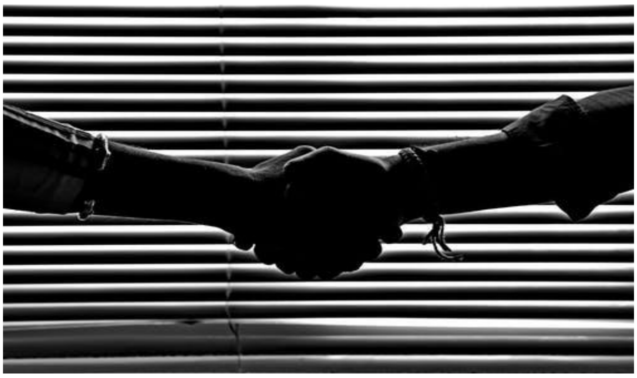
MULTI CREDITOR WORK-OUT ARRANGEMENT

The Bank of England (BOE) London Approach



During financial distress, the number of insolvency cases increases. Proceeds from the forced Sale Value of assets may not be sufficient to offset outstanding amounts due or satisfy all the creditors, in the event of multiple creditors. The CBN Financial Stability Report for 2017 shows that total non-performing loans (NPLs) grew by 14.59 per cent from N2,084.92 billion at end-December 2016 to N2,389.11 billion at end-June 2017. Also, the exposure of the top 50 and 100 obligors stood at N5,461.51 billion (34.33%) and N7,111.53 billion (44.7%) of the total industry exposure of N15,908.08 billion, respectively, reflecting high concentration risk. Consequently, credit risk increased as the industry-wide NPLs ratio rose from 12.8percent to 15.02 per cent at end -June 2017, reflecting a 2.22 percentage points increase compared with 1.1 percentage points in the preceding period. The increase was occasioned by the continued low level of oil prices and government revenue. It is expected that NPL growth would moderate as aggressive debt recovery strategies are employed by banks.

In a standstill agreement the participating creditors agree between themselves and with the debtor group not to press for repayment of their debt or pursue proceedings against the debtor during either a defined period or until a majority of their number decide otherwise.

Given the absence of adequate insolvency laws with provisions to govern business restructuring in Nigeria, litigation will naturally be the next approach to recover funds lent to borrowers. Litigation looks to use the instrument of the law to ensure payment of debt by a borrower usually by the realization of secured or unsecured assets, without taking into account the underlying cause of the insolvency. The end result of litigation is hardly ever favourable to the creditors considering the time, effort and cost put into the litigation.

In light of the foregoing, any out of Court restructuring is considered an "informal" arrangement. Informal workouts serve as a timely alternative to recovering funds lent to borrowers. The objective is to ensure that the company can continue as a going concern and the creditor is able to get as much payment as it ordinarily would if his company allowed entering into bankruptcy proceedings.

Workouts are a coordinated approach to restructuring whereby a financially distressed business and its significant creditors reach an agreement on adjusting obligations of the company. A workout in insolvency practice is usually an informal mutual arrangement between the lender and the obligor, wherein an insolvent or financially troubled company agrees on a scheme designed to enable the troubled company meet its obligations to its creditors and lenders and thus avoid bankruptcy. It is a delinquent borrower's repayment plan worked out and agreed with the creditor/lender.

This arrangement typically involves rescheduling of debt and modification of terms to ensure the company meets its obligations under less onerous terms. It includes for example agreeing on a moratorium on interest and/or principal repayment, extending the repayment period, reducing the level of interest and principal repayment tranches etc.

Nigeria being a third world and developing country, most of the basic infrastructures are not readily available in all sectors. Thus, pioneer investors and other investment requires huge funds for the various projects which in most cases are provided by syndicates or consortiums of financial houses. Arrangement of workouts can be fairly straightforward in a single creditor-borrower situation. However, where there are syndicates or consortiums of creditors/lenders, the so-called multi-creditor workout arrangement can be very complicated. This is so because the difference in the terms of borrowing agreed by the borrower with the individual creditors/lenders and the nature of liens and securities that they hold with respect to their lending, confers different rights, priorities and claims to the various lenders.

For example, some lenders are secure lenders and may hold securities that attach to specific assets of the borrower. Where this class of lender decides to exercise his right to realize the asset in repayment of his loan, it may seriously compromise the ability of the borrower to continue as a going concern.

A multi-creditor workout arrangement that optimizes the position of all creditors/lenders may therefore be a less contentious approach, creating a win-win for all parties, especially in Nigeria where the legal process can be very drawn-out and expensive. It is also not unknown in Nigeria for judgments in favour of secured lenders to be caught in protracted appeals or difficult to execute or enforce.

Different approaches and principles have been developed towards the multi-creditor work out. Some of which include the London approach as conceived in the 1970's by the Bank of England, the Hausbank approach as developed in Germany, Government involvement and the INSOL (International Association of Restructuring, Insolvency and Bankruptcy Professionals) Principles. One significant approach is the London approach which has as an essential component, the Standstill period. During the Standstill Period, all relevant creditors are to refrain from taking any steps to enforce their claims against the debtor to reduce their exposure to the debtor but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.

The initial stabilisation process is traditionally achieved by **a Standstill agreement.** Typically, in standstill agreement the participating creditors agree between themselves and with the debtor group not to press for repayment of their debt or pursue proceedings against the debtor during either a defined period or until a majority of their number decide otherwise. In return for the support from the participating creditors, the debtor group will generally agree not to take any action which would be disadvantageous to the participating creditors, either individually or collectively during the standstill period (e.g., by offering security to non- participating creditors, transferring assets from companies that participating creditors have recourse against, or otherwise running down its business or assets so that the prospects of repayment for creditors are diminished). In some cases, the participating creditors will demand that security be given for their collective benefit at this stage in return for the support.

The standstill agreement serves to reassure the directors of the debtor group that it is appropriate for them to continue their business and to incur credit and that for the time being there is a reasonable prospect of a successful rescue. The debtor is also expected to supply certain information to the Creditors to enable them verify information about the debtor.

To assist with the restructuring, it is usual for the participating creditors to appoint a representative **Steering committee**. The committee serves as the intermediary between the creditors and the debtor and the manager of the restructuring process. The committee facilitates communication between the parties and instructs the necessary professionals i.e Lawyers and Accountants. Lawyers assist in negotiating and documenting restructuring/work-out terms, acting for debtor or creditor(s); identify and review main contracts, terms of existing financing and security arrangements; advise on best legal structure to give effect to restructuring terms agreed between debtors & creditors, while utilizing supporting legal frameworks (i.e. law of contract & CAMA). Accountants on the other hand verify financial information produced by management; assess systems and management capabilities; conduct critical reviews of budgets and forecast; estimate realisable values of assets and verify liabilities; evaluate cash flow requirements, earnings and provide an opinion on the viability of the business and its growth plans.

There are however certain challenges associated with the Multi-Creditor work out. The major challenge of course is how to manage the interest of a secured lender who decides to opt for a litigation-based realization of its security, a situation which may compromise the ability of the other creditors/lenders from being able to collect their debt. A principle that may apply here is the "self-interest approach". Another challenge is the failure of the various lenders/creditors to understand the fundamental construct of a business.

In spite of the fact that many creditors will rather seek recourse to court of law for insolvency proceedings, the London Approach provides an effective framework for cooperation between creditors. This move towards business rescue is being promoted as it usually results in creation and preservation of real value for all parties, including the secured lenders/creditors, unsecured lenders/creditors, third parties, the borrower and the economy at large. It is usually less contentious, more equitable, easy to negotiate, confidential, devoid of stigma characterized by formal procedure, less expensive to orchestrate and it takes less time. This I must say will be valuable to the Nigerian situation. In addition, taking an agreed form of collective action prior to the commencement of any insolvency proceedings reduces the risk of an economically inefficient free-for-all raid on the assets of the debtor.

The legislation that governs the practice of insolvency in Nigeria is the Company and Allied Matters Act (enacted in 1990) and the Companies Winding Up Rules 2001. Where the borrower is a bank or a financial house, the Banking and Other Financial Institutions Act 1999 will be applicable, with the NDIC as the statutory liquidator. However, as it relates to the practice and process of insolvency, restructuring, bankruptcy and liquidation, there have been no significant provisions or current legislation to support the 21st century corporate and project finance in Nigeria.

Although, multi creditor workout may be a welcome development in Nigeria, it is imperative that there is an enabling environment to drive such innovation. This will include a reformation of the impediments that may affect enterprise reorganizations, encouragement of lending to, investment in, or re-capitalization of viable financially distressed enterprises, accommodation of a broad range of restructuring activities, involving asset sales, discounted debt sales, debt write-offs, debt rescheduling. The government should also provide favorable or neutral tax treatment with respect to losses or write-offs that are necessary to achieve a debt restructuring based on the real market value of the assets subject to the transaction. Finally, good risk-management practices should be encouraged by Regulators of financial institutions.

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