

Restructuring and insolvency: dealing with creditors

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Dealing with creditors can be difficult at the best of times, however with the onset of solvency issues the manner in which creditors are managed can become a minefield for the uninitiated.

While the approach can, in many cases, be dictated by the particular facts, there are some common principles to consider:

1. Talk early

A common mistake made by debtors is to talk to their creditors after they have run out of cash. Not only does this typically frustrate creditors, it places the debtor in a weaker position to negotiate. The ability to offer a payment, even if partial, should not be underestimated.

Creditors generally appreciate communication and transparency. In many cases proactively highlighting future cash flow issues can reflect a business that is being closely monitored and managed.

2. Be transparent

While there can be a tendency not to disclose the true position or all of the facts to creditors, this often backfires. Bank creditors, in particular, typically become aware of all matters related to their customers, and to the extent facts have been deliberately withheld this can impact the willingness to accommodate future requests.

3. Treat creditors equally

While often difficult, the starting point should be to treat all creditors equally. In situations involving a large number of creditors, the ability to manage individual creditor relationships separately is time consuming and fraught with potential danger.

As highlighted in our article on Directors Duties, preferring certain creditors over others can also open directors and managers to liability in certain circumstances where the company is insolvent.

In saying that, there are common considerations that may necessitate a different approach to the general rule:

1. Trade creditors – do certain trade creditors need to be paid to allow supply of goods and services essential for the business?
2. Landlords – do landlords have to be paid to ensure continued access to property essential to the business?
3. Banks – what if a bank is providing certain working capital lines essential for the business, how are they kept open? Do you differentiate between term facilities and working capital lines?
4. Cheques – are there cheques that need to be honoured to avoid potential action by creditors?

4. Offer something, but be realistic

While in many cases creditors will prefer not to resort to legal proceedings, there will commonly be an expectation that something should be offered to enable them to agree to any restructuring request. This could be a payment of arrears, a partial payment, payment of interest on a loan, enhancement of security through to, in more sophisticated restructuring, increased oversight and perhaps control over the business.

The ability to offer something can be limited depending on the financial situation of the debtor, meaning creative solutions may need to be explored (in some cases there may be a legal solution through, for example, the use of execution deeds or other payment instruments to offer creditors an incentive). Whatever it is, something should be offered with certainty that it can be delivered.

5. Understand your creditors

Not all creditors are the same, and there can be stark differences in their approach and expectations. The obvious example of this is trade creditors versus bank creditors. Bank creditors in particular can be much more complicated, from the internal structures and which team is in control of your file (often moving from relationship managers to remedial) through to provisioning and regulatory reporting they are obliged to undertake. Understanding these differences and applying this to the way you communicate and what (and how) you offer is often key.

6. Deliver what you promise

Trust and confidence go a long way in the region. Unfortunately, there are too many instances of debtors defaulting on agreed terms following refinancing or restructuring. It is much better to under promise and over deliver.

7. Consider hiring a financial advisor

Depending on the size of the business and total debt owed, serious consideration should be given to hiring a financial advisor to assist with any financial restructuring.

In addition to assistance they may be able to offer to turn around the business, typically they will be able to assist in the preparation of any financial restructuring proposal (including financial projections) which will be submitted to creditors. Comfort levels for creditors often increase when financials have been prepared and verified by independent specialist advisors.

Financial advisors will also understand how bank creditors operate and will be able to help construct and present restructuring plans to banks in a manner they are accustomed to, including addressing issues such as what payments should be made (trade creditors versus banks, interest versus principal), payment holidays, rate reductions, new money requirements and so on.

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