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*The Vultures Fly East: the Creation and Globalisation of the Distressed Debt Market**

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> "I always say in this area of practice [insolvency] the law has very little to do with the practice of law. It's really a question of being able to recognize several things: it's being able to recognize leverage; it's being able to recognize options and being able to help people understand. Because at the end of the day, and this is a universal fact, most people will act in their economic best interests"
>
> (Bankruptcy lawyer—Toronto).

IN AN AGE of juridification it is intriguing to encounter a process, as suggested above, that has resolutely opposed this trend. I refer to systems of large-scale corporate restructuring in the UK and at the transnational level. As in most countries, the UK has its "normal", formalised bankruptcy and insolvency laws, but a significant number of restructurings are handled outside the legal frameworks—indeed never to enter it. The USA has similar "turnarounds" and also assembles "pre-packs" (pre-packaged bankruptcies), which are developed outside the walls of the courtroom but ultimately sanctioned within in a telescoped Chapter 11 hearing (see Delaney, 1992; 1999).

The fastest growing area of corporate restructuring is in the global arena. The globalisation of economic life through the global expansion of trade and investment has taken what is essentially a local legal matter—insolvency—and converted it into a global system, but one that presently lacks systemic features (cf. Giddens, 1991; Robertson, 1992; Arthurs and Kreklewich, 1996; Teubner, 1997). What is essentially an enterprise impregnated with risk, i.e., international trade, is left bereft when failure strikes. The legal system fails to support it. Instead, it makes do with ideas of trust and dense institutional networks to cope. This is a feature of the transnational system that Dezalay and Garth pick up in their work (Dezalay and Garth, this volume).

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In the UK, the informal rescue has a venerable tradition: Rothschilds bailed out Barings in the nineteenth century at the behest of the Bank of England. And this example provides the key to the informal regulation of rescue. If the stability of the financial system is threatened, then the central bank will step in to prevent it happening. During the collapse of Barings in the 1990s, the other British merchant banks argued very strongly that if Barings were allowed to go under their collective reputation would be ruined. On this occasion, their pleas failed (Fay, 1996).

This chapter is concerned with threats to economic stability that are being generated by the globalisation of financial markets; and how lawyers are implicated in maintaining stability and yet paradoxically destabilising it.[1] Globalisation is causing severe flux in the institutional structures we take for granted, including the ability of legal or normative cultures to maintain their self-identities and resist incursion from others. Instead, we find that legal or normative cultures are forced to deal with alien concepts that are imported, or that emigrate, for example, through regulatory instruments or in contract. In examining these processes, we can begin to establish the conditions that enable legal or normative transplants to take hold in receptive or resistant host legal systems, and the role globalisation plays in piercing legal culture (cf. Nelken, 1995; see also Watson, 1993; Ewald, 1995; Legrand, 1997). I emphasise the use of the term "normative" here in contrast to legal because most comparative law scholars think in terms of law as their topic. Those of us who have been immersed in the anthropological and sociological debates on law regard this interpretation of law as restrictive and narrow (e.g., see Roberts, 1979). Many law jobs are done outwith the legal paradigm but within a normative one, that is, one not necessarily sanctioned officially by the State. Yet the force of the normative paradigm is as vital as the legal one, and often the State is implicated in its activities. Any discussion of legal transplants has therefore to take account of activities that occur within groups that are not part of the dominant legal culture.

These groups—as my example of the London Approach below will show—are comprised of powerful elites who are able to move between and accommodate to different paradigms without sense of contradiction.[2] I essentially follow Teubner's conception of legal irritants (1998) that legal or normative cultures do not undergo wholesale change or adaptation as the result of orderly transplantation. Instead, the exogenous incursion resembles an irritant or virus that creates unpredictable alterations to the host, depending on the degree of the host's receptiveness, whether indifferent or hostile. To paraphrase Marshall McLuhan (1964: 98), the system "responds to new pressures and irritations by resourceful

[1] The research is based on interviews with lawyers, accountants, judges and bankers in London, New York and Toronto. A number of these interviews were carried out with Dr Eleni Skordaki. Not much academic writing has appeared on these areas, so I have had to rely on the financial and trade press for additional information.

[2] I have attempted to outline a conception of normative pluralism, as distinct from the usual legal pluralism, in Flood and Caiger (1993).

new extensions—always in the effort to exert staying power, constancy, equilibrium, and homeostasis". The question of the possibility of transplants is potentially misleading because norms, structures and institutions can interact at both local and global levels and between them, as the example of insolvency demonstrates. It is their inherent reflexivity that renders the concept of transplant too deterministic, even singular, in its impact on the host. Therefore, we are not addressing the wholesale transplanting of normative concepts. While lawyers play a strong role in the dispersion of normative concepts, they are not the exclusive players; and the processes, by virtue of their fragmented natures, are indeterminate and, where global, are not always intended to replace or supersede the current legal or normative culture. Normative dispersion is therefore not always deliberate.

THE INSOLVENCY FIELD

The insolvency field is a field within a field. It is part of the juridical field, which for Bourdieu "is the site of a competition for monopoly of the right to determine the law" (Bourdieu, 1987: 817). And with globalisation the world legal field has begun to emerge (Bourdieu, 1995). These concentric fields, instead of fulfilling a harmonious division of the labour of symbolic domination, militate against it (Bourdieu, 1987: 823).

Insolvency has always occupied an uncomfortable position in the legal field. Its history is linked with failure and the cleaning of the leftover ordure. In the UK it benefited from the burgeoning of the railway system in the nineteenth century and its attendant collapses. Lawyers, however, shunned insolvency because it was "dirty work", leaving it instead to accountants (Napier and Noke, 1992; see also Hughes, 1958: 49–52). Elsewhere, most notably in the USA, lawyers have traditionally dominated the insolvency field, although not without difficulty. For example, in the United States insolvency (or bankruptcy) was ignored by the elite "white shoe" law firms of Wall Street. Most of the work was picked up by Jewish lawyers who were excluded from mainstream corporate practice. It was only after the development of large-scale restructurings in the 1970s that Wall Street began to accommodate these outsiders and bankruptcy became almost respectable. Similarly in the UK, big insolvencies convinced lawyers in the City of London that this was not an area of business to be ignored (Flood and Skordaki, 1995; cf. Carruthers and Halliday, 1998).[3]

Since the Insolvency Act 1986, which created the position of insolvency practitioner (IP) in Britain—someone authorised to do insolvency work—the division of labour between lawyers and accountants as to which group takes receiverships and so forth has been discreetly and covertly allocated in order to

[3] Legal education is also culpable in situating insolvency at the margins. It has been an excluded subject from the traditional law school curriculum, and even now is found mostly in graduate degrees.

maximise the potential wealth creation accruing to professionals inherent in corporate restructuring. This division of labour reflects the peculiarly distinctive cultural twist put on insolvency practice in the UK.[4] Accountants represent the key players, with lawyers providing the technical know-how. Part of the explanation is found in the British reluctance to take insolvency into the courts: rather, it is taken to be almost a private matter between creditors and debtor. The 1978 US Bankruptcy Code tied insolvency to the courts, to the extent of creating a separate, but inferior, court system to handle the work (Carruthers and Halliday, 1998). Such a move assured the lawyers' hegemony over insolvency work with accountants, this time, adopting the role of underlabourer.

Despite some convergence in the insolvency systems of the USA and the UK brought about by the legislation, there is a fundamental difference between the two. Broadly (and crudely) the American system of Chapter 11 bankruptcy is debtor-friendly and keeps the creditors at bay. The British system ejects debtors rapidly, replacing them with accountants who service the creditors (Flood and Skordaki, 1997). This basic philosophical disjuncture has, in effect, created two fields of practice. Within these fields are found different practices, tastes and preferences: they are part of the ***habitus*** of the field (Bourdieu and Wacquant, 1992). Bourdieu puts it this way: "all the external stimuli and conditioning experiences are, at every moment, perceived through categories already constructed by prior experiences" (Bourdieu and Wacquant, 1992: 133). It is the case with insolvency, a field constantly disrupted by domestic and international change, economic boom and slump, and professional turf wars. Partly because of the pressure of change practitioners in the insolvency field have developed practices that enable them to respond to change without engaging steep learning curves: apparently they already know it. This is an example of the creation and functioning of *habitus*—it integrates

> "past experiences, functions at every moment as a matrix of *perceptions, appreciations, and actions* and make possible the achievement of infinitely diversified tasks, thanks to analogical transfers of schemes permitting the solution of similarly shaped problems" (Bourdieu, 1977: 83).

The facility to create new markets arising out of insolvency is a differentially distributed skill. For example, as shown below, the distressed debt market was nurtured by American lawyers, but resisted initially by British lawyers who felt their informal, club-like rescue culture would be disturbed by such incoming waves of potential disequilibria. However, it was not long before British lawyers began to learn how to exploit the distressed debt market and establish themselves as players in the field. The UK insolvency field has not been completely distorted by these new ways, yet a profound change has infiltrated it that means the players are unable to revert to prior ways of doing their work. Because of the globalisation of corporate rescue, it is almost impossible for practitioners in

[4] Abbott (1988) refers to this informal division of labour as "workplace jurisdiction", the weakest type of jurisdiction.

different parts of the world to prevent the importation of new techniques and the concomitant skills necessary to exploit them. What this does not signify, however, is that all practitioners are open to accepting the consequences of free exportation and importation. The closure of various groups to importation of techniques and ideas suggests an active lack of receptivity as a means of avoiding the "contagion" of importation. Nevertheless, the grip of the Anglo-American modalities of legal work is supremely vigorous and backed by powerful national and world institutions (cf. Dezalay and Garth, this volume).

From the perspective of comparative law, insolvency and its attendant rescue culture have, on the whole, been remarkably resistant to invasion from other legal systems. Neither rules nor philosophy have been transplanted, but certain ideas have been bruited that have stimulated the insolvency field into thinking it can adapt to the ideas of others. For example, as far back as 1960 the EEC attempted to move a European Bankruptcy Convention, yet failure dogged its steps until 1996, when it should have been signed but was not because the UK government was embroiled in the "mad cow" war with the EU (Smart, 1998: 9–10). Teubner (1998: 12) summarises these processes thus: "I think that in spite of all benign intentions towards an 'Ever Closer Union', attempts at unifying European . . . law will result in new cleavages". Insolvency does, however, demonstrate Watson's thesis that comparative lawyers should study the interrelations of legal systems rather than the operation of foreign laws (Watson, 1993). Since difference rather than convergence appears to be the dominant motif in insolvency, Teubner's (1998) idea of legal irritants as a method of explaining the change induced by external ideas has force.

> "[W]hen a foreign rule is imposed on a domestic culture . . . it is not transplanted into another organism, rather it works as fundamental irritation which triggers a whole series of new and unexpected events. It irritates . . . the minds and emotions of tradition-bound lawyers; but in a deeper sense . . . it irritates law's 'binding arrangements' . . . 'Legal irritants' cannot be domesticated; they are not transformed from something alien into something familiar, not adapted to a new cultural context, rather they will unleash an evolutionary dynamic in which the external rule's meaning will be reconstructed and the internal context will undergo fundamental change" (Teubner, 1998: 12).

For example, the company voluntary arrangement (CVA) is one such irritant. It was introduced in the Insolvency Act 1986 as a way of enabling companies to trade out of their difficulties without being put into receivership. For various reasons it has not been used much; the majority of accountants and lawyers were opposed to it. One of its failings was the lack of a stay (or moratorium) against creditors. Since 1995 governments have toyed with the idea of introducing a moratorium of a month to three months in duration (Icclaw, 1999), and finally in 2000 government introduced a new Insolvency Act that will enable CVAs to benefit from a creditors' moratorium of 28 days (DTI, 2000). The unusual feature about this aspect of the corporate rescue culture is that the same group of professionals, who have opposed CVA moratoriums and still do, is

content to adopt stays against creditors or moratoriums in informal, large-scale corporate restructuring, e.g., the "London Approach", which intertwines elements of UK and US insolvency regimes.

The secret of success for the London Approach is the subscription to a set of shared values among bankers and cognate professionals, their *habitus*. The recession of the late 1980s and early 1990s displayed how fragile these values could be when the secondary debt or distressed debt market emerged from the USA and rearranged coalitions and factions. What is little understood, however, is the roles lawyers have played in promoting this market, leading to various unintended consequences as the market was exported around the world.

THE LONDON APPROACH

The London Approach is an arcane procedure (Bird, 1996; Smith, 1996; City of London Law Society, 1996; Economist, 1997), which dates back mainly to the mid-1970s (Floyd, 1995).[5] Kent (1994a: 7) calls it "a means of reducing mistrust".[6] Smith (1992: 2) graphically describes the inception of the London Approach:

> "The origins of the London Approach can be traced back to the recession of the mid-1970s. This was the first serious interruption to world economic growth since 1945. We at the Bank of England (at least those of us with as many grey hairs as me) remember it most for the secondary banks' crisis and for the launching by the Bank [of England] of the so-called lifeboat. This was the first bank support operation that the Bank of England had had to organize, but, in the context of the London Approach, it was an influential forerunner of the Bank's later involvement in workouts for non-financial companies".

It was the switch from financial to non-financial contexts that set the Bank of England on a new path towards corporate rescue. But the path meandered only among the big, major corporates; it circumvented small and mid-sized companies. Smith (1992: 2–3) explains how the Bank of England became involved:

> "The mid-1970s saw an increasing number of non-financial companies encountering severe financial problems. Burmah Oil . . . was a notable example, highlighted by the suddenness with which the crisis blew up and the need for some very prompt action—on that occasion by the Bank of England itself. There was very little experience of organizing workouts in those days; we were not used to major companies coming to their bankers and saying that, unless they were given more liquidity immediately, they would have to stop trading. In particular, we had hardly any experience of arranging support operations for companies which had obtained finance from a wide range of banks and other sources, a trend which had just taken hold in the early 1970s. These

[5] Bird (1996: 87) has produced an unruly definition of the London Approach as "a co-operative basis by which lender creditors recognise individual and collective risk at a point in time and keep that balance throughout an agreed debt recovery strategy that seeks to preserve business".

[6] Cf. Luhmann (1979) who characterised trust as a means of reducing complexity and chaos.

> were the beginnings of what became to be called multi-bank support operations. My predecessors at the Bank in the late 1970s identified a need to co-ordinate discussions among the banks with loans outstanding to a company in difficulty. This usually meant the Bank taking the initiative in convening meetings of banks and, on occasions, other interested parties to help secure collective agreement to a refinancing package".

The Bank of England thus had as its motive:

> "not want[ing] companies to be placed in receivership or liquidation unnecessarily for wider economic reasons; we wanted viable jobs and productive capacity to be preserved" (Smith, 1992: 3).

During the recession of the late 1980s and early 1990s the Bank of England was involved in about 150 workouts (Kent, 1994b).[7]

The current incarnation of the London Approach stems from a circular the Bank of England helped to draft, which was distributed by the British Bankers' Association in 1990. It has no formal status in law, nor does it constitute a set of rules. At best it is a set of principles which contains as its objective:

> "to provide a flexible framework whereby Banks can continue to extend support to companies in financial difficulty, pending agreement as to the way forward [which] may include the provision of additional short term liquidity." (Pointon, 1994: 5)

The London Approach applies only to major corporates. Or, as Pointon (1994: 7–8) characterises it:

> "The final major flaw that I see is that the London Approach is only really appropriate for large situations, therefore the number of cases handled using this process is relatively small. Indeed, it has been said that only those who have borrowed vast sums receive the benefits of such treatment".

The London Approach has four phases. First, there is a standstill covering all debt owed. All bank lenders must give unanimous support. In this stage the banks often have extremely limited information about the debtor's true financial position, thus emphasising the notion of trust as an essential component of rescue. Secondly, the banks send in investigating accountants who are not the company's auditors. Thirdly, the lead bank negotiates with the other banks—which can be as few as six or as many as 106—to provide a new facility for the company. This is a difficult and tense period. It is also one where the "majority banks", i.e., those with the most exposure, may take decisions that will bind all banks. Pointon (1994: 7) describes this phase:

> "To give an idea of the complexity of arrangements, many major groups have multinational subsidiaries in as many as 20 countries. Funding of these groups is frequently through syndicates with 30 or more banks who all need to agree with the proposed restructure. These banks are often in differing financial positions; some may be

[7] This figure completely misrepresents the Bank of England's involvement as Smith (1996: 3) indicates, "we were actively involved in some 160 multi-lender workouts during the early 90s recession and have been kept informed of many others by the banks concerned".

secured, for example, and may come from countries with different business cultures and differing perceptions of the ways in which situations should be dealt with. As a result of these complexities there has been one case where the legal documents needed to be redrafted 17 times. Problems such as this can make achievement of final agreement very expensive in legal terms".[8]

In the final phase, according to Pointon (1994: 7), "the corporate has a new operating and financial structure which should allow it to prosper. Naturally, the Banks and their appointed accountants will, however, monitor on-going progress closely".

A key role in a London Approach workout is assigned to the lead bank. It will co-ordinate the rescue and have the task of bringing it to fruition. Smith (1992: 7–8) remarks that a lead bank has:

"to perform a difficult balancing act; it must, for example, provide firm but not overbearing leadership. It must also be a good communicator; one of the most frequent complaints we receive at the Bank of England is that a lead bank has failed to provide banks with information which they regard as essential for the decisions that they are being asked to make. A lead bank is tempting disaster if it takes, albeit probably inadvertently the views of banks for granted. It must, in other words, be sensitive to the circumstances of individual banks. Above all, a lead bank needs to be flexible; it must be able to respond to the unexpected and know when to give ground in difficult discussions".

How is the lead bank chosen? A banker who has led workouts answered thus:

"It's usually the bank with the biggest exposure. But that doesn't always work out. Suppose the biggest lender is [X foreign bank], well, they don't have the experience to be the lead bank, they're not competent, they don't know how. So, their chap might come to me, say, because I'm the largest lender who's a clearer and ask me if we'd be lead bank. It's a lot of responsibility being the lead bank. You have to put the team together—you're responsible for appointing the investigating accountants, and you have to make sure everyone reports their total exposures. We freeze lendings at the date of the standstill".

The London Approach is also expensive to implement. A successful workout could cost £6 million over its life. A banker put it this way:

"Let's, for example, take a small company, a typical mid-corporate, with three bankers, poor management, lousy at forecasting, with annual sales of £10 million, borrowings of £4.5 million, owns its own factory and some machinery, has a mortgage debenture to one and a charge to another. This wouldn't be any good for a London Approach. There's no meat on the bone, there's no value, nothing to play with, all the assets are secured".

[8] To give an idea of the scale of the debt that can be involved in London Approach rescues consider Queens Moat Houses plc. This was a large rescue in the early and mid-1990s where, *inter alia*, two European banks found themselves participating in this process. Bank One was owed DM 25 million plus a share of a credit facility (*in toto* DM 1 billion). Bank Two was owed £20 million represented by five different currencies (based on interview material). None of this exposure was secured.

To achieve London Approach status, therefore, a company must have assets largely unsecured or undersecured. Sometimes there are no assets, but this is not necessarily a bar to rescue as another banker said:

> "[XxXx], the advertising company, had no assets; it had the goodwill, its business, the clients. There we traded debt for equity thereby downsizing the debt. The company traded over a few years and fortunately kept its Stock Exchange quote. At the end the banks sold out their equity and recovered their money. [XxXx] is still going: that was a successful London Approach".

Bankers could be harsh, as one indicated when he dismissively referred to Broadgate, the office *cum* shop development by Liverpool Street station in London, "There's nothing there. There are the buildings, but the debt matches the value. There's nothing to play with and the equity isn't worth anything". If the company has the right configuration, a successful London Approach is feasible. But it is possible for a company in the London Approach scheme to remain under bank control for up to ten years.

Two other factors help make the London Approach unique. The whole process takes place outside the glare of publicity. One banker said the last thing he wanted to see was the unsecured creditors jumping out at the news. The cloak of secrecy also helps the banks work together rather than in competition with each other. This is especially so in the meetings where the workouts are structured. These meetings are delicately negotiated, contingent affairs rife with bluff and double bluff. A banker told of his first London Approach rescue:

> "A colleague of mine dropped me in it. He had another commitment and asked me to take his meeting. Everything was taken care of, he said, they've all agreed to sign. All you've got to do is collect the signatures. I went in to the meeting where there were sixty banks from all over—Europe, US, Japan. I asked if they were all ready to sign and all except two Belgian bankers said they were. I wasn't expecting this. They said their creditors' committee hadn't been able to meet last night and they would expect a phone call soon to let them go ahead. I asked the rest if they would sign anyway and they said no, only if everyone signed. After that great start, I put the two Belgians in a room with a phone and we waited. The meeting started about ten o'clock and at twelve there was no sign of an answer from their banks. At this point, a Dutch banker came up to me and said, 'I have a plane to catch to Amsterdam in an hour and I don't want to wait around any longer'. I said all right why don't you sign and I'll hold your paper until everyone else has signed on. I won't use it unless everyone signs. He was happy with that and left to catch his plane. Next, the Americans agreed to the same deal. I asked the Japanese if they would do the same. They refused saying they could only sign if everyone did. Their creditors' committees had given them strict instructions. We had a large screen TV in the room which was used for videos, but I had it hooked up to an external feed and there was Wimbledon on. The Japanese watched away. There was still no call from Belgium. Eventually I spoke to the representative of the Bank of Tokyo saying why don't you call your bank in Japan. He said he couldn't because it was a bank holiday in Japan. I said why don't you call them anyway. He caught *my drift* and I took him to another room. He came back a while later saying his bank said he could sign, they trusted us not to use the document unless everyone

signed. Eventually I had everyone's signatures except for the Belgians. I went in to see them and said you should phone your banks now and tell them every bank except yours has signed up to this deal. If it falls through now because your banks won't authorize you to sign, everyone is going to know it's your fault. That won't look good for you in the future, will it? In no time at all they signed".

In this scenario the lead banker played off the major players against the minor ones. If the Belgians had held out and destroyed the deal, their reputations would have been severely tarnished in the City, where reputation is crucial. This banker remarked that everyone knew everyone else in the business and that the "favour bank" was frequently used: "You scratch my back, I'll scratch yours. Banks will help each other out in workouts" (cf. Wolfe, 1987).

The risk of rescue is also negotiated between the banks. A workout specialist said:

"Everyone must share the pain equally. Sometimes its not the same and we have various matrices we use to make it equitable. You sit around the table with the other banks and you say if we liquidate the business you will get fifty cents in the dollar. Is there anyone who wants to take that? Everyone says no, but one or two say we can't take this or that. They've said they don't want the fifty cents, so it's a matter of moving them to one of the other scenarios. You have to run different scenarios for restructuring plans—worst-case scenario, second worst case, best case, etcetera. You don't know if it'll work since it's all guesswork. We run the scenarios over one year, three years, 12 years to see what it will look like".

In difficult moments the Bank of England is able to step in to "ease" the process. Kent (1994a: 5) declares:

"The Bank of England's role in workouts is part missionary, part peacemaker. As missionary, we advocate the London Approach as a basis for constructive cooperation regarding a customer's cashflow crisis. As peacemaker, we try to help banks resolve those differences which threaten to undermine an attempted workout".

He has further followed that view: "I have always made clear that our interest is not as a supervisor or 'regulator' of the market" (Kent, 1994b: 5). Another banker believed the Bank of England was useful:

"It is good for dealing with bank regulators in other countries. If you have seventy banks in a team and one, say, a Spanish bank, hasn't signed on then the Bank of England can talk to the Spanish bank regulator, and say we've got a major restructuring going on here and sixty nine banks have signed on but yours hasn't. Why not? And very often it's because the bank doesn't know about it. They might send a relatively junior official who has to pass recommendations up to his seniors and depending on how quickly they get passed, it can screw up or work well. The Bank of England can make it move up the hierarchy quickly. The Bank could also make rumbling noises about bank licence renewals, but they don't control foreign banks".

One official at the Bank of England commented that this was not how he viewed the role of the Bank:

> "Our role is one of peacemaker, that is, not passive but quite active. We come in when, for example, there are fifteen banks and one or two don't agree. There are always two sides to a story, so we'll talk to the ones who say no and then I'll talk to the others or bring them together. Usually the differences can be ironed out. But if there's a nine to six split, then we would not be involved".

He concluded by saying, "there was always the threat of the Governor's eyebrows". Those involved in the London Approach know each other well. It is a club with customs and habits understood by the members, which helps explains the perceived lack of need for formal rules or legislation. The official noted that:

> "We know the core group of bankers well and the main players are always in contact with each other. We are invited in. A bank calls me and says there may be a workout coming up, and that might be enough—that call—to bring everyone into line. We have no sanctions, although we have all sorts of relationships with banks and companies. Some companies are so big; they borrow in their own names. Indeed, they have better credit ratings than their banks. So we do have considerable authority. In a workout it may be worth going along with the majority because they will be in a similar situation again soon. If a bank is prepared to cooperate in a workout now, it will be to its advantage next time".

On the whole, bankers (and lawyers) are strongly opposed to the thought of a statutory basis for the London Approach (City of London Law Society, 1996: 2). It would run counter to its philosophy. Many thought that parliamentary draftsmen would be incapable of understanding the minutiae of the London Approach and so it was best left in the hands of those who knew how to do it.

To the bankers and lawyers involved in the London Approach its genius lies in the informality and the infinite flexibility with which it can be moulded and shaped. Its *habitus* is well adapted to the field. It also benefits those who wish to retain control of the field and banish outsiders who attempt to break in and capture the market. To learn the folkways of the London Approach requires almost a mystical ability to divine the procedures, since nothing is formalised. It is not beholden to a formally rational authority, even though the Bank of England is an authoritative body whose strictures cannot easily be ignored. Nevertheless, the system is not hermetically sealed and can be irritated, as the growth of the distressed market has shown.

THE DISTRESSED DEBT MARKET

> "The international distressed-debt industry is shifting its focus to Asia. Such major UD commercial banks as Citicorp, J.P. Morgan and Chase Manhattan have advanced ideas to Asian governments in recent months, but some governments are leery of taking over private corporate debt. Investment bankers, meanwhile, are scrambling to devise ways of packaging companies' debts into fund-like collateralized bond obligations or other structured finance vehicles that would not require direct government participation" (Hanes, 1998: 30).

The distressed debt market (or secondary debt market) began in North America, primarily in the USA. It was the creation of bankruptcy lawyers. During the 1980s and early 1990s bankruptcy lawyers were enjoying a tremendous boom in their work. Chapter 11 bankruptcy gave the restructuring/reorganising business a boost while diminishing the importance of liquidation. Re-emphasising reorganisation, as opposed to cashing in the assets, meant that those involved in bankruptcy had to take a more "entrepreneurial" view of their roles. The crucial players here were the lawyers, given that bankruptcy in the USA is driven by lawyers. Two points are important here: one, that the bankruptcy bar was small (most of the major players in the bar could trace their introduction to a particular law professor, Charles Seligson, who taught bankruptcy at New York University law school and whose name now designates an endowed chair at the school),[9] and, two, that it had been predominantly Jewish. Jews were discriminated against and found it difficult to join "white shoe firms", so they practised law on the periphery until they were invited to enter the core. This small world built up substantial expertise as bankruptcy became a normal fact of economic life. Not only did it supply the legal experts, but it was also providing the State with bankruptcy judges and advisers for bankruptcy commissions. Bankruptcy lawyers were able both to create the rules of the game and to interpret them.

Bankruptcy had been a marginal activity with inferior courts—no Article III judges—but with the fevered activity in the mergers and acquisitions (M&A) market in the 1980s, bankruptcy lawyers were becoming attractive, if not necessary, to the mainstream bar. The 1980s produced many very highly leveraged buyouts, which generated a lot of high-yield debt, especially through junk bonds (cf. Burrough and Helyar, 1990). And as one bankruptcy lawyer said:

> "The companies were basically performing OK; on an operating basis they just had too much debt. If you have that phenomenon then you might want to not deal with the trade [creditors]—leave them alone—and you might not want to take good operations that haven't screwed up by the virtue of being in a bankruptcy. So, you just restructure the balance sheet".[10]

The secondary market makers began to become aware that a lack of liquidity was a strong draw to enter this market. Bankruptcy lawyers were awakening hedge funds to the possibility of profits in these deals. These funds were largely

[9] The current holder of the chair, Professor Lawrence King, is a member of the US Bankruptcy Commission and of counsel to Wachtell Lipton, a Wall Street law firm.

[10] Brooks (1995: 26) neatly defines how distressed-debt investing works, "Distressed-securities investing aims to produce superior risk-adjusted returns by buying undervalued debt and equity in bankruptcy and troubled companies. Not surprisingly, bankruptcy investors tend to purchase the debt securities of a troubled company rather than the equity. The rights and privileges of an investor in non-distressed debt are generally limited to what is spelled out in the indenture of loan agreement. In bankruptcy, however, additional rights rebound to the bankrupt company's assets. These assets typically have positive value, regardless of whether the company is in bankruptcy or not". The analogy with the London Approach is apparent.

"totally unregulated mutual funds that are possible under US law", said an English insolvency lawyer. Moreover, selling debt would most likely enable the restructuring to move ahead smoothly. The lawyers were able to persuade buyers that apparently "worthless" paper had value, both in the short and long term. If someone was prepared to buy distressed debt at 20 cents on the dollar, they could sell later for 40 cents. If they preferred to take a longer-term view, they might buy at 20 cents on the dollar and wait until they could sell for 75 cents on the dollar. The equation of lack of liquidity for creditors in bankruptcy and too much cash for the funds meant buyers could move and guarantee an enormous spread. The buyers were known as vulture funds.

Their name graphically indicates their role: to pick off the meat from the carcass. For example, the late Drexel Burnham Lambert acted like a vulture fund (Bruck, 1988; Stewart, 1991). The first vulture funds were smaller companies that tended to buy at the junior end of the capital structure. They were less interested in restructuring and more in making a profit on the spread: a lawyer couched it thus, "They can play a terrorist role". Their interest was not in acquiring the company. Another lawyer said, "The secondary people are more sort of driven by the market and they assess their position daily". An American lawyer claimed:

> "[The vulture funds'] worst enemies are the existing management of a corporation—with their panoplies of ratchet options and other pseudo-capitalist toys—and the mezzanine financier, to all of which the British system is too kind".

As the market grew, larger funds, including banks and insurance companies, entered. Williams (1998: 28) acclaims the distressed debt players:

> "Distressed debt players raised $2.6 billion last year [1997], a record amount . . . While records are being broken, a distressed debt fund for the first time raised more than $1 billion. Los Angeles-based Oaktree Capital Management took in $1.2 billion from investors last year for its OCM Opportunities Fund II. Its investors include Washington State Investment Board, Massachusetts Pension Reserves Investment Trust, the Rhode Island State Investment Commission, and the San Diego County Employees' Retirement Association. Other groups to successfully close distressed debt vehicles were DDJ Capital Management, which raised $500 million, Contrarian Capital, which raised $250 million, and Rothschild Asset Management Recovery Fund, $200 million".

These entrants created an odd scene. In a Chapter 11 the banks are often major creditors, ones that are, as in the London Approach, concerned with stability in the process of reorganisation (or otherwise they prefer liquidation). Yet, as the banks entered the distressed debt market, they found themselves playing against themselves at the bankruptcy table.[11] They achieved this by creating divisions within the banks to play the distressed debt market, and rarely did

[11] Currently more hedge funds are now being established by banks rather than individuals (Garfield, 2000: 21).

different departments in the same institution communicate with each other.[12] Even if they were to there would have been problems, as a bankruptcy lawyer argued:

"Historically banks would have a view of the credit that would not have been driven by considerations away from the true value, accounting considerations, write downs in a particular quarter, considerations that were away from the actual inherent value of the piece of paper".

From the perspective of the debtor-in-possession and his lawyers these character changes were unsettling.

"I have had committee after committee where it started with the original par holders, there was a bank group, an insurance company, trade debt bondholders, and at some point in the case they were all gone. They were replaced by secondary holders who blurred the lines. So the problem is you sit there with a group, I mean from the perspective of creditors, and even the debtor . . . you are negotiating toward a particular end, and then somewhere in there it's a whole new group to negotiate with, with perhaps different motivations".

Usually the demands and needs of each group are also different. The same lawyer continued:

"[Vultures] may want equity where the banks typically don't want to take equity as the currency if they can help it. They would much rather have the reorganization value distributed in cash and debt. The distressed holders often prefer equity . . . They come in often not knowing the facts, which is understandable because there are some facts that are not publicly available, so they have to be educated and their expectations may not jive with the facts. Sometimes it's helpful in the sense that they come in typically with a lower basis because they've bought this thing at discount and it's easier to make a deal. They're very time-sensitive because at the end of the day they're really traders, most of them, and so sometimes issues that were gigantic issues when you were dealing with the banks and the insurance companies become easy issues because we don't care about that. We paid fifty cents on the dollar; if we can get seventy-five cents on the dollar in six months we're thrilled. It's a fifty per cent return on our money in six months: that's what we want, we want in and out quickly".

Vulture funds therefore received an ambivalent reception since they may both facilitate or destabilise workouts. It partly depends on the type of institution involved in distressed debt, its values, the types of debt it wants to trade. The only clear principle is that everyone agrees vulture funds are buying and selling for their own self-interest.

[12] Wirth (1998: 12) provides an example, "PPM America, the US investment arm of one of Europe's largest institutional investors, Prudential Corp. of Britain, plans to launch a new $473 million fund to focus on distressed debt and equity opportunities. PPM America's strategy for the new fund will be to focus solely on below-investment grade instruments, such as bank debt, trade claims and junk bonds".

THE MARKET MOVES ON

The buoyancy of the secondary debt market began to jeopardise its success. As long as the spreads were generous through the relatively small number of people involved, the market could be described as reasonably stable. Within this frame, for example, vultures helped establish the "pre-pack" market:

> "A pre-pack works when you have a relatively small cohesive creditor group, so that it's usually used to restructure obligations if you have a public debt so you can get the bond holders who are in a troubled company context . . . What usually happens is the secondary buyers, the investors in distressed securities, gather these things and there's a concentration in that group, and that's when you can do a pre-pack".

The market in distressed debt soon became competitive as the numbers of institutions investing in the market increased.

> "There's so much money chasing distressed debt that maybe the spreads aren't wide enough to justify the risk in buying the paper. People may be paying too much. For a while it was only a buyers' game. The buyers were making the money and the sellers either looked stupid or didn't care because they had other considerations".

Besides pushing up the price of paper, the intensified competition forced the vulture funds to seek markets outside the USA. The most natural next market for them was Canada, as it was tied to the USA by an economic umbilical cord. The prevalent view of Canada by the vulture funds (assuming they knew where it was, which one attorney doubted) was that it was "a horizontal Chile", in so far as it had some value but was not overly endowed (and all major conurbations were situated in a strip along the USA/Canada border). The collapse of the property market in both western and eastern Canada provided a strong stimulus. A Canadian lawyer describing the restructuring of a large company with big real estate holdings told of the combinations of interests:

> "We had Swiss banks, we had German banks, we had American vulture funds, we had some Canadian financial institutions, and we had insurance companies. So you can see from that there are totally diverse approaches. The other interesting thing is you've got people who paid a hundred cents to the dollar who have a certain view of life, and others, a huge part of the group, who bought in at sixty cents and they are people trading at ninety cents within a few months, so you know it is a whole different perspective on life".

The interaction of the diverse interests was in his view a good thing:

> "I think the vulture funds have done a great deal to change the environment because, number one, you have got all these people who have bought out and so they've gone; and, number two—you see what you're dealing with—is once you get these people in, you are dealing with 20 cent dollars, 30 cent dollars, which opens a whole range of alternatives that wouldn't otherwise be palatable to people who got in with 100 cent dollars. So it is a whole different ball game".

The new players had the ability to generate new ideas to the advantage of restructuring: "[i]t allows for a greater variety of exits and . . . vulture funds . . . tend to understand and be more accepting of creative exits". As another Canadian lawyer put it:

> "The vulture funds have a completely different ethos and much more amenable to doing a deal . . . Their presence saved a couple of really decent companies here because they don't have a lot of baggage with them. They actually create value by creating a market for debt that would otherwise just be turned into a sale on a receivership. I am a big fan of them".

Having begun to saturate the northern American market, vulture funds looked elsewhere for creative exits. Europe, or rather the UK, appeared on their horizon.[13] Intense competition between fields loomed as American market-making met with established English congeries of clubby bankers and insolvency specialists. One of the key advocates for the distressed market arranged for the Bank of England to participate in an INSOL International conference where he was organising a group to study how US professionals could become better involved in the European markets. He was attempting to persuade the banks that vulture funds

> "make the whole [restructuring] process much quicker and less expensive way to proceed and also you get very sophisticated investors who are able to spend the time to try fix the company and bankruptcy, even though they have a profit motive. If they can fix the company, make a profit and get out, that's fine. For the banking community and the trade creditor community it provides a market to sell out. They don't have to hang in for the uncertainty of bankruptcy over a two or three or five year period".

A classic example of a market-maker in UK distressed debt is Gary Klesch. Klesch built his reputation on trying to "engineer outlandish corporate breakups" (Economist, 1998: 104). His company has been involved in a number of high-profile restructurings, including Eurotunnel.[14] One lawyer pointed out that "vulture funds have a bad reputation in the UK, largely because of the Heron bonds fiasco with Klesch".

[13] "Interest in corporate debt trading is awakening in the UK and Europe. Bankers, lawyers, and investors involved in the distressed debt market are taking advantage of a slowdown in activity" (Warner, 1997: 25).

[14] "The secret of the Klesch approach to investing in bankruptcy is to look for obvious mistakes—often quite basic ones. Mr Klesch and his team noticed that one acquisition was losing money on contracts because it had given its customer big discounts, even though other suppliers' prices were higher. They also concluded that the company was paying too much for its premises, so they demanded three rent-free years from the landlord, and got them. After buying Myrys, Mr Klesch called the firm's 7 middle managers to a meeting; it was the first time they had all been in one room together. 'It's amazing the things companies won't do for themselves when they are in trouble', says Mr Klesch, who swears by the KISS principle: Keep it Simple, Stupid" (Economist, 1997: 104).

VULTURES AND THE LONDON APPROACH

The system of the London Approach worked because of the shared understandings and values of the participants, their *habitus* (Smith, 1996): they had been through the process of rescue and restructuring together and were essentially bound by a common cause. They attempted to reduce the uncertainty inherent in such risky ventures on the basis of imperfect information and future projections. However, some of the smaller lenders were tempted by short-term gains to sell their debt in the secondary distressed debt market. They may have had doubts about the trustworthiness of the main lenders, so that they formed a cabal against the majority debt holders. As long as unanimity obtained as the guiding principle, under the London Approach, the risk of defection into the distressed debt market remained. This kind of behaviour brought the flavour of the auction into what, on the whole, appeared a settled process (Smith, 1989; 1996).[15] The City of London Law Society's banking law sub-committee expressed great concern at the rise of 'disintermediation', where

> "Larger companies had access to new sources of capital from home and abroad; commercial paper, Euro-commercial paper, Eurobonds and US private placements, and even sources of capital which are not strictly debt such as convertible preferred shares, etc. Such instruments may contain negative pledges and other restrictions. As a result, holders of these instruments are given a "seat at the table". Unfortunately, there are serious problems where the holders of such instruments are numerous or difficult to identify (e.g., as in the case of bearer bonds) . . . In all of these situations, bondholders can take advantage of the requirement for unanimity and insist on being bought out at an advantageous price by threatening to block agreements. Holders often include individual investors who have a very different attitude and approach to institutional investors. Bondholders are quite understandably not influenced by the views of the Bank of England or pleas from banks to adhere to the London Approach. In addition, bondholders have not traditionally been invited to sit on steering committees, which in general have remained the exclusive preserve of bank creditors" (City of London Law Society, 1996: 1.16–1.18).

Unanimity has been emphasised before and a Bank of England official argued its justification thus:

> "One of the reasons for the London Approach is that in some countries where this type of situation arises, because of the different levels of exposure of the banks, they have different attitudes to a workout. The smaller banks are in a strong position, so there's a tendency to take them out. But that's a spiral because next time others will try it and eventually you're left with one bank holding the debt. We don't want that to happen".

[15] The Banking Law Sub-Committee of the City of London Law Society (1996) identified 5 potential 'threats' to the London Approach, namely, the advent of multi-banking, the globalisation of the financial services industry, the emergence of a secondary market in debt trading, the growth in disintermediation and the complexity of group structures.

Kent also worried that

> "if debt trading became commonplace, lenders would direct their energies to extricating themselves from a situation rather than working to help resolve it—in other words, it could undermine the spirit of the London Approach . . . some buyers of debt would be driven by short-term speculative motives and would not want 'insider' status; they might have no intention of subscribing new monies as part of a restructuring. Indeed, they may want to exploit their veto on the terms of a refinancing" (1994a: 7).

Attempts to prevent the distressed debt market from undermining the London Approach ranged from appealing to "the positive and constructive spirit" (Kent, 1994b: 6), to creating a code of conduct, to a ban on debt trading at "sensitive" times. The latter suggestion was firmly rejected by both British and foreign banks: they wanted the freedom to engage in this expanding market. They interpreted a code of conduct as too legalistic an approach, rather than respecting the spirit of the London Approach. Thus, the Bank of England and the other major players were left with the force of exhortation and the capacity of their insider status to deter potential spoilers. Smith (1996: paragraphs 18–21), head of the Bank of England's Business Finance Division, argued that:

> "Our fear is that such jockeying for position could be disruptive, deflecting attention from the underlying issues. Long-term relationships in the lending community can also be soured by such horse-trading and, in extreme cases, a fundamentally sound business could fail".

Yet Smith also believed that "trading corporate debt can introduce liquidity into banks' loan portfolios and be used as a tool for sound portfolio management".

Since success in the City depended on engaging with many of the same institutions time and time again, renegades would over time face increasing difficulties in achieving their objectives. As Kent tellingly recounted:

> "All parties involved must recognise that by cooperating they are collectively preserving and enhancing value for themselves. My experience suggests that the speed with which the terms of a workout are agreed is often hindered by a lack of trust, preventing openness and leading to suspicions that certain players have hidden agendas" (1994a: 7).

For senior debt traders the element of trust is important. It takes time, an English lawyer remarked:

> "Market makers need to spend a lot of time on the telephone before sending out 'confirms' to seller and buyer. Where the buyer is a stranger to the syndicate, there is a flurry of confidentiality undertakings".

In part, the lawyer's role is to reduce transaction costs by diminishing information asymmetries between buyer and seller and so enhancing value (Gilson,

1984).[16] Tradition and modernity here coexist and trust, therefore, has to be learned (Luhmann, 1979: 27), even though its acquisition is often based upon the irrational.

The condition of international business is predicated on the concept of trust. As Giddens bluntly put it:

> "Modernity is inherently prone to crisis, on many levels... Crises in this sense become a 'normal' part of life, but by definition they cannot be routinized" (1991: 184).

Globalisation, a key feature of modernity, encapsulates this sense of crisis by inflaming and amplifying uncertainty and, potentially, irrationality: the idea that business ignores borders does not negate the cultural and moral dangers that inhere in dealing with "strangers" and "outsiders". Another way of putting this has been framed by Luhmann who postulated that:

> "Where there is trust there are increased possibilities for experience and action, there is an increase in the complexity of the social system and also in the number of possibilities which can be reconciled with its structure, because trust constitutes a more effective form of complexity reduction" (1979: 8).

The state of the London Approach now is that ideas of trust are being re-evaluated and relearned. Before vulture funds there was stability by virtue of knowing those who sat around the table, namely, the banks. And since the process is largely external to law, barring the vulture funds from entry was impossible. They had to be incorporated (Bird, 1996).

The movements of financial and normative technology are therefore problematic.[17] Globalisation suggests the direction is towards instantaneity and convergence, but the picture presented here shows how time lags are built in by environmental and cultural conditions, which may well depend on the context of legal, social and economic institutions. The secondary debt market has developed piecemeal through market possibilities opened up by American bankruptcy lawyers and bankers and the eventual saturation of those markets. From this we could say the creation of "legal" knowledge is constrained by cultural values. The rise of the secondary debt market, and vulture funds, appears to follow this line of thinking. But even within the framework of legal institutions, their rise is spasmodic. Whereas lawyers in the United States were closely involved in the development of distressed debt markets, English lawyers have, on the whole, been notably absent, really only entering the fray at the point

[16] There has been a flurry of interest in trying to invest the distressed debt market with some stability. In 1996 the Loan Market Association was established to promote the standardisation of documentation and market practices (Burgess, 1997). And in 1997 the Financial Law Panel—largely a collation of the financial-legal great and good sponsored by the Corporation of London and the Bank of England—produced a discussion paper on 'Legal Uncertainties in the Secondary Debt Market'. The panel concentrated on the legal issues in transfer of bank debt, e.g., novation, legal assignment and equitable assignment, and noted that traders could be caught by insider trading laws.

[17] Cf. Flood and Skordaki (1997) on the development of the Maxwell *Protocol* to cope with the regulation of conflicts between US Chapter 11 and UK administration.

where the markets have needed tidying up. Institutional factors are heavily implicated in interpreting the movement of legal and normative transplants, as well as the values and roles of the players involved in the construction of markets. Globalisation has brought about the acceleration of distribution and reconstruction of artefacts across borders. We could argue that hostile or indifferent legal systems (as defined as those who constitute them) may be able to repel these incursions.[18] Strong closed networks of actors in the system may form an impermeable (or slowly permeable) barrier to foreign imports. Open systems, which arguably the UK is, where networks are not fully closed are incapable of preventing the reception of foreign irritants (cf. Coleman, 1988). The manner of reception varies according to the host legal system's values: the alternate may occupy a vacant space or it may mutate to become something distinctly less foreign and more native. Indeed irritant is possibly too weak a term: *virus* may express the impact of imports into more open, receptive legal systems, having the ability to reproduce rapidly and change the character of the host. As Teubner states, "legal irritants force the specific *epistème* of domestic law to a reconstruction in the network of its distinctions" (1998: 32).[19]

But transplants or irritants do not wait for orderly reconstruction; they move on. Already vulture funds have established themselves throughout the remainder of Europe and with the Asian recession, the vultures have flown east:

> "As a growing number of Korean corporations go bankrupt, so called vulture funds are looking for investment opportunities in Korea. For the most part, they are now merely investigating the market situation with a focus on target companies . . . The [Korean] Financial Supervisory Commission intends to allow the establishment of vulture capital funds in order to facilitate the sale of insolvent companies or their real estate" (Business-Korea, 1998: 83).

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[18] I am very grateful for the stimulation of Dr John Paterson's ideas at this point.

[19] It is worth noting here that the Bank of England's bank supervisory powers have been transferred to a new super-regulator, the Financial Services Authority (FSA), which could also reduce the Bank's persuasive powers in the London Approach (Houghton and Wrighton, 1998). This is typical of the regulatory culture emerging in the UK, e.g., the Takeover Panel is also in conflict with the FSA.

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