RESTRUCTURING NEWSLETTER

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CLEARY GOTTLIEB

Restructuring

CLEARY IN THE NEWS

Cleary Gottlieb wins 2003 Restructuring *Deal of the Year* from IFLR for its work in **SK Networks**' restructuring

Cleary Gottlieb wins 2003 *Corporate Restructuring Deal of the Year* from LatinFinance for its work in **Sanluis Corporación**'s restructuring

Cleary Gottlieb wins 2003 *Syndicated Loan of the Year* from LatinFinance for the $2.3 billion commercial bank debt restructuring by **Enersis** and **Endesa**

Cleary Gottlieb wins 2003 *Liability Management Deal of the Year* from LatinFinance for its work in **Uruguay**'s ground-breaking $5.2 Billion Debt Restructuring

Cleary Gottlieb wins settlement of major **Enron** claim

Cleary Gottlieb counsel in the second largest restructuring in **Thailand**

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WELCOME TO THE CLEARY GOTTLIEB RESTRUCTURING NEWSLETTER

We are happy to introduce the Cleary Gottlieb Restructuring Newsletter, which will be circulated on a quarterly basis to friends and clients of the firm. The impetus behind this publication — apart from the obvious marketing aspect — is that with the ever shrinking global business community, the work we do in one jurisdiction increasingly has an impact in other jurisdictions. As we work to make sense of these developments, it only made sense to put this information together in a small package that can be reviewed at a trading desk, on interoffice circulation or during a daily commute. Our goal is to create a useful, but not overwhelming, distribution.

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All Yell "Stop Trading"

By James Bromley, Joseph Lamport and Kristofer Hess

The Bond Market Association (the "BMA") and The Loan Syndications and Trading Association (the "LSTA") have jointly retained Cleary Gottlieb to assist in developing a model order for use in Chapter 11 proceedings under the U.S. Bankruptcy Code that will protect a debtor's net operating losses ("NOLs") without unduly restricting trading in unsecured claims during the pendency of a company's bankruptcy proceeding (the "Model NOL Order"). Page 2

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By Knut Sauer and Marc Grey

The recent awakening of a burgeoning market for distressed debt in Germany can be attributed to a number of factors. Chief among these are Germany's troubled economy, which has caused a spike in corporate insolvencies, and banking regulations that exert pressure on German banks to address the non-performing loans in their portfolios. Page 3

Indian Supreme Court Upholds Key Foreclosure Statute

By Sanjeet Malik

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The Hunt for *Pari Passu*

By Lee Buchheit and Jeremiah Pam

The pari passu clause found in most cross-border lending instruments contains the borrower's promise to ensure that the obligation will always rank equally in right of payment with all of the borrower's other unsubordinated debts. Page 6

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This report was prepared as a service to clients and other friends of Cleary Gottlieb to report on recent developments that may be of interest to them. The information in it is therefore general, and should not be considered or relied on as legal advice.

All Yell "Stop Trading"

By James Bromley, Joseph Lamport and Kristofer Hess

Mr. Bromley is a partner in the New York office.
Mr. Hess and Mr. Lamport are associates in the New York office.

The Bond Market Association (the "BMA") and The Loan Syndications and Trading Association (the "LSTA") have jointly retained Cleary Gottlieb to assist in developing a model order for use in Chapter 11 proceedings under the U.S. Bankruptcy Code that will protect a debtor's net operating losses ("NOLs") without unduly restricting trading in unsecured claims during the pendency of a company's bankruptcy proceeding (the "Model NOL Order").

The Model NOL Order project was initiated in the hope of avoiding the serious and costly disruptions in the trading markets that have occurred when U.S. bankruptcy courts have issued broad injunctions prohibiting or severely restricting the ability to buy and sell unsecured claims. Such overly restrictive orders have become commonplace in recent large bankruptcies, including UAL, US Airways, Mirant, Conseco, and Worldcom, where bankruptcy courts, at the debtor's initiative, have imposed limits on trading claims far beyond what is actually necessary to protect a debtor's tax attributes, usually leaving the trading markets and their participants in a dangerous state of limbo.

Bankruptcy courts have been willing to restrict trading in unsecured claims in an attempt to avoid the possible impairment of a debtor's NOLs that could result if the debtor's plan of reorganization were to trigger a change in control under section 382 of the Internal Revenue Code. In general, a loss corporation's NOLs will be subject to limitation if the percentage of the stock of the loss corporation that is owned by 5-percent shareholders increases by more than 50 percentage points over a 3-year testing period. Ordinarily, under the section 382(l)(5) exception, equity that is issued in exchange for debt under a plan of reorganization will not be considered in the change of control determination so long as at least 50-percent of the new equity is issued to "qualified creditors", which by regulation will include any person owning less than 5-percent of the equity after implementation of the plan. Consequently, the trading orders entered by numerous bankruptcy courts have prohibited "substantial claimholders" from either buying or selling unsecured claims without prior notice (and subject to the debtor's opportunity to object) in an attempt to prevent the accumulation of unsecured claims by creditors who would otherwise become entitled to receive in excess of 5-percent of a debtor's new equity pursuant to an eventual plan of reorganization. By requiring prior notice, these trading orders have effectively prohibited purchases and sales of unsecured claims by parties that fall within the definition of 'substantial claimholder', an amount which will vary depending upon the total amount of unsecured claims and the percentage of such claims that will be converted to equity in any particular case.

In contrast to the overly restrictive court orders that have required prior notice and thereby impaired the trading market, the approach adopted by the Model NOL Order enables unrestricted buying and selling of unsecured claims throughout a bankruptcy proceeding, subject to the possibility that substantial claimholders may be required to reduce their holdings to a predetermined level in the event that the debtor demonstrates that such a sell-down will, in fact be necessary in order to preserve economic value in a plan of reorganization that would otherwise be lost

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Germany: Turning Bad Debt into Good Equity

By Knut Sauer and Marc Grey

Mr. Sauer is an associate in the Frankfurt office.
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The recent awakening of a burgeoning market for distressed debt in Germany can be attributed to a number of factors. Chief among these are Germany's troubled economy, which has caused a spike in corporate insolvencies, and banking regulations that exert pressure on German banks to address the non-performing loans in their portfolios. This substantial supply of distressed debt in Germany – estimated at over €300 billion – is being met by growing demand from investment banks and other institutions eager to take advantage of the perceived bargains and restructuring opportunities presented by this phenomenon.

Secondary markets for distressed bank loans first developed in the United States in the wake of the Savings and Loan crisis of the late 1980's and early 1990's. Banks were eager to rid their balance sheets of non-performing loans whose uncertainty burdened them with additional capital requirements. Less regulated buyers saw opportunities for realizable value – by collecting on the debt outright, or by gaining equity positions through bankruptcy and restructuring arrangements. The Loan Syndications and Trading Association (LSTA) was formed in 1995 to streamline these transactions, facilitate the due diligence necessitated by the higher risk factors associated with them, and promote greater confidence for market participants. With the advent of the LSTA, the U.S. market for distressed debt has become more regimented in recent years. As the U.S. market has become more active, bargains have become harder to find, leading many in the field to focus their attention elsewhere in the world for growth opportunities.

Germany, the world's third largest economy, with an estimated €3 trillion in total bank loans, is in the midst of a financial crunch similar to the one experienced by the U.S. in the 1980's. Combined with increased pressure from banking regulations and a recent flurry of activity in the distressed bank loan market, these factors indicate that the German market is in the early stages of a business cycle that will mirror the one currently winding down in the U.S.

Pressure on German banks to consolidate their balance sheets and shed non-performing assets follows from German banking laws that impose greater capital requirements on banks holding high-risk assets such as non-performing loans. But the German national regulations are just the beginning – in 2006, the New Basel Capital Accord (Basel II) will take effect, requiring banks throughout the European Union to back high-risk assets with even larger percentages of capital. Moreover, many German banks are running short of underlying equity; in order to attract new capital they will need to discard many of their non-performing loans. One such bank is preparing to auction off over €7 billion in non-performing loans, signaling confidence in an increased demand for these assets.

This confidence is affirmed by recent developments among United States investors. One U.S.-based hedge fund has created a new fund specifically to purchase European bank debt of distressed companies, with the aim of actively participating in the restructuring of those companies in order to take equity positions at their conclusions. Fund managers are eager to capitalize on bargain-prices – control of a company for as little as two to four times EBITDA core earnings – while the market

is still young. Another U.S. fund has bought loans with face values of over €1.5 billion and expects to spend another €3 billion this year alone.

Investment strategies undertaken by buyers of distressed debt are forward-looking and complex, implicating a wide range of complicated legal issues. Buyers' due diligence is often made more difficult by the sheer size of the banks' loan portfolios, many of which contain a wide array of loans that vary in terms of their transferability, participation, notice and consent requirements, lender obligations, and governing law. Due diligence on the borrowers is further hampered by Germany's traditional banking secrecy laws. Overcoming these obstacles and avoiding regulatory pitfalls requires the employment of careful structural planning and unique legal strategies.

The substantial supply of distressed debt in Germany is being met by growing demand from a myriad of institutions eager to take advantage of value bargains and restructuring opportunities. Cleary Gottlieb, a leader in international restructuring for decades, has been at the forefront of this trend, facilitating some of the largest transactions in Germany by navigating the complex legal, tax and regulatory obstacles surrounding them.

Cleary Gottlieb is a pioneer in the development and implementation of innovative and successful strategies for dealing with the difficulties surrounding troubled companies and problem credits. Since opening its office in Frankfurt in 1991, Cleary Gottlieb has built an internationally recognized corporate practice in Germany that reflects the prestige of the firm's reputation worldwide. With over forty-five attorneys in its German offices (most of whom received their primary legal training in Germany), and an international restructuring team led by ten partners who devote a majority of their time to corporate restructuring and bankruptcy matters, Cleary Gottlieb provides its clients with a valuable combination of specialized domestic knowledge and renowned restructuring expertise.

For more information, please contact Zygmunt Wyka at zwyka@cgsh.com.

All Yell "Stop Trading" (cont.)

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through a section 382 change in control. In other words, the Model NOL Order avoids imposing a blanket up front restriction on the purchase and sale of unsecured claims but rather puts market participants on notice that a sell-down may be required to a predetermined level in the event that a debtor ultimately carries the burden of proof in demonstrating its necessity.

Working with the BMA and LSTA, Cleary Gottlieb is now in the process of reviewing the proposed NOL Model Order and receiving comment from leading bankruptcy legal and financial professionals in the hope of achieving a broad consensus and support for its acceptance. Ultimately, the adoption of the NOL Model Order will benefit all market participants by enhancing liquidity, reducing administrative costs that have been incurred in negotiating and litigating overly restrictive orders, protecting creditors' rights while nonetheless protecting a debtor's ability to preserve its valuable tax attributes through Chapter 11 reorganization.

If you are interested in further information on the NOL Model Order project please contact Zygmunt Wyka at zwyka@cgsh.com.

Indian Supreme Court Upholds Key Foreclosure Statute

By Sanjeet Malik

Mr. Malik is an associate in the New York office.

"In present day global economy it may be difficult to stick to old and conventional methods of financing and recovery of dues."

In a recent decision, the Supreme Court of India upheld the constitutional validity of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 ("Securitization Act"), which the Indian Parliament enacted to "curb the menace of growing non-performing assets" of financial institutions. The ruling, which was generally welcomed by India's banking sector, however, struck one of the provisions of the Securitization Act as unconstitutional.

The Securitization Act provides banks and financial institutions with a number of powerful remedies against defaulting borrowers. In particular, Section 13 of the Act provides that upon 60-day written notice a secured creditor may enforce its security interest, without intervention of any court, against a borrower in default of repayment of a secured debt. In other words, where a borrower fails to pay any outstanding principal and interest under a secured financing within 60 days of receiving notice of such default, a secured creditor may foreclose or otherwise take over the management of its collateral and the borrower has no judicial remedy to stay such foreclosure.[1] Even upon such foreclosure, the borrower could seek judicial redress (under Section 17 of the Act) only upon depositing 75% of the amount in question with the court. The remedies under the Act, however, are only available to "secured creditors," which are defined under the Act to cover only banks or financial institutions.

The petitioners challenged the Securitization Act as unconstitutional for failing to provide any judicial recourse to a borrower prior to foreclosure by a secured creditor. In addition, the petitioners argued that Section 17 of the Act provided an illusory remedy because a borrower in financial trouble would in most cases lack the liquidity to post the deposit.

The Supreme Court of India in a well-balanced decision held that nearly all of the Securitization Act, including remedies provided by Section 13, is constitutional. The Court observed that the "[n]ormal process of recovery of debts through courts is lengthy and time taken is not suited for recovery of such dues." The Court held that "[t]he effect of some of the provisions may be a bit harsh for some of the borrowers but on that ground the impugned provisions of the Act cannot be said to be unconstitutional in view of the fact that the object of the Act is to achieve speedier recovery of the dues declared as NPAs [non-performing assets] and better availability of capital liquidity and resources to help in growth of economy of the country."

The Supreme Court, however, did not hand a carte blanche to the creditors. Justice Brijesh Kumar admonished that "[t]he procedure [for collection of dues] should also be fair, reasonable and valid . . ." The Court, in striking the deposit requirement under Section 17 as unconstitutional, held that the deposit requirement was not only "onerous and oppressive but also unreasonable and arbitrary." In addition, the Court held that the borrower may petition for judicial intervention prior to the sale of the secured assets by the secured creditor.

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The Hunt for *Pari Passu*

By Lee Buchheit and Jeremiah Pam

Mr. Buchheit is a partner and Mr. Pam is an associate in the New York office.

The *pari passu* clause found in most cross-border lending instruments contains the borrower's promise to ensure that the obligation will always rank equally in right of payment with all of the borrower's other unsubordinated debts. For example, "The Notes rank, and will rank, *pari passu* in right of payment with all other present and future unsecured and unsubordinated indebtedness." The international financial markets have long understood the clause to protect a lender against the risk of legal subordination in favor of another creditor (something that cannot happen under U.S. law without the lender's consent, but that can occur involuntarily under the laws of some other countries).

In the fall of 2000, however, Elliott Associates, a distressed debt fund, seeking to enforce a New York court-issued judgment that it had obtained in respect of some defaulted debt of Peru, put forward a novel interpretation of the *pari passu* clause in a Belgian court, in asking that Euroclear be enjoined from processing any payments received from Peru in respect of its Brady Bonds. (These Brady Bonds had only recently been issued by Peru in order to clean up finally its old defaulted debt and regularize its relations with the capital markets). Elliott argued that such an injunction was called for by the *pari passu* clause in its New York law-governed debt instrument, which it claimed prohibited Peru from paying (and Euroclear from assisting in the payment of) some *pari passu* creditors (like the Brady Bond holders) while in default to others (like Elliott itself). To the surprise of virtually all emerging markets professionals, the Brussels Court of Appeals embraced Elliott's interpretation of the *pari passu* clause, saying "the … pari passu clause … in effect provides that the debt must be repaid pro rata among all creditors."

Thus was the 'ratable payment' interpretation of the *pari passu* clause unleashed. Since then, at least half a dozen other investors in both sovereign and corporate international debt have advanced similar arguments. But is this novel interpretation really what the *pari passu* clause means?

In order to find out, we embarked several years ago on a small exercise in legal paleontology: the hunt for *pari passu*. As part of this exercise, we surveyed the limited U.S. and English case law and secondary literature discussing the *pari passu* covenant from the late nineteenth century to the present. In order to better understand the function this kind of clause had historically played in sovereign debt instruments, we also traced the development of sovereign lending over the past one hundred years or so, beginning with an earlier period of bond financing in the late nineteenth and early twentieth centuries, and progressing in turn to the shift after World War II to financing from official lenders such as the World Bank, the return to private lending during the syndicated loan era of the late 1960s through the 1980s, and finally to the return to sovereign bond financing in the 1990s to present.

Our research produced a number of interesting discoveries about the evolving function and meaning of the *pari passu* clause in cross-border debt instruments over the past hundred years. We found that as the *pari passu* clause migrated from its original home in nineteenth century secured domestic debt instruments into the unsecured cross-border debt instruments of the

last thirty years, it made several jumps along the way – from secured to unsecured credits; from domestic to cross-border credit instruments; and from an expression of the debtholders' ratable interests in collateral securing the instrument to a promise to maintain the unsubordinated character of the debtholders' unsecured claims. For each jump there was a good reason.

At no time in its long journey, however, did the *pari passu* clause ever require a borrower to make ratable payments to all of its equally-ranking creditors. Nor did it ever provide a legal basis for one unsecured creditor to enjoin or intercept non-ratable payments to another creditor, notwithstanding the equal ranking of their respective claims against the borrower. To the contrary, when lenders have wished to address the problem of ratable payment, they have done so explicitly (and very often elaborately) in contracts or clauses that establish their right to receive equal and ratable payments, as well as their remedies – against the borrower and against each other – if they do not. Such intercreditor duties are not inferred merely by virtue of being a lender to the same borrower (under the "its only fair" theory of intercreditor relationship), nor are they implied by a lender's equal legal ranking with other creditors or by a contractual promise by the borrower to preserve that equal ranking. In short, we found that the ratable payment theory of the *pari passu* clause is, under the light of history, just a fallacy.

If anything, the ratable payment theory episode highlights the dangers of allowing boilerplate contractual provisions to detach themselves from the market's collective memory of where they originated and what they were designed to achieve. Standardized commercial and financial contracts are organic things: they evolve over time in response to a complex and shifting set of influences. These include changes in the underlying legal rules, unexpected and aberrant judicial decisions whose teaching must be disowned by contract, subtle but nonetheless palpable shifts in the treatment that parties expect to receive in contract negotiations, and cross-pollination among the "model" documents produced by different participants such as banks and law firms. Because of this web of influences, to read a standard form of commercial agreement or a boilerplate contractual provision with a knowledge of its historical evolution is to appreciate the inherent drama of the instrument. To read it without that knowledge is to mistake it for an inanimate thing, without progenitors and without posterity.

For the complete story of Lee Buchheit and Jeremy Pam's "hunt for pari passu" and what they found, copies of their article on the subject, "The Pari Passu Clause in Sovereign Debt Instruments" (forthcoming in the Emory Law Journal, Fall 2004), are available on request from Zygmunt Wyka at zwyka@cgsh.com.

Indian Supreme Court... (Cont.)

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This decision is not only important for its holding but it also demonstrates that the Supreme Court of India is on board with the emerging consensus among Indian politicians, bureaucrats and international donor agencies that in order for India to successfully compete in the global economy, certain laws of India harking back to its flirtation with socialism need to be overhauled.

[1] The Securitization Law, effectively, overrides the automatic stay protections typically provided under India's insolvency laws. For instance, section 22 of the Sick Industrial Company (Special Provisions) Act, 1985 suspends all legal proceedings against any company that is under the jurisdiction of the Board for Industrial and Financial Reconstruction (BIFR). However, the Securitization Act provides that 75% of the secured creditors may initiate action to overcome this moratorium of proceedings.

CLEARY IN THE NEWS

CG wins IFLR's Restructuring Deal of the Year for SK Networks

Cleary Gottlieb completed the final major step in the restructuring of indebtedness of SK Networks and its overseas subsidiaries. The SK transaction was one of the largest corporate restructurings in Asia since the Daewoo Group restructuring in 2000 in terms of the amount of debt restructured, the number of creditors represented and the legal complexities involved. The restructuring was successfully completed within eight months.

CG wins LatinFinance's Corporate Restructuring Deal of the Year for Sanluis Corporación

Cleary Gottlieb represented our longtime Mexican client Sanluis Corporación, S.A. de C.V. in a $234 million restructuring of its suspension components division's debt. This is the fourth and final step in Sanluis' restructuring, which began 18 months ago and has involved $520 million of debt. All of the debt has been rescheduled, and the holding company debt has been substantially reduced, without any dilution (so far) to Sanluis' shareholders.

CG counsel in the $2.3 billion commercial bank debt restructuring by Enersis and Endesa

Cleary Gottlieb represented the lead arrangers and bookrunners in the $2.3 billion commercial bank debt restructuring by ENERSIS and Empresa Nacional de Electricidad (Endesa Chile). 32 participating banks signed the restructuring loan documentation. Enersis and Endesa Chile are Chilean electric utilities and subsidiaries of Endesa S.A., Spain's largest utility company.

CG represents the Republic of Uruguay in Groundbreaking $5.2 Billion Debt Restructuring

Cleary Gottlieb represented The Republic of Uruguay in an international exchange offer that, together with a domestic exchange offer and the amendment of a Samurai bond, resulted in the reprofiling of more than 90% of the country's $5.2 billion of outstanding foreign currency bonds.

CG represents the Government of Indonesia in $1.65 billion power plant restructuring and project financing

Cleary Gottlieb represented the Government of Indonesia, PLN and Pertamina in the restructuring of $142.5 million in loans for the Dieng/Patuha independent power project (IPP). We have been advising the Government of Indonesia and PLN since 1999 on the restructuring of more than 20 IPPs, including a $1.65 billion project financing in June 2003 for the Tanjung Jati B coal-fired project in Central Java.

CG wins settlement of major Enron claim

Cleary Gottlieb represented noteholders of Marlin Water Trust, one of the 70 off-balance sheet vehicles established by Enron, in settling claims against Enron. This is the first settlement of an SPV claim against Enron, and the Marlin claim was one of the largest single claims filed in the Enron case.

CG represents Multicanal in its groundbreaking $520 million debt restructuring

Cleary Gottlieb is representing Multicanal in a $520 million debt restructuring including a cash tender offer and an exchange offer. Multicanal's exchange offer marks the first time an Argentine company has sought to restructure its U.S. dollar-denominated capital markets debt. Multicanal owns and operates cable systems in Argentina, Paraguay and Uruguay.

CG represents Close Brothers as financial advisor in Parmalat proceedings

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INTRODUCTION (CONT.)

For those who have an interest in a particular article, please use the contact information at the end of the article to obtain further information. In this inaugural issue, for example, *The Hunt for Pari Passu* is a short summary of a much longer, and interesting, law review article written by Lee C. Buchheit, one of the leaders of our much feted sovereign practice (indeed, Lee will supervise our recent mandate from the Republic of Iraq to renegotiate its external debt), together with associate Jeremiah Pam. We aim for four articles per issue, focusing on important developments in each of North America, Latin America, Europe and Asia, where we have substantial restructuring practices. We hope you find the newsletter useful.

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UPCOMING ISSUES

Korean Corporate Restructuring Promotion Act of 2001

Report on the Korean Corporate Restructuring Promotion Act of 2001 ("CRPA") enacted following the Daewoo group collapse to encourage voluntary restructuring with minimal court intervention.

Reform of French Insolvency Laws

Update on efforts to reform French insolvency laws to provide more similarity to Chapter 11 proceedings to help companies avoid liquidation.

The Intersection of State Aid, Competition and Insolvency Laws in Europe

Views on the growing role of state aid and competition laws in Europe in the rescues of financially troubled companies.

Financial Advisors and Underwriters, Changing the Rules

Report on the proposed changes to the rules in the U.S. governing the retention of investment bankers that have served as underwriters to a debtor.

Italian Insolvency Law Finalized

Review of the final version of the Italian law on Extraordinary Administration recently approved by the Italian Parliament.