of RCC were inflated. Not clear that it failed in what it was mandated to do, but it did fail in what it was expected to do. Has not achieved much restructuring.

- IRCJ seems to be a restructuring agency (not an AMC)
  - Apparently aimed at large, viable firms (though so far has handled very few)
  - But why is a government agency needed for these – what is the real, underlying problem which prevents private solutions for these firms?
Are the courts the solution in Japan?

- Not surprising that out-of-court settlements have been preferred (low-cost, quicker, most countries prefer)
- Are the courts now the right way to solve problems of:
  - Information asymmetry
    - Main banks are mistrusted by other creditors in non-transparent out-of-court deals
    - So creditor coordination is hard – some mechanism is needed
  - Missing markets
    - Value discovery hard in absence of a market for distressed debt
    - So the courts have been useful in establishing realistic write-downs when junior creditors suspect main banks are not taking a big enough cut.
- Are there other problems?
Comments on Hyoung-Tae Kim

- Description of Korea
- Korea’s restructuring vehicles
- Korea’s bankruptcy law reforms
- Questions
- Recommendations for Japan
Description of Korea

- Mechanisms are new (post crisis 1997-98)
- Multi-faceted
  - Several vehicles
  - Several types of instrument
- A mixture of public and private sector though the initiative was government
Korea’s vehicles

- Disposing of bad debt with minimal or no restructuring of debtor (asset management companies): KAMCO (government), CRFund (semi-government + private)
- Disposing of bad debt *together with* restructuring of debtors: CRV (private, mainly bank established (?) with some public money)
- Specialising in restructuring: CRC (private) and M&A Fund(s) (not clear – government?)
Korea’s bankruptcy laws

- 1962 Corporate Reorganisation Law plus Composition Law plus Bankruptcy Law
- 1997 and 2001 and currently amendments to limit use of Composition Law, allow “pre-packaged” bankruptcy and eventually integrate all 3 into one insolvency law.

- Intended to achieve greater speed and ??
  - Lower cost?
  - More rights for creditors, less for incumbent management?
Questions on Restructuring in Korea

- Will the development of private funds gradually replace KAMCO and government role or is the government role essential? What does it provide which private cannot?

- What role do the creditors themselves play in restructuring (e.g. banks)? Why was it necessary to provide other vehicles to do this (banks not performing?)? Where does the specialist turn-around expertise come from?

- Are the M&A funds active yet? Why haven’t private M&A vehicles developed? Are restrictions on foreign acquisitions a barrier? (Perhaps there are recommendations from Japanese experience here?)
Questions on Bankruptcy Law in Korea

- Why was Composition Law rarely used if most companies prefer a composition to a reorganisation?
- Why try to discourage compositions? Can they not be made to give creditors greater control over management?
- What is the difference between “pre-packaged” bankruptcy and composition and what prevented creditors from coordinating before it was introduced? (Legal or behavioural issue?)
- Is it the law or the changed economic circumstance matter more for handling bankruptcies? (see Baird)
Recommendations for Japan

- More focus on corporate restructuring/less on NPL disposal
  - Agree

- Government needs to create the vehicles
  - Maybe agree but arguable – what role for the market?

- Need consolidation of bankruptcy regime
  - Not sure. Does the legal structure matter so much?
  - Use and application, not black letter law, matters more.
Comments on Douglas Baird

- Argument of the paper
- Legal questions
- Economic questions
- What do we learn about Japan
The paper

Key statements in the paper

1. “The basic decisions in a reorganisation ought to begin with an examination of the way in which control rights are allocated. Their coherence, or lack of coherence, tells us how much work the legal system must do. When the rights are coherently allocated, or the assets are conventional and easy to identify, there is little work to be done.” [This may not yet apply in Japan]

2. “…it is all too easy...to assume that any particular business has an enormous going-concern value...In a world in which transactions costs are rapidly declining, the value created by simply bringing assets into the firm is likely to decrease over time. [If this is true generally it is probably true in Japan – but is it true generally?]
3. “The disappearance of the traditional reorganisation stems not from changes in the law, but from changes in the economy” (p 11)
The argument

- The nature of Chap 11 has changed over time
  - From mechanism to preserve going-concern value to mechanism to allow either (most frequently) sale (whole or part) or capital restructuring
- Mainly used as the *final stage* of a process – most of the real work has been done informally, outside the legal system, before Chap 11 is invoked
The argument

- Large Chap 11 sales in recent years had buyers lined up before invoking Chap 11
- Some piece-meal sales have occurred – so not all are going-concern sales
- In some, the court has conducted auctions when higher priced bids were believed possible
- Some are almost indistinguishable from normal M&A – new owners, new structures, redundancies
The argument

- Large Chap 11 *capital restructurings* (where no sale of company) often have pre-negotiated plan amongst creditors
- Power of junior creditors to hold up process is lower than in past
- Result of pre-negotiation is quicker resolution
Why have these changes happened?

- Not the law but the economics which changed
- Capital structures are simpler (fewer creditors and fewer types of claim?)
- Creditors more able to communicate and coordinate
- Going-concern value is lower (in service and technology industries) than in past.
Implications

- Chapter 11 has limited use
- It either prolongs life of zombie firms (which ultimately die)
- Or, increasingly, is just validating agreements reached in the market
- Results are often similar to M & A
- Changing economic circumstances make it an anachronism
- Policy (my interpretation): support the outside market developments which provide non-court-based solutions? Don’t introduce Chapter 11
Legal questions

- Were there legal changes which were necessary to facilitate the use of pre-negotiated plans? (What other laws do you have to change to get creditors to coordinate)

- If junior creditors have less power to hold-up, bear more risk, what legal processes were necessary to get there? Are there other legal remedies for them? Does this matter?
Economic questions

- How do we know credit claims are less complex and coordination easier?
  - Sovereign debt issues suggest not

- How would we demonstrate that going-concern value is lower than in past?
  - (a sweeping statement which may apply to advanced technology industries in economies with contestable markets, strong competition laws, low first-mover advantages and well-developed, liquid capital markets. Not even Japan fits all these to the same degree as US)

- If these are not general observations would the absence of Chapter 11 or mechanism for negotiated reorganisation reduce the liquidity of capital markets and raise risk premia?
What do we learn from comparisons: on bankruptcy law?

- Countries seem to move in different directions in use of informal out-of-court mechanisms.
- In US - a move away from the early use of legal system towards more use of the informal system. Cheaper and quicker when creditor coordination is possible. Legal system invoked to ratify and/or provide price discovery when the market has not done that adequately.
- In Korea - move away from informal (or less formal, compositions) towards more court-based system BUT with “pre-packaged” option. Suggests need to substitute or aid purely private coordination of creditors.
What do we learn on bankruptcy law?

- In Japan the movement may be in reverse direction. Intention seems to be away from more common use of informal procedures outside the legal system towards more use of rule-based, in-court system.

- Why would this be desirable?
  - the question to ask about Japan is not why were so many reorganisations done informally in the past but why do more need to be done through the courts today?
What do we learn on bankruptcy law?

- Need to ask what circumstances (or market structures) influence when the legal system should encourage out-of-court systems (or pre-packaged) and when rule-based, in-court systems?
  - Baird’s analysis suggests: contestable markets, low information asymmetry, strong competition laws, low first-mover advantages and well-developed, liquid capital markets.

- How can we avoid excessive emphasis on “preserving business value” beyond economically viable state.
  - Don’t let the law create zombie firms.

- Transparent value discovery is important
  - how can it be facilitated? Courts can be the auction house.

- Creditor coordination is important –
  - If it works well the law matters less. How can it be facilitated? Do governments need to intervene or legislate it?
What do we learn about restructuring of distressed debt and debtors: a spectrum

Improve creditor coordination, support markets for M&A, open to foreign investors?

- Leave on Banks’ Balance Sheets
- Sell to Bad Bank for Collection
- Sell to CRV for Restructuring
- Temporarily Nationalise

Japan, Korea, Sweden, Norway, Eastern Europe, US
What do we learn about restructuring of distressed debt and debtors?

- Theoretical work on when to leave distressed debt with banks and when to remove it (Mitchell)
  - What strategy works best depends on incentives for banks to be tough and to avoid soft-budget constraints. If banks forbear you’ve probably got it wrong.

- Empirical evidence on success of AMCs (World Bank)
  - Few have actually been successful so don’t rely on them too long. Get the markets working.
What do we learn about restructuring of distressed debt and debtors?

- Policy writings on international debt crises (Eichengreen, Portes et al, Krueger)
  - all note need for mechanisms to get creditor coordination – it doesn’t just happen.

- Does bankruptcy law matter?
  - having one helps but the details matter less than the culture of implementation.