International Insolvency & Restructuring Report 2021/22

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Digest of Case Law on the UNCITRAL Model Law on Cross-Border Insolvency

The secretariat of the United Nations Commission on International Trade Law(UNCITRAL) is pleased to announce the publication of the first edition of the Digest of Case Law on the UNCITRAL Model Law on Cross-Border Insolvency.

The main objective of the Digest is to provide wider and more readily access to judicial cases interpreting the Model Law and to draw attention to emerging trends in the interpretation of that text. The Digest is expected to promote uniformity in the application of the Model Law by encouraging judges to consider how the Model Law has been applied by courts in jurisdictions where it has been enacted.

The Digest in English may be accessed from:

https://uncitral.un.org/en/texts/insolvency or https://uncitral.un.org/en/case_law/di-gests

(Arabic, Chinese, French, Russian and Spanish versions will be posted in the respective language versions of those web pages soon).

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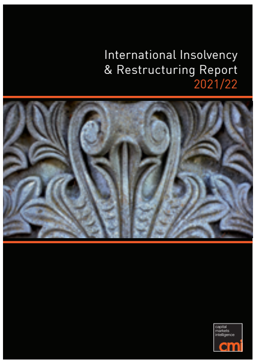
The publication of two other UNCITRAL publications expected to be of use by legislators, judges and practitioners in the insolvency field is upcoming: an updated edition of the Judicial Perspective (found in English at https://uncitral.un.org/en/texts/insolvency/explanatory-texts/cross-border_insolvency/judicial_perspective); and a Guidance Note on Enacting Two or More of the UNCITRAL Model Laws on Insolvency (in addition to the UNCITRAL Model Law on Cross-Border Insolvency, those laws are the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments (2018) and the UNCITRAL Model Law on Enterprise Group Insolvency (2019) , all found at https://uncitral.un.org/en/texts/insolvency).



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Foreword

by Debra Grassgreen, President, International Insolvency Institute, and Partner at Pachulski, Stang, Ziehl & Jones LLP

The global pandemic has changed the restructuring and insolvency industry around the world in ways that none of us would have ever predicted a year ago. Courts, advocates and academics around the world quickly adapted to a new way of work and rose to meet the challenges of the times. The work of academics and practitioners in our field has identified numerous ways that insolvency-related laws can be made more flexible to help struggling companies survive the disruption to their businesses, and many governments around the world enacting legislation to assist these companies, at least temporarily, to ease the impact of this crisis.

The International Insolvency Institute has harnessed the resources of its members in many different ways. Webinars on different topics including challenges for the airline industry, retail, real estate or reaction to the broader aspects of crisis, have reached a broad band of participants from around the world. We are also hosting open forums in each of our regions so that our members can share their respective experiences. Working together also brought us to our Thought Leadership Project where members joined together to prepare a suggestion for state-run restructuring agencies to mitigate the crisis.

With the final steps of Brexit, we joined forces with the American College of Bankruptcy and the American Bankruptcy Institute to run three webinars that dealt with the impact of Brexit from a European, North American and Asian perspective.

Our cooperation with INSOL International on the Ian Fletcher International Insolvency Law Moot Court Competition was also brought to the virtual world this spring. To consider the bright side of the new way of work, we have had the highest number ever participating in the competition. Nevertheless, there is no substitute for the exchange of ideas that take place in person and we look forward to the time when we can gather together.

Until then, I share the best wishes of the Institute with all of your readers.

The current work by UNCITRAL in the area of insolvency law

by Samira Musayeva, UNCITRAL secretariat, Office of Legal Affairs, United Nations[1]

The United Nations Commission on International Trade Law (UNCITRAL) was established by the General Assembly in 1966 as the core legal body within the United Nations system in the field of international trade law. Considering that divergencies arising from laws of different States in matters relating to international trade constitute an obstacle to the development of world trade, the Commission was entrusted with the mandate to further the progressive harmonisation, modernisation and unification of the law of international trade. Since the early 1990s, the Commission has been working in the area of insolvency law, authoring texts that have been used worldwide as a benchmark for insolvency law reform. Currently, UNCITRAL Working Group V (Insolvency Law) is preparing recommendations to States on a simplified insolvency regime.

Overview of UNCITRAL texts in the area of insolvency law

Insolvency law appeared on the work programme of UNCITRAL in the early 1990s. Since then UNCITRAL has adopted various texts, addressing both domestic and cross-border insolvency aspects.

The UNCITRAL Model Law on Cross-Border Insolvency with its Guide to Enactment (1997) (MLCBI) became the first text adopted by UNCITRAL in that area. It was prepared in response to the increasing incidence of insolvencies where, as a result of the continuing global expansion of trade and investment, an insolvent debtor (an enterprise or individual) had assets in more than one State.

These cases call for cross-border cooperation and coordination in the supervision and administration of the debtor's assets and affairs to reduce the risk of concealment or dissipation of assets and improve the chances of rescuing viable business or efficiently liquidating non-viable businesses. National insolvency laws, by and large, have been ill-equipped to keep pace with that trend.

MLCBI was prepared to assist States with putting in place a legislative framework for effective coordination and cooperation of cross-border insolvency cases involving a single debtor with assets in more than one State. While respecting national procedural and judicial systems, the text minimises formality, time and costs for obtaining cross-border recognition of foreign insolvency proceedings and ensures the availability of appropriate relief and the protection of creditors in that context. The steadily increasing number of jurisdictions enacting their cross-border legislation on the basis of MLCBI proves that the text remains relevant.[2]

Experience with the use of MLCBI led to the preparation of several practical tools to assist judges with the use of that text. In 2009, UNCITRAL adopted the Practice Guide on Cross-Border Insolvency Cooperation, which expanded on article 27 of MLCBI, discussing various ways in which cooperation in cross-border insolvency cases can be achieved and compiling experience with the use of cross-border insolvency agreements.

In 2011, "UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective" was adopted, which was subsequently updated in 2013. It identifies issues that may arise on an application for recognition or cooperation under MLCBI and discusses approaches that courts have taken in countries that enacted MLCBI.

In order to promote the harmonised interpretation of MLCBI, in the light of its international origin (see article 8 of MLCBI), the UNCITRAL secretariat collects judgments involving interpretation and application of MLCBI. Abstracts of 135 judgments have so far been published in the Case Law on UNCITRAL Texts (CLOUT) system in the six official languages of the United Nations (Arabic, Chinese, English, French, Russian and Spanish).[3] They have been systematised in a digest of case law on MLCBI expected to be published soon.

Some of that case law has raised questions relating to the interpretation of certain provisions of MLCBI, in particular the meaning of "centre of main interests" (COMI), the scope of the public policy exception in MLCBI and application of MLCBI's relief provisions. To provide additional information and clarify those issues, the 1997 Guide to Enactment accompanying MLCBI was revised, and on the basis of a revised text, without changing the substance of MLCBI itself, the Commission adopted in 2013 the Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency.

Experience with the use of MLCBI led to preparation of two subsequent UNCITRAL model laws in the area of insolvency law: the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgements (2018) (MLIJ); and the UNCITRAL Model Law on Enterprise Group Insolvency (2019) (MLEGI). Both are accompanied by their respective guides to enactment.

The work on MLIJ had its origin, in part, in certain judicial decisions related to MLCBI[4] that led to uncertainty concerning the ability of some courts, in the context of recognition proceedings under MLCBI, to recognise and enforce judgments given in the course of foreign insolvency proceedings, such as judgments issued in avoidance proceedings. Such uncertainty arose on the basis that neither article 7 nor 21 of MLCBI explicitly provides the necessary authority.

By adopting MLIJ, UNCITRAL resolved that uncertainty[5] and also addressed the lack of an international instrument covering the recognition and enforcement of insolvency-related judgments.[6] MLIJ is designed to allow any foreign insolvency-related judgment to be enforced, including a judgment relating to the recovery of assets of the debtor located in a jurisdiction whose insolvency proceedings would be neither a main nor a non-main proceeding under MLCBI.

MLEGI complements MLCBI by addressing insolvency proceedings relating to multiple debtors that are members of the same enterprise group.[7] MLEGI recognises that key to facilitating the conduct of such proceedings is their centralisation.

To that end, MLEGI envisages: (a) the development of a group insolvency solution for the whole or part of an enterprise group through a planning proceeding commenced at the location where at least one group member has COMI; (b) voluntary participation of multiple group members in a planning proceeding for the purposes of coordinating a group insolvency solution for relevant enterprise group members; (c) appointment of a group representative to coordinate the development of a group insolvency solution in a planning proceeding; (d) cross-border recognition of a planning proceeding as well as measures to support the recognition and formulation of a group insolvency solution; and (e) measures designed to minimise the commencement of insolvency proceedings relating to enterprise group members participating in a planning proceeding by according the appropriate treatment to claims of creditors of those enterprise group members in the main proceeding.

In addition to these core provisions, MLEGI provides for a set of supplemental provisions to States that may wish to adopt a more extensive approach with respect to treatment of the claims of foreign creditors in enterprise group insolvency.

The UNCITRAL work in the area of insolvency law is not limited to aspects of cross-border insolvency cooperation and coordination. Since early 2000s, UNCITRAL has been working on substantive insolvency law issues, addressing in several parts of its Legislative Guide on Insolvency Law such issues as key objectives, structure and core provisions of an effective and efficient insolvency law (parts one and two of the Guide adopted in 2004), treatment of enterprise groups in insolvency (part three adopted in 2010 and expanded by MLEGI in 2019) and directors' obligations in the period approaching insolvency (part four adopted in 2013 and expanded by a text on obligations of directors of enterprise group companies in 2019).

The UNCITRAL secretariat assists States with the use of UNCITRAL texts, in particular by providing technical assistance with drafting legislation based on those texts and judicial training. Recognising that the interaction of three UNCITRAL model laws in the area of insolvency law may give rise to questions, the UNCITRAL secretariat is currently preparing explanatory materials to States wishing to enact the model laws simultaneously or sequentially.[8]

Most recent developments: Work by UNCITRAL Working Group V (Insolvency Law) on a simplified insolvency regime

UNCITRAL Working Group V (Insolvency Law) is working on a simplified insolvency regime, developing mechanisms and solutions to address the insolvency of individual entrepreneurs and micro and small businesses of an essentially individual or family nature with intermingled business and personal debts (collectively referred to as MSEs).

The end-product is expected to contribute to UNCITRAL texts aimed at reducing the legal obstacles faced by micro, small and medium-sized enterprises (MSMEs) throughout their life cycle. The work proceeds in close cooperation and coordination with UNCITRAL Working Group I (MSMEs) that is taking a lead in addressing various legal obstacles faced by MSMEs. It is also coordinated with the World Bank Group that is updating the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes to deal with specifics of the MSEs insolvency.

The work on the topic commenced in UNCITRAL in 2013, with a preliminary examination of issues relevant to the MSME insolvency.[9] In 2016, the Commission gave the Working Group mandate to develop appropriate mechanisms and solutions, focusing on both natural and legal persons engaged in commercial activity, to resolve the insolvency of MSMEs.[10] Having completed its work on enterprise group insolvency, the Working Group commenced detailed deliberations of features of such possible mechanisms and solutions at its 55th session in May 2019 and continued discussing them at its 56th and 57th sessions in December 2019 and 2020, respectively.[11]

From the outset, the Working Group decided to focus on the needs of MSEs in insolvency, recognising that issues arising from insolvency of medium-sized enterprises were already adequately covered in the Guide. The Guide was used as the starting point. Acknowledging that the Guide was prepared mostly for larger enterprises that face complex issues in insolvency expected to be resolved with the involvement of interested creditors, the factors that are absent in MSE insolvency, the Working Group proceeded with adjustments of procedures provided in the Guide to MSEs' characteristics and specific needs in insolvency.

The goal was to simplify standard business insolvency proceedings and make them more expeditious, flexible and cost-efficient.

As a result, unlike the Guide, the current draft under consideration by the Working Group[12] does not envisage an active role for the insolvency representative in proceedings, does not provide for creation of a creditor committee and disclosure statements and does not require a debtor eligible for a simplified insolvency regime to prove insolvency, allowing it to apply for simplified insolvency proceedings at an early stage of financial distress. The competent authority, defined as an administrative or judicial authority, assumes the main responsibility for conduct and oversight of simplified insolvency proceedings. It may be assisted by an independent professional when and as appropriate.

The Working Group has introduced new mechanisms and concepts, not found in the Guide, such as deemed approval and liquidation schedule. The mechanism of deemed approval aims to address one of the main issues in the MSE insolvency - creditor disengagement. Without eliminating a requisite majority threshold for approval by creditors of matters requiring their approval under domestic law, it removes the need to organise a formal voting and allows counting silence as approval. Creditor rights to raise objections or opposition and to seek review of the competent authority's decisions are not erased by that mechanism. Creditor protection is ensured by individual notification of creditors about matters requiring their approval, clearly explaining consequences of their silence.

A liquidation schedule is introduced in the text as a transparency and efficiency safeguard, but also to ensure that the liquidation process is properly organised and all steps expected to be taken in liquidation are made known to parties in interest from the outset of the liquidation proceeding to prevent possible problems and delays at a later stage.

Although many MSE insolvency cases end up in liquidation, the text, like the Guide, provides for both liquidation and reorganisation. Reduced formalities and shorter deadlines are envisaged for both. In addition, debtor-in-possession is introduced as the default in simplified reorganisation proceedings. Provisions on liquidation envisage fast procedures for liquidating MSEs with no assets and no proceeds for distribution to creditors.

Some mechanisms and procedures, although taken from the Guide unchanged, may raise distinct issues in a simplified insolvency context, for example avoidance proceedings. Notwithstanding those distinct issues, novelties and deviations from standard business insolvency procedures, a simplified insolvency regime is still part of a general insolvency law framework of a State and is subject to the same principles and objectives.

At its next session in May 2021, the Working Group is expected to continue consideration of some issues deferred from its December 2020 session including new provisions on protection of employees.

It is also expected to finalise draft recommendations that it did not have time to consider in December, on: (a) discharge; (b) treatment of personal guarantees and procedural consolidation and coordination of linked proceedings (e.g. business, consumer and personal insolvency proceedings of the same debtor or insolvency proceedings against the debtor and insolvency or enforcement proceedings against its guarantor); (c) conversion of proceedings; (d) appropriate safeguards and sanctions; and (e) MSE insolvency prevention measures, including obligations of persons exercising control over MSEs in the period of financial distress of that MSE, early warning signals, informal debt restructuring negotiations and pre-commencement business rescue finance.

At its May 2021 session, the Working Group is also to agree on how to name the text. Different options were considered in the past in the context of the discussion of whether the text should become an additional part to the Guide (i.e. part five) or its supplement. The text has been drafted so far as a stand-alone text. Its title would need to convey the final status of the text in relation to the Guide, the nature of the text (legislative guide or guidance) and its scope (e.g. whether it is on insolvency law for MSEs or broader on a simplified insolvency regime).

The Working Group is also to consider desirability of annexing to the text a table of concordance that would identify recommendations of the Guide that were not repeated in the text but remain applicable in the simplified insolvency context and those that were found inapplicable or necessary to be deviated from.

Despite COVID-19-caused disruptions,[13] the

Working Group has made substantial progress during its three sessions working on the topic. It realises the urgency of finalising the text as soon as possible in the light of the relevance of the topic to COVID-19 response and recovery measures. This was acknowledged by UNCITRAL at its 53rd session.[14] The upcoming May 2021 session, which like the December 2020 session will be held online, is expected to be intense, testing again the Working Group's ability to tackle insolvency issues professionally and thoroughly while preserving inclusiveness and the spirit of compromise and consensus-building even in unprecedented conditions created by COVID-19.

Notes:

1. The views expressed in this article are those of the author and do not necessarily reflect those of the United Nations.
2. A list of MLCBI enacting jurisdictions is available at uncitral.un.org. As of March 19, 2021, the UNCITRAL secretariat ascertained that 53 jurisdictions enacted MLCBI, Brazil and Myanmar being among the most recent enacting jurisdictions.
3. As of March 19, 2021. See http://www.uncitral.org/clout/search.jspx?f=en%23cloutDocument.textTypes.textType_s1%3aModel%5c+Law%5c+on%5c+Cross%5c-Border%5c+Insolvency%5c+%5c(1997%5c)
4. For example, *Rubin & Anor. v. Eurofinance SA*, [2012] UKSC 46 (on appeal from [2010] EWCA Civ 895 and [2011] EWCA Civ 971); CLOUT case No. 1270.
5. Article X of MLIJ, addressed to States that have enacted legislation based on MLCBI, clarifies that, notwithstanding any prior interpretation to the contrary, the relief available under article 21 of MLCBI includes recognition and enforcement of a judgement.
6. Existing international conventions that deal with recognition and enforcement of foreign judgments exclude judgments relating to insolvency (see e.g. the Convention of June 30, 2005 on Choice of Court Agreements (article 2.2. (e)) and the Convention of July 2, 2019 on the Recognition and Enforcement of Foreign Judgments in Civil or Commercial Matters (article 2.1 (e)).
7. There is much similarity between the two model laws. Consistent with MLCBI's fundamental principles, MLEGI preserves the jurisdiction of the State in which each group member has its COMI and its ability to commence insolvency proceedings in respect of a group member as and when such proceedings might be required and protects the interests and expectations of creditors and other interested persons. Several provisions of MLEGI replicate those of MLCBI (e.g. on public policy exception, relief, recognition and cooperation and presumption of authenticity of documents).
8. *Official Records of the General Assembly, Seventy-third Session, Supplement No. 17* (A/74/17), para. 222 (b).
9. Ibid., *Sixty-eighth Session, Supplement No. 17* (A/68/17), para. 326.
10. Ibid., *Seventy-first Session, Supplement No. 17* (A/71/17), para. 246.
11. For the reports of those sessions, see A/CN.9/972, A/CN.9/1006 and A/CN.9/1046, respectively, available in the six languages of the United Nations at the UNCITRAL website on the web page of the Working Group (for the English version of the web page, see https://uncitral.un.org/en/working_groups/5/insolvency_law).
12. The most recent draft is contained in document A/CN.9/WG.V/WP.172 and Add.1 that will be considered by the Working Group at its 58th session in May 2021.
13. The planned 57th session of the Working Group in May 2020 did not take place due to the measures put by States and the United Nations in response to the Coronavirus disease (COVID-19) pandemic. It took place in December 2020 with most delegations and observers participating online. Between its 56th and 57th sessions, in December 2019 and December 2020, the Working Group held

informal consultations online in May and September 2020 with the results of those consultations reflected in document A/CN.9/WG.V/WP.170/Rev.1 and considered by the Working Group at its session in December 2020.

[14] *Official Records of the General Assembly, Seventy-fifth Session, Supplement No. 17* (A/75/17), para. 45.

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Sovereign debt restructurings in 2020: A year in review

by Tom MacWright and Dimitrios Lyratzakis, White & Case LLP[1]

Economic contraction and rising fiscal expenditures in 2020 posed significant liquidity and debt sustainability challenges for many sovereigns around the world. Many low-income countries were able to obtain significant debt relief as a result of the G-20's Debt Service Suspension Initiative, while other emerging economies had to bilaterally negotiate debt restructuring solutions with their official and private creditors. Notably, *Ecuador* and *Argentina* successfully restructured their external debts, while *Zambia*, *Suriname* and *Lebanon* announced their intention to seek comprehensive debt restructurings but have yet to reach agreement with their respective creditors.

Global liquidity challenges and debt sustainability pressures

For many emerging and developing countries, the global economic slowdown and increased expenditures caused by the COVID-19 pandemic, higher re-financing costs, as well as falling commodity prices, exacerbated existing economic imbalances and vulnerabilities over the course of 2020. For many sovereigns, this led to a decline in debt service capacity, a decrease in foreign exchange reserves and an increase in debt-to-GDP ratios to potentially unsustainable levels.

In the absence of a sovereign bankruptcy regime, obtaining debt relief has been a matter of ad hoc negotiation between a sovereign and its official and/or private creditors, with the expectation that a consensual solution will be found to the sovereign's liquidity or solvency challenges.[2] During 2020, low-income countries benefited from a systemic effort, led by the IMF, the World Bank, and the G-20, to alleviate some of their mounting debt burden through a debt suspension initiative.

In this article, we provide an overview of that systemic effort to help distressed sovereigns in need of debt relief – the G-20 Debt Service Suspension Initiative (DSSI) – and then discuss how certain middle-income and emerging economies who were not eligible for relief under the DSSI, or were faced with comprehensive debt issues outside the limited scope of the DSSI, commenced restructuring processes to address their financial constraints.

Systemic approach: the DSSI

After the IMF and the World Bank called on the international community to take action in response to the COVID-19 pandemic, the G-20 nations announced a debt service suspension initiative (DSSI) in April 2020. Relief under the DSSI is only available to countries that are eligible to receive assistance from the World Bank's International Development Association and to all nations defined as "least developed countries" by the United Nations.

The DSSI allows a net present value-neutral, time-bound suspension[3] of principal and interest payments for eligible countries that formally request debt relief from their official bilateral creditors. The initiative intends to ease the short-term financing constraints for these countries and redirect resources towards mitigating the human and economic impact of the COVID-19 crisis.

During 2020, 44 eligible countries requested debt relief under the initiative, benefitting from an estimated US$5bn of debt service relief from participating G-20 nations.[4] However, while the DSSI encouraged private creditors to participate in the debt relief initiative on comparable terms as official creditors, private creditor participation was not required. With no incentive to participate in the debt relief initiative, and no mechanism to enforce such participation, private creditors for the most part chose not to participate.[5]

As the benefits of DSSI do not extend to middle-income or emerging economies, and in any event may be an insufficient solution to a country's debt sustainability concerns, various sovereigns in 2020 had to rely on bilateral negotiations with their private and official creditors in order to obtain debt relief.

Completed restructurings: Ecuador and Argentina

Ecuador and Argentina were the first sovereigns in 2020 to successfully negotiate the terms of a restructuring of their external debt with their bondholders.[6] The two countries entered restructuring negotiations with their bondholders from different economic positions, and took arguably different approaches to the respective negotiations.

Ecuador

Ecuador, already facing severe liquidity pressures as a result of depressed oil prices, was hit particularly hard by the COVID-19 pandemic. After consultation with its bondholders, Ecuador launched an initial consent solicitation in April 2020 to defer interest payments for four months to allow it time to negotiate with its bondholders the terms of a comprehensive debt restructuring, as well as request an IMF-supported program.

Ecuador engaged in constructive discussions with its largest bondholder group that resulted in an agreement in principle in July 2020 on the terms of a debt restructuring. To address Ecuador's liquidity and sustainability concerns, the parties agreed to a small principal reduction, interest rate reductions, and maturity extension on US$17.4bn of external bonded debt.[7]

The restructuring terms, which were also conditional on Ecuador obtaining staff-level agreement on an IMF-supported program[8], will provide debt service relief in excess of US$15bn by 2030. The terms of the exchange offer and consent solicitation – which would amend and exchange 10 series of bonds maturing between 2025 and 2030 into 3 new series maturing in 2030, 2035, and 2040 – were accepted by 98% of bondholders,[9] after operation of the bonds' collective action clauses (CACs).[10]

Argentina

Argentina, on the other hand, faced a steep currency depreciation in late 2019 as a result of political and economic uncertainty following the election of Alberto Fernandez, who inherited a US$65bn external debt stock (most of it incurred since Argentina's return to the international capital markets in 2016), that became increasingly difficult to service.

In contrast to Ecuador's constructive restructuring approach, Argentina engaged in prolonged and oftentimes acrimonious negotiations with its bondholders. In particular, Argentina launched a unilateral exchange offer in April 2020 without first reaching agreement with a critical mass of its bondholders and without anchoring the offer to a credible and agreed IMF program.

Additionally, while both Ecuador and Argentina structured their transactions to utilise the bonds' ICMA CACs[11] (which premise the consummation of a transaction on the support of a bondholder supermajority), Argentina structured its initial offer so as to retain the discretion to proceed with a partial restructuring – where a majority of bonds within the perimeter of the offer decline to participate.[12]

Argentina's tactics were criticised by bondholders and market participants, who perceived Argentina as violating the spirit of the ICMA CACs in trying to consummate a restructuring that was overwhelmingly rejected by the market.

Following months of negotiations and several failed restructuring offers, Argentina reached agreement with its largest bondholder groups[13] in August 2020, for the comprehensive treatment of its external debt.[14] The agreed restructuring terms contemplated the exchange of Argentina's existing 25 bond series for 12 series of new bonds, with interest reductions and maturity extensions that would provide US$37bn of debt relief over a period of nine years.

In addition to negotiating financial terms, Argentina's largest bondholders required, as a condition to the restructuring, certain contractual changes in the documentation of the new bonds with respect to the ICMA CACs to rectify certain deficiencies that permitted Argentina's controversial behaviour.[15]

Restructurings in progress: Zambia, Suriname and Lebanon

Zambia

Zambia's debt to GDP exceeded 110% in the end of 2020,[16] primarily driven by increased bilateral borrowing to finance infrastructure projects. In recent years, falling copper prices, which is Zambia's main export and a key growth component, have significantly reduced the country's revenues and foreign exchange reserves. This has made it challenging for the country to manage its US$12bn of outstanding external debt, which includes debt owed to multilateral and plurilateral institutions, such as the World Bank and the African Development Bank, debt owed to bilateral official creditors, such as China, debt owed to commercial banks, and debt owed to international bondholders.

As a DSSI-eligible country, Zambia requested relief from its bilateral creditors in September 2020 and became the first country to concurrently ask comparable relief from its private creditors. Zambia asked its bondholders to agree to a temporary payment suspension in September 2020, and in October announced it would suspend payments of all its external debt obligations owed to official and commercial creditors (with certain narrow exceptions for priority projects). Zambia's bondholders, however, rejected the payment deferral proposal, and in November 2020 Zambia became the first African nation in the COVID-19 pandemic-era to default on its external debt.

Zambia has requested a formal IMF program under the Extended Credit Facility window in order to stabilise its economy severely hit by the COVID-19 pandemic, which, as of the date of this writing, is being negotiated and will ultimately anchor Zambia's restructuring negotiations with its private and official creditors under the G-20 Common Framework.

Suriname

Suriname elected a new government in May 2020, which inherited a deep economic crisis, caused by chronic fiscal imbalances as well as global commodity price shocks. Suriname's vulnerable fiscal and external positions deteriorated further as a result of the COVID-19 pandemic.

Against the backdrop of a sharp devaluation of the local currency, Suriname's public debt became unsustainable and its foreign currency reserves dwindled. While not eligible for DSSI assistance, Suriname requested its official and private creditors to agree to a temporary period of payment deferral, in order to provide time for the authorities to request and negotiate an IMF program and agree an appropriate debt restructuring solution with Suriname's external creditors.

After engaging with the representative committee of bondholders, Suriname launched consent solicitations with respect to two series of outstanding Eurobonds (totalling US$675m) requesting the deferral of interest payments falling due between October 26, 2020 and April 26, 2021. Bondholders accepted the terms and later agreed to an extension of the payment deferral period through at least May 2021. On April 29, 2021, the IMF announced it reached staff-level agreement with Suriname, the parameters of which will underpin Suriname's negotiations with its external creditors.[17]

Lebanon

Lebanon defaulted on its external debt for the first in its history in March 2020, following years of economic mismanagement and over-borrowing, which spiraled its debt in excess of 150% of GDP and cut its access to international capital markets. Following such default, Lebanon's bondholders have organised in two groups, one comprised of international bondholders, and one comprised of Lebanese banks with exposure to Lebanon's Eurobonds. Despite creditor efforts to commence negotiations with the Lebanese authorities, Lebanon has yet to take a credible stance towards resolving its ongoing default and debt payment issues.

Lebanon is in a continued state of political paralysis (having been unable to form a government since the previous cabinet resigned following the Beirut port explosion in August 2020), which has left the nation unable to secure multilateral or international donor support and has stalled restructuring discussions.

Any views expressed in this publication are strictly those of the authors and should not be attributed in any way to White & Case LLP.

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This article is prepared for the general information of interested persons. It is not, and does not attempt to be, comprehensive in nature. Due to the general nature of its content, it should not be regarded as legal advice.

Notes:

1 The authors have been part of the teams that advised or are advising the major bondholder groups in Argentina's, Ecuador's and Lebanon's restructurings, as well as the Republics of Suriname and Zambia in their respective restructurings. Any views expressed herein are strictly those of the authors and should not be attributed in any way to White & Case LLP. This article is prepared for the general information of interested persons. It is not, and does not attempt to be, comprehensive in nature. Due to the general nature of its content, it should not be regarded as legal advice.

2 Restructuring of official bilateral debt has historically been achieved under the auspices of the Paris Club, which is a group of twenty-two advanced and emerging economies who operate under agreed common principles to provide coordinated relief to distressed sovereign debtors.

3 The original period of suspension was originally set to expire in December 2020 but has now been extended to December 31, 2021.

4 See International Monetary Fund, Current Sovereign Debt Challenges and Priorities in the Period Ahead, November 16, 2020 (available at https://www.imf.org/en/News/Articles/2020/11/16/vc111620-current-sovereign-debt-challenges-and-priorities-in-the-period-ahead). China's participation in the DSSI has been crucial, as almost a third of African sovereigns' external debt service over 2020-24 is owed to China or Chinese state-owned lenders. For example, *Angola*, Africa's second largest oil exporter, owes more than US$15bn of debts to a number of Chinese bilateral and state-owned commercial entities. Over the course of 2020, Angola saw its economy hit by oil price fluctuations and further deteriorate as a result of COVID-19. Pursuant to the DSSI and agreements with two Chinese state-owned commercial entities, *Angola* successfully achieved agreements for cumulative cash flow relief of US$6.9bn in 2020 through 2023. See International Monetary Fund, Angola: Fourth Review Under the Extended Arrangement Under the Extended Fund Facility, January 19, 2021 (available at https://www.imf.org/en/Publications/CR/Issues/2021/01/19/Angola-Fourth-Review-Under-the-Extended-Arrangement-Under-the-Extended-Fund-Facility-and-50024).

5 In February 2021, the G-20 announced the "G20 Common Framework for Debt Treatments beyond the DSSI" to expand the scope of debt relief available under the DSSI. Importantly, under the Common Framework, DSSI-eligible countries can request deeper debt relief from their official creditors to address solvency concerns, and are required to seek comparable relief from their private creditors. To date, no sovereign has completed a debt restructuring pursuant to the Common Framework, although *Chad*, *Ethiopia*, and *Zambia* have applied for relief under the framework.

6 On a smaller scale, *Belize* also successfully negotiated certain limited amendments to one series of its foreign currency bonds, with bondholders agreeing to capitalize quarterly interest payments between August 20, 2020 and February 20, 2021.

7 See Republic of Ecuador Press Release, *The Republic of Ecuador Reaches an Agreement in Principle With a Group of Substantial International Investors of Its International Bonds*, PRNewswire, July 6, 2020 (available at https://www.prnewswire.com/news-releases/the-republic-of-ecuador-reaches-an-agreement-in-principle-with-a-group-of-substantial-international-investors-of-its-international-bonds-301088475.html).

8 Ecuador reached staff-level agreement with the IMF on August 27, 2020, pursuant to which Ecuador would receive US$6.5bn from the IMF under an Extended Fund Facility program to help support domestic economic reforms and stabilisation programmes. The IMF Executive Board approved the 27-month Extended Fund Facility in September 2020. *See* International Monetary Fund Press Release, available at https://www.imf.org/en/News/Articles/2020/10/01/pr20302-ecuador-imf-executive-board-approves-27-month-extended-fund-facility.

9 Following the launch of Ecuador's exchange offer and consent solicitation, a small group of bondholders filed a motion in the Southern District of New York for a temporary restraining order to block the settlement of the transaction, claiming that Ecuador had committed securities fraud by making certain statements in its press releases related to the restructuring offer. *See* Compl. (July 29, 2020), *Contrarian*, ECF No. 1; Pls.' Mem. of Law in Supp. of Proposed Order to Show Cause at 4-9 (July 29, 2020), *Contrarian*, ECF No. 27. The Court denied the motion and the parties subsequently reached agreement pursuant to which bondholders would dismiss the lawsuit.

10 Collective action clauses allow a bondholder supermajority that approves the amendment of certain bond terms to bind a remaining minority, therefore allowing a sovereign to consummate a restructuring transaction that is supported by a supermajority of its bondholders over the objection of a bondholder minority. Most series of Ecuador's and Argentina's bonds included the latest iteration of CACs endorsed by the International Capital Markets Association in 2014 (hereinafter the "ICMA CACs").

11 Specifically, Ecuador and Argentina utilised the "two-limb" ICMA CAC, which provides that the issuer can amend the payment terms of multiple series of bonds if it receives the consent of holders of more than 66-2/3% in principal amount across series and more than 50% within each series.

12 For a full discussion of the legal structure of the transaction and the application of the CACs, see Ian Clark & Dimitrios Lyratzakis, Towards a More Robust Sovereign Debt Restructuring Architecture: Innovations from Ecuador and Argentina, *Capital Markets Law Journal*, Volume 16, Issue 1, January 2021, Pages 31–44.

13 Argentina's bondholders were represented by three bondholder groups. The principal groups in terms of size were the Ad Hoc Argentine Bondholder Group, comprised

of some of the world's largest institutional investors who held more than 30% of Argentina's bonds across the curve and across indentures, and the Exchange Bondholder Group, which primarily held bonds issued pursuant to Argentina's prior restructuring in 2005 and 2010.

[14] See Republic of Argentina Press Release, *Argentina and three creditor groups reach a deal on debt restructuring*, Ministry of Economy, August 4, 2020 (available at https://www.economia.gob.ar/en/argentina-and-three-creditor-groups-reach-a-deal-on-debt-restructuring).

[15] For a full discussion of the negotiated contractual refinements and enhancements, see Clark & Lyratzakis, supra n. 12.

[16] See International Monetary Fund Country Data, Zambia, (available at https://www.imf.org/en/Countries/ZMB) (accessed April 27, 2021).

[17] See International Monetary Fund, Press Release No. 21/116, *IMF Reaches Staff-Level Agreement with the Republic of Suriname on a $690 million Three-Year Program Under the Extended Fund Facility*, April 29, 2021 (available at https://www.imf.org/en/News/Articles/2021/04/29/pr21116-suriname-imf-reaches-staff-level-agreement-with-suriname-on-3-year-program-under-eff).

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Delivering value in a virtual world

by Julie Hertzberg, President, INSOL International

I'm delighted to have been invited to contribute to this publication once again. Now coming to the end of my Presidency with INSOL International, I find myself reflecting on what an unusual term it has been. I don't think anyone could have predicted the situation we have been faced with, affecting the entire globe, and with no solid date for a conclusion to international travel restrictions or the impact this pandemic will have. What has been heartening to see, is how we have all adapted in both our professional and personal lives. Our community is continuing to rise to the challenges presented through adapting working practices and finding solutions to issues we never imagined we would face.

INSOL, its Member Associations, other professional bodies and our own firms have continued to ensure that information is available to a community thirsty for knowledge, opinions, and insight into topical matters. The quality of this information has been exceptionally high, and INSOL specifically has strived to bring members the support needed in this climate through papers, publications and webinars.

Facilitating the much-needed peer-to-peer sharing of knowledge and relationship building that is provided through the usual programme of international events has been an area of particular focus at INSOL International. It is with pride that the first Virtual Conference was delivered in September 2020 in addition to a broad range of virtual seminars, webinars and meetings of special interest groups since the virtual programme began in early May 2020.

The inaugural INSOL Virtual Conference in September 2020 received high praise from across the industry and was well attended by delegates worldwide. The conference streamed across the world in three time zones and consisted of a keynote address from Former Prime Minister of Australia Malcolm Turnbull and six panels which addressed the impact of COVID-19 on various sectors and were made up of subject matter experts from across the globe. The upcoming Virtual Conference 2021, due to broadcast live on and June 8, 9 and 10, 2021, looks set to be equally as prestigious.

INSOL's digital events are made available for all registered delegates to view on-demand at insol.org for 90 days after the live broadcast. This has been a well-used option given that the entire profession is now under unprecedented time pressures, the ability to recap on sessions at a convenient time has proved invaluable. I can recommend browsing the past event programme to catch up on previous sessions as well as looking at those planned for the future on your next visit to the website.

While there, you might notice the result of another INSOL project that has recently come to fruition; the improvement of the website. The new, improved version was launched in April 2021 and features a fresh design, enhanced functionality and a better user experience. Member feedback on this latest improvement has been positive, improvements to the search function of the technical library and the ability to search INSOL Fellows are two favoured advancements.

It is not only through virtual events that the team at INSOL are working to ensure members' have all that is needed to succeed in the current climate. The extensive library of technical publications has been significantly expanded over the past 12 months with a range of topical and useful publications. These include the *Global Guide to Measures Adopted To Support Distressed Businesses Through COVID-19*, produced in partnership with the World Bank Group. The guide was first published in April

2020 and subsequently expanded in May 2020. Another substantial update of this invaluable guide covering over 80 countries has just been published.

In November 2020 INSOL published its book *Treatment of Secured Claims in Insolvency and Pre-Insolvency Proceedings II* a successor to the first edition published in 2007. Now consisting of 20 country chapters – an increase of seven from the last edition. I am proud to say that this book, as well as all publications and reports and INSOL's quarterly journal INSOL World are all distributed entirely digitally, meaning that in 2020 INSOL has achieved the goal of being fully paperless. We have received such immensely supportive feedback on this move, it's clear that INSOL members have embraced the new digital formats.

Last, but by no means least, the array of educational opportunities at INSOL have continued to be developed. The Foundation Certificate in Insolvency Law, delivered entirely online, began its second year in September 2020 with a larger cohort of students than 2019. It is so satisfying to see that despite the current environment, there remains a thirst for learning. Also encouraging is the geographic spread of candidates which shows that this course is truly global – something the online nature of its delivery surely helps.

Furthermore, having established an appropriate infrastructure for this method of learning, INSOL is already developing new online training courses. The online platform has also enabled INSOL to deliver to its special interest groups. In recent months we have facilitated gatherings of the judiciary, financiers, legislators and academics. Bringing together individuals from around the globe to discuss relevant issues and share experiences.

2020 forced us all to respond to a number of challenges, both personally and professionally and unfortunately 2021 has begun as last year left off. However, I am both confident that INSOL International will continue to deliver value for its members this year, and hopeful that 2022 will see a return to a world that provides us with opportunities to meet again in person.

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A good time to be P-I-K-y? The role of PIK instruments and other hybrid debt/equity in financing structures

by Juliette Challenger, Arunima Misra and Natasha Chan, GLAS

In the wake of some notable high-profile failures of PIK notes in debt restructurings following the financial crisis, arrangements combining a variety of debt and equity-like characteristics have been re-emerging with a variety of features which make these more attractive to companies and investors alike. This article focuses on the increasing trend for innovative uses of PIK notes in such financing arrangements.

Introduction

The popularity of PIK ("payment in kind") debt, which peaked in the high-risk appetite era just prior to the 2008 financial crisis, has seen a resurgence in recent years, incorporating a variety of characteristics and features designed to attract investors. Given the abundance of capital and low interest rates, a number of "hybrid" investments, which fall between pure debt and pure equity, are a popular feature in complex restructurings, enabling companies and investors alike to take a more cautious approach to PIK debt, while providing incentives and potential significant advantages. These instruments offer much needed liquidity for companies, whilst protecting downside risk with equity upside potential for investors.

Preferred equity shares (being a class of equity which ranks ahead of ordinary shareholders in an insolvency), convertible debt instruments (where loans or bonds can be converted into a specified portion of equity), and PIK debt (where interest payments are deferred and capitalised in accordance with certain terms), have been an increasing feature of recent deals for investors looking for ways to deploy capital and generate attractive returns, and deals structured with instruments of this nature will continue to develop and build confidence in such arrangements.

Features of PIK financings

PIK debt typically refers to a loan or bond where all or some of the accrued interest is capitalised throughout the life of the debt instrument. Deferred payment of cash is compensated by a higher rate of return than for senior debt. The PIK loan or bond will typically be issued by the holding company of the parent of the corporate group receiving senior debt, with the PIK debt ranking behind the senior secured bank debt issued to the company, but ahead of equity investors.

PIK financings can be structured in many ways, but typically have the following features.

Interest – can be fixed or floating instruments comprising:

- "True" PIK – all interest is capitalised and added to the principal of the loan.
- Pay if you can – interest is paid to the extent that certain financial tests are met; where these are not met, the interest is capitalised and added to the principal of the loan.
- PIK toggle/ pay if you want – the company/ issuer can decide whether to pay interest in cash, in kind (i.e. with the issue of further bonds or loan notes) or in a combination of the two.

PIK loans:

- These are particularly helpful if a company has liquidity problems, as they enable the company to pay interest without paying it in cash form. This is attractive to companies that want to avoid making immediate cash outlays for debt interest.
- Are privately held and not publicly tradeable on an exchange, and generally unsecured.

PIK notes:

- These are debt instruments with fixed terms and call protection, and many equity-like features (e.g. observer rights and carry tag along rights on exit).
- They are generally unsecured and are structurally subordinated in the debt capital structure. Where security is granted, it will typically be limited to a pledge over shares in the issuer, or a form of guarantee from the direct holding company.
- Covenants tend to follow those in the senior debt documents, but will often be looser, and will typically include:
  i. an anti-layering covenant to ensure that the PIK debt remains the only tranche of junior capital in the structure in order to maintain the priority of the PIK holders above shareholders in respect of the senior debt, due to the structural subordination arrangements;
  ii. additional rights to be involved in future capital raising or restructurings;
  iii. rights to limit any increases in the size of the senior debt, and any waivers or consents that could adversely impact the PIK noteholders; and/or
  iv. the ability to appoint an observer to attend board meetings, and certain other governance rights, e.g. controlling the extent to which dividends or other distributions or certain payments can be paid to shareholders, in order to minimise or prevent cash leakage from the business.
- Can be privately held (particularly where stapled or semi-stapled to equity) or publicly traded on Stock Exchanges and through the Clearing Systems (often when part of a wider debt package), which ensures ease of transferability.
- May have a slightly longer tenor than senior term debt.

Why and when used?

PIK instruments are attractive to companies preferring not to make cash outlays. This affords the company greater flexibility to conserve cash for specified events or actions or to weather downturns in the business cycle by choosing to compound interest or determine when cash interest is paid.

In most cases, PIK instruments comprise a fraction of a company's total outstanding debts and are structured so they mature later than the company's other debts. This allows the company to focus on repaying its traditional debt, and provides a form of "mezzanine" debt, without impacting on the company's balance sheet.

PIK instruments can also be used as an incentive for creditors to vote in favour of a restructuring or lock up to support a restructuring at an early stage, with noteholders allocated PIK bonds/ notes as an entitlement post-restructuring.

PIK instruments are often stapled/semi-stapled with other debt or shares in a new holdco structure, meaning that they will need to be held/ transferred together. This can be seen as an incentive for investors who wish to receive an upside to the senior notes.

In addition, PIK instruments can have additional restrictions/obligations placed on their transfer including the loss of rights to receive further payments of cash or PIK interest, and other governance rights.

PIK pros

Some notable advantages of PIK instruments are:

- High rates of interest – the capitalisation mechanic results in a substantial increase to the principal amount of each holder, and potential for significantly higher returns on investment than senior debt.
- May be used as an incentive to holders to agree other material changes to a company's debt which affect creditors and investors.
- Offers companies increased liquidity without diluting ownership.
- Can include certain controls relating to distributions to shareholders and

certain limitations on senior debt.

- Enables the company to receive more investment without overleveraging and deferring outgoings, therefore in many cases enabling and promoting growth.

Potential PIK pitfalls

- PIK debt is inherently riskier as it typically ranks behind other senior debt and is frequently structurally or contractually subordinated.
- PIK debt also requires lenders to assume additional credit risk from a borrower because the amount of the principal owed will grow over time, and PIK holders will only make a recovery to the extent that there is any surplus cash once the senior debt has been repaid.
- Whilst attracting certain governance rights, PIK instruments carry limited rights on an insolvency or breach of covenant, and limited influence on how the underlying business is operated, or how restructuring discussions progress. Additionally, any enforcement steps may be of limited practical value, especially where value of the operating group breaks in the senior debt.
- An inherent risk for a company is that its PIK liabilities may become unsustainable, resulting in an inability to repay at maturity. A prominent example of this was the failure of retail fashion brand Peacocks, which issued PIK notes at 17.2% per annum, leading to a significant PIK liability. By the time of its administration in 2012, over half (£400m) of its £750m total debt was attributable to PIK liabilities, which contributed to its demise.

The practicalities of PIK instruments

There are several practical considerations when dealing with PIK debt instruments, which will be dependent on, amongst other things, the specific transaction, the type of PIK selected, and the ability of the instrument to be cleared in the Clearing Systems. Where PIK instruments are not held within the Clearing Systems (and therefore not assigned a related ISIN code), they will be recorded on a register, which is held with a note registrar, such as GLAS. As these are entries in a register, holders will not get position statements but can approach the PIK registrar to confirm their position.

For registered PIK notes, Bloomberg also can assign a Unique Identifier so that holders/custodians can keep a record in their systems.

Trading of PIK notes involves completion of transfer certificates which need to be signed by both transferor and transferee. Share transfer certificates (and arrangements for delivery of original documents), will need to be completed simultaneously if the instruments are stapled, together with any debt transfer certificates, where relevant. Typically, the purchase price of the PIK notes will move directly between holders in this instance, and not via the Clearing Systems or the agent on the PIK notes, such as GLAS.

Where PIK notes are stapled to shares in the structure, there is often a separate share registrar, or company secretary, who is in charge of updating the share register. Holders will need to liaise with both the PIK notes registrar and the share registrar in respect of their particular holdings.

Tax considerations will also be relevant in determining the form that a PIK instrument takes, and whether or not this will be privately held, or issued through the Clearing Systems, and/or issued on a stock exchange.

PIK in practice – HEMA Group

As a global independent provider of debt administration services, GLAS frequently works on complex debt restructuring deals involving a PIK debt element, and other hybrid instruments. The recent HEMA Group restructuring, which was implemented via an English scheme of arrangement combined with a Dutch share pledge enforcement, was one such deal involving PIK notes in the debt structure.

HEMA Group ("HEMA"), one of the largest and highly renowned Dutch retailers, had unsustainable indebtedness and had fallen into financial difficulties, compounded by the COVID-19 pandemic. HEMA restructured its indebtedness of €750m debt (including bond debt with a face value of €600m) via a partial debt to equity swap, which halved its debt to €300m.

The restructuring also saw the issuance of PIK notes by a new holding company within the Group ("Holdco"), and the improvement in its liquidity position by the issuance of an additional €42m of new bonds, secured private placement notes (to be held in the Clearing Systems) and listed PIK notes, which were quasi-stapled to the new equity issued, offered to scheme creditors.

The new Holdco PIK notes provided for cash and "payment-in kind" interest, were unsecured and structurally subordinated to the senior debt, held in dematerialised registered form, and listed on the International Stock Exchange. The Holdco PIK notes were quasi-stapled to the shares in the new Holdco with certain restrictions on receiving interest (in cash and further new PIK notes) and certain limitations on voting rights placed on holders of new PIK notes where such holder did not hold the corresponding amount of newco shares.

GLAS was mandated on a number of significant roles on the restructuring, including Note Trustee (across all series of existing and new notes), Security Agent, Facility Agent, Principal Paying Agent, Transfer Agent, Registrar, Information Agent, Lock-Up Agent, Tabulation Agent, PIK Notes Trustee, PIK Notes Paying Agent, PIK Notes Registrar and Transfer Agent, and Holding Period Trustee, and carried out various bondholder communications and liability management exercises that were integral to the transaction throughout the process over several months.

Conclusion

The current competitive post-COVID environment of both debt and equity investors with an increased appetite for higher degrees of risk looking to deploy cash reserves on one hand, and companies keen to secure additional liquidity without overleveraging or diluting ownership on the other, see circumstances ripe for PIK instruments and other types of "hybrid" investments to continue to increase in popularity as part of a wider debt package as demand for products offering a high yield increases.

It is anticipated that companies and issuers will continue to create ways to make use of PIK instruments and other debt/ equity hybrid instruments in order to attract investors, and that the features and structures of such "hybrid" investments will continue to evolve over time with further bespoke terms to afford even greater flexibility for market participants.

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The role of the Insolvency Section of the International Bar Association

by Anja Droege Gagnier and Darío Oscós,
Co-Chairs of the Insolvency Section of the International Bar Association

2020 was and 2021 still is under worldwide COVID-19 unprecedented health, economy and financial distress. It is unclear for how long this status will last, although vaccination is promising to minimise the COVID-19 catastrophic effects. Economies are being reactivated, notably in China and in the US. We should be realistic, optimistic and positive.

Most industries and commercial chains as well as enterprises have been affected, from individual and micro enterprises to large group of companies. Health restrictions for in-person meetings and travelling have prevented most gatherings and networking opportunities during the COVID-19 era. This crisis has led to a new life standard: the widespread use of online virtual environments among families and businesses.

Indeed, the 2020 IBA annual conference was fully virtual with an outstanding success. Nevertheless, in-person meetings and face to face contact cannot be replaced. The 2021 IBA annual conference, expected to take place in Paris, will also go virtual and the Paris in-person conference is postponed to 2023. It is planned that the 2022 IBA annual conference will take place as an in-person conference in Miami, US. The IBA Insolvency Section 'Spring conference' was postponed to September 5-7, 2021 with the hope that it could take place in-person or at least, in a hybrid version. For next year, the Insolvency Section Spring conference is planned for May 2022 in Montreal, Canada. Fingers crossed!

In order to promote its activities, keep the link among officers and make more cohesion and interaction among its officers, members and invitees, the Insolvency Section has set up monthly online gatherings, namely the "*aperitif/coffee meetings*". These "*aperitif/coffee meetings*" are informal by nature to freely discuss, in a friendly atmosphere, hot, insight, informative and current insolvency issues. The first one started in February 2020 and was a great success with a high number of attendees. The second was scheduled for April 21, 2021.

In the insolvency industry, most jurisdictions have provided a wide range of legal tools to alleviate the financial crisis seeking to keep businesses as going concerns and securing employment as far as possible. Assets value in liquidation should also be maximised. Legal measures include financial and tax support and rescue programmes, simplified insolvency proceedings, no mandatory debtor insolvency filings, ban involuntary filings by creditors, less strict sanctions for director's liability and the like. Notably, the increasing debt restructuring and out-of-court settlements have characterised the way out to get relief.

In other instances, creative and innovative insolvency vehicles like airlines have sought insolvency protection under US Chapter 11. New simplified insolvency proceedings have been enacted by legislators or governments to support and alleviate the current COVID-19 financial crisis.

The International Bar Association, established in 1947, is the world's leading organisation of international lawyers, bar associations and law societies. Membership includes over 80,000 lawyers and 190 bar associations. Within the International Bar Association, there are various groups focused on specific practice areas. One such group is the Insolvency Section. The Insolvency Section, then known as

Committee J, originated sometime in the 1970s as a small assembly of business insolvency lawyers mostly from North America, the United Kingdom and Western Europe. Today the Insolvency Section is a truly global group of insolvency professionals with about 1,000 members from most world jurisdictions.

In the 1990s, the World Bank promoted the idea that it was important for economies, especially those in early stages of development, to establish predictable and transparent insolvency regimes to attract financing. At about the same time, UNCITRAL recognised the need for increased coordination and cooperation across borders in large multi-national insolvencies. In the 1990s Insolvency Section's representatives played a critical role in drafting UNCITRAL's Model Law on Cross-Border Insolvency and in the early 2000s its Legislative Guide to Insolvency Law. In addition, in the mid-1990s, the Insolvency Section drafted and published the first Cross-Border Insolvency Concordat, which has since provided the basis for protocols for administering many of the world's largest cross-border insolvencies.

Insolvency Section's delegates at UNCITRAL Working Group V Insolvency have permanently participated in UNCITRAL insolvency projects. As of today, UNCITRAL has adopted a number of insolvency laws and their guide to enactment: Model Law on Cross-Border Insolvency (1997), Legislative Guide on Insolvency Law (2000), Part three: treatment of enterprise groups (2010), Part four: director´s obligations in the period approaching insolvency (2010), Practice Guide on Cross-Border Insolvency Cooperation (2011), Model Law on Cross-Border Insolvency: the Judicial Perspective (2011), Model Law on Recognition and Enforcement of Insolvency Related Judgments (2018), Model Law on Enterprise Group Insolvency (2019), and text on obligations of directors of enterprise group companies.

Currently, the UNCITRAL Working Group V is in the process of finalising a simplified insolvency regime of individuals entrepreneurs and micro and small businesses.

As cross-border businesses and insolvencies grew in number, so did the Insolvency Section, focusing no longer just on insolvency, but also on out-of-court restructuring as well as transactional and litigation aspects, including alternative dispute resolution mechanisms, e.g. mediation.

Over time, the Section developed a practice of meeting twice per year – once at the International Bar Annual Meeting in autumn in conjunction with all other IBA practice groups and once all by itself at a focused mid-year meeting of Section members in May, with traditionally between 140 and 200 participants. In addition, the Section occasionally has held colloquiums on special subjects.

In 2007, the Section began to publish a semi-annual journal called the Insolvency and Restructuring International. Since then, the Journal has featured numerous scholarly articles contributed by hundreds of authors. The Section has also produced a number of valuable treatises, including one on Cash Pooling and Insolvency, one on Title Retention, one on Licences and Insolvency and another on Financing Company Group Restructurings.

The Section has four major subcommittees – Creditor's Rights, Legislation and Policy, Reorganisations and Workouts, and Financial Institutions and Insolvency. Each subcommittee plans and puts on topical programmes at the annual and mid-year meetings. There are also officers of the Section focused on, amongst others, projects and publications; membership; conference planning; and coordination with organisations such as UNCITRAL, the World Bank and other professional associations.

In recognition of the fact that insolvency practice often requires specialised knowledge, the Section has developed task forces focused on oil and gas, transportation and infrastructure, shipping, real estate, automotive, and finance and insurance, private equity, insolvency administration, and employment.

As of 2021, the Section has 71 officers from

31 countries in six continents. The section officers are advised by the wisdom and experience of an Advisory Board comprising of former co-chairs of the Insolvency Section.

The following are the Insolvency Section's main goals:

1. to support the effectiveness application and enforcement of the rule of law and human rights protection worldwide;
2. to meet at least twice a year to provide:
   - stimulating programming on important insolvency topics with leading thinkers and creative and innovative legal and practical tools; and
   - networking opportunities to enable members to develop enduring business and social relationships;
3. to provide opportunities for members to disseminate new ideas, experiences and insights in insolvency through active participation in dialogues at meetings and publication of materials in the IS Journal and IS books, as well as by enhanced use of the Section's website and social media;
4. to achieve cultural, gender and geographical balance among speakers at conferences and in leadership positions;
5. to participate in the important work of UNCITRAL, the World Bank and similar organisations in their efforts to promote more effective insolvency laws and cross-border cooperation and coordination; and
6. to increase membership of in-house legal counsel and non-lawyer insolvency practitioners.

The Insolvency Section endeavours to spread its mid-year conferences globally, aligned with the IBA's annual conferences.

Anja and Darío, as co-Chairs of the IBA Insolvency Section for the period 2021-22, invite and welcome all interested insolvency practitioners and insolvency professionals to join the section and actively participate in its goals and be benefitted from the wide and deep range of insolvency knowledge, practice, insightful information, experience, networking and friendship of its members and outstanding participants.

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The COVID-19 pandemic and emerging market restructurings: The view one year later

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As was widely forecast over a year ago when the pandemic first struck countries around the world, the global economy suffered a major contraction in 2020, and the emerging markets also experienced a significant decline in GDP (although not as steep a decline as the advanced economies). Global growth declined by approximately 3.3% in 2020, and growth in emerging economies and developing countries declined by approximately 2.2% over the same period, according to the International Monetary Fund (IMF).

The economic landscape

However, one possible surprise has emerged: the global economy has recovered more quickly than expected, and the emerging economies in aggregate have rebounded as well. Indeed, the latest economic projections from both the World Bank and the IMF indicate that global economy overall and the emerging economies in particular are projected to grow in 2021 and 2022. For example, in its late March "World Economic Outlook" report, the IMF was forecasting growth for the global economy of 6.0% in 2021 and 4.4% in 2022 and was forecasting growth for the emerging economies of 6.7% in 2021 and 5.0% in 2022.

China, whose economy was the first to shut down in the wake of the spread of COVID-19 in China during the first quarter of 2020, began to recover quickly in the second quarter of 2020 when factories in China started to reopen and Chinese workers started to return to their jobs. In fact, China registered GDP growth of 11.5% in the second quarter, making China the only country among G20 countries to grow during that time, according to the OECD. After growing a mere 2.3% in 2020 (China's lowest growth rate in several decades), China is expected to grow at a fairly robust 8.4% in 2021 but at a slower rate of 5.6% in 2022, according to the latest projections from the IMF.

Other major emerging economies are also expected to experience relatively healthy growth rates, especially when compared to their growth rates in 2020 when global growth collapsed as it has just a few times in the last century or longer.

For instance, just a couple of months ago, India was expected to be a star performer in the global economy in 2021, and the IMF was projecting in its late March forecast that India's economy would grow by 12.5% in 2021 and by 6.9% in 2022. Yet, those forecasts were made before India was unfortunately struck by a devastating second wave of COVID in recent months. Projections for GDP growth in India that were made early this year, before the onset of the second wave in India, will almost certainly need to be recalibrated in order to take account of that recent surge in COVID and its expected adverse impact on the Indian economy.

The emerging economies as a whole have relatively strong tailwinds behind them for 2021, particularly with the expected growth in the Chinese and US economies. The US economy is projected to grow by 5.1% in 2021 and 3.6% in 2022, according to the latest IMF projections. The US economy is expected to be propelled forward by the trillions of dollars being pumped into the economy in connection with, among spending programmes, the recently enacted US$1.9 trillion recovery plan and, if enacted in one form or another, the potential infrastructure plan and social spending programmes that have been proposed by the Biden administration.

While commodity prices across the board

plummeted in the early months of 2020, they have since recovered, and this has naturally benefited a number of the many emerging markets whose economies are heavily dependent on commodity exports. For instance, the US Energy Information expects the price of oil to average above US$60 per barrel in 2021 from an average price of just below US$42 per barrel in 2020 (although the price was much lower at certain points in 2020), and many non-oil commodity prices such as various metals are reported to have recovered even more strongly than oil prices.

Furthermore, the resumption of global trade, after its virtual collapse particularly in early 2020, has been a boon to those emerging economies which are very trade-dependent, such as those emerging economies that are heavily tied into global supply chains.

Nonetheless, the aggregate numbers for the emerging economies mask certain underlying realities that belie the seemingly relatively bright prospects for the emerging economies in the next few years. In the first place, as in the wake of the global financial crisis in 2008-09, China is contributing the lion's share of growth among emerging economies as a whole. Specifically, without China in the picture, the growth rate in emerging economies and developing countries for 2021-22 drops from 4.6% to 3.5%, according to World Bank forecasts.

Further, the aggregate numbers do not point up the divergent growth rates in different regions around the world. For example, a group of five major emerging economies in Southeast Asia are expected to grow at a decent (although certainly not blockbuster) rate of 4.9% in 2021 and 6.1% in 2022. However, emerging economies in other geographic regions, such as Latin America/Caribbean, the Middle East/North Africa, and Sub-Saharan Africa, are expected to grow more slowly. This is part of what economists are referring to as a "multi-speed" economic recovery.

Finally, the aggregate numbers for the emerging economies, which generally look encouraging, do not highlight another less positive fact — namely, what those numbers would have looked like if there had been no COVID crisis. The bottom line is that the COVID crisis is believed to have essentially shaved off a few percentage points of GDP growth in the coming years for many emerging economies and developing countries (compared to what had been projected pre-COVID). Indeed, the IMF has pointed out that many emerging market and developing countries are not expected to return to pre-pandemic growth levels until 2023.

Even with the improved economic growth expected for the emerging economies in the next couple of years compared to the major contraction experienced by many of these economies in 2020, the emerging economies are not yet completely out of the woods. To begin with, the availability of the COVID-19 vaccines has been fairly limited in many emerging economies and developing countries. Thus, as has been widely discussed by public health experts, there is always the risk the pandemic could continue to fester in some of these countries for the foreseeable future and that new variants emerging in these countries could then spread to other countries (with the associated deleterious health and economic effects).

Apart from the tragic and heartbreaking situation in India discussed above, other important emerging economies have not emerged from the danger zone when it comes to the pandemic. For instance, the two largest economies of Latin America, Brazil and Mexico, have continued to experience high COVID infection and death rates, and the vaccination rates in both of these countries have been fairly low so far.

Despite the more positive outlook expected in 2021 for the global economy as a whole and the emerging economies in particular, there will continue to be several vulnerabilities in the emerging economies going forward. First, several of the sectors that were hardest hit by the COVID-related economic slowdown — including, for example, tourism/hospitality and the airline industry—could continue to suffer for the foreseeable future.

In fact, the global airline trade association, the

International Air Travel Association (IATA), has predicted that global passenger traffic will not return to its pre-pandemic levels until at least 2024. Further, a full-scale resumption of international air travel may depend in no small part on countries and/or airlines instituting a system based on so-called vaccine passports or similar travel passes.

Accordingly, the many emerging economies around the globe that are heavily dependent on international tourism may experience a noticeably slower recovery than some other economies less dependent on tourism.

Second, many emerging economies and developing countries may suffer now and in the coming years from what economists are now referring to as the "scarring" effects of the COVID crisis — i.e. the longer-term negative fallout from the crisis. Most notably, it is estimated that over 100 million people worldwide have fallen back into poverty as a result of the COVID crisis, according to the World Bank. Moreover, with nationwide lockdowns leading not just to the closure of businesses but schools as well, millions and millions of children in these countries risk falling seriously behind in their education which represents a serious blow to the development of human capital in these countries.

Third, with national budgets strained by the COVID crisis, governments have not been able to make the necessary investments in infrastructure development which is considered key to economic development in these countries. In addition, with constrained cash flow resulting from the economic slowdown, many businesses have not been able to make the necessary investments in capital equipment which is considered essential to productivity gains in these economies.

Sovereign debt restructuring

As was foreseeable a year ago and indeed as was predicted by many observers, emerging market sovereigns experienced rough sledding in the last year. There were a record number of sovereign defaults among emerging market economies during this period. Six emerging market economies defaulted over the last year, including Argentina, Belize, Ecuador, Lebanon, Suriname, and Zambia. Separately, a number of countries, at least those which still had the capability to tap the debt markets, may have layered on additional sovereign debt during the COVID crisis and thus may have further exacerbated any debt sustainability challenges that those countries were already facing pre-pandemic.

While the past year was a fairly active year on the sovereign debt restructuring front, this area is widely expected to become even more active in the next few years as the impact of the pandemic-related economic slowdown continues to work its way through the system. Moreover, on the debt sustainability front, many emerging economies and developing countries are currently considered to be (or, in the coming years, are expected to be) in a state of debt distress or at high risk of debt distress.

Serial defaulter: Argentina

A few restructuring situations that were in progress early in 2020, such as those involving Ecuador and Argentina, came to successful conclusions in the third quarter of 2020. Argentina upheld its reputation as a serial defaulter with its bond default late last May, a record ninth default for Argentina since it became an independent nation in 1816. But even before the default in May 2020, Argentina had been engaged in debt restructuring negotiations with its foreign bondholders. After months of a somewhat tortuous negotiation process, Argentina finally struck a deal with its foreign bondholders in early August 2020.

The Argentine sovereign debt restructuring was notable for several reasons, among them the fact that it was clear that the pandemic affected the ultimate outcome. Indeed, it may have even cost the creditors at least a few cents on the dollar in their projected recoveries under the restructuring plan that was ultimately agreed to by Argentina and its creditors — i.e. what might be termed a "*pandemic discount*."

In the restructuring negotiations, the creditors were basically walking a very fine line. On the one hand, the bondholders naturally wanted to maximise their recoveries and were therefore motivated to drive as hard a bargain as possible with the Argentine government. On the other hand, the bondholders needed to be sensitive to the fact that if they pushed too hard for a higher recovery, they might be perceived as forcing the government to prioritise debt service payments over necessary health care expenditures to combat COVID (and thereby putting the lives of Argentineans at risk).

As one of the most important post-restructuring pieces of business, Argentina for the last several months has been engaged in discussions with the IMF over how to address, whether through refinancing, debt reprofiling or otherwise, the IMF's outstanding loan of US$45bn to Argentina, the largest ever in the history of the IMF.

The purpose of the loan was to help the Argentine government of President Mauricio Macri to address an economic crisis that was confronting Argentina in 2018, including a serious run on the Argentine peso that was then underway. Nonetheless, the loan was not able to stem the continued deterioration in the Argentine economy.

At the present time, Argentina needs to reach a deal with the IMF because it has very heavy debt service payments due to the IMF in the next few years, including approximately US$4.8bn due by the end of 2021 and approximately US$38bn due in the following two years. Yet, to put it mildly, the IMF has never been particularly popular in Argentina, and as a result Argentina has not enjoyed especially cordial relations with the IMF over a long period of time. Even so, Argentina's new president since December 2019, Alberto Fernández, and his Economy Minister, Martin Guzman, have tried to keep the Argentine government's current relationship with the IMF on a relatively even keel.

By contrast, Vice President Cristina Fernández de Kirchner, formerly Argentina's president from 2007-15 and still a very influential voice in the Argentine government, has been seemingly marching to a different drummer. She has argued that Argentina should not repay the IMF loan since she considers to the loan to have been "illegal," and she has said, for instance, that the loan was used only to finance capital flight from Argentina and that Argentina should therefore not feel bound to repay the loan.

In short, it remains to be seen what type of deal the Argentine government will be able to reach ultimately with the IMF. Specifically, the issue will be how accommodating the IMF will be vis-à-vis Argentina in light of Argentina's current economic travails, as well as how receptive the Argentine government will be to any demands from the IMF that it adopt stringent austerity measures as part of any new IMF deal , particularly with upcoming mid-term legislative elections in a few months.

Failing states: Lebanon and Venezuela

Other sovereign debt situations continue to frustrate any easy resolution, mostly because the underlying economic and financial circumstances of the countries in question are so dire and the political situations in the countries are in such disarray. As will be discussed more fully below, Venezuela is a dramatic case in point of a failing, if not a failed, state, but Lebanon is also another example of a deeply troubled state.

The fundamental questions with respect to failing (if not failed) states conducting sovereign debt restructurings are essentially two-fold: First, how does one restructure a country's sovereign debt when the underlying national economy that will ultimately generate the revenues to repay that restructured debt is in a state of collapse or near-collapse? Second, how can creditors have meaningful restructuring discussions and negotiations with a sovereign debtor whose government/political system is in substantial disarray?

Lebanon, which has approximately US$31bn of outstanding sovereign bonds, defaulted on a US$1.3bn Eurobond in March 2020. However, Lebanon has had major financial and economic difficulties for several years even pre-pandemic — difficulties that have only worsened in the recent months. The Lebanese economy is suffering from rampant inflation, an increasingly weakened currency, high unemployment, dwindling foreign exchange reserves, and a stagnant growth for a number of years followed by a 25% contraction in the economy in 2020 (with a further 9.5% contraction expected in 2021). Lebanon also has a nearly insolvent banking system.

In a very troubling new report released in early June just as this article was going to press, the World Bank expressed the view that Lebanon's economic and financial crisis is likely to rank as one of the three most severe crises that the world has seen in more than 150 years. Lebanon is also facing myriad serious social ills, including very high levels of poverty among its population as well as major shortages in essentials such as medicines and fuel.

But Lebanon's political situation is almost as equally unsettled and dysfunctional as its economic/financial situation. In fact, Lebanon has only had a caretaker prime minister since last August. The dysfunction in Lebanon's governance was brought into sharp relief by the huge, tragic port explosion in Beirut in early August 2020.

Since Lebanon's default just over a year ago, a rescue package from the IMF has been viewed by the acting Lebanese government (such as it is) as effectively the silver bullet that would resolve Lebanon's difficulties or at least put Lebanon on a path to recovery. But under the current circumstances in Lebanon, it is hard to imagine that the IMF could or would enter into a major rescue package with Lebanon.

Specifically, with the Lebanese government in such disarray, which officials in the Lebanese government could the IMF negotiate with in a meaningful way, and who would there be in the government to carry out any "reforms" that the IMF would almost certainly insist upon as part of any rescue package? Moreover, with the Lebanese economy in a state of near-collapse, how could the IMF (or any other creditors, for that matter) have confidence that Lebanon would be able to climb out of its deep economic and financial hole anytime soon, with or without any "reforms" that would be proposed by the IMF?

For its part, Venezuela has been in default on over US$60bn in bond debt since late 2017. Yet, a debt restructuring seems to be no closer at hand today than it was a year or two ago. It is hard to conceive of a debt restructuring taking place between Venezuela and its international creditors as long as the Maduro regime remains in power and also as long as the current US sanctions remain in place (since among things, US sanctions prevent US persons from negotiating with certain "specially designated nationals" in the Venezuelan government).

Even if Venezuela could get to a place where it could undertake a debt restructuring, it would face truly daunting challenges. Of paramount importance, the Venezuelan people are facing an absolutely grave humanitarian crisis which is reflected in extremely high levels of poverty, malnutrition and disease.

Moreover, the Venezuelan economy has been collapsing for the last several years, and it contracted by approximately 65% between 2013-19 and was estimated to have contracted by approximately 25% in 2020, according to the IMF.

In its current condition, Venezuela is widely considered to be a failing state, if it is not already a failed state. Consequently, conducting a sovereign debt restructuring — and, crucially, also rebuilding a national economy — under those circumstances will be incredibly difficult at best, particularly if in the interim the Venezuelan economy continues its precipitous decline of recent years.

Zambia's default and the China/bondholder dynamic

Zambia, one of the world's largest copper-producing countries, went on a borrowing spree starting roughly in 2012 and built up a debt burden of over US$12bn, resulting in a high debt-to-GDP ratio, always a red flag for creditors and investors. Zambia ended up defaulting in November 2020 on a US$42.5m coupon payment to the holders of its Eurobonds, the first default of an African sovereign during the pandemic.

Just prior to its default in November 2020, Zambia had been attempting to negotiate with its bondholders a deferral of debt service payments until April 2021. Zambia said it would try by that date to work out an overall restructuring deal for all of its outstanding debt (including reaching a possible deal with the IMF).

In considering this deferral request from Zambia, the bondholders were reportedly seeking greater transparency concerning the terms and scale of the Chinese loans to Zambia since they were apparently concerned that any debt relief that they provided to Zambia might be used to repay Chinese loans. The bondholders were also reportedly seeking greater clarity as to how Zambia intended to deal with other creditors, including Chinese lenders, and in particular whether there would be equal treatment among all creditors. Moreover, the bondholders were apparently not convinced that the Zambian government was firmly committed to reaching a deal with the IMF (including agreeing to any associated IMF "adjustment" program) which the bondholders considered to be an essential element in resolving Zambia's overall debt sustainability issues.

The Zambian government's finance minister took the position that confidentiality agreements "prevented him from disclosing [to the bondholders] the terms of the country's loans from China," as reported at the time in the *Wall Street Journal*.

As a result of the impasse between Zambia and the bondholders over disclosure of information concerning the terms and scale of the Chinese loans to Zambia as well as other bondholder concerns (including what they claimed was a lack of engagement with them by the Zambian government), the talks between Zambia and its bondholders eventually collapsed, and that ultimately led to the bond default by Zambia.

For our purposes, the Zambian default is significant because it could, in a manner of speaking, be the "canary in the *copper mine*" as to what may be to come with other sovereign issuers of debt in Sub-Saharan Africa (SSA). A number of these countries in SSA tapped the capital markets for first time ever in the last several years, and thus in any future restructurings involving SSA sovereigns, bondholders may well constitute an important creditor constituency for SSA sovereigns in view of all of the capital market debt that has been issued by new and old SSA issuers alike.

Moreover, of critical importance, China in recent years has also become the largest bilateral lender to countries in Africa generally, but its lending activities and the terms of its loans are considered to be fairly opaque. Also, China lends through many different types of institutions, from its policy banks (e.g. China Development Bank, China Export-Import Bank, etc.) to some of its large state-owned commercial banks as well as some of its state-owned enterprises, and the Chinese approach to restructuring in any particular case may depend in part on what types of Chinese lending institutions are involved.

However, at least in the COVID era, the Chinese playbook for sovereign debt restructuring in the emerging markets and developing countries may still be a work-in-progress, or, to a certain extent, that playbook may simply not be well understood by non-Chinese creditors, possibly in part because of what many consider to be the fairly opaque nature of China's lending and restructuring transactions.

Many SSA nations are currently either in a state of debt distress or at high risk of debt distress, according to a recent IMF report, and this could potentially give rise in the not-too-distant future to a number of new SSA sovereign debt restructurings and/or sovereign debt defaults. Thus, there is a distinct possibility in the coming years that other SSA sovereigns may undergo their own Zambia-type debt restructuring scenarios marked by serious intercreditor conflicts between parties such as Chinese lenders, bondholders, and even non-traditional lenders (e.g. multinational mining/commodity trading firms such as Glencore).

Only time and experience will tell whether the recent G20 initiative known formally as the "Common Framework for Debt Treatments beyond the DSSI" will provide a reliable mechanism for addressing, for instance, the types of intercreditor disputes discussed above in sovereign debt restructurings in the emerging economies and developing countries. Nonetheless, since Zambia was one of the first sovereigns to request a "debt treatment" under the Common Framework, it may serve as an early test case of the efficacy of the Common Framework in resolving relatively thorny restructuring situations, and the Zambia case (together with a few other recent cases) may also illuminate whether in practice the Common Framework will be able to fully engage all creditors – private creditors, Paris Club creditors, and non-Paris Club bilateral creditors such as China – in equitable burden-sharing.

Corporate debt restructurings

For the emerging economies (possibly like advanced economies), insolvency filings have been fairly muted over the last year, and this is a likely result of several factors. Of course, the expansionary fiscal and/or monetary policies that were adopted in many economies in response to the COVID crisis helped to soften the economic blow from the pandemic. Further, lenders in many jurisdictions granted borrowers forbearance (including payment deferrals or holidays) for an extended period of time, and thus as a result the number of defaults in these jurisdictions was in effect artificially reduced.

In addition, the governments in many jurisdictions adopted changes to their insolvency laws that, among other things, relaxed requirements that companies file for insolvency upon the emergence of financial distress. Meanwhile, other jurisdictions (such as India) suspended the operation of their insolvency laws altogether for a specified period of time during the COVID crisis.

The flip side of this is that once these developments — such as the expansionary government policies, the bank forbearance policies, and the insolvency law relaxations — come to an end, then the number of insolvency filings could surge. Some observers are even predicting that there might be a tsunami of insolvency filings at that point, but whether or not there will be a tsunami of filings or rather instead a smaller but still not insignificant surge of filings remains to be seen. It is expected that small and medium-sized enterprises (SMEs) in particular could constitute a large part of the universe of firms that may experience financial distress in the coming period.

Furthermore, even as emerging market and developing country corporates entered the COVID crisis with a high level of corporate debt, there has been a further major buildup of debt among corporate borrowers during the COVID crisis itself. This could lead to debt servicing difficulties among corporate borrowers and could usher in a new wave of defaults, restructurings, and non-performing loans (NPLs) in the emerging economies and developing countries.

Nonetheless, if and when there is a sharp increase in insolvencies and restructurings in emerging market jurisdictions, this could pose a major problem for the court systems in the emerging economies and developing economies. These court systems, which even in the best of times do not necessarily have the capacity to deal with a large volume of cases and/or cases involving any degree of complexity, may find themselves overwhelmed with new filings.

In sum, if they are to be able to deal effectively with the expected surge in insolvencies and restructurings, the governments in the jurisdictions in question may need to encourage the relevant stakeholders to make much greater use of out-of-court restructuring mechanisms as opposed to formal in-court proceedings. Finally, the governments will have to do their part in developing the legal/regulatory frameworks and/or institutional platforms that could help facilitate expedited out-of-court restructurings.

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2020 in review: How Australia managed the COVID-19 crisis

by Peter Bowden, Anna Ryan and Charbel Moujalli, Gilbert + Tobin

In March 2020, the Australian Federal Government acted swiftly and decisively in response to the onset of the COVID-19 pandemic, introducing extraordinary temporary relief measures for Australian directors and fiscal support to Australian businesses. In this article, we recap on the impact of the fiscal and legislative measures taken by the Australian Federal Government to Australia's insolvency landscape. Such measures have had a stabilising effect on Australia's economy and also saw the introduction of new insolvency regimes for small businesses effective from January 1, 2021.

Temporary changes to insolvent trading and statutory demands

Following the outbreak of the COVID-19 pandemic in early 2020, the Australian Federal Government moved quickly to enact temporary measures in an effort to ensure and promote continuity for Australian businesses and jobs. On March 22, 2020, the Federal Treasurer proposed amendments to the *Corporations Act 2001* (Cth) (Act) and, after just three days, the *Coronavirus Economic Response Package Omnibus Act 2020* (Cth) (Economic Response Act) came into effect on March 25, 2020 (originally for a temporary period of six months).[1]

The Economic Response Act introduced temporary changes to the Australian insolvency regime (operating in parallel with recent reforms to protect directors), which sought to provide temporary support to distressed businesses and can be summarised as follows:

- relief for directors and holding companies from any liability for new debt incurred where a company trades whilst insolvent where the relevant debt was incurred in the ordinary course of the company's business;
- an increase to the statutory minimum (from A$2,000 to A$20,000) required for a creditor to issue a statutory demand and to the time for companies to respond a statutory demand (from 21 days to six months); and
- the ability for the Treasurer to provide targeted legislative relief for classes of persons from provisions of the Act to enable companies to deal with unforeseen events as a result of COVID-19.

With continued business disruptions and uncertainty as to the impact of the COVID-19 pandemic around travel and other restrictions, on September 7, 2020, the Federal Government announced an extension of these temporary relief measures to December 31, 2020. As at the date of this article, no further extension of the temporary protections has been granted.

The JobKeeper scheme

In addition to the very welcome temporary protection measures noted above, the Federal Government also enacted the *Coronavirus Economic Response Package Omnibus (Measures No. 2) Act 2020* (Cth) and the *Coronavirus Economic Response Package (Payments and Benefits) Act 2020* (Cth), which amended the Fair Work Act 2009 (Cth) to give effect to the Federal Government's "Jobkeeper" payment scheme (JobKeeper).

This unprecedented fiscal support measure, the JobKeeper scheme, entitled employers significantly affected by COVID-19 to wage subsidies of A$1,500 per fortnight per employee for a period of six months from March 30, 2020. Employers were required to demonstrate that they would incur a significant reduction in turnover due to the COVID-19 pandemic; 30% for businesses with a turnover of less than A$1bn, 50% for businesses with a turnover of greater than A$1bn and 15% for charities registered with the Australian Charities and Not-For-Profit Commission.

On July 21, 2020, the Federal Government announced that it would extend the JobKeeper scheme by a further six months to March 28, 2021. The fiscal support was slowly phased out, with the full employee subsidy decreasing to A$1,200 per fortnight from September 28, 2020 to January 3, 2021 and A$1,000 from January 4, 2021 to March 28, 2021.

Effect of the temporary relief measures and JobKeeper

The decisive action taken by the Australian Federal Government in the wake of the COVID-19 pandemic has had a stabilising effect on the economy. While many observers predicted a "tsunami" of corporate insolvencies following the expiration of the insolvent trading relief and the JobKeeper scheme, as at the date of this article, no such wave has eventuated.

Rather, the Australian economy appears to be recovering faster than expected. Forward looking and high frequency indicators suggest increased activity and growing strength in the Australian labour market, despite the expiry of the JobKeeper fiscal support.[2] Unemployment has fallen from 7.5% in September 2020 to 5.6% in March 2021 – just 0.5% higher than the pre-COVID rate in February 2020.[3]

Moreover, recent insolvency data provides no clearly discernible pattern of a deteriorating corporate environment. While formal insolvency appointments increased from 192 in January 2021 to 392 in February 2021, those figures remain significantly lower than their corresponding months in previous years.[4]

It is uncertain to what extent this apparently brisk recovery is owing to the fiscal and legislative measures taken by the Australian Federal Government (described above) or to the relatively minor effects Australia experienced since the onset of the pandemic as compared to Europe and the US. As such, it is critically important for Australian directors to remain vigilant of any further business disruption from COVID-19 outbreaks, despite the roll-out of global vaccination programmes.

Background to the small business restructuring reforms

The focus of the Australian Federal Government following the outbreak of the COVID-19 pandemic was not solely on temporary relief measures. On September 24, 2020, the Federal Government announced a suite of insolvency reforms aimed at reducing the costs of external administration for small businesses to improve viability and returns to creditors and employees. These reforms are yet another move towards modernising Australia's insolvency laws to facilitate corporate restructures (in this case, for smaller businesses).

The reforms took effect on January 1, 2021, coinciding with the expiration of the temporary relief measures for insolvent trading, and implemented a new small business restructuring process (SBR Process) and simplified liquidation process (SL Process) for small businesses. The *Corporations Amendment (Corporate Insolvency Reforms) Act 2020* (Cth) establishes the framework under the Act, while details on the operation of the simplified processes are included in regulations which amend the *Corporations Regulations 2001* (Cth) (Regulations) and rules made under the Act.[5]

SBR Process

The primary objective of the SBR Process is to enable distressed but viable companies to restructure their debts so they can continue to trade (that is, adopting a US-style 'debtor-in-possession' process for the first time in Australia). Part 5.3B of the Act follows the structure and key aspects of voluntary administration under Part 5.3A, but aims to provide a faster and less complex process to restructure existing debts.

Directors of an eligible small business can commence the SBR Process by appointing a "Small Business Restructuring Practitioner"

(SBRP) if they resolve that the company is insolvent or is likely to become insolvent and that a SBRP should be appointed.

A small business is eligible to appoint a SBRP if:[6]

(a) its total liabilities are less than A$1m;

(b) it is substantially compliant with its requirement to pay employee entitlements and make tax lodgements; and

(c) none of its directors (within the prior 12 months) have been a director and engaged the SBR Process for another company or have been the subject to a SL process within a seven-year period.

It is important to note that no reforms have been introduced in respect of businesses with an annual turnover of greater than A$1m.

As part of the SBR Process, the directors of the company and the SBRP work together to prepare a restructuring plan which must include a description of how the company's creditors would be repaid. This plan must be prepared and put forward to the company's creditors within 20 business days of the commencement of the SBR Process[7] and must be accompanied by a restructuring proposal statement which includes a schedule of the debts and claims of the company's creditors.[8]

Once the restructuring plan has been prepared, the SBRP must provide the plan, statement and the relevant declaration[9] to as many of the company's creditors as is reasonably practicable and invite creditors to indicate in writing whether or not the plan should be accepted. In the absence of an extension, creditors then have 15 business days to vote to accept or reject the plan.[10] A plan is accepted if a majority in value of the company's creditors who receive the plan and Statement vote to approve the proposal.[11]

While the directors remain in control of the company during the SBR Process, the directors must not enter into, or purport to enter into, a transaction or dealing affecting the property of the company unless:[12]

- doing so is in the ordinary course of the company's business;
- the SBRP provides its written consent (which can only be given if the relevant transaction is in the best interests of the company's creditors);
- the transaction or dealing was entered into under an order of the Court; or
- in the case of specific payments, the payment is specifically exempted from the prohibition.

Except with the leave of the Court, creditors cannot commence or continue proceedings against the company or, in relation to any of its property, recover an admissible debt or claim, or begin or proceed with an enforcement process to recover an admissible debt or claim.[13]

Despite its recent enactment, there has already been judicial consideration as to the operation of the SBR Process in two recent decisions of the Supreme Court of Victoria.[14]

While the Court considered discrete questions as to the operation of SBR Process *vis-à-vis* an adjournment of the creditor's winding up application, each of these decisions demonstrate that the new SBR process is being utilised by Australian small businesses.

SL Process

The SL Process is intended to provide a simpler, faster and lower cost liquidation for small businesses to increase potential returns to creditors and employees. The SL Process may be utilised if a company has total liabilities of less than A$1m, is insolvent and has entered into a creditors' voluntary liquidation.

If the directors of a company believe on reasonable grounds that the company meets the eligibility criteria for the SL Process (which is broadly the same as that for the SBR Process), the directors may give the liquidator of the company a declaration to that effect within five business days after the day of the meeting at which the resolution for voluntary winding up of the company is passed.[15]

The liquidator may adopt the SL process if the liquidator reasonably believes that the company satisfies the eligibility criteria. However, the liquidator must not adopt the SL process if:[16]

- more than 20 business days have passed since the day on which the triggering event that brought the company into liquidation occurred;
- at least 25% in value of the creditors request that the liquidator not follow the SL process in relation to the company (SL Creditor Threshold); or
- at least 10 business days before adopting the SL Process, the liquidator has *not* given a written notice to the members and creditors of the company that includes:
  (i) a statement that the liquidator believes on reasonable grounds that the company will meet the eligibility criteria for the SL Process when the SL Process is adopted;
  (ii) an outline of the SL Process containing the prescribed information (if any);
  (iii) a statement that the liquidator will not adopt the SL Process if the SL Creditor Threshold is satisfied; and
  (iv) prescribed information on how a creditor may give a direction in writing not to adopt the SL Process.

The liquidator must cease to follow the SL process if the eligibility criteria for the SL process are no longer met or if they have reasonable grounds to believe that the company, or a director of the company, has engaged in fraud or dishonest conduct and the conduct has had, or is likely to have, a material adverse effect on the interests of the creditors as a whole or of a class of creditors as a whole.[17]

As at the date of this article, we are not aware of any judicial consideration of the SL process.

Concluding remarks

While it may be too early to draw conclusions, it appears, for the time being, that the swift and unprecedented relief and fiscal stimulus measures enacted by the Australian Federal Government in 2020 were effective in stabilising the economy and positioning it for what appears to be a strong recovery.

The outbreak of the COVID-19 pandemic prompted the introduction of legislation aimed at addressing aspects of Australia's creditor-focussed voluntary administration and liquidation processes, which have often been questioned for their utility in successfully restructuring companies.

Continuing its focus on supporting distressed businesses following the outbreak of the COVID-19 pandemic, as part of its budget for 2021-2022, the Federal Government announced[18] that it will continue to examine ways to improve Australia's insolvency framework.

The Government is currently consulting with stakeholders as to:

- the treatment of trusts and corporate trustees under insolvency law; and
- improving the current scheme of arrangement model, including the introduction of a moratorium on creditor enforcement while a scheme is being negotiated.

In addition, the Federal Government also proposes an increase to the minimum threshold at which creditors can issue a statutory demand from A$2,000 to A$4,000 and the commencement of a review of the insolvent trading safe harbour provisions.

While the Federal Government has only provided limited details of these further reforms as at the date of this article, it is clear that further reform to Australia's insolvency framework is a priority for the Federal Government and is intended to play an integral part in Australia's wider economic recovery.

While the SBR Process and the SL Process are welcome additions to Australia's insolvency regime for Australian small businesses (particularly with the SBR Process adopting a 'debtor-in-possession' approach), it remains to be seen whether these processes will be effective in significantly improving small business continuity and/or realising better returns for creditors, when compared to the existing voluntary administration and liquidation regimes.

Notes:

[1] For a more detailed discussion as to the contents and effect of the Economic Response Act, see: Bowden, P. & Ryan, A., *Managing uncertainty: Australia's response to COVID-19 for distressed businesses*, CMI International Insolvency & Restructuring Report 2020/21.

[2] Oster, A. (April 2021) *The Bigger Picture – A Global & Australian Economic Perspective*, National Australia Bank – Group Economics, accessed April 27, 2021.

[3] Australian Bureau of Statistics (March 2021) *Labour Force, Australia*, ABS Website, accessed April 27, 2021.

[4] Australian Securities and Investments Commission, *Insolvency Statistics*, ASIC Website, accessed April 27, 2021.

[5] *Insolvency Practice Rules (Corporations) 2016* (Cth).

[6] Regulation 5.3B.03 of the Regulations.

[7] Regulation 5.3B.14 and 5.3B.21 of the Regulations.

[8] Regulation 5.3B.16 of the Regulations.

[9] Where the SBRP does not believe on reasonable grounds that the company will be able to discharge the obligations created by the plan, a declaration setting out the reasons for reaching that conclusion. See regulation 5.3B.18 of the Regulations.

[10] Regulation 5.3B.21 of the Regulations.

[11] Regulation 5.3B.25 of the Regulations.

[12] Regulation 5.3B.39 of the Regulations.

[13] Regulation 5.3B.30 of the Regulations.

[14] See *Re Dessco Pty Ltd* [2021] VSC 94 and *Re DST Project Management and Construction Pty Ltd* [2021] VSC 108.

[15] Section 498 of the Act and regulation 5.5.03 of the Regulations.

[16] Section 500A of the Act.

[17] Regulation 5.5.07 of the Regulations and section 500AC of the Act.

[18] Treasury (Cth), 'Further insolvency reforms to support business dynamism' (Media Release, May 3, 2021); Australian Federal Government, 'Budget Paper No. 2 - Part 2: Payment Measures' p. 188 (Budget 2021-22, May 11, 2021).

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A quick guide to corporate insolvency in Austria

by Markus Fellner, Josef Danler and Elisabeth Fischer-Schwarz, Fellner Wratzfeld & Partner Rechtsanwälte GmbH

Although the COVID-19 pandemic has hit the global market as a whole, mainly national laws within the European Union still govern restructuring and insolvency proceedings. As a result, the measures to mitigate the effects of the coronavirus pandemic vary significantly from jurisdiction to jurisdiction. This article summarises the applicable law relating to corporate insolvency and restructuring in Austria and answers some of the questions most likely to be asked by distressed companies or their creditors.

Legal framework

The legal framework for insolvencies of business entities (as well as individuals) in Austria is codified in the Insolvency Act. The primary objective of the Insolvency Act is to ensure uniform and proportionate satisfaction of unsecured creditors. In addition, insolvency proceedings are also intended to restructure companies and relieve individuals of debt.

Ahead of insolvency proceedings, solvent debtors may apply for reorganisation under the Business Reorganisation Act. The Austrian Business Reorganisation Act sets out rules for corporate reorganisation proceedings (which are not to be confused with insolvency proceedings) in relation to a solvent debtor's business, which affect creditors' rights to a lesser degree.

The purpose of the Business Reorganisation Act is to encourage businesses to attempt a restructuring under the supervision of a court-appointed restructuring auditor where the business is not yet insolvent, but where the financial position of debtor has deteriorated beyond a certain point (showing a debt-equity ratio of less than 8% and a pro-forma debt amortisation period of 15 years or more).

Restructuring proceedings are intended to be completed within a two-year period and are not available to insolvent companies. In practice, due to the high costs of the restructuring auditor, the fear of reputational damage and outcome uncertainty means that these types of proceedings are rarely applied.

On February 22, 2021, the eagerly awaited ministerial draft regarding the Federal Law on the Implementation of the Directive on Restructuring and Insolvency (EU) 2019/1023 (DRI) was published. The main objective of the DRI is to establish a uniform pan-European restructuring framework that enables debtors to restructure their business in order to limit the unnecessary liquidation of economically viable companies. For this purpose, viable companies that have run into financial difficulties are to have access to court-based "pre-insolvency restructuring proceedings". The draft includes a new federal law on the restructuring of companies. The review period ends on April 6, 2021. Austria is obliged to implement the directive by July 17, 2021.

Types of insolvency proceedings

There are three different kinds of insolvency proceedings under the Insolvency Act:

(i) bankruptcy proceedings;
(ii) restructuring proceedings with self-administration; and
(iii) restructuring proceedings without self-administration.

While bankruptcy proceedings lead to the liquidation or the sale of the debtor's business, the aim of both restructuring proceedings with self-administration (the debtor generally retains control over the estate's assets subject to certain restrictions) and restructuring proceedings without self-administration (a court-appointed insolvency administrator takes control) is the restructuring of an insolvent entity as a going concern.

Insolvency proceeding triggers

Under Austrian law, a debtor is obliged to file for the opening of insolvency proceedings if the debtor is insolvent, which means that the debtor is either illiquid or over-indebted. The Insolvency Act does not provide a legal definition for illiquidity and over-indebtedness.

According to case law, illiquidity is to be assumed if the debtor is unable to pay more than 5% of its due monetary liabilities and cannot obtain the necessary means of payment in the foreseeable future.

The determination of over-indebtedness involves a two-pronged test. According to case law, the necessity to apply this test is triggered by negative equity. The subsequent testing steps are as follows:

(i) the company needs to assess whether the liabilities on the debtor's balance sheet exceed the debtor's assets (calculatory indebtedness); and

(ii) the company needs to assess whether it qualifies for a positive going-concern prognosis.

If the company is in a state of calculatory over-indebtness and a positive going-concern prognosis is not feasible, the company is insolvent by reason of over-indebtedness.

The Insolvency Act requires the debtor to file for the opening of insolvency proceedings without culpable delay no later than 60 days after the debtor has become insolvent. If the debtor's insolvency is caused by a "natural disaster" such as an epidemic or a pandemic (including the COVID-19 pandemic), the 60-day period is doubled to 120 days. This time period can be used for restructuring efforts, such as downsizing operations, selling assets, reducing staff, raising new capital and undertaking measures to boost sales. Any restructuring measures deployed by the management need to focus on the restoration of liquidity and removal of over-indebtedness, as long as the particular action does not harm the debtor's creditors.

If an entity is illiquid or over-indebted, the legal representatives are obliged to file for the opening of insolvency proceedings. If the legal representatives fail to file for insolvency without undue delay – or in any event, no later than within the 60 or 120-day time period, whichever is applicable – the legal representatives expose themselves to possible civil and criminal charges (including fraud and undue preference for a creditor) for impairment of the creditors' interests.

Disregarding the 60 or 120-day time limit is one of the few cases where a legal representative of a limited liability company may be held personally liable for damage inflicted on the company's creditors (a possible reduction of the insolvency quota). Furthermore, the legal representatives may be liable to the entity for any payments implemented while already in a state of insolvency.

Due to the COVID-19 crisis, the duty to file for insolvency due to over-indebtedness is suspended until June 30, 2021 for the time being, whereby this deadline has been extended several times thus far mirroring the continuation of the COVID-19 pandemic: A debtor is not required to file an insolvency petition for over-indebtedness occurring between March 1, 2020 and June 30, 2021. If the debtor is over-indebted at the end of June 30, 2021, it must file for the opening of insolvency proceedings without undue delay, but at the latest within 60 days after the end of June 30, 2021 or 120 days after the date of determination of over-indebtedness, whichever period ends later.

Apart from the company's legal representatives, any creditor is entitled to file for insolvency in the form of liquidation bankruptcy proceedings. In case a creditor attempts to put the debtor into involuntary bankruptcy, the creditor must provide evidence that the following statutory requirements are met:

(i) the existence of a claim against the debtor; and

(ii) insolvency of the debtor, which is to be presumed if the debtor has stopped to pay its debts as they fall due (illiquidity).

Procedural aspects

Insolvency proceedings of companies are conducted by the insolvency court, a separate part of the court of general jurisdiction, in which the debtor has its legal seat or residence. Insolvency proceedings of private individuals are an exception, as they are conducted before district courts, which are courts of limited general jurisdiction. The court, among other things, decides on the opening of proceedings, appointment of the insolvency administrator and a possible creditors' committee, the sale of the business or relevant assets, and the end of the proceedings.

The insolvency administrator is appointed by the court from a list of potential candidates (typically the insolvency administrator is a lawyer). The insolvency administrator has a central oversight and management function in any type of insolvency proceedings. Regularly, the insolvency court's order for the commencement of the proceedings cuts off the debtor's (management's) authority to represent the insolvent entity and to make any dispositions in respect of its assets and liabilities, which powers are transferred to the administrator under such order.

In case restructuring proceedings with self-administration are opened, the debtor is generally entitled to keep on running the company and take steps and measures in the ordinary course of business, but the consent of the insolvency administrator and/or insolvency court is required for a number of other extraordinary measures.

The court must promptly assign a creditors' committee consisting of three to seven members if the nature or particular scope of the debtor's business necessitates such a measure. The court must always assign a creditors' committee to the insolvency receiver where a sale or lease of the debtor's business, or a portion thereof, is intended. The creditors' committee has the duty to supervise and assist the insolvency administrator.

Effects of insolvency proceedings

Once insolvency proceedings or reorganisation proceedings without a debtor-in-possession regime are opened, the debtor (in most instances, the debtor's management) loses its right to represent the insolvent entity and to make any dispositions with respect to its assets. Any attempted disposition by the debtor or its officers is void and without effect.

Creditors may not initiate or continue legal actions – specifically enforcement actions – against the debtor. After the opening of insolvency proceedings, the enforcement of a claim requires the filing of the claim as an insolvency claim with the insolvency court. The period in which the claim must be filed is published in the official notice. The insolvency administrator summarises all claims in a special registration list, which is then submitted to the court. In practice, all claims are first examined by the debtor and the insolvency administrator, and then again formally in the examination hearing in court. The insolvency administrator needs to declare whether he acknowledges or rejects a claim.

Furthermore, legal actions and transactions that have taken place within certain periods may be challenged if the following general prerequisites are fulfilled:

(i) the avoidance results in an increase of the insolvency estate; and
(ii) the challenged legal act or transaction caused the direct or indirect discrimination of creditors.

A transaction can be contested for intent to discriminate, squandering of assets, free-of-charge disposal, preferential treatment of creditors and knowledge of illiquidity. A successful challenge forces the other party to return received payments or transferred assets to the debtor's estate. The look-back period varies, ranging from a maximum of 10 years for intent to discriminate, to 60 days prior to the commencement of insolvency proceedings for preferential treatment of creditors, whereas certain periods are shortened where the third party knew or should have known (i.e. negligently did not know) the respective facts.

Rights of creditors

In all types of insolvency proceedings (reorganisation proceedings with debtor in possession, reorganisation proceedings without debtor in possession and liquidation proceedings), claims are classified and ranked in the following order of priority:

Secured creditors

Secured creditors either have claims of separation to receive assets (*Aussonderungsanspruch*) and/or claims of separation to receive the proceeds of enforcement after sale (*Absonderungsanspruch*). These claims generally are not affected by the opening of the insolvency proceedings but may be challenged if the prerequisites therefor are met.

In order to assert its claim, the secured creditor merely has to inform the insolvency administrator. If the insolvency administrator does not acknowledge the claim, the secured creditor has to file a lawsuit against the insolvency administrator in order to enforce the senior security. However, under Austrian insolvency law no secured claim can be paid within six months from the commencement of insolvency proceedings in case such claims might jeopardise the business continuity of the debtor. Only if the enforcement is vital to prevent severe economic disadvantage to the secured creditor may this be disregarded.

Estate claims

Ranked behind secured claims are estate claims (*Masseforderungen*), which are to be satisfied prior to other insolvency claims. Estate claims comprise, *inter alia*, the costs of the insolvency proceedings, the expenses of management and administration of the estate, claims for labour, services and goods furnished to the estate post-filing, and the costs of the insolvency administrator. Preferential creditors of estate claims share in such claims on a pro rata basis.

Estate claims are to be paid by the insolvency administrator without any filing procedure.

Insolvency claims

The next rank is taken by insolvency claims (*Insolvenzforderungen*), which are claims of unsecured creditors. Insolvency claims must be filed with the insolvency court within a certain time period after the opening of insolvency proceedings as fixed by the court. The insolvency creditors who file a claim acknowledged by the insolvency administrator also share in such claims on a pro rata basis.

Subordinate claims

Subordinate creditors only participate in the insolvency proceedings if a surplus for distribution is generated. Subordinate claims may result from contractual provisions or from statutory provisions. For example, claims for repayment of equity substituting shareholder loans, which are loans granted to a company during its crisis, are subordinate claims.

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The insolvency scenario in Brazil: Certain relevant issues

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Being one of the larger economies of the world, Brazil has suffered the impact of international as well as national crises, aggravated by the harsh impacts of the COVID-19 pandemic on the Brazilian economy. For the insolvency sector, many issues of importance have been discussed at different levels of government, resulting in a major reform of the Brazilian Bankruptcy Law. This article will discuss the main aspects of such reform, as well as other issues that were addressed by case law.

The adoption of the UNCITRAL Model Law and other issues addressed by Law 14,112/2020

Law nr. 14,112/2020, enacted in December 2020, adopts, among other provisions, the model law on cross-border insolvencies of the United Nations Commission on International Trade Law (UNCITRAL).

After almost 15 years in effect, expectations in relation to reforms in the Brazilian Bankruptcy Law were high, considering that several provisions no longer met the current needs of the business world. Law nr. 14,112/2020 came about to address some of these issues, modernising the application of the Brazilian Bankruptcy Law.

The absence of specific legislation in the international area has led Brazilian courts to apply current Brazilian law to cross-border conflicts, considering the rise in the number of cases of insolvency that traverse national borders. Legal certainty and recognition of foreign insolvency decisions, however, have been subject to vagaries inconsistent with the requirements of modern inter-dependent economies.

With the intention of overcoming this legislative gap, Law nr. 14,112/2020 introduces a chapter in the Brazilian Bankruptcy Law dedicated to international insolvency through the adoption of the UNCITRAL rules, created in 1997, with the purpose of providing greater strength to nations in their ability to resolve cases involving insolvency of a transnational nature.

In addition to the general provisions relating to international insolvency, Law nr. 14,112/2020 also presents specific rules concerning access to Brazilian jurisdictions by foreign representatives; the equal standing of the rights held by foreign and Brazilian creditors in insolvency processes; provisions addressing requests to Brazilian judges for recognition of foreign processes; the cooperation between foreign and Brazilian courts; and specific regulations for processes running concurrently in Brazil and overseas.

Law nr. 14,112/2020 also has other provisions, many of which are positive, such as:

(i) an improvement in the tax treatment of distressed companies (which was vetoed by the President, but restored by the Congress);
(ii) the possibility of presentation of an alternative plan by creditors if the insolvent company does not present its plan or if the presented plan is rejected;
(iii) the possibility of selling the debtor company or group of companies as a whole, with the restructured indebtedness, to a new investor interested in continuing the business, including measures to protect the buyer from being held liable for other debts of the seller;
(iv) the option to replace in-person creditor meetings by virtual meetings or written adherence terms that prove the achievement of the deliberation quorums;
(v) new rules for substantive consolidation, with the proposition of objective criteria to guide its application by the Courts;
(vi) the possibility of replacing the two-year judicial monitoring of insolvent companies

by private monitoring (hence terminating the reorganisation procedure with the Court confirmation of the plan);

(vii) the reduction of the quorum needed to approve pre-packaged reorganisation plans, from 66% to more than 50% of the claims of each impaired class of creditors;

(viii) healthy reforms of the liquidation in bankruptcy system, including a 180-day deadline to complete the sale of all the assets;

(ix) the possibility of a fresh start for insolvent companies and related individuals, with a significant reduction on the applicable timeframes; and

(x) the introduction of a new treatment for debtor-in-possession (DIP) financing.

As to the last item, Law nr. 14,112/2020 now expressly refers to DIP financing operations, protecting the guarantees and the priority of the claim even if the authorising decision is reversed by the Court of Appeals. However, the provisions related to the DIP financing are not immune to criticism made by legal experts, especially with regard to the uncertainty of which operations can be qualified as "DIP financing", as well as the lack of priming rules.

Despite the positive changes, several legal experts have expressed their concern in relation to certain alterations addressed in other chapters of Law nr. 14,112/2020, especially the increase of the prerogatives conferred on the tax authorities in insolvency proceedings. In addition, Law nr. 14,112/2020 addresses matters which were efficiently addressed by current legislation and case law and did not require change.

The representation of bondholders in the General Meetings of Creditors and the individualisation of their credits

The raising of financial resources through the issuance of trade currency on the international markets has become common practice in Brazil since the 1990s. According to available data, hundreds of billions of US dollars have been raised by companies or government entities over the past few years through the issuance of fixed income securities, including bonds, medium-term notes and securitisation transactions.[1]

This situation affects the Brazilian insolvency legal system, as the number of companies that have issued bonds and are in judicial recovery has risen, an example being the Odebrecht Group, with US$3bn in bonds issued.

Brazilian case law permits bondholders to be represented by their indenture trustees or to individualise their right to vote on the credits involved in an insolvency proceeding.

As an example, in the restructuring of the OGX Group[2], the 4th Commercial Court of Rio de Janeiro approved the adoption of a procedure proposed by the trustee, by means of which the bondholders could opt to individualise their proofs of claim to vote on the judicial reorganisation plan during the general meeting of creditors. The same happened in the Oi[3], Rede[4] and Aralco[5] cases, amongst others.

In 2015, the 'II Jornada de Direito Comercial' approved Statement nr. 76, which established that "in the cases of issuance of debt securities by a company under reorganisation, in which there exists a fiduciary agent or similar figure representing a collective group of creditors, it is the responsibility of the fiduciary agent to exercise the vote at the general meeting of creditors, under the terms and by means of the authorisations provided in the issuance deed, subject to the power of any final investor to file with the judicial reorganisation court a request for the break-up of the right to a voice and a vote at a general meeting to exercise such individually, solely by means of judicial authorisation."

The foreclosure of credits which are not subject to a court reorganisation

Creditors that hold title to assets or rights which were granted by an insolvent company as security are, in principle, not affected by an insolvency filing and are therefore authorised to enforce their rights.

Courts have however been resistant to applying this rule, in its strictest sense, whenever the enforcement of such rights during the stay period could jeopardise the reorganisation of the insolvent company. Several theories have emerged to justify this position, amongst which are the "essentiality" of the asset, the lack of "individualisation" of the credit, the recognition that the acceleration clause of such a debt is subject to the filing, or even the partial enforcement of the rule.

In those terms, in 2019, the Court of Appeal of São Paulo (AgInt nr. 2236949-78.2018.8.26.0000) recognised that a creditor may not remove its security if it is essential to the debtor's activities.

Nonetheless, this decision does not represent the consolidated understanding of the Superior Court of Justice.

The Superior Court, thus far, is contrary to the release of bank locks and the non-submission of credits assigned in fiduciary guarantee to the effects of judicial recovery, under the terms of the Bankruptcy and Judicial Reorganisation Law (art. 49, § 3).

These matters are still being discussed at all levels in the state courts and a final definition has yet to be structured.

Government credits against companies under judicial reorganisation

Even after the reform, the Brazilian Bankruptcy Law establishes that the processing of judicial reorganisation shall not suspend the course of tax enforcements[6] filed against the debtor (art. 6, §7) and, in parallel, the National Tax Code (art. 187, lead paragraph) excludes tax credits from any insolvency proceeding.

Thus, in relation to tax credits there can be no doubt: these are not subject to the judicial reorganisation proceedings and the foreclosure may proceed in the specialised courts in which they have been filed. Only the enforceable acts designed to constrict or expropriate the assets of a company under judicial reorganisation must be previously submitted to the proper restructuring court.[7]

Albeit not subject to the judicial reorganisation proceeding, Law nr. 14,112/2020 provides that the debtor must deal with its tax indebtedness to have its reorganisation plan confirmed. Tax authorities can even file for the liquidation of the debtor in case of default of tax obligations. However, Law nr. 14,112/2020 introduces new means for the debtor to deal with tax credits (at least on a federal level), such as refinancing mechanisms and the possibility of tax settlements.

Government non-tax credits, on the other hand, have received different treatments by the courts, because statutory law is not clear in this respect, even after the reform.

In the Celpa and Oi[8] cases, penalties imposed by their respective regulators have been classified as unsecured (non-tax) credits in insolvency proceedings. Yet in the Libra Group[9] case, according to the 2nd Bankruptcy Court of São Paulo, these same credits were treated as tax credits.

It is important to stress, however, that the Higher Courts have still not made their position clear with respect to this issue. There is however a trend in the Judiciary to accept the judicial restructuring of such credits, which is confirmed by a recent precedent from São Paulo recognising that a public credit arising from contractual non-compliance should be subject to the judicial reorganisation of the Viracopos Group[10].

Credits in foreign currency within the judicial reorganisation

The Brazilian Insolvency Law establishes that, in the general meetings of creditors, for decisions on any matters that are incidental to the judicial reorganisation proceeding, the creditor's vote shall be proportional to the sum of their credit (art. 38, lead paragraph). In relation to the decisions for approval or rejection of the judicial reorganisation plan, this regulation also applies for the purposes of calculating the quorum for all the classes of credits, except for the credits from classes I (labour) and IV (micro-companies and small companies), the quorums of which are calculated by a simple majority of the creditors present, regardless of the value of their credits (art. 45, §2º).

But if the creditors belonging to other classes that are not I or IV (that is, the holders of *in-rem* guarantees [class II] and unsecured creditors [class III]) vote, in all cases, the issue arises as to how foreign-denominated credits should be treated, given the natural fluctuation in exchange rates.

The sole paragraph of article 38 regulates the matter, establishing that, in judicial reorganisation procedures, for the exclusive purposes of voting at the general assembly, the credit in foreign currency should be converted into local currency using the exchange rate on the eve of the date upon which the meeting takes place. However, the law does not define the rate that should be applied to this conversion.

There exist different interpretations on this matter in legal doctrine. For some, considering that the currency has a sale price and a purchase price, the conversion should be performed in accordance with the currency sale price. The best understanding, however, seems to be that defended by other scholars, who suggest the equitable criteria applicable in Brazilian law to overcome the legal gaps, defending that an average market rate should be applied, such which corresponds to the average falling between the purchase rate and the sale rate.

In relation to the payment conditions, the current Insolvency Law is favourable to a debt expressed in foreign currency: the legislation establishes that the exchange rate variation shall be the parameter of indexation of the debt, unless the amounts owed should come to be otherwise determined by the creditor (art. 50, §2).

In other words, unless the foreign currency creditor expressly agrees to the provision of the judicial reorganisation plan that alters the parameters of the calculation of their credit when payment is effectively made, the rate of conversion should necessarily be observed as a parameter for the establishment of their credit.

The abovementioned issues are but a few of those which are being discussed by the legal and business communities, as well as in our courts and universities. They reflect the vibrant atmosphere in which insolvency matters are being dealt with in this country, especially after the recent reform in the legislation.

Notes:

1 http://portal.anbima.com.br/informacoestecnicas/boletins/mercado-de-capitais/Documents/BoletimMK_201508.pdf

2 In re OGX, Case nr. 037762056.2013.8.19.0001, 4th Lower Commercial Court of Rio de Janeiro.

3 In re Oi S.A., Case nr. 0203711-65.2016.8.19.0001, 7th Lower Commercial Court of Rio de Janeiro.

4 In re Rede Energia, Case nr. 0067341-20.2012.8.26.0100, 2th Lower Commercial Court of São Paulo.

5 In re Aralco, Case nr. 1001985-03.2014.8.26.0032, 2th Lower Civil Court of Araçatuba.

6 Judicial process of foreclosure for satisfaction of a tax or non-tax debt.

7 On the other hand, the debtor should present a certificate of good tax standing when requesting ratification of its judicial reorganisation plan, precisely so that its restructuring, although having an impact on the charging of the tax credits, does not end up providing defense for those under restructuring against their tax creditors.

8 Court of Appeals of Rio de Janeiro, Interlocutory Appeal n. 0057446-63.2017.8.19.0000 (2017).

9 2nd Bankruptcy Court of São Paulo, dockets n. 1077065-21.2018.8.26.0100 (2019).

10 Court of Appeals of São Paulo, Interlocutory Appeal n. 2197201-05.2019.8.26.0000 (2019).

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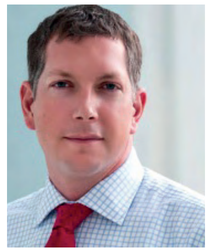
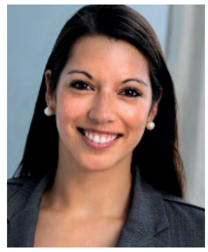
"Brothers in arms": How certain companies in dire straits can implement restructurings with Cayman Islands assistance





by Neil Lupton, Tim Buckley, Fiona MacAdam, Marc Hecht and Jennifer Sangaroonthong
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The Cayman Islands has long established itself as one of the leading offshore financial centres by offering an internationally recognised corporate and financial services regime, a robust regulatory framework that is in line with international standards and flexible restructuring options by which to implement cross-border restructurings. With a common law legal system based on English law (with ultimate recourse to the Judicial Committee of the Privy Council in the United Kingdom) thereby providing certainty and predictability, a dedicated financial services division of the Grand Court of the Cayman Islands (the "Grand Court") and an experienced network of judges, practitioners and advisors in the insolvency and restructuring sector, the jurisdiction has a proven track record for delivering solutions to complex situations in order to achieve successful corporate restructurings.

The unprecedented financial volatility and operational uncertainty brought about by the COVID-19 pandemic has forced many companies to consider a range of restructuring options in a variety of jurisdictions, either on a proactive basis or as a reaction to creditor pressure. Where it is not possible to achieve a restructuring with the unanimous consent of a company's creditor base, companies are required to carefully consider the most suitable restructuring regime and jurisdiction that will best serve their objectives and those of their stakeholders.

Given the flexibility of the Cayman Islands restructuring regime and the prevalence of Cayman Islands incorporated entities in corporate structures, there has been an increase in the number of cross-border restructurings involving the use of Cayman Islands incorporated entities as a restructuring vehicle.

The deployment of the provisional liquidation regime includes instances where there is an existing Cayman Islands incorporated entity in the structure (such as, an investment holding company and/or debt issuer) or where one is purposely inserted into the group structure in order to make use of the restructuring options that the Cayman Islands has on offer to facilitate a cross-border restructuring.

Cayman Islands - flexible restructuring options available

In the Cayman Islands, there is presently no formal rehabilitation process for companies in financial distress which is similar to US Chapter 11 proceedings or the English administration regime. Where a Cayman Islands company intends to effect a financial restructuring, provisional liquidators are often appointed in order to take advantage of the statutory automatic moratorium which protects the company from creditor enforcement action and/or proceedings being commenced or continued without the leave of the Grand Court.

This automatic moratorium is key because it provides breathing space for a debtor to negotiate with its stakeholders and to then propose and implement a restructuring without the risk of the process being derailed by the actions of one or more dissenting creditors.[1]

Pursuant to section 104(3) of the Cayman Islands Companies Act (2021 Revision) (the "Companies Act"), following the presentation of a winding up petition, a company may at the same time make an application seeking the appointment of provisional liquidators where: (a) the company is, or is likely to become unable to pay its debts; and (b) the company intends to present a compromise or arrangement to its creditors. A compromise or arrangement can be implemented by way of a Cayman Islands' scheme of arrangement, a US Chapter 11 plan of restructuring or a foreign scheme of arrangement.

A Cayman Islands scheme of arrangement is a statutory procedure under the Companies Act and the provisions are similar to those set out for an English scheme under the English Companies Act; it is a court-approved compromise or arrangement between a company and its creditors or shareholders (or classes thereof).

A scheme of arrangement is frequently used to implement a financial restructuring by varying or cramming down the rights of the relevant creditors and/or shareholders of a company in appropriate circumstances but may also be used to complete corporate transactions such as group restructurings, reorganisations, acquisitions, mergers and take-private transactions. Accordingly, a scheme of arrangement offers a flexible mechanism that is not a formal insolvency process. The directors of the company would remain in control of the company whilst formulating the terms of and promoting a scheme outside of a liquidation.

However, a scheme of arrangement implemented outside of a Cayman Islands liquidation would not have the benefit of the automatic moratorium from unsecured claims that a provisional or official liquidation can offer.

The presentation of a winding-up petition against a company is a necessary pre-requisite to the application to commence provisional liquidation proceedings in the Cayman Islands. However, whilst that winding up petition is the gateway to accessing the Cayman Islands provisional liquidation regime, provisional liquidation does not necessarily result in the formal winding up and liquidation of the debtor. Rather, where provisional liquidation is used to support a successful financial restructuring where the debtor company is intended to survive, the end result is typically that the winding up petition is dismissed and the newly restructured company continues as a going concern.

Provisional liquidators are officers of the Grand Court and agents of the company, to which they owe fiduciary duties to act in good faith and in the interests of the company as a whole. The powers of the provisional liquidator are not circumscribed by statute and instead are expressly set out in the court order appointing the provisional liquidator.

The court order will often limit the powers of a provisional liquidator to monitoring the progress of the restructuring and reporting to the Grand Court and the company's stakeholders, and will typically also set out the powers which may be retained by the directors and existing management of the company. It is typical for provisional liquidators' powers to not completely displace the powers of the company's directors or existing management. Accordingly, there is scope for the provisional liquidation regime to be used with real flexibility in the context of a restructuring, depending upon how much control over the process the provisional liquidator is intended to have. This flexibility has developed a practice in the Cayman Islands known as a "light-touch" provisional liquidation.

It is open to "light-touch" provisional liquidators to apply for further powers as necessary, but it is clear that the provisional liquidation proceeding can be structured as a quasi-debtor in possession process or can be utilised as an ancillary proceeding in order to support a debtor in possession process already underway in another jurisdiction, such as Chapter 11 of the US Bankruptcy Code. This would ensure that the restructuring plan that is agreed between the company and its creditors is effective as a matter of Cayman Islands law (that is, binding on the Cayman entity and its creditors).

Once the restructuring plan or compromise has been implemented and given effect in the Cayman Islands, the company can seamlessly and simultaneously emerge from both the foreign proceeding and the Cayman Islands provisional liquidation and continue as a going concern post-restructuring.

Cayman Islands vehicles

Section 104 of the Companies Act provides that, at any time after the presentation of a winding-up petition but before the making of a winding-up order, the Grand Court may appoint a provisional liquidator. Since provisional liquidation requires, as a pre-requisite, the presentation of a winding-up petition, it follows that provisional liquidation is available to any company which is liable to be wound up by the Grand Court under the Companies Act. Whilst that includes a company incorporated and registered in the Cayman Islands under the Companies Act, a foreign company may also be wound up under the Companies Act if it has property located in the Cayman Islands, is carrying on business in the Cayman Islands, is the general partner of a Cayman Islands limited partnership or is registered as an overseas company under Part IX of the Companies Act.

It is not uncommon for global corporate groups to include a Cayman Islands incorporated entity in their structure, whether an ultimate or intermediate holding company. The two main types of Cayman vehicles used in these circumstances are: (i) a Cayman Islands exempted limited company ("ELC"), which is governed by the Companies Act; and (ii) a limited liability company ("LLC"), which is governed principally by the Limited Liability Companies Act (as amended)[2] (the "LLC Act").

Both vehicles are body corporates with separate legal personality that provide flexibility in terms of control and corporate governance. Importantly, both vehicles also provide limited liability to their owners (being the shareholders of an ELC and the members of an LLC).

The business of an ELC is managed by the directors, who owe various fiduciary duties to the ELC, and shareholders do not generally participate in the management of the ELC's business, although their approval is required for certain actions of the ELC.

Compared to an ELC, an LLC (which is very similar to a Delaware limited liability company) provides significantly more flexibility in terms of corporate governance and membership control, which are agreed contractually in a limited liability company agreement (the "LLC Agreement"). By way of example, the types of mechanisms that can be agreed (which are helpful in a restructuring context where the emerging parent company of the group is a Cayman entity), can include:

- a mechanism by which those who held certain claims against the company in provisional liquidation can be admitted to the LLC as members pursuant to the plan filed pursuant to Chapter 11 proceedings and the confirmation order received pursuant to the Chapter 11 process – in a debt-for-equity restructuring context;
- designations of certain classes of membership interests in the LLC;
- providing for certain rights and obligations of holders of membership interests in the LLC, including controls on voting rights;
- governance mechanisms dealing with the appointment and removal of managers and observers;
- limitations and restrictions on transfers of membership interests; and
- drag-along and tag-along rights.

Cayman Islands' entities also provide great flexibility for the ultimate exit of the owners, for example, by trade sale, merger or amalgamation or listing on any recognised stock exchange.

Pacific Drilling restructuring

Walkers recently advised an ad hoc group of noteholders in connection with the balance-sheet debt-for-equity restructuring of the Pacific Drilling group, an international offshore drilling company that specialises in ultra-deepwater drilling and well construction services.

The restructuring, which was achieved by way of a concurrent US Chapter 11 proceeding and Cayman Islands provisional liquidation process, resulted in the Pacific Drilling group emerging with a de-levered capital structure (with in excess of US$1bn of debt obligations being eliminated) and with a healthy liquidity position to support its operations as a world-class provider of drilling services.

To facilitate the restructuring, a Cayman Islands holding company (initially an ELC which was subsequently converted to an LLC (as noted below)) was inserted into the group structure between Pacific Drilling S.A., the Luxembourg parent company ("Lux Parent") and Pacific Drilling Holding (Gibraltar) Limited, the Lux Parent's immediate subsidiary at the time (that is, pre-restructuring).

The insertion of the Cayman Islands company occurred prior to the US Chapter 11 filing, which enabled the group to avail itself of the Cayman Islands provisional liquidation regime and the benefits it provides (as noted above). This Cayman Islands entity, Pacific Drilling Company LLC ("PDCL"), was the parent company of the restructured Pacific Drilling group on exit and was owned by the group's pre-restructuring creditors and certain of the group's debtor affiliates.

In order to provide PDCL's members (that is, the pre-restructuring creditors) with the various benefits and flexibility of an LLC (as noted above), PDCL was converted from an ELC to an LLC whilst in provisional liquidation with the approval of the Grand Court. We understand that this is the first such occasion of an ELC converting to an LLC whilst in provisional liquidation and is therefore a successful test case for future restructurings and an example of the sophistication and flexibility of the jurisdiction.

The Grand Court was comfortable approving this corporate conversion, particularly in circumstances where the conversion did not break the chain of existence of the entity or interfere with any proceedings that were underway in respect of the entity in other jurisdictions.[3]

Conclusion

With the successful implementation of high-profile cross-border restructurings such as Pacific Drilling, Ocean Rig, CHC Helicopters, Mongolian Mining (to name just a few) together with the sophisticated restructuring options available, the Cayman Islands restructuring regime has demonstrated that it has the flexibility to overcome the various issues that arise in the course of successfully completing a complex multi-jurisdictional restructuring.

In addition, the restructuring and insolvency expertise and experience (both onshore and offshore) that are prevalent amongst the Cayman Islands judiciary and professionals, underpin the prevalence of the Cayman Islands as a jurisdiction of choice for corporate groups that are seeking to restructure their financial indebtedness.

To maintain and further strengthen the Cayman Islands' standing as a primary jurisdiction for the implementation of complex and high-value cross-border restructurings, the legislature is currently considering a bill that will, when implemented, allow for the appointment of restructuring officers and a global automatic moratorium on unsecured claims upon the filing of an application for the appointment of restructuring officers (separate from the Cayman Islands winding up regime).

The proposed regime would provide an additional avenue by which to benefit from an automatic stay on claims whilst pursuing a restructuring, allowing the Cayman Islands to remain as one of the leading jurisdictions of choice to implement complex cross-border restructurings.

Notes:

1 It should be noted that such moratorium does not extend to restrict the rights of secured creditors who may enforce their security notwithstanding the appointment of a liquidator and accordingly, standstill or restructuring support agreements with secured creditors or the seeking of supporting relief in other jurisdictions

may be necessary in certain circumstances. Section 142(1) of the Companies Act permits secured creditors to enforce their security interests without leave of the Grand Court or without reference to the liquidator.

2 In 2016, the Limited Liability Companies Act (2016) of the Cayman Islands introduced a new type of Cayman Islands vehicle which is very similar to a Delaware LLC.

3 For completeness, only companies registered as an ELC under section 164 of the Companies Act or companies registered as a limited duration company under section 179 of the Companies Act may be converted into an LLC. It should also be noted that once an LLC has been registered upon conversion, it cannot be converted into a Cayman Islands ELC. In circumstances where a conversion applicant is in provisional liquidation, the matter of the proposed conversion will need to be declared and submitted to the Grand Court for consideration pursuant to a validation application under section 99 of the Companies Act. Once the validation order has been granted by the Grand Court, the conversion applicant can then proceed to register its conversion application with the Cayman Islands Registrar of Companies.

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New trend of bankruptcy legislation and practice in China

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Prior to 2016, the vitality of the People's Republic of China's ("China") bankruptcy law was not enough. China had established a market-oriented bankruptcy system but, due to the social cognition, it was limited and the practical application was insufficient.

The basic background of China's bankruptcy work

In 2016, for the first time, China proposed the strategy of supply-side structural reform and Zombie Enterprise disposal. This important strategy became the main line of China's economic life from that point. The purpose of this strategy is to promote the structural adjustment of the economy, reduce ineffective and low-end supply, eliminate backward production capacity, expand effective and medium to high-end supply, and solve the structural dislocation of supply and demand.

In this historical process, the bankruptcy system has been entrusted with important tasks because of its characteristics of marketisation and legalisation. This background is the basic entry point to interpret the significance of bankruptcy procedure in China in recent years.

In addition, in recent years, China has paid more attention to improving and optimising the business environment. As an important indicator of the Business Environment Evaluation System, conducting bankruptcy cases has also received more attention. These factors have objectively promoted the development of China's bankruptcy procedure.

Further improvement of China's bankruptcy legal system and breaking ice of natural person bankruptcy

The Enterprise Bankruptcy Law of the People's Republic of China ("Enterprise Bankruptcy Law") came into effect on June 1, 2007. It is a bankruptcy law that embodies the basic principles of market economy and establishes the bankruptcy reorganisation system for the first time. The judicial interpretation formulated by the Supreme People's Court is also an important basis with legal effect in China's bankruptcy judicial activities.

The judicial interpretation of the Enterprise Bankruptcy Law mainly includes the Provisions of the Supreme People's Court on Designating the Administrator during the Trial of Enterprise Bankruptcy Cases implemented in 2007, The Provisions of the Supreme People's Court on Determination of the Administrator's Remunerations implemented in 2007 and the Provisions(I),(II)and(III) of the Supreme People's Court on Several Issues concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China implemented respectively in the year of 2011, 2013 and 2019.

In addition, there are also various judicial replies made by the Supreme People's Court to the specific questions for regulating specific issues.

In addition to the judicial interpretation mentioned above, other normative documents formulated by the Supreme People's Court and its Guidance Cases on bankruptcy cases also play an important role in the trial of bankruptcy cases, such as the Minutes of the National Court Work Conference on Bankruptcy Trials published in March 2018 and the Minutes of the National Courts' Civil and Commercial Trial Work Conference issued by the Supreme People's court published in September 2019.

Through the documents with different levels and effects, China has further refined and developed the relevant bankruptcy laws and regulations. The judicial practice thus further tried to explore new bankruptcy legal systems, such as the prepackaged reorganisation system. Because the prepackaged reorganisation system has the advantages of both judicial procedure and private consultation, the value of the system has been widely recognised.

At present, the prepackaged reorganisation system has been comparatively fully applied in China's bankruptcy practice, but it is still necessary to establish a unified standard system in the whole country.

In 2017, the Supreme People's Court issued the Guiding Opinions on Several Issues concerning the Transfer of Enforcement Cases for Bankruptcy Examination, which enables qualified enforcement cases to be transferred for bankruptcy examination, thus setting up the connection between civil enforcement procedures and bankruptcy procedures. This Guiding Opinions enables a large number of cases that cannot be enforced to be transferred to bankruptcy procedures.

According to the law, the applicable object of China's Enterprise Bankruptcy Law is enterprise (or legal person), not the natural person. In recent years, with the development of China's economic situation, the voice of establishing natural person bankruptcy system is rising. In this context, the Standing Committee of Shenzhen Municipal People's Congress passed the Regulation of Shenzhen Special Economic Zone on Individual Bankruptcy on August 26, 2020, which was the first individual bankruptcy legislation in China.

In addition, Jiangsu province court and Zhejiang province court are also exploring the centralised liquidation system of personal debts in the nature of natural person bankruptcy. At present, China's individual bankruptcy is mainly explored by local courts first, and after the related experience is accumulated, a national individual bankruptcy system will be established accordingly.

It is understood that the National People's Congress has incorporated the revision of the Enterprise Bankruptcy Law into the legislative plan and is expected to complete the comprehensive revision of the Enterprise Bankruptcy Law in 2021 and 2022. The revision of enterprise bankruptcy law will reflect the new trend of bankruptcy legislation and practice in China in recent years, thus further improving China's bankruptcy legal system.

The number and scale of bankruptcy cases have been significantly improved

By 2016, the number of bankruptcy cases that China concluded every year was between 2,000 and 3,000. In the context of the above-mentioned special background, since 2017, the number of bankruptcy cases in China has risen dramatically, with the number of cases concluded annually exceeding 10,000. The number of concluded bankruptcy cases in 2020 reached 10,132.

As an enterprise rescue procedure, reorganisation procedure has received increasing attention in China, with more and more enterprises adopting the reorganisation procedure to restructure debts, bring in new investors and rehabilitate. In 2020, China concluded 728 reorganisation cases and revitalised assets of RMB470.8bn.

The value of reorganisation in the rescue of listed companies and large enterprises is particularly obvious. Since the implementation of the Enterprise Bankruptcy Law in 2007, up to March 2021, a total of 79 companies listed in China have implemented reorganisation. At present, there are no cases of reorganisation that have been concluded by failure which would then lead the enterprise to go into the bankruptcy liquidation procedure.

In the aspect of large enterprises reorganisation, there are several colossal group enterprise reorganisation, such as the reorganisation of Northeast Special Steel Group Co., Ltd and affiliated companies, the reorganisation of

Liaoning Huishan Dairy Group Co., Ltd and affiliated companies, the reorganisation of Bohai Steel Group Co., Ltd and affiliated companies, etc. Among them, the reorganisation of Bohai Steel Group Co., Ltd and affiliated companies involved a total debt of RMB280bn. The number and scale of reorganisation cases in China are growing rapidly.

In February 2021, Hainan Provincial High People's court ruled to accept the application for reorganisation of HNA Group Co., Ltd., and in March 2021, it ruled that the HNA Group Co., Ltd and 320 affiliated companies would adopt a substantive merger reorganisation rule. This reorganisation case is expected to be the largest reorganisation case in China to date.

Further development of bankruptcy trial specialisation

Since 2016, the intermediate people's court and some higher people's courts have successively established bankruptcy courtrooms. At the beginning of 2016, five courts established bankruptcy courtrooms, and the number increased to 97 by the end of 2017.

In January 2019, the Shenzhen intermediate people's court took the lead in setting up the bankruptcy court. Since then, the intermediate courts of more than a dozen cities, including Beijing, Shanghai, Tianjin and Guangzhou, have successively set up bankruptcy courts. As a result, China's bankruptcy trial professional construction and bankruptcy trial strength has been significantly improved.

The construction of a bankruptcy administrator team is also an important part of bankruptcy trial specialisation. At present, China has established more than 100 associations of bankruptcy administrators, which covers provincial, municipal and county levels. As a self-disciplined management organisation, the association of bankruptcy administrators plays an important role in standardising and improving the executive ability and discipline of administrator.

For a long time, the Supreme People's court focused on the information construction of bankruptcy trial to enhance the transparency and credibility of bankruptcy trial. On the one hand, the Supreme People's court set up the National Information Website of Enterprise Bankruptcy Reorganisation Cases in 2016, and the information about the trial process of bankruptcy cases, as well as information about the announcement, legal documents, debtors and other information related to the bankruptcy procedure are uniformly published on the Information Website of Bankruptcy and Reorganisation cases. On the other hand, with the help of information technology, the creditor's rights are declared through the network, and the creditor's meeting is held in the form of a network meeting. Modern network technology has been widely used in bankruptcy cases in China.

Bankruptcies of banks and financial institutions emerge

In November 2020, the Beijing first intermediate people's court ruled to accept the bankruptcy liquidation petition of Baoshang Bank Co., Ltd. This is the first market-oriented bank financial institution bankruptcy case implemented in accordance with the Enterprise Bankruptcy Law in China. In 2015, the State Council promulgated the Deposit Insurance Regulations, which is an important supporting measure and premise for banks to implement market-oriented bankruptcy.

In addition to banks, after the implementation of the Enterprise Bankruptcy Law in 2007, a number of securities companies entered into bankruptcy proceedings, such as the liquidation of HanTang Securities Co.,Ltd and the liquidation of Minfa Securities Co.,Ltd. China has accumulated relevant experience in hearing bankruptcy cases of financial institutions. The bankruptcy practice has also fully explored the issues related to the bankruptcy of financial institutions.

Further development of cross-border bankruptcy

As the world's second largest economy, the practical significance of cross-border bankruptcy in China has become increasingly prominent, the degree of attention has increased significantly, and the number of related cases has also increased.

The practice of bankruptcy in China is also exploring further the issue of cross-border bankruptcy. For example, in October 2019, the Bankruptcy Court of the Southern District of New York in the US recognised and assisted the case of reorganisation procedure of LOVA Technology Industrial Group Co., Ltd., which is initiated by the people's Court of Chaoyang District of Beijing City; in January 2020, the court of first instance of the Hong Kong High Court ruled on the bankruptcy case of Shanghai Huaxin International Group Co., Ltd., for recognising the legal status of bankruptcy administrator appointed by the Shanghai Third Intermediate People's court; and in June 2020, the Singapore High Court recognised the bankruptcy procedure and the legal status of bankruptcy administrator of Jiangsu Suntian Shipbuilding Development Co., Ltd.

In August 2019, the Supreme People's Court said that it is actively promoting the amendment of the Enterprise Bankruptcy Law, which will further regulate and refine the regulation concerning the jurisdiction of cross-border bankruptcy, the status and treatment of foreign bankruptcy representatives and creditors, and the conditions and methods of providing judicial assistance to foreign bankruptcy proceedings. It is believed that the amendment shall promote the further development of cross-border bankruptcy in China.

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Cyprus: Corporate distress and financial tools in the era of the pandemic; healing the traumas

by Ioannis Sidiropoulos, Elias Neocleous & Co LLC

The COVID-19 pandemic has undoubtedly caused a severe disruption in global business. Companies worldwide have found themselves facing severe cash flow difficulties as they may be owed and/or owe significant sums. The disruption of supply chains, the various challenges faced by the workforce, and the worsening of credit conditions are all issues that exacerbated the problems already existing as the legacy of the 2008 financial crisis. This article will examine some of the reasons for corporate distress in the Cyprus market, institutional efforts to tackle the problem and some of the less obvious financing options available to assist a business.

Unfortunately, in Cyprus, it is widely observed that due to the fear of stigma and delusional hopes of recovery, company leaders are rarely willing to initiate business rescue proceedings. These kinds of initiatives are often left to creditors with the risk for company management being that proceedings will get out of their control.

There is also the risk that (unless the creditor is reliant on the business for supplies) their main focus is on recovering their money and not on ensuring the long-term survival of the business. These companies are often referred to as "Zombie" companies as immediate and radical turnaround management is necessary, yet insufficient efforts to achieve this are initiated from the inside.

Another quite important aspect that, unfortunately, recently drove many Cyprus companies into distress is the underrepresentation of the finance function at board level. This means that, in many cases, there is an issue of lack of required control on fundamental key-performing indicators such as average creditor days and average debtor days. Insufficient information on accounting issues exemplifies one category of such business failure. As a result of the abovementioned lack of (self) awareness, disproportionate business expansion has also been a critical factor in instances of corporate distress in the Cyprus market.

The above brings the problem of excessive debt exposure in Cyprus into the spotlight. This is often the result of a lack of (intentionally or not) dependable studies/estimations of investment and lending (on behalf of the banks) purpose and any possible excess of investment budget. It has also been found that a common problem for Cyprus SMEs in decline is the inability to compete in price due to high fixed and variable production costs and small profit margins. This creates a vicious circle putting an additional strain on rescue efforts. Of course, the above deficiencies were exacerbated by the adverse effects of the pandemic on the economy.

The Cypriot Government did take action to support the economy in light of the COVID-19 adversities. At the end of May 2020, the Finance Minister of Cyprus announced further economic measures to assist in the economy's recovery. Collectively the current financial packages have a multi-billion euro value. Direct grants have been given to small businesses and, also, interest rate subsidies for corporates with liquidity pressure have been provided. The stimulus provided to Cyprus companies through the European Investment Bank (EIB) by way of loans backed by a state guarantee and the participation in the Pan-European Guarantee Fund collectively appears particularly helpful not only to SMEs but also to mid-cap companies.

Furthermore, the Cypriot Government implemented loan repayments suspensions and also a postponement of foreclosures.

Concerning the institutional restructuring/insolvency proceedings, in June 2020, the "Department of Insolvency and Related Matters" Law 68(I)/2020 entered into force. It established the Department of Insolvency, which is primarily responsible for the restructuring and modernisation of operational procedures. The new framework is expected to enable the department to meet its duties successfully, and to support the effective implementation of insolvency proceedings for individuals and legal entities. This includes the execution of bankruptcy and liquidation orders and the assessment and evaluation of proposals and potential reforms relating to insolvency and restructuring matters.

A fundamentally sound business with cash flow issues resulting from the pandemic might explore obtaining some form of insolvency protection, such as the recently introduced examinership method under the Cyprus Insolvency Law. Such an action would, in a broad sense, offer a moratorium or breathing space for possibly temporarily insolvent companies.

In this procedure, provided there is (imminent) insolvency, and the court assumes a possible restructuring is feasible, an examiner is judicially appointed on request. The examiner's task is to reach a settlement with the creditors under the protection of a moratorium. If the restructuring attempt fails, the examinership goes into formal insolvency proceedings. The management remains in office during this procedure and works together with the examiner.

The Board of Directors of any distressed company must be alert and ready to take action, rescue and recover the business. There are practical options to consider that may seem unpalatable, but sometimes hard times mean hard choices. Corporate management cannot afford to lose grip of reality and it does not have the luxury to waste time on panic. Instead, there must be careful and daring consideration of all available options. These include DIY or private options outside of State-related efforts.

Factoring is one of these options. Factoring, receivables factoring or debtor financing are all different terms describing essentially the same methodology; the case of a company buying a debt or invoice from another company. The core concept of factoring is that a company in need of cash flow liquidity sells its accounts receivable at a discount to its book value. This allows the buyer of the company's receivables' ledger to profit upon the settlement of the debts at their original book value, which is a higher value than the discounted price paid for them. Factoring, therefore, transfers the ownership of some or all of the receivables ledger at a discounted price. The purchaser of the ledger is then legally responsible for the collection of the transferred debts receivable and assumes the associated risk of non-payment.

As a result of factoring, the company exchanges debt/debts owed to it for less than the total amount due. While it is understood that this might be painful for the company and the shareholders from an accounting and psychological point of view, it provides the company with vital working capital to survive and continue trading. It also removes the administrative cost and burden related to the collection of debts and, by removing the bad debt risk, offers cashflow certainty. Moreover, the company does not have to provide security in the form of a fixed and/or floating charge over the company assets, which would often be required to obtain a bank-provided working capital facility.

However, as a DIY solution, factoring usually costs more than bank-based financial solutions. Moreover, it often provides only a limited beneficial financial impact to the company and, consequently, it can sometimes be perceived as best used to give a one-off solution to a temporary squeeze on liquidity.

Invoice discounting is another way to generate the much-needed cash flow for the rescue of a distressed company. In many respects it is not significantly different from factoring; the company raising an invoice can quickly access a percentage of the invoice value from a finance company for use as working capital. However, a key difference is that the company maintains the legal responsibility for their sales ledger, payment pursuance and invoice processing in the case of invoice discounting. In this case, the receivables ledger is also used as collateral for a working capital facility and retaining the bad debt risk.

As a result, the company's customers are unlikely to be aware of the relationship with the lender, lacking any direct contact with them. This can be beneficial to the longer-term prospects of a company. The sudden introduction of a factoring arrangement can result in customers assuming that the company is in financial difficulties and as a result they may switch suppliers and push an otherwise viable business into insolvency.

Another variant on the above is forfaiting. Forfaiting involves purchasing an exporter's receivables, i.e. the amount that the importer owes the exporter, at a discount by paying cash. The importer must pay the purchaser of the receivables, or forfaiter, to settle the debt. This is another process often used to accelerate the cash flow cycle and provide risk mitigation for the exporter on, potentially, the totality of the debt value rather than, as in factoring or invoice discounting, a limited percentage of the total.

As the importer's bank usually guarantees the receivables, the forfaiter releases the exporter from the risk of non-payment by the importer. When a forfaiter purchases the exporter's receivables directly from the exporter, it is legally referred to as a primary purchase. The receivables technically become a form of debt instrument that can be sold on the secondary market as bills of exchange or promissory notes. This is known as a secondary purchase. Therefore, this is a tradeable mechanism suitable for receivables of a medium to the long-term maturity date.

On the other hand, a short-term fix, not suitable for medium or long-term finance, can be bridging loans. These are a type of short-term finance usually repayable within less than 12 months, also known as "caveat loans" or "swing loans." The purpose of this type of loan is to 'bridge' the gap between a payment falling due and finance/or funds being received from another source (e.g. the sale of a property). Their relatively high-interest cost is a considerable disadvantage.

However, there is a derivative of this credit type that can be more flexible; development finance. While bridging is a one-off loan that bridges a gap between two credit frameworks, development finance is a loan where the funds are generally released in stages. Generally, this occurs as key pieces of the property development or project infrastructure that they are being used to finance are completed. Development finance can also be arranged for much more significant sums of money than bridging, at lower cost, and for longer timeframes. The exit strategy for a development loan is generally either the sale of the property or a commercial mortgage.

Businesses can also use commercial mortgages to obtain finance for the acquisition of property such as offices or land. Commercial mortgages are offered over shorter timeframes than private mortgages, typically five to ten years, although the premiums are based on much longer terms. For businesses wishing to purchase their own space, rather than paying out significant rent amounts, obtaining a commercial mortgage can be a cost-effective option and offer high flexibility.

Less commonly, property investors may use auction finance to obtain land and buildings at below-market rates. Auction finance is usually used for larger finance amounts whereby the profit gained is how the company will repay the borrowed money. Consequently, it is often deemed an appropriate form of finance for property developers and commercial real estate transactions. The loan is initially offered in cash, transforming into equity, usually after an agreed timeframe between the parties has passed without repayment of the loan. In other words, it is the very own equity of the company that is used as loan security.

Finally, mezzanine loans can be another solution. They are 'subordinated' loans meaning that in the event of the liquidation of the lender, the loan will rank after some other 'senior' debts, such as secured bank loans, in preference for payment but ahead of common equity holders.

Mezzanine finance is usually subordinate to senior debt, i.e. first charge loans, often but not necessarily unsecured. Moreover, it is, in most cases, structured to include part fixed and part variable interest. It can be offered in addition to, or as a 'top up' to, funds provided by a main lender, and the usual repayment periods are one to five years.

Many investors and financial institutions regard mezzanine finance as quasi-equity, from an accounting point of view (meaning lower debt levels are maintained, and therefore, access to additional finance may be possible if necessary). As is the case with bridging finance, mezzanine funding is also more suitable for large, profitable deals which can tolerate the relatively high-interest rates associated with it.

Thus, it can be seen that there are numerous forms of financing other than the "traditional" bank lending facilities. The above are just a few examples. Other options also exist, outside of raising new finance, for businesses adversely impacted by the pandemic to help ensure their survival. Apart from maximising the efforts to maintain and enhance shareholder value and minimise shareholder loss, the management could also look internally at cost-control measures. However, the latter course of action might lead to a need to reduce staff levels and/or renegotiate certain contracts. In all instances, it would be prudent to take expert legal advice before acting.

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Restructuring under Danish law with most recent amendments

by Pernille Bigaard, Anders Ørskov Melballe and Louise Krarup Simonsen, Skau Reipurth & Partnere Advokatpartnerselskab

Danish businesses facing financial difficulties can either negotiate an out-of-court solution with all or part of their creditors, file for bankruptcy or file for in-court restructuring proceedings. The in-court restructuring proceedings have recently been updated to support the restructuring of businesses considering the financial challenges following the Coronavirus epidemic.

Danish in-court restructuring proceedings

Restructuring proceedings in general

The current Danish restructuring rules came into force in 2010. The Danish Parliament has recently passed amendments to the restructuring rules to make it easier and more flexible to complete restructurings.

The purpose of restructuring proceedings is to allow distressed companies to continue either by making them solvent and viable by debt adjustment (compulsory composition) or by transferring the business wholly or partly to a third party. Restructuring proceedings must consist of a business transfer and/or a compulsory composition.

The restructuring proceedings. Commencing restructuring proceedings against a company requires that the company is insolvent. Under Danish law, a company is insolvent if it cannot discharge its obligations as they fall due unless the inability to pay is merely temporary (illiquidity).

Restructuring proceedings may commence against a distressed company when the debtor itself or if a creditor requests it. Restructuring proceedings will be heard by the insolvency court before any bankruptcy petitions against the same debtor. However, the new rules prevent restructuring proceedings against a company if less than a month has passed from the conclusion of previous restructuring proceedings.

Restructurer and restructuring accountant. On commencement of the restructuring proceedings the insolvency court immediately appoints one or more restructurers (usually an attorney). Under the new rules it is no longer mandatory that a restructuring accountant (typically an auditor) be appointed but this may take place if the company requests it.

The restructurer's task is to propose a solution where the company or the viable parts of the company may continue either as the same company through debt adjustment or by transfer of the business to a new legal entity.

The restructuring accountant's task is to verify and produce financial data to strengthen the creditors' confidence in the financial records to be used in the restructuring and to strengthen the restructurer's and the company's work towards a viable business.

Restructuring plan and proposal. The restructurer prepares a restructuring plan which informs the creditors about the company and the plan for the restructuring proceedings. The plan is to be heard at a meeting before the insolvency court no later than four weeks after the filing of the petition for restructuring proceedings. Previously a specific reason had to be given if an extension was required, but under the new amended rules the restructurer no longer has to justify a request for an extension.

At the meeting the creditors must vote on the adoption of the restructuring plan. The role of the insolvency court is primarily to chair the meeting and assess whether the fundamental principles of the plan is in accordance with the law. A restructuring plan is adopted unless the majority of the creditors represented at the meeting cast their votes against the plan, provided that such creditors amount to at least 25% of the total known creditors. This means that the creditors that remain passive and do not participate and vote will in principle be in favour of the restructuring plan.

If the restructuring plan is adopted, a meeting must be held no later than six months after the four-week meeting before the insolvency court for the purpose of voting on the restructuring proposal (although there is the possibility for extensions).

The restructuring proposal proposes how the business is to continue after the restructuring, i.e. the exact content of the restructuring: compulsory composition, business transfer or both plus information about the purchase, transfer price, expected dividend, etc. A restructuring proposal is adopted unless the majority of the creditors represented at the meeting vote against it.

Until recently bankruptcy proceedings would commence against the company if the restructuring plan or the restructuring proposal was not adopted. With the recent amendments to the rules, bankruptcy no longer automatically occurs if the restructuring proceedings end before a restructuring proposal has been adopted.

Employees

Another important issue in the restructuring process and bankruptcy are the employees and the Employees Guarantee Fund (the "Fund"). It is an insurance fund to which all private employers pay. The purpose of the Fund is to ensure that employees receive their salary if their employer ceases to exist due to bankruptcy or if they shut down their business.

Employees, who do not receive their salary because the employer ceases to trade, may receive coverage from the Fund of their net salary after tax of up to DKK160,000 (2021 level), equal to approximately €21,475.

Salary claims are often decisive for which solution to choose as the employees' salary claims are preferential in relation to the company's other ordinary creditors and because obligations to the employees are typically a considerable liability – and a vital part of the value - of a business in crisis.

Amendments to the restructuring rules and their importance

General comments

The amendments were passed in connection with the COVID-19 crisis but will also apply after the world has returned to a more normal state.

The five most important amendments to the restructuring rules are explained below.

"Fast-track" model

Earlier, a business transfer in a restructuring process could only occur if it had been adopted by the creditors in a restructuring proposal. There are quite a few formal requirements to the content of a restructuring proposal and the rules have sometimes drawn criticism for making it too difficult in terms of time and procedure to complete a business transfer in a restructuring process.

For some of the companies undergoing restructuring proceedings it is necessary for the survival of the business that a transfer happens quickly. Liquidity may be very strained or the value of the company may drastically be reduced if the business transfer does not take place immediately after restructuring proceedings have commenced. In practice, bankruptcy has sometimes been the consequence if a business transfer needed to happen quickly.

Consequently, the focus of the new rules has been to allow a business transfer immediately after commencement of the restructuring proceedings, and new "fast-track" business transfer proceedings are a new possibility in restructuring. The previous rules will still apply for cases where there is not a clear need for the "fast-track" model.

The "fast-track" model means that the restructurer can approve a business transfer without it being adopted by the creditors as part of a restructuring proposal. Instead the restructurer shall inform the creditors of a contemplated business transfer and give them a five-day deadline for any objections against the business transfer.

A restructuring "fast-track" transfer requires the following:

- The restructurer must consent to the application of the "fast-track".
- It must be deemed expedient to use the "fast-track" to maintain the business's value.
- No objections against the transfer must have been received from the majority of creditors within five business days from sending the proposed business transfer.
- A restructuring plan must not have been adopted.

The "fast-track" model will be expedient if the debtor needs cash to keep the business going during the ordinary restructuring proceedings or if the purchaser cannot await the normal procedure.

The restructurer must send a new notice to the creditors to inform them whether the transfer was completed no later than five business days after the deadline for the creditors' objections.

A "fast-track" transfer may only be completed until a restructuring plan has been adopted. Subsequently, business transfers may only be completed under the rules applicable until now. But as before it is possible to make a combined restructuring plan and proposal and complete the business transfer rather quickly.

The Employees' Guarantee Fund

Employees working for a company in restructuring will typically receive salary from the company in the restructuring period. The terminated employees had to await the conclusion of the restructuring proceedings before payment could be made by the restructured company or bankruptcy proceedings commence against the company and the employee could then receive payment from the Fund or the bankruptcy estate.

The new rules mean that employees who have had their role terminated and released before or during the restructuring proceedings can now receive payment from the Fund from the commencement of the employer's restructuring proceedings.

The employees still employed by the company being restructured will still have to receive a salary from the company. With the new rules, the Fund can pay up to three months' salary to the employees which are due during the restructuring proceedings and pay up to one month's salary which was due before the restructuring proceedings with the restructurer's consent.

The new rules also limit the employee obligations that the buyer in a restructuring-business transfer agreement must assume. With the new rules the buyer – like in bankruptcy – only assumes obligations from the commencement of the restructuring proceedings. Any obligations from before the restructuring can now be covered by the Fund as is the case in bankruptcy.

These new rules help improve the cashflow problems which are typically present in restructurings. Further, choosing bankruptcy proceedings instead of restructuring in order to obtain payments for employees from the Fund should no longer be necessary.

Restructuring accountant

Under the previous rules it was mandatory to appoint a restructuring accountant together with the restructurer. However, under the new rules, a restructuring accountant is no longer mandatory. The purpose of the amendment is to make restructuring less costly. Previously, the restructuring accountant could not be the company's former auditor and, consequently, the restructuring accountant did not have advance knowledge of the company. The new rules intend for the restructurer to use the auditor who already knows about the company and accordingly reduce costs.

The tasks formerly carried out by the restructuring accountant are to be carried out by the restructurer. This will typically be together with the company's former auditor or bookkeeper.

The company in restructuring, the restructurer or 25% of the creditors may still request that a restructuring accountant be appointed.

From a cost perspective, the amendments may be reasonable as a restructuring accountant must, due to the impartiality requirement, spend some time on mapping the company's financial situation. The negative consequence is, however, that the creditors may not find the restructuring plan and proposal as reliable as before. In many cases it may still be a good idea to appoint a restructuring accountant.

It is expected that restructurings with no restructuring accountant will often be restructurings of companies with limited values and a limited number of creditors where the restructurer assesses that it will be sufficient and safe to prepare the restructuring material with the assistance of the company's own auditor. In companies of some complexity it will still often be prudent to appoint a restructuring accountant.

No automatic bankruptcy

Under the previous restructuring rules, a company that commenced restructuring proceedings would either become solvent via the restructuring or be declared bankrupt. With the amended rules, a company may withdraw from commenced restructuring proceedings until a restructuring plan has been adopted without automatic commencement of bankruptcy proceedings.

To avoid misuse, assumed insolvency has been introduced if a bankruptcy petition is filed within three weeks from the end of the restructuring. For a month after the end of the restructuring proceedings, new restructuring proceedings cannot commence against the company.

The former "no way back" principle has drawn criticism for keeping companies from commencing restructuring proceedings. Instead some companies may have tried out-of-court restructuring which can be difficult to complete because it requires agreement between all affected creditors and there may be a risk of management liability if operations are maintained past the time of no return and the restructuring is not successful.

No requirement for security for bankruptcy costs

The new rules have also removed the requirement to provide security for the cost of any subsequent bankruptcy proceedings. The amended rules abolish this requirement to ease the cashflow strain. The security was between DKK30,000-DKK40,000, equal to €4,026-€5,370.

Conclusion

The Danish restructuring rules have sometimes drawn criticism for not being sufficiently flexible and too complicated particularly in relation to business transfers and the employees' position which could, in some cases, counter the application of the restructuring proceedings. The new rules endeavour to make solutions more flexible which in our assessment will result in the improvement and possibilities of completing restructurings in the future, not least considering the economic problems due to the Coronavirus pandemic.

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An overview of the Indian insolvency regime and recent developments

by Piyush Mishra, Suharsh Sinha and Shruti Sethi[1]*,*
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In India, insolvency and liquidation of corporate entities such as companies and limited liability partnerships is governed by the (Indian) Insolvency and Bankruptcy Code, 2016 ("IBC"). The IBC was passed by the Indian Parliament in May 2016 to address the crisis of large non-performing assets in the banking sector. The IBC replaced the entire gamut of extant insolvency and restructuring laws in India by introducing a single comprehensive law for insolvency of corporates and individuals. The provisions relating to insolvency of companies and limited liability partnerships were notified on December 1, 2016. The provisions relating to insolvency of personal guarantors to corporate entities were notified with effect from December 1, 2019. The provisions relating to insolvency of partnership firms and other individuals (who are not personal guarantors to corporate debtors) are yet to be notified.

Introduction to IBC

The IBC classifies creditors as financial creditors and operational creditors. Creditors that extend debt along with interest, disbursed against the consideration for the time value of money are classified as financial creditors and include, *inter alia*, banks, bondholders, lessors of financial leases and beneficiaries of guarantees in relation to such debts. Creditors that are owed a debt in respect of the provision of goods and services are classified as operational creditors and include, *inter alia*, employees, workmen and trade creditors. Importantly, dues to the central and state governments including unpaid tax dues are also classified as operational debt.

Under the IBC, any creditor (financial or operational) or the corporate debtor itself may file an application with the National Company Law Tribunal ("NCLT") to commence the corporate insolvency resolution process ("CIRP") of a corporate debtor on a payment default of INR10m (approx. US$134,000).[2]

Admission of CIRP

The NCLT, after determining if a payment default has taken place, must pass an order admitting the insolvency petition and for commencement of CIRP against the corporate debtor ("Insolvency Commencement Date" or "ICD"). From the ICD, a moratorium becomes operative till the date of completion of the CIRP process, i.e. the date of approval of the resolution plan by the NCLT or date of liquidation order, as the case may be ("CIRP Period"). During the CIRP Period, no suit or legal proceeding can be commenced (including any action to enforce security interest) against the corporate debtor and no pending proceeding can be proceeded with against the corporate debtor.

On the ICD, an interim resolution professional proposed by the creditor filing the CIRP application takes over the management of the corporate debtor ("IRP"). The IRP is also required to invite and verify proofs of claims submitted by creditors of the corporate debtor and constitute a committee of creditors ("CoC"). The CoC consists of all the unrelated financial creditors (and not operational creditors) of the corporate debtor. The CoC, during its first meeting (which must be held within 30 days from ICD), appoints an insolvency professional (IRP or his substitute) as the resolution professional ("RP").

Role of the CoC

Once the CIRP commences, it may either lead to successful restructuring via a resolution plan or a liquidation of the corporate debtor. An application for withdrawal of IBC application may be made to the NCLT by the applicant through the (i) IRP (before constitution of CoC); or (ii) IRP/RP (after constitution of CoC) where such application is approved by the CoC by a vote of 90% by value.

CoC is required to ensure resolution of the insolvency of the corporate debtor and value maximisation. In the event no resolution plan is received or approved by the CoC, before the expiry of the CIRP Period, the NCLT must pass an order of liquidation against the corporate debtor. The CoC may also resolve to liquidate the corporate debtor at any time during the CIRP Period.

All major decisions of the CoC like: (i) extending the CIRP Period; (ii) replacing the IRP/RP; (iii) approving the resolution plan; (iv) raising interim finance (i.e. debt financing availed by the corporate debtor after ICD), etc., are driven by the financial creditors holding 66% of the financial debt of the corporate debtor.

Resolution plan

Under IBC, the RP is required to invite resolution plans from bidders who (and whose connected persons) meet a stringent eligibility criteria to submit a resolution plan.[3] The IBC provides that any resolution plan must mandatorily fulfil certain conditions before it is placed before the CoC for its approval. Such conditions include (a) payment of insolvency resolution process costs (i.e. costs incurred in conducting the CIRP and any interim finance availed by the corporate debtor) in priority to any other payment; (b) payment of debts of operational creditors in priority to financial creditors which shall not be less than the threshold provided in the IBC; and (c) payment of at least the liquidation value to dissenting financial creditors prior to any recoveries being made by assenting financial creditors, etc.

After the CoC approves the resolution plan, the RP must submit the resolution plan to the NCLT for its approval. The NCLT does not have jurisdiction to evaluate the commercial contours of the plan and is merely required to ensure that the mandatory conditions stipulated by the IBC are met.[4]

On approval of a resolution plan by the NCLT depending on the resolution plan (a) all liabilities of the corporate debtor existing at or pertaining to the period prior to the ICD are extinguished; and (b) no action may be taken against the property of the corporate debtor, in relation to the offences committed in the period prior to the ICD.

However, immunity is available only if the resolution plan results in change in the management and control of the corporate debtor to a person who is (a) not a promoter managing or controlling the corporate debtor or his relative; or (b) a person with regard to whom a report or complaint has been filed by an investigative authority in relation to the offence.

Avoidable transactions

The NCLT (on the application by the RP) may reverse a preferential transaction, an undervalued transaction, a fraudulent transaction or an extortionate transaction. The relevant look-back period for scrutinising such transactions is two years prior to ICD in case of related parties and one year preceding the ICD in case of any other person, except in cases of fraudulent and wrongful transactions, where no look-back period has been prescribed.

Liquidation

An order of liquidation may be passed against the corporate debtor in the following circumstances: (i) CoC resolves to liquidate the corporate debtor during CIRP Period; (ii) CoC does not approve a resolution plan and the CIRP Period expires; (iii) a resolution plan that has been passed is violated; or (iv) the NCLT rejects a resolution plan for non-compliance with mandatory requirements.

The priority of payments in liquidation is as follows:

(a) costs of CIRP and liquidation (includes interim finance);
(b) amounts due to secured creditors (if security relinquished with the liquidator and not enforced separately) and workmen dues (workmen dues will be capped at two years);

(c) employees' dues (capped at one year);
(d) amounts due to unsecured financial creditors;
(e) amounts due to central and state government (capped at two years) and any shortfall due to secured creditors (if security was enforced separately outside liquidation process);
(f) any remaining debt;
(g) preference shareholders; and
(h) equity shareholders or partners.

Voluntary liquidation

Voluntary liquidation process of a corporate debtor can be initiated in case the corporate debtor has not made any payment default. This requires a declaration from the majority of the directors confirming, *inter alia*, that (a) the corporate debtor is not being liquidated to defraud any person; and (b) either the corporate debtor has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the liquidation.

Within four weeks of the issuance of the declaration, (i) a special resolution[5] of the members of the corporate debtor resolving to liquidate the corporate debtor voluntarily; or (ii) a resolution of the members of the corporate debtor in a general meeting requiring the corporate debtor to be liquidated voluntarily in accordance with the corporate debtor's articles is required. In such meetings, the members must also resolve to appoint an insolvency professional to act as the liquidator and fix his or her terms of appointment and remuneration.

If the corporate debtor owes any debt to any person, creditors representing two-thirds in value of the debt of the company shall also approve the resolution passed by the shareholders.

The liquidator must endeavour to complete the voluntary liquidation process of the corporate debtor in one year. Voluntary liquidation shall be deemed to have commenced from the date of passing of the special resolution at the extraordinary general meeting/general meeting (subject to creditors approval, if applicable). On commencement of voluntary liquidation, the company shall cease to carry on its business from the liquidation commencement date except as required for the beneficial winding up of its business. The company shall continue to exist until it is dissolved in accordance with the Insolvency and Bankruptcy board of India (Voluntary Liquidation Process) Regulations, 2017 ("Voluntary Liquidation Regulations").

Introduction to the RBI - Prudential Framework for Resolution of Stressed Assets dated June 7, 2019 ("RBI Resolution Framework")

Apart from the process under the IBC, voluntary debt restructuring (with a debtor-in-possession model) may also be undertaken under the RBI Resolution Framework.

Under the RBI Resolution Framework, lenders (*i.e. Scheduled Commercial Banks (excluding Regional Rural Banks), All India Term Financial Institutions, Small Finance Banks; and, Systemically Important Non-Deposit taking Non-Banking Financial Companies and Deposit taking Non-Banking Financial Companies*) ("Lenders") are required to put in place board approved policies for the resolution of stressed assets, including resolution timelines.

The RBI Resolution Framework provides a 30-day review period ("Review Period") for reviewing the account of the company on the occurrence of a default and determining a resolution strategy and a resolution plan. During the Review Period, the Lenders and asset-reconstruction companies with exposure to the borrower are required to enter into an inter-creditor agreement ("ICA") to provide a framework for the finalisation of a resolution plan. The ICA must provide that decisions of lenders representing 75% of outstanding facilities and 60% by number will bind all lenders. The resolution plan is required to provide payment of at least the liquidation value due to the dissenting lenders.

A resolution plan (meeting conditions set out in the RBI Resolution Framework) is required to be implemented within 180 days from the end of the Review Period.

Further, (a) 20% additional provisioning is required if a viable resolution plan is not implemented by the end of 180 days from the end of the Review Period; and (b) 35% additional provisioning (including above 20%) is required if a viable resolution plan is not implemented by 365 days from the commencement of the Review Period. Conditions for reversal of additional provisioning are also specified in the RBI Resolution Framework.

Recent legal developments

Pre-packaged insolvency in India

Apart from the CIRP process under IBC (as explained in Section A above), micro, small and medium enterprises ("MSME")[6] can also be restructured under the pre-packaged insolvency resolution process ("PPIRP") introduced by the Government of India in light of the distress caused by the coronavirus pandemic vide its notification dated April 4, 2021. PPIRP is a debtor-in-possession and the creditor-in-control model which may be extended to other companies (other than MSMEs) in due course.

An application for initiating PPIRP of an MSME may be made:[7]

(a) in case of default of more than INR 10,00,000 (i.e. US$13,250);
(b) if the MSME has not undergone a PPIRP or completed CIRP in the three years preceding the date of the application;
(c) if the MSME is not undergoing CIRP;
(d) if no order requiring the MSME to be liquidated has been passed;
(e) If the MSME is eligible to submit a resolution plan under the IBC; and
(f) if the unrelated financial creditors of the MSME by (i) 10% majority propose the name of a resolution professional ("RP") for conducting the PPIRP, and (ii) 66% majority approve the suggested RP.

Commencing PPIRP, would also require (a) a declaration by majority of the directors or partners of the MSME, stating, *inter alia*, (i) that the MSME shall file an application for initiating PPIRP within a time period not exceeding 90 days; (ii) that the PPIRP is not being initiated to defraud any person; and (iii) the RP proposed and approved by the financial creditors; and (b) a special resolution passed by 75% of the members of the MSME approving the filing of an application for initiating PPIRP.

Under the IBC, if during the pendency of a PPIRP application, an application for initiating CIRP against the same corporate debtor is filed, the CIRP application will be proceeded with only after the PPIRP application is disposed of. If PPIRP application is filed within 14 days from filing the CIRP application then the NCLT shall first dispose of the PPIRP application. However, if PPIRP application is filed after 14 days from filing the CIRP application then the NCLT shall first dispose the CIRP application.

Admission of PPIRP and appointment of RP. Within 14 days of the filing of an application for initiating PPIRP, if the NCLT is satisfied that the corporate debtor is eligible to file for a PPIRP and that the application filed is complete, it shall admit the application. The date of such admission shall be the pre-packaged insolvency commencement date ("PCD"). The NCLT shall, while admitting the application, declare a moratorium and appoint a RP.

During the PPIRP, the management of the affairs of the corporate debtor continues to vest with its board of directors/ partners, who are expected to protect and preserve the value of the property of the corporate debtor.

On commencement of PPIRP, the RP shall prepare reports on the eligibility of the corporate debtor to file for PPIRP and confirm if the base resolution plan submitted by it meets the requirements laid down under the IBC. The duties of a RP *inter alia* include confirming the list of claims submitted by the corporate debtor, informing the creditors regarding their claims, maintaining an updated list of claims, monitoring the management of the affairs of the corporate debtor, constituting the CoC, preparing the information memorandum etc.

Committee of creditors. The CoC shall be constituted by the RP within seven days of the PCD and its first meeting shall be conducted within seven days of its constitution. The CoC shall be empowered to make an application to the NCLT, at any time by a vote of not less than 66%, seeking an order to vest the management of the corporate debtor with the RP.

The NCLT shall make an order to that effect, if it is satisfied that the affairs of the corporate debtor are being conducted in a fraudulent manner or that there has been a gross mismanagement of the affairs of the corporate debtor. If such order is passed by the NCLT, the resolution plan under PPIRP needs to involve change of management or control of the corporate debtor.

Resolution plan. The corporate debtor submits a base resolution plan to the RP within two days of the PCD, which is presented to the CoC. The CoC may either (a) elect to approve the base resolution plan (by a vote of 66%) if it does not impair any claim owed by the corporate debtor to its operational creditors; or (b) invite prospective resolution applicants ("PRAs") to submit resolution plans to compete with the base resolution plan. The base resolution plan as well as the resolution plans must conform to certain mandatory requirements of a resolution plan (*as elaborated above*). The resolution plans submitted by PRA's must also fulfil such criteria as may be laid down by the RP with the approval of CoC, keeping in mind the complexity and scale of operations of the corporate debtor.

Where, on the basis of such criteria, the CoC decides that a resolution plan is significantly better than the base resolution plan, it may approve such resolution plan. However, in the event that such plan is not significantly better than the base resolution plan, the submitter of the resolution plan and the corporate debtor shall improve their plans over the plan of the other party. For this, both bidders will have a fixed period of 48 hours to increase their bid by a pre-specified percentage. At the end of the process, whichever plan has the highest score shall be considered by the CoC for approval. After the CoC approves a resolution plan by a majority of 66%, the RP shall submit the approved resolution plan to the NCLT along with a compliance certificate, for its approval. Upon approval by the NCLT, the resolution plan shall become binding on all stakeholders.

Termination of PPIRP. The PPIRP process may be terminated if: (a) the control of the corporate debtor was vested in the RP (due to affairs of the corporate debtor being conducted in a fraudulent manner or there being gross mismanagement of the affairs of the corporate debtor) and the approved resolution plan does not result in a change in the management and control of the corporate debtor; (b) if the resolution plan with the highest score is not approved by the CoC; or (c) if the CoC does not approve any plan within 90 days of the PCD, and NCLT shall commence the liquidation process for the corporate debtor.

The CoC, at any time after the PCD but before the approval of resolution plan by a vote of 66%, may resolve to initiate a CIRP in respect of the corporate debtor, if such corporate debtor is eligible for CIRP.

Avoidable transactions. The provisions for avoidance of preferential, undervalued, extortionate credit and fraudulent transactions as applicable to CIRP, shall also apply to the PPIRP process.

Group insolvency

The IBC does not codify a mechanism for dealing with group insolvencies.[8] The Insolvency and Bankruptcy Board of India set up a working group under the chairmanship of Mr. UK Sinha on January 17, 2019 to recommend a complete regulatory framework for insolvency resolution and liquidation of companies in a corporate group under the IBC.

Some of the recommendations of the working group are:[9]

(a) a corporate group may be defined as a group of companies, including holding, subsidiary and associate companies, as defined under the (Indian) Companies Act, 2013 ("CA, 2013"). However, companies which are intrinsically linked with the group and do not fall under the definition provided in CA, 2013 may be included in a corporate group by making an application to the NCLT;

(b) the framework may provide for procedural coordination in the first phase by providing for (i) joint applications; (ii) communication, cooperation and information sharing; (iii) single insolvency professional and single adjudicatory authority; (iv) formation of group CoCs; and (v) group coordination proceedings;

(c) the framework may be implemented in a phased manner, where the first phase is focused on domestic group companies. Cross-border group insolvencies may be dealt with at a later stage;

(d) the framework may be enabling and may be voluntarily used by stakeholders. However, provisions relating to communication, cooperation and information sharing may be mandatory for insolvency professionals, Adjudicating Authorities and CoCs.

However, no such amendments have been notified to date.

In the case of *State Bank of India v. Videocon Industries Limited ("VIL")*, the NCLT, bench at Mumbai vide its order dated August 8, 2019[10] consolidated the CIRP of 13 group companies of VIL and set out the following criteria for consolidation of CIRP processes: (1) common control; (2) common directors; (3) common assets; (4) common liabilities; (5) inter-dependence; (6) interlacing of finance; (7) pooling of resources; (8) co-existence for survival; (9) intricate link of subsidiaries; (10) inter-twined accounts; (11) inter-looping of debts; (12) singleness of economics of units; (13) cross shareholding; (14) inter dependence due to intertwined consolidated accounts; (15) common pooling of resources, etc. Following this, the NCLT, bench at Mumbai also consolidated the CIRP processes of the Lavasa Group of companies.[11]

Notes:

1 Piyush Mishra and Suharsh Sinha are partners at AZB & Partners. Shruti Sethi is an associate at AZB & Partners.

2 Notification No. SO 1205(E) dated March 24, 2020, issued by the Ministry of Corporate Affairs.

3 Section 29A of the IBC. Some of the grounds for disqualifications include:
(i) being an undischarged insolvent;
(ii) being a wilful defaulter;
(iii) being prohibited from trading in the securities market;
(iv) having an account classified as a non-performing asset ("NPA") (for more than one year);
(v) being convicted for certain offences;
(vi) being disqualified from acting as a director under Companies Act, 2013;
(vii) being under any similar disability under any law in a foreign jurisdiction.

4 Committee of Creditors of Essar Steel India Limited Through Authorised Signatory v. Satish Kumar Gupta & Ors., Civil Appeal Nos. 8766-67 of 2019, Supreme Court of India; K Sashidhar v. Indian Overseas Bank & Ors, Civil Appeal No. 10673 of 2018, Supreme Court of India.

5 A special resolution is one which is passed by 75% approval of the members with voting rights (present and voting).

6 As per the notification of the Ministry of Micro, Small and Medium enterprises dated June 1, 2020, (i) a micro enterprise refers to an enterprise where the investment in Plant and Machinery or Equipment does not exceed one crore rupees (approx. US$133,400) and turnover does not exceed five crore rupees (approx. US$667,00); (ii) a small enterprise refers to an enterprise where the investment in Plant and Machinery or Equipment does not exceed ten crore rupees (approx. US$1,334,100) and turnover does not exceed fifty crore rupees (approx. US$6,670,600); (iii) a medium enterprise refers to an enterprise where the investment in Plant and Machinery or Equipment does not exceed fifty crore rupees

(approx. US$6,670,600) and turnover does not exceed two hundred and fifty crore rupees (approx. US$33,333,400).

[7] Notification No. SO 1543 (E) dated April 9, 2021, issued by the Ministry of Corporate Affairs, read with Sections 54A(2)(a), (b), (c), (d) and (e) of IBC.

[8] https://vidhilegalpolicy.in/research/report-of-the-ibbi-working-group-on-group-insolvency/

[9] Report of the Working Group on Group Insolvency, September, 2019. Available at - https://ibbi.gov.in/uploads/resources/d2b41342411e65d9558a8c0d8bb6c666.pdf

[10] MA 1306/2018 in CP No. 02/2018 decision dated August 8, 2019.

[11] In the matter of Axis Bank Limited and Lavasa Corporation Limited, MA 3664/2019 in C.P.(IB)-1765, 1757 & 574/MB/2018 (NCLT, Mumbai, February 26, 2020).

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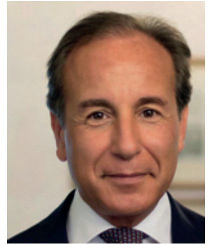
Current issues on Italian bankruptcy law and COVID-19



by Stanislao Chimenti, Delfino e Associati Willkie Farr & Gallagher LLP

The sudden outbreak of the pandemic required the Italian Parliament to promptly take the necessary measures to face the greatest world crisis since the end of the Second World War. These interventions on the legal framework are mainly aimed at "deactivating" some provisions that have the function of protecting creditors, but which, in the current situation, could have led to the liquidation or bankruptcy of otherwise not-insolvent companies. In this article we will briefly analyse the main provisions approved by the Italian lawmaker regarding insolvency and bankruptcy law and the impact of the pandemic on the bankruptcy proceedings in Italy and the possible future scenarios.

The new COVID-19 insolvency provisions

With reference to the changes made to the regulation of the business crisis, it is possible to identify essentially two legislative interventions:

i) Law – Decree April 8, 2020, n. 23 (so-called "Liquidity Decree" - converted into Law June 15, 2020, no. 40);
ii) Legislative Decree October 26, 2020, no. 147 (so-called "Corrective Decree").

The Liquidity Decree

First of all, the Liquidity Decree (art. 5) postponed the entry into force of Decree January 12, 2019, no. 14 (the "Crisis and Insolvency Code", which is to replace Italian Bankruptcy Law, "IBL") to September 1, 2021, the entry into force of which was originally scheduled for August 2020. Such a postponement is to be positively considered because most of the provisions of the Crisis and Insolvency Code were approved before the outbreak of COVID-19 and therefore could not take in to account the dramatic change of the whole economic and legal situation.

Pursuant to art. 10, co. 1 of the Liquidity Decree, the bankruptcy applications filed in the period between March 9, 2020 and June 30, 2020 were to be declared inadmissible without prior verification of the existence of the eligibility conditions provided for by IBL. Two exceptions were provided: (i) the debtor was always entitled to file a request for its own bankruptcy where the insolvency was not justified by the crisis caused by the pandemic; and (ii) the court could not declare as inadmissible the bankruptcy requests filed by the Public Prosecutor containing requests for precautionary or conservative measures pursuant to art 15, co. 8 IBL, to protect assets or the company, with the intent, in the latter case, to prevent dissipative conduct of criminal relevance that risked being substantially permitted in the event of general inadmissibility of bankruptcy applications.

According to the Bankruptcy Section of the Court of Milan[1], the Court of Florence[2] and even the Court of Novara[3], "*The legislator, in short, as mentioned above, does not want any postponement, but an immediate dismissal of bankruptcy requests for the period from March 9 to June 30, and one cannot replace its provision with a different solution that it did not want*".

With regard to composition with creditors, restructuring agreements, crisis settlement agreements and consumer plans already approved, art. 9 of the Liquidity Decree provided a six-months extension of the terms of fulfilment expiring after February 23, 2020, therefore extending for an equal term the relevant proceedings.

Pursuant to art. 9, co. 2 of Liquidity Decree, in the proceedings for the approval of the composition with creditors and the restructuring agreements pending as of February 23, 2020, the debtor was (and is still) entitled to file, up to the hearing set for the approval, a specific request for the granting of a term not exceeding 90 days for the filing of a new plan and a new composition proposal pursuant to art. 161 IBL, or a new restructuring agreement pursuant to art. 182-bis IBL.

In particular, for the approval proceedings pending on February 23, 2020 – for which the plan and/or the restructuring agreement has already been filed – the debtor was and is entitled to file until the scheduled hearing for the homologation:

- an application for the setting of a new term – not exceeding 90 days, not extendable, starting from the provision that grants it – for the presentation of a "new" plan and a "new" composition proposal or a new agreement of restructuring, not necessarily improving for the satisfaction of insolvency creditors; or, where the debtor intends to change only the terms of fulfilment of the composition with creditors or the debt restructuring agreement;
- a "*brief containing the indication of the new terms*" for the fulfilment of the arrangement or the restructuring agreement, not exceeding "six months with reference to the original deadlines", also filing the documentation proving the need to change the terms. In case of homologation, the Court will be able to implement these new deferred terms of fulfilment, without the possibility for creditors to be able to plead anything in this regard.

The last measure provided for by art. 9 of the Liquidity Decree is the possibility to request an extension up to a further 90 days of the term of the so-called automatic stay, i.e. the suspension of individual executive and precautionary actions in the negotiation period prior to the restructuring agreement already implemented pursuant to art. 182-bis, co. 7, IBL. Also in this case, the suspension is allowed only on condition that the need for this extension is based on the evidence of facts that have occurred as a result of the COVID-19 crisis.

Finally, the debtor who, by December 31, 2021, has already obtained the grant of the terms referred to in Articles 161, co. 6, IBL or in art. 182 bis, co. 7, IBL, is entitled to renounce (within the same terms) the related application, replacing it with a recovery plan certified pursuant to art. 67, paragraph 3, lett. d), IBL that it has been published in the registry of business.

The Corrective Decree

The main innovations provided by the Corrective Decree include:

i) the new definition of business crisis: Previous reference to "economic-financial difficulty" has been replaced by "economic-financial imbalance", capable of making the debtor's insolvency probable. This imbalance must be highlighted on the basis of the non-sustainability of the debts for at least the following six months and the absence of business continuity prospects for the current year or in the following six months if the residual duration of the year at the time of the assessment is less at six months. The notion of crisis is therefore removed from the reference to the state of "economic-financial difficulty" and linked to a concept of economic-financial imbalance, in order to limit the scope of application of the alert measures to an effective and concrete crisis situation (reversible), reducing the risk of excessively early reports, taking into account the correlative detrimental effects that could arise on the business continuity of the debtor, subject of the report;
ii) the raising of the relevant thresholds for the purpose of activating the so-called external alert from the Income Revenue Authority, requesting for this purpose an unpaid VAT of €100,000 for companies with a turnover resulting from the return for the previous year not exceeding €1 m, for €500,000 for companies with a turnover of up to €10m, and for €1m for companies with a turnover exceeding €10m and introducing a deadline within which these obligations must be fulfilled

(by and no later than 60 days from the period for submitting the declarations relating to the following year);

iii) the possibility for the public prosecutor to intervene in all proceedings aimed at opening a crisis or insolvency regulation procedure; and

iv) the extension of the pre-deductibility regime, in addition to the already foreseen hypotheses, also in the case of (a) credits legally arising during the insolvency procedures for the management of the debtor's assets and the continuation of the business activity, the credits deriving from non-contractual activities of the bodies in charge, as long as they are connected to their functions, the compensatory claims deriving from negligent acts of the aforementioned bodies, their remuneration and the professional services requested by the bodies themselves; and (b) loans, as part of composition procedures preventive or restructuring agreements, functional to the presentation of the application for admission to the composition with creditors procedure or of the application for approval of debt restructuring agreements.

The Corrective Decree also modifies Articles 2257, 2380 *bis*, 2409 *novies* and 2475 of the Italian Civil Code ("ICC"). It is now provided that the directors of partnerships and limited liability companies are exclusively entrusted with the establishment of adequate organisational, administrative and accounting structures – functional to the timely emergence of the business crisis and the loss of continuity – and not the entire corporate administration which may continue to be shared with non-administrator shareholders.

Finally, the Minister of Justice has appointed a commission of experts in charge of reforming the Crisis and Insolvency Code by June 1, 2021 and possibly ordering the postponement of certain specific provisions of the Code. In detail, the four objectives of the commission are:

i) to evaluate whether to order a further postponement of the entry into force of some rules of the Crisis and Insolvency Code;

ii) to formulate corrective proposals of the Crisis and Insolvency Code;

iii) to formulate proposals for adaptation to Directive no. 2019/1023 / EU; and

iv) to formulate proposals for temporary amendments to the Crisis and Insolvency Code in relation to the pandemic.

The impact of the pandemic on the bankruptcy proceedings in Italy and the possible future scenario

According to a report issued by the Bank of Italy[4] (the "BI Report"), since the beginning of the economic crisis caused by the pandemic, there has been a widespread fear that it would lead to a wave of bankruptcies. The available evidence indicates that economic support measures for businesses, such as grants and non-repayable grants loan moratoriums have significantly reduced the impact of the crisis.

However, the uncertainty about the economic outlook, the increase in corporate indebtedness and the weakening of assets that have intervened in the meantime raise the question of how bankruptcies will evolve in the coming months, when the support measures are "withdrawn".

In 2020 the number of bankruptcies decreased by about one-third compared to 2019. According to the BI Report the lower number of bankruptcies depends on two factors. First of all, the moratorium on bankruptcies (in force, as previously examined, from the beginning of March 2020 to the end of June) and the general slowdown in court activity as a result of the pandemic containment measures contributed to it. Secondly, some of the companies already in trouble before the pandemic, and which allegedly went bankrupt during the year, may have survived thanks to the economic support measures. However, if the difficulties of these companies are of a structural nature, it is possible that they are only postponed bankruptcies.

Based on estimates of the elasticity of bankruptcies to the business cycle and assuming that the "missing" ones in 2020 will re-emerge in the coming months, the number of bankruptcies could increase by about 6,500 cases (almost 60% of those registered in 2019) by 2022, with the majority of case already occurring in 2021.

Notes:

1 Court of Milan, "Circular for the period 16.04.2020 / 11.05.2020 and for the so-called phase B until 30 June 2020 - Guidelines for behaviour", p. 13.

2 Court of Florence, Decree no. 60/2020 - April 30, 2020, p. 4.

3 Court of Novara, Decree no. 21/2020 - April 14, 2020, p. 24.

4 Silvia Giacomelli, Sauro Mocetti e Giacomo Rodano "Fallimenti di impresa in epoca Covid", Banca d'Italia, Note Covid – 19, 27 gennaio 2021.

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Common struggles faced by international creditors in Luxembourg bankruptcy proceedings

by Anne-Marie Nicolas and Olivier Marquais, Loyens & Loeff Luxembourg S.à r.l.

A large number of international corporate groups conducting their activities all over the world have holding or finance companies in Luxembourg. Naturally, further to the 2007-2008 global financial crisis, business law firms witnessed a surge of international debt restructuring and insolvency proceedings involving large groups of companies and in particular their Luxembourg entities. By reason of the current COVID-19 pandemic, history is repeating itself and a number of international creditors need to handle situations involving financially distressed debtors, where Luxembourg is one of the key jurisdictions to look into. The present note addresses selected aspects around Luxembourg bankruptcy law which international creditors may encounter and should watch for when seeking to have their debtors declared bankrupt in Luxembourg or, on the contrary, trying to assess the bankruptcy risk when negotiating a distressed investment or a debt restructuring with a group or structure having its key entities located in Luxembourg.

Satisfying the "loss of creditworthiness" criteria

An international creditor's first struggle, when seeking to have a debtor company declared bankrupt in Luxembourg, relates to meeting the conditions of bankruptcy under Luxembourg law. In accordance with Art. 437 of the Luxembourg Commercial Code ("LCC"), a commercial entity is bankrupt when (i) it has ceased its payments (*cessation des paiements*) and (ii) its credit is exhausted (*ébranlement du crédit*).

Whether the first condition is met can be objectively determined as case law has ruled that the failure to pay a single undisputed, certain, liquid and due debt is sufficient for the District Court to declare a company bankrupt. A creditor may satisfy this requirement by obtaining a judgment against its debtor.[1]

The second condition is less clear-cut and more subjective, as a commercial entity is deemed to have lost its creditworthiness if its trade or business partners refuse to continue trading with it. As it concerns the debtor's internal affairs, information on other creditors' unwillingness to trade with the debtor may not easily be available. Yet, when a creditor applies to the District Court to have a debtor declared bankrupt, it must ensure that both conditions of bankruptcy are met on the day that the bankruptcy judgment is rendered.

Case law provides little guidance as to when or how the second condition is met, and courts often tie the loss of creditworthiness to the debtor's cessation of payments since one's failure to pay its debts as they become due would logically not inspire trust to equity, debt or commercial partners.[2] Loss of creditworthiness may thus be both the cause and the consequence of the cessation of payments. In theory, the existence of one single debt may lead to the loss of creditworthiness if it is sufficient to jeopardise the debtor's affairs entirely.

In order to demonstrate that the "loss of creditworthiness" criteria is met, creditors may seek to provide any evidence that the activities of the debtor are frozen by reason of other creditors' unwillingness to wait to collect what is owed to them, suppliers' refusal to deliver (unless paid in cash), financial institutions' refusal to lend funds, or that the debtor proceeds with payments to ordinary creditors to the prejudice of preferred creditors.[3] One supplier's refusal to deliver may constitute evidence of loss of creditworthiness, but on its own will generally not be sufficient as the criteria concerns the general commercial loss of one's credit in the eyes of trade partners.

How many trade partners must have lost their confidence in the debtor for the criteria to be met? As can be expected, Luxembourg case law does not provide any figures or indications, but rather takes all circumstances and submitted evidence into consideration. Doctrinal guidance provides that a commercial entity is deemed to have lost its creditworthiness when there is no longer a sufficiently broad consensus of creditors maintaining their confidence in the debtor, which results in the debtor not being able to pursue its activities.

Facing oppositions after having had a debtor declared bankrupt

Even when the conditions of bankruptcy are met and a judgment declaring a commercial entity bankrupt is rendered, the bankrupt company (or other creditors) may seek to oppose it.[4]

The publication of the bankruptcy in the local Luxembourg newspapers starts an eight-day period for the bankrupt company (or a 15-day period for interested parties such as other creditors) to file an opposition, before the same court that rendered the bankruptcy judgment (Art. 473 LCC). The objective of this opposition procedure, or third-party opposition procedure (*tierce opposition*) when initiated by an interested party, is to retract the bankruptcy judgment. Grounds upon which one may rely to submit such opposition include the following:

(i) The bankrupt company does not qualify as a merchant (*commercant*) in accordance with the LCC. Arts. 2 and 3 of the LCC does not define the term "merchant" but rather widely defines a merchant's acts. These generally include most commercial activities, banking and financial operations. It becomes quickly obvious whether one may rely on this ground to seek to have a judgment retracted.

(ii) The Court was not competent to declare the company bankrupt. In the vast majority of cases, the competence of the court will be difficult to dispute, but opportunities arise when a company is incorporated in two jurisdictions, where the Luxembourg company was just an empty shell or without sufficient Luxembourg substance or where its center of main interests ("COMI") was located in another EU jurisdiction. In such a case, the bankrupt entity can be expected to submit evidence that its COMI (or equivalent criteria applicable for third party/non-EU jurisdictions), including commercial, economic and fiscal ties, are located in another jurisdiction, so that the courts of this second jurisdiction should be held competent to handle its bankruptcy rather than the Luxembourg courts. In most of these cases, choosing a jurisdiction to open bankruptcy proceedings is a strategic decision.[5]

(iii) The bankrupt company is not in cessation of payments. With respect to the first condition of bankruptcy, the bankrupt entity may seek to establish that it is not in cessation of payments as the conditions of the debt (that it is certain, liquid and due on the day of the bankruptcy judgment) are not met. Opportunities to oppose on this ground arise in the event of contingent claims, which may come as a surprise to international creditors. In a number of common law jurisdictions, a creditor may provide evidence of all debts and liabilities of the debtor, present, future or contingent, in order to have the debtor declared bankrupt. In Luxembourg, one may oppose a bankruptcy judgment on the ground that debts have not yet matured and are thus not sufficiently certain if they are contingent or future. This may be the case if the debtor acts as guarantor in a contractual arrangement.

(iv) The bankrupt company has not lost its creditworthiness. With respect to the second condition of bankruptcy, the bankrupt entity may seek to establish that it continues to benefit from payment deferrals, that it is able to renegotiate agreements, that its commercial affairs are not seriously disrupted, and provide evidence of the quality of its commercial organisation and reputation.

Relinquishing control to the trustee

Contrary to what many foreign creditors would expect, creditors play a minor role in the Luxembourg bankruptcy process. Once appointed by the court (without consultation of any third parties, including creditors), the trustee represents the interests of both the bankrupt company and its creditors, and will not seek the creditors' approval or views when taking any decisions. Rather, the trustee acts under the supervision of the supervisory judge (*juge-commissaire*) which is appointed at the same time as the trustee in the bankruptcy judgment. There is also no credit bidding process under Luxembourg law and the trustee does not have to consider bids made by any creditors.

Creditors may reach out to the trustee to draw its attention to the bankrupt company's financial status, any suspicious prior commercial acts or possibly fraudulent transactions, which the trustee may seek to challenge to recover monies for the benefit of creditors as a whole.[6] Trustees also have the power to initiate proceedings against directors of the bankrupt company under Art. 495 LCC,[7] Art. 495-1 LCC[8] and Art. 441-9 of the law of 1915 on commercial companies.[9] While the trustee is under no obligation to respond to creditors' communications, it is likely to take into consideration any objective information and facts.

However, in our experience, Luxembourg trustees are unlikely to accept creditors' requests to form a committee of creditors and convene regular meetings to consult them, get their views and answer their questions. This contrasts drastically with the approach taken by common law jurisdictions.

This being said, we note that trustees are often willing to keep the creditors updated of the steps taken during the bankruptcy process. In certain cases, trustee have set up websites to inform creditors of the evolution of the situation of the bankrupt company, of the assets recovered, the steps taken by the trustee (e.g. investigations, proceedings, etc.) and to communicate with the creditors generally. This may provide creditors with guidance on the next procedural steps, the conduct of the process which they may not be familiar with and an opportunity to state their position.[10]

Assisting with securing funding to initiate proceedings on the merits

When a trustee believes that it has grounds to seek the annulment of a transaction, during the hardening period or prior to it, or recover assets from the bankrupt company's directors, it will start legal proceedings by way of a writ filed before the District Court sitting in commercial matters, and make the case for the reimbursements of the amounts.

Taking such steps will require the trustee to have funds already at its disposal within the bankrupt company's estate. In cases where little or no assets are available, the trustee may seek outside funding from third parties if it is in the best interests of the bankrupt company and of its creditors. Typically, trustees have two options:

(i) If the bankrupt company has claims against third parties, the trustee may sell these claims, likely at a discount. The bankrupt company's movable goods (such as claims) may be sold with the authorisation of the tribunal, which, upon the supervisory judge's report, will determine the conditions of the sale.

(ii) Trustees may also approach third-party funders which business model is to finance the costs of the proceedings (legal costs, expert costs, etc.) in exchange for a percentage of the proceeds. While the practice of third-party funding is not regulated in Luxembourg, nothing prevents it. It has become common practice in neighboring countries and third-party funders have opened offices and invested in claims in Luxembourg.

Luxembourg directors' duties in an insolvency context

Creditors often try to assess the Luxembourg board of director's strategy when the Luxembourg is in financial distress and there could be a risk of their filing for bankruptcy. We also see often that, especially US creditors try to pressure boards into following their views on what to do with the companies' assets to satisfy their claims.

In this context, the fact that directors have a legal duty under Luxembourg law to file for bankruptcy within one month of the cessation of payment (though this obligation was suspended as part of the COVID-19 emergency measurer) sometimes puts a strain on debtor-creditor discussions.

While under Luxembourg law there is not, as such, a concept of "fiduciary duty" similar to the one under US law for instance. However, the directors of a Luxembourg company must act with loyalty, honesty and in good faith and for the Luxembourg company's corporate benefit. While a creditor may state a claim against the directors of a Luxembourg company for failure to comply with their duties, the burden of proof is high as the claimants would need to prove (i) a fault/negligence (violation of the articles of association and/or the law or under the general principles of tort)[11]; (ii) a prejudice or loss that the claimants sustained as a result (which must be a personal prejudice and not simply a general one)[12]; and (iii) the causality between the fault/negligence and the loss or damage incurred.

When assessing the interests of the company, directors should primarily consider the company on a standalone basis, and not the interests of the broader corporate group unless these are linked to the individual interest of the Luxembourg company itself.[13]

Luxembourg law also sanctions situations where directors use the company for personal purposes and do not respect the principle of the company as a separate entity, its object and the functioning of the its bodies. In this respect, the provisions of Art. 495 LCC allow to extend the bankruptcy of the company to the directors personally when (i) they pursued their own interests while seeming to act on behalf of the company; or (ii) they used the company's goods/assets as their own; or (iii) they abusively pursued, in their personal interests, an operating deficit which could only lead to the company's cessation of payments.[14]

Further, when it appears that the assets of the bankrupt company are not sufficient to satisfy its creditors, the trustee may petition the Court to declare that the directors shall be held liable for the debts of the company, in whole or in part, jointly or severally, if it can be demonstrated that the directors' gross misconduct led to the company's bankruptcy.[15]

This action seeks to force the directors to cover the company's liabilities and is not common in Luxembourg since it would be necessary to establish that the directors' wrongdoings (and possibly fraudulent intent) were sufficiently grave to have significantly contributed to the company's bankruptcy. The causal link between the wrongdoing and the bankruptcy is essential for this action to succeed.

No specific duties are imposed however on directors if the company encounters financial difficulties, other than to closely and regularly monitor the company's financial situation and take any measures that may be deemed necessary and appropriate to allow the company to continue its existence and avoid a value-destructive Luxembourg insolvency/liquidation process. In particular, there is no requirement or expectation under Luxembourg law that directors of a distressed or insolvent company would have to hold the assets of the company on trust for the benefit of its general body of creditors, or any particular creditor. The directors' responsibility in a financial distress scenario remains to continue to act in the best interest of the company.

Notes:

1 A commercial entity seeking to declare voluntary bankruptcy (*aveu de faillite*) must submit its balance sheet with evidence of the extent of its liabilities and subsequent warranty calls from

its creditors. It should however be noted that there have been certain instances where the Luxembourg court did not request a court order to evidence that the claim was indeed due.

[2] The reverse is not necessarily true as a company would not be found bankrupt if it maintains strong credit with partners despite having ceased its payments.

[3] Trib. Lux., 10 février 1995, n°44568; CA, 4 décembre 2013, n°40250; CA, 12 novembre 2014, Pas. Lux., 2015/5, p. 340-345; M. Lemal, *Manuel de la liquidation des sociétés commerciales*, Wolters Kluwer 2013, parag. 853.

[4] In practice, one does not have any opportunity to object before the bankruptcy judgment is rendered.

[5] In the case of a voluntary declaration of bankruptcy, the company can be expected to strategically file for bankruptcy in one jurisdiction and submit documentation to prove the competence of the chosen court. In doing so, it may go as far as to seek the support of the second court.

[6] A trustee may rely on several provisions of the LCC to seek to annul payments and transactions made by a bankrupt company concluded during the "hardening period" (*période suspecte*), usually starting 6 months and ten days prior to the bankruptcy judgment, on the basis of Arts. 445 and 446 LCC. Irrespective of the hardening period, a trustee may rely on Art. 448 LCC to challenge any fraudulent payment and transactions made prior to the bankruptcy and which are damaging to the creditors as a whole, without any limitation of time.

[7] These provisions allow the trustee to extend the bankruptcy of the company to the directors personally, and seek to sanction situations where directors use the company for personal purposes and do not respect the principle of the company as a separate entity, its object and the functioning of its bodies.

[8] When it appears that the assets of the bankrupt company are not sufficient to satisfy its creditors, the trustee may petition the Court to declare that the directors shall be held liable for the debts of the company, in whole or in part, jointly or severally, if it can be demonstrated that the directors' gross misconduct led to the company's bankruptcy.

[9] Under these provisions, directors are responsible for the execution of their mandate and any misconduct in the management of the company's affairs. The standard applicable is how a good parent would manage its family (*en bon père de famille*).

[10] By way of an example, the trustee of the Espirito Santo insolvencies has set up a website available at: http://www.espiritosantoinsolvencies.lu/default.htm (last consulted on April 7, 2021).

[11] Article 441-9 (2) of the Law of 10 August 1915 on commercial companies

[12] Trib. Lux., 29 June 2007, n° 104787.

[13] A. Steichen, « Précis de Droit des sociétés », *La création de groupes de sociétés*, 2018, pp. 438-472.

[14] Directors may be declared personally bankrupt when one of these conditions is met, provided that the usual conditions of bankruptcy are also met (they can be considered as merchants, lost their creditworthiness and are in a situation of cessation of payments).

[15] 495-1 LCC.

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Mexico's insolvency law after COVID-19

by Luis Palomino Bernal, Palomino, Flores, Hernández Abogados

Mexico, being within the 20 largest economies in the world and having more than six million companies that have suffered the onslaught of the crisis generated by COVID-19, in addition to the internal management of economic policy, needs the help of professionals today more than ever in insolvency and restructuring. We will briefly comment on our current situation and what needs to be done to address this delicate issue.

Current legislation

For more than a year, our way of working and living has radically changed due to the COVID-19 pandemic. We have become accustomed to communicating through video conferences, whether for work issues with our clients and colleagues, academic and social activities, or, with regard to our professional performance, to process a trial entirely online.

In this maelstrom of changes, we have seen how different laws on insolvency have been modified in a number of countries, so today what we knew up to March 2020 has changed dramatically.

However, Mexico is the exception.

On May 12, 2000, the bankruptcy law was published in Mexico, to regulate the insolvency procedure for merchants. Here the insolvency procedure of financial institutions and auxiliary credit institutions is also regulated in an accessory way.

However, Mexico does not have an effective and efficient legislation that regulates the insolvency of the non-merchant natural person or consumers.

There is also no special legislation to regulate the insolvency of financial institutions. They depend, as already mentioned, on the bankruptcy law enacted for merchants.

Similarly, there is no legislation that regulates the insolvency of sovereign entities.

Therefore, the only current legislation that is applied in Mexico in insolvency situations is the bankruptcy law, which has been modified four times: in 2007, in 2014, in 2019 and at the beginning of 2020. The most important modifications were in 2007 but especially in 2014. The last two have been minor.

Before the pandemic, in Mexico those dedicated to litigating issues of insolvency and financial restructuring of companies had detected the need to reform the legislation or to generate new laws that address the following specific issues:

1. the bankruptcy law needs to be flexible in the case of micro, small and medium-sized enterprises;
2. a legislation is needed to address the insolvency of natural persons and/or consumers;
3. an exclusive legislation needs to be issued to deal with the insolvency of credit institutions and the like;
4. real Alternative Dispute Resolutions in matters of insolvency are needed, since the current ones are insufficient; and
5. finally, Mexican lawyers dedicated to the insolvency process require that the reforms of 2014 be implemented in reality.

In other words, in 2014 the online trial in bankruptcy matters was implemented and federal district judges with exclusive competence in commercial and insolvency matters were established or created by law. But nowadays the online bankruptcy proceedings have not been implemented and the exclusive federal district judges in commercial and insolvency matters have not been created in the main cities of Mexico to deal with such procedures in an efficient and timely manner.

While the lack of implementation of the bankruptcy online trial was not an issue from which we suffered before the pandemic, but the lack of specialised judges is a major issue, since the courts that today process the insolvency trial are also familiar with many other procedures (including amparo), which is why in practice they constantly reject bankruptcy proceedings.

Emergency legislation

At the beginning of the pandemic, several members of the Bankruptcy Commission of the Mexican Bar Association began to analyse what would be optimal but also possible for our legislation to adapt to this health contingency. It was very difficult and very complex to achieve the reforms of the size and scope that I referred to at the beginning of this work, so instead we set ourselves a simpler objective to add an emergency chapter only applicable in such times like those experienced during the pandemic.

Thus, a series of works began that concluded in the presentation of an initiative to reform the commercial bankruptcy law dated April 28, 2020, in which it was proposed to add a 15th title called: Emergency Bankruptcy Regime. To date, the said reform is still pending approval.

The reform proposal starts from the premise that in times of crisis the best way to proceed is by using the same legislation that we have but applying exception rules. Therefore, it was proposed that a specific chapter should be added where it would be possible to process bankruptcy processes in a more flexible way.

There are 11 main points contained in this proposal:

1. The processing of the electronic trial without the need to bring a physical file to court.
2. The application form for a company that requires a voluntary insolvency proceeding will be very simple: under oath, the company has to declare before the federal court fits under insolvency premises that the law establishes, without having to prove them at the moment of the filing.
3. Automatic stay: Maximum three days after the filing, the court shall admit the insolvency proceeding, as mandatory. And without any requirement, the court must order the stay of any execution agains the company.
4. All the frozen bank accounts will be liberated: Nowadays this is a problem, because the federal judges are very clear that once the insolvency proceeding is initiated nobody can freeze an account, but accounts seized before the initiation of the proceeding are more complicated to liberate.
5. There is no appeal versus the bankruptcy declaration.
6. More power to the federal judges' resolutions: Arrest for anyone that disobeys the order or if the creditor disobeys they will loss every right they have at the contest.
7. The stay includes collaterals.
8. Fresh money: Within five days from the petition, the court can authorise the loan of new money, and those creditors will have preference.
9. Tax debts will not have any preference in the insolvency proceeding.
10. Bankruptcy: Labour executions will be transacted before the bankruptcy judge.
11. Bankruptcy: After liquidation, will lead to discharge.

Total opposition of the banks to the reform proposal

On May 15, 2020, the Mexican Banking Association issued a statement in which they considered the proposed reform initiative inconvenient, untimely and unnecessary.

Basically, the banks introduced five reasons to oppose the reform proposal:

1. First, they pointed out that the direct beneficiaries of the said reform would be large corporations and not small and medium-sized companies. This is totally false, since from

the year 2000 and up to date it is precisely the large companies who have been able to use the Concurso Mercantil in Mexico, because the requirements are so complex and onerous that they are out of the reach of small and medium-sized companies. In other words, what the reform is trying to do is allow these micro, small and medium-sized companies easily and quickly access to the insolvency procedure.

2. The banks say that, instead of a reform to the insolvency law, the small and medium-sized companies must use alternative means of dispute resolution (ADRs); however, they omit to point out that in Mexico we do not have the alternative means for efficient and effective dispute resolution in an insolvency case.
3. They also point out that by eliminating requirements to go to an insolvency process, there will be many more companies that can benefit from this procedure and, therefore, having more commercial insolvency procedures will violate the equal treatment between the parties: The principle of equality between creditor and debtor will be violated.
4. They also point out that insolvency proceedings are contrary to the rights of creditors. Obviously, the insolvency process tends to protect creditors, but we must not lose sight of the fact that the legal asset protected in the first place is the rescue of the company. That is to say, first you have to seek to safeguard the company and obviously you will have to have certain sacrifices between all parties, including creditors.
5. Finally, they point out that a rescue or aid of any kind should not be generated to the debtor companies to maintain the balance between said companies and the banks themselves. However, in the 1995 crisis in Mexico, the so-called Tequila Effect, there was a bank rescue of incalculable magnitude called Fobaproa. While the banks were helped out by the Mexican government in 1995, they are adamantly opposed to a similar bailout for the business sector now.

The judges: our salvation

The proposed reform is still stagnant in the branches of the Mexican legislative framework and what we have now is what we have had for the last 21 years: *La Ley de Concursos Mercantiles*.

Therefore, with the tools we have, we must work to move forward all the companies that face non-compliance and liquidity problems at this time by using the Mexican federal judiciary to begin to admit all commercial insolvency procedures either through the request of the merchant himself or the petitions of the creditors.

The admission must be immediate without requiring unnecessary documents from the parties and the same immediacy protection must be granted to the company, the Automatic Stay, and the court must order the suspension of all enforcement proceedings against the assets and rights of the merchant, for the benefit of the merchant protects the source of employment and generation of wealth as well as for the benefit of the creditors.

In Mexico the timely implementation of the insolvency legislation and the rapid response that we obtain from the courts of the federation's judicial power, will make a great difference that will mark the way in which Mexico attends to and solves insolvency problems during and after the pandemic.

We are basically in the hands of the federal judges so that in a historic act at a national level they stop rejecting the admission of the processes of insolvency and address this problem so as not to lose our economy and its value and can rescue as many companies as possible.

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Building a business rescue friendly regime in Nigeria: The Companies and Allied Matters Act, 2020

by Anthony Idigbe, PUNUKA Attorneys & Solicitors

There have been significant changes in the Nigerian Insolvency Framework in the last 12 months owing to the introduction of the Companies and Allied Matters Act, 2020 ("the New CAMA") which came into force on January 1, 2021.

Prior to the advent of the New CAMA, the framework for insolvency under the 1990 CAMA focused on liquidation and receivership, management displacing and potentially value-destroying tools. The weak debtor and creditor rights and insolvency framework with a limited restructuring menu meant a weak secondary market for distressed assets. The enforcement and realisation of creditors rights left little room for debtors to manoeuvre. There was debtor resistance to these management displacing tools leading to protracted litigation and erosion of value.

Practitioners at the time would have recourse to the adaptable scheme of Arrangement & Compromise (A&C) tool to promote insolvent business rescue, albeit with its own challenges (requirement of fairness and qualified majority, lack of moratorium).

Some proactive commercial judges on their part also encouraged business rescue through use of their directive powers and amicable dispute resolution powers of the Court available under the law and the Court's rules.[1] This, in some cases, has created a framework for negotiations and multi-creditors' workouts culminating in entry and enforcement/implementation of scheme under a consent judgment.

The new law has, however, introduced two new insolvency and restructuring procedures: Company Voluntary Arrangement (CVA) and Administration while retaining and/or amending the Receivership, Liquidation and A&C Schemes in varying degrees[2]: the overall picture shows a significant shift towards business rescue, a more balanced debtor and creditor rights regime, and deference to the new procedures as opposed to what existed under the old law.[3]

Overview of the new procedures and the framework for regulation of insolvency practice

Beyond the introduction of debtor-friendly and rescue-focused procedures such as CVA/ Administration and the registration of insolvency practitioners – including the recognition of the Business Recovery & Insolvency Practitioners Association of Nigeria (BRIPAN) as a certifying professional body, amongst others, – the new law went even further to both acknowledge the imperative of informal multi creditor or stakeholders' workouts within these new procedures and stated a more limited usefulness of receivership and managership.

Company Voluntary Arrangement

CVA, which can be commenced in or out of court, is tagged "voluntary" because it is ordinarily director-controlled with the directors being able to kickstart the process with a proposal while retaining control and management of the debtor unlike in liquidation and, in most cases, administration.

CVA also offers optimism for debtors given that the procedure can be initiated either by a Liquidator or Administrator and, as such, there is now some statute-backed way out of liquidation which could be explored rather than the previously established "undertaker" liquidation approach to the business of the debtor, particularly as the effect of arrangement, regardless of the source of the proposal, could lead to cessation or stay of the winding-up or administration proceedings which by implication would lead to a resurrection of the directors' control.

Practically, the CVA is implemented under the supervision of a nominee who shall be qualified to act as an Insolvency Practitioner (IP) concerning the company. The nominee's role consists of advising the Court concerning approval of meeting to consider the Proposal to the company's creditors and to act as a trustee or implement the arrangement eventually reached and sanctioned by the Court.

Except where initiated within an existing Administration or Liquidation, the procedure involves the company making a proposal to creditors, followed by a meeting of the company and its creditors without any provision for a moratorium.

The CVA essentially allows the company to propose composition with its creditors or a scheme of arrangement of its affairs. Its main features would be (a) ease of access (a consensual process under the shadow of the law and the Court); (b) negotiation and implementation of a Plan; (c) in a time(ly) efficient process; and (d) provision of potential protection of interests for all stakeholders.

Further, creditors' adverse decision in respect of the proposal may be sidestepped where the court so orders and this makes CVA an exciting prospect for debtor-oriented framework.

Administration

The expressed primary objective of the Administration process is business rescue while the high point from a debtor's standpoint is in its effects. Where an appointment is made by the Court, all post commencement winding-up proceedings are largely dismissed or stayed; a hitherto ongoing receivership terminates.

A moratorium inures on all other legal processes including execution, attachment, distrain, enforcement of security and institution of legal proceedings amidst others without the consent of the administrator or the leave of court. This scales up the moratorium framework in Nigeria which had been hampered by the decision in *FMBN v. NDIC* supra.

All these are in place to afford the debtor company and the administrator time, without dealing with these claims, to strategise and execute a plan to either paddle out of the distress through a rescue or explore other objectives of the process.

While not expressly spelt out, the new CAMA also admits to the possibility of procurement of rescue finance for debtors including ensuring sustained delivery by critical suppliers. Failing administration, the process will be converted to liquidation.

Moratorium is also available under the new law for creditors consummating a scheme of arrangement or compromise with their creditors: this is a departure from the old law scheme.

Feature wise, an Administrator may be appointed by the Court, the holder of a floating charge, a Liquidator, a company or its directors, where the company is likely to become unable to pay its debt. His powers include the power to manage the company's affairs, displace/retain management, deal with assets, including some level of justifiable interference with secured property for efficient realisation of the objective of the Administration.

Administration combines all the features and advantages of a CVA with additional coercive power of the court and a moratorium protection for the purpose of achieving a formal collective resolution for all creditors participating in the formal process. The potential downsides are issues such as the cost, the longer (though clearly one-year tenured) period, and the formalism.

However, whilst the management displacing feature is optional in this formal business rescue procedure, it could be argued that the strong bias for an involuntary and creditor friendly regime, pre-existing the new law, may remain entrenched as the opportunity to essentially abolish receivership (as was done in the UK with the advent of the UK Insolvency Act) has not been fully taken. Though with regards to a receiver and manager appointed out of court, the law has stated that he will function as or be deemed for all intents and purposes to be an administrator, it remains to be seen whether Chapter 19 on Receivership would not result in turf litigation between extra curial Receivers and other Insolvency Office Holders.

The new law provides a framework for regulation of insolvency practitioners by – in addition to a minimum formal education- assigning (a) certification of standard of knowledge, continuous training and capacity building in recognised professional bodies such as BRIPAN, and (b) licensing and authorisation to practice to the Corporate Affairs Commission (CAC), being the registry/regulator for companies' proceedings generally saddled with the administration and implementation of the new law.[4]

Other special sector insolvency frameworks

In addition to the above legislative progress, there continues to exist a special rescue framework in the context of regulated industries such as banking and telecommunications through the Government's enactment of AMCON Act, NDIC Act and NCC Act, establishing the Asset Management Corporation of Nigeria (AMCON), Nigerian Deposit Insurance Commission (NDIC) and the Nigerian Communications Commission (NCC) respectively.

In the case of the reform of the AMCON Act introduced in 2015, the legislation allows AMCON to essentially drive an administrative receivership of the affairs of a recalcitrant perennial debtor company where this becomes necessary where the business is one that is critically strategic or too big to fail or to save employees or other such vital objectives of the Federal Government of Nigeria. However, to the extent that it is conceived and functions under bilateral court proceedings and a special law, it is not truly a formal collective procedure.

However, this does not dwarf the seemingly progressive contribution of the AMCON's Act to the current regime particularly through the rescue-focused provisions injected by the 2015 and 2019 amendments to the AMCON Act which enables the receiver to elect to manage the affairs of the debtor company with objectives, processes, and effects like those in administration including one-year moratorium (extendable for an additional year) without prejudice to claims of existing staff of the debtor, appointment of an advisory committee and implementation of a rehabilitation plan drawn up within 90 days of election to explore business rescue along with the possibility of resorting to restructuring schemes like a hive-down, even though the provisions of the Act appear to convey a strong bias for AMCON at the expense of the collective body of creditors which may clog the whole process and strangulate business rescue options available under general law.

Government's response to COVID-19 and efforts at business continuity[5]

After a case of COVID-19 was recorded in Lagos State, Nigeria (the economic and commercial centre of the Federation) on February 27, 2020, the Federal Government of Nigeria through the Central Bank of Nigeria (CBN) announced key economic and fiscal policies/measures calculated at minimising insolvency consequences caused by the pandemic and government lockdown.

These included a one-year moratorium on all principal repayments; interest rate reduction on intervention facilities from 9% to 5%; grant of a three-month repayment moratorium for all government funded loans including government funded loans issued by the Bank of Industry, Bank of Agriculture and the Nigeria Export Import Bank; and regulatory forbearance to Deposit Money Banks for the restructuring of loans for affected businesses and households among other additional incentives to encourage the extension of longer-tenured credit facilities.

The forbearance on interest rates has been extended for another one-year period after its expiration on February 28, 2021 while extension of moratorium is being considered on a case-by-case basis.

The House of Representatives also passed an Emergency Economic Stimulus Bill 2020 (the Bill) on March 24, 2020 to provide a broader framework for the management of COVID-19 induced financial distress. To date, no further progress has been made on the Bill.

New legislative reform efforts or agenda

With the prominent statutory recognition given to it by virtue of its legislative reform advocacy for the past decade, and requirement of certification of practitioners by the Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN) and other professional bodies, BRIPAN has commenced engagements with the Corporate Affairs Commission (CAC -- the Regulator) towards the promulgation of procedural legislations which would aid implementation of the new business rescue schemes above mentioned.

Another area which requires urgent attention for insolvency and business restructuring is the creation of a robust framework for cross-border insolvency, cooperation and coordination of courts and insolvency office holders.

Forecast

It is anticipated that the new law would create a conducive framework for the rescue finance market. It is also forecasted that whilst A&C is likely to continue as an alternative tool for achieving business rescue, particularly where it involves the merger and acquisition of more than one company[6], the before-now favoured receivership and managership office will fade away over time in favour of Administration given the new law's provision.[7] The new law is poised to provide for a single portal entry for insolvency through Administration. With the expanded policy space for restructuring, the growth of the rescue market will likely pick up the pace.

The same cannot be said, however, with regards to the personal insolvency framework which sadly remains unreformed.

Notes:

1. Section 483 of CAMA 1990 (s.588 CAMA 2020 new law). Order 18 of the Federal High Court Rules 2019.
2. See Chapter 19 on receivership and management, Chapter 20, on winding-up and Chapter 27 on arrangements and compromise.
3. See Chapters 17 and 18 CAMA 2020 respectively.
4. Sections 705 to 708 CAMA 2020.
5. https://insol.azureedge.net/cmsstorage/insol/media/documents_files/covidguide/30%20april%20updates/nigeria-v3-12-may2021-final.pdf
6. See section 710 of CAMA 2020.
7. Section 452(4) CAMA 2020 provides that appointment of a receiver under a floating charge amounts to administration. An administration is only invalid against a receiver appointed pre-CAMA 2020 by section 454. However, fixed charge holder can appoint a receiver and appointment of administrator required consent of fixed charge holder – see sections 476 and 450 of CAMA 2020.

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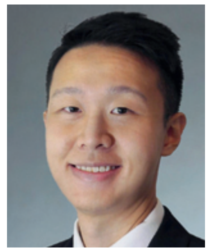
The restructuring of corporate bonds in Singapore



by Stephanie Yeo, Clayton Chong and Muhammed Ismail Noordin, WongPartnership LLP

Large-scale restructurings in modern times almost invariably involve bonds and other debt securities. In this article, we discuss the mechanisms and processes for restructuring bonds in Singapore, and highlight common legal and practical issues that arise in bond restructurings. This article should interest not only Singapore restructuring practitioners, but also international practitioners whose clients may want to leverage on the robust, efficient and well-developed Singapore regime to implement complex debt restructurings.

Introduction

The Singapore restructuring industry has seen a spike in the number of restructurings involving corporate bonds in 2020 and 2021. This development is unsurprising given the flourishing bonds market in Singapore which has grown steadily over the years, with the total outstanding corporate bonds reportedly rising 10.2% to SGD420bn as of December 31, 2019.[1] Where a company that has issued bonds in Singapore's capital markets seeks to restructure its bonds, it will need to consider a variety of legal issues in determining its approach.

Procedures for bond restructurings

Bonds are usually restructured in Singapore either by way of a:

(a) consent solicitation exercise; or

(b) scheme of arrangement.

A consent solicitation exercise involves restructuring the bonds by amending the terms of the bonds pursuant to the amendment and modification clauses set out in the bond documents. Typically, the approval of a supermajority of 66 2/3% or 75% of the bondholders would be required. A meeting of the bondholders is usually convened for them to consider and vote on the restructuring proposal.

A scheme of arrangement is a court-supervised restructuring plan that requires the approval of each class of creditors (by a majority in number and three-quarters in value) and the court.[2] A scheme of arrangement, once effective, binds all creditors including any dissenting creditors who voted against the scheme.

In broad terms, a typical scheme process involves circulating an explanatory statement to the scheme creditors, convening a scheme meeting (which requires the leave of the court), and thereafter applying for the court's approval of the scheme assuming the creditors have approved it at the scheme meeting. A "pre-pack" scheme of arrangement, which is an expedited procedure that does away with a scheme meeting, is also possible where the requisite majorities of creditors have pre-negotiated and agreed to the scheme terms.[3]

Choosing the right procedure

Choosing between a consent solicitation exercise and a scheme of arrangement is a critical decision in any bond restructuring, requiring an analysis of an interplay of strategic, legal and commercial considerations.

Getting a restructuring across the line

The analysis usually begins with an assessment of which procedure is more likely to meet the approval thresholds required to get the restructuring across the line.

The approval threshold for a consent

solicitation exercise may be lower than that for a scheme of arrangement. It is not unusual for a consent solicitation to require the approval of only 66 2/3% of bondholders, compared to the 75% value requirement for schemes.

Additionally, a scheme requires the approval of a majority *in number* of the scheme creditors (sometimes referred to as the "headcount test"). It can be challenging to meet the headcount test where the bonds are held by a dispersed and wide group of bondholders, especially for bonds issued to retail investors. The headcount test gives rise to other unique legal issues which are discussed later in this article.

For deal certainty, practitioners may therefore prefer consent solicitation exercises over schemes to avoid having to meet the headcount test. This could be particularly advantageous in a situation where a small number of key bondholders have entered lock-up arrangements and own enough bonds to carry the vote in a consent solicitation exercise.

Another relevant factor to be considered is the time required for the processes to be completed. As compared to a typical scheme of arrangement which would require the filing of at least two court applications (which may be contested by creditors who oppose the deal), consent solicitation exercises can typically be completed on a much quicker timeline.

However, there are strategic advantages to undertaking a bond restructuring through a scheme of arrangement. In complex restructurings with multiple creditor groups, a debtor company may want to encompass the bondholder group in a scheme together with the other creditor groups, in order to help sway the overall vote in its favour. If the bondholders are supportive, including them in the scheme can help the debtor company increase the pool of votes in favour of the scheme, making it more likely for the scheme to be passed.

We discussed a real-life example of these strategic calculations at play in our previous article in this publication in 2020, where a debtor company proposed a single scheme of arrangement for two sets of bonds to prevent a dissenting group of bondholders from vetoing a restructuring.[4]

"Supercharged" scheme of arrangement

The key advantage of a scheme of arrangement compared to a consent solicitation exercise is that the debtor company can access a suite of tools to help facilitate its restructuring. These tools were introduced in legislation as part of efforts to "supercharge" the scheme of arrangement regime in Singapore:

(a) moratorium protection against legal proceedings and enforcement action (including an automatic 30-day interim moratorium upon filing), which can be given extraterritorial *in personam* effect;[5]
(b) moratorium protection for related entities of the debtor company;[6]
(c) a super-priority rescue financing regime;[7]
(d) a cross-class "cram-down" mechanism allowing the court to sanction a scheme even if there are dissenting classes of creditors;[8] and
(e) an *ipso facto* regime that restricts the exercise of *ipso facto* contractual rights, such as termination of contracts on the basis of the debtor company's insolvency.[9]

These tools can be particularly helpful to a debtor who has not yet formulated a detailed restructuring proposal but whose bonds are about to fall due as they provide crucial breathing space to the debtor and help to preserve the debtor company's position while it carries out negotiations with its creditors. For these reasons, a debtor company may very well choose to undergo a scheme process even though it entails being placed under the supervision of the court.

International bond restructurings in Singapore

The Singapore scheme of arrangement process and its "supercharged" scheme tools can be utilised by foreign companies as long as they can show a "substantial connection" with Singapore.[10]

A "substantial connection" can be shown by, among other things, the company having a place of business or substantial assets in Singapore, the company being registered as a foreign company in Singapore, or the company having submitted to the jurisdiction of the Singapore court for one or more of its transaction disputes.

In 2020, the Singapore High Court held that having the company's securities traded on a Singapore exchange was a strong connecting factor, which on its own was sufficient to meet the jurisdictional test.[11] The debtor company in that case was able to obtain moratorium protection in Singapore even though it did not have substantial business activities or assets in Singapore and its bonds were governed by New York law. This decision helps to provide an important gateway for foreign debtors to access the Singapore restructuring regime, especially considering that the Singapore Exchange lists over 3,000 debt securities in issuances from 45 countries.[12]

Unique legal issues in bond schemes

A unique issue that arises in schemes of arrangement involving bonds is whether the ultimate beneficial owners of the bonds should be regarded as creditors for the purpose of the scheme, or whether the bonds trustee should be regarded as the only relevant creditor.

This peculiar issue arises where the bonds are held through global custodian arrangements. In such arrangements, the debtor company covenants to pay the bond debt to the trustee (not the ultimate beneficial owners) while the trustee holds the debtor's covenant on trust for the benefit of the ultimate beneficial owners of the bonds. Superficially, the trustee may be seen as the only 'true' creditor as it is the party with a direct monetary claim against the debtor company.[13]

However, there are situations in which the courts would recognise the ultimate beneficial owners of the bonds as *contingent* creditors of the debtor company, thereby giving them a right to vote directly on the scheme. This "contingent creditor analysis" was affirmed in 2018 in a thorough and lucid judgment of the Singapore High Court, following a detailed survey of cases in other common law jurisdictions.[14]

In order for the "contingent creditor analysis" to apply, the test is whether the bond documents entitle the ultimate beneficial owners to require definitive securities to be issued to them (e.g. upon an event of default), and thus to acquire direct rights against the debtor in respect of their interests in the bonds. In this regard, we have observed in practice that bond documents are not consistent across the board, and a careful scrutiny of the bond terms is required in each case to determine the extent to which the "contingent creditor analysis" applies.

Leaving aside the strict legal position, Singapore regulators have also (in at least one instance) required the debtor company to treat the ultimate beneficial owners as the creditors for the purpose of the scheme, even though the bond documents did not lend itself to such treatment. That restructuring involved debt securities purchased by many individual "mom-and-pop" retail investors which affected the dynamics of the restructuring and public perception.

These various issues discussed above have given rise to slightly different results in restructuring matters:

(a) Hyflux (2019) – a hybrid approach was applied, whereby sub-account holders whose debt securities were held through regulated entities (e.g. the Central Provident Fund, capital market services licensees, and banks) had direct votes (via proxy), while beneficial owners whose debt securities were held through sub-account holders had to vote through their sub-account holder.[15]

(b) Miclyn Express Offshore (2020) – beneficial owners of the bonds were treated as contingent creditors of the scheme companies and were allowed a direct vote on the scheme.[16]

(c) Pacific International Lines (2021) – the persons registered as bondholders with the

Central Depository ("CDP") (which provides clearing, settlement and depository services in the Singapore securities market) were entitled a direct vote.[17] The persons registered as bondholders with the CDP might not necessarily be the ultimate beneficial owners of the bonds, and could be custodians or nominees holding on behalf of such ultimate beneficial owners.

This has important practical implications for the calculation of votes on the putative scheme (and the prospects of getting the scheme passed):

(a) If the ultimate beneficial owners of the bonds are regarded as creditors, each one of them would be counted for the purpose of the headcount test, giving them a substantial influence in determining whether the scheme passes or not. Given that an issuer may not necessarily have visibility over who the ultimate beneficial owners of the bonds are (as the bonds could be held by nominees and banks on behalf of their clients whose identities are to be kept confidential), this increases the level of uncertainty involved in getting the scheme passed.

(b) If the trustee is regarded as the only creditor, the trustee has to split its vote into a vote for and a vote against the scheme based on the instructions of the ultimate beneficial owners (assuming their instructions are not unanimous). For the purpose of the headcount test, the trustee's votes for and against the scheme cancel each other out, which means its vote effectively has no influence on the headcount test.[18]

Practical aspects of bond restructurings[19]

Bond restructurings give rise to distinctive practical challenges, considering the sometimes-vast number of bondholders involved, particularly for retail bonds. One such challenge is coordination between the creditors and the debtor in conducting negotiations and information flow.

In the Singapore context, a practice has developed where the company takes the lead in commencing the process to form an ad-hoc committee for the relevant stakeholder constituency. An ad-hoc committee can serve to facilitate coordination, negotiations, and information exchange, between the stakeholder group and the debtor as well as with other creditor groups *inter se*, ultimately enabling the formulation of a restructuring plan with better prospects of success.

In bond restructurings, the formation of an ad-hoc committee comprising bondholders who hold a significant amount of bonds can be useful in generating momentum for obtaining the necessary approvals as well.

Townhall sessions are also a common feature of bond restructurings. These townhalls provide a platform for engaging with the bondholders, sharing information and explaining the restructuring proposal. Interestingly, due to the safe distancing restrictions in Singapore that were implemented in light of the COVID-19 pandemic, townhall sessions which previously took the form of large-scale physical meetings in Singapore are now taking place via video conferencing platforms which allows bondholders residing outside Singapore to participate as well.

It is also commonplace for the debtor company to seek the support of investor advocate groups such as the Securities Investors Association (Singapore) and to get buy-in from regulators such as the Singapore Exchange at key milestones of the restructuring process.

Conclusion

As outlined in this article, bond restructurings in Singapore give rise to important strategic, legal and commercial considerations. With the growing bond market, the size and complexity of cross-border bond restructurings in Singapore will likely continue in an upward trajectory. Practitioners will therefore increasingly be required to deftly navigate the complex terrain of nuances unique to such restructurings in Singapore.

Notes:

[1] Singapore Corporate Debt Market Development 2020 by the Monetary Authority of Singapore (accessible at https://www.mas.gov.sg/-/media/MAS/News-and-Publications/Surveys/Debts/Singapore-Corporate-Debt-Market-Development-2020.pdf).

[2] Section 210 of the Companies Act (Cap. 50) ("Companies Act").

[3] Section 71 of the Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) ("IRDA").

[4] Smitha Menon and Clayton Chong, "*The emergence of a debt restructuring regime for corporate groups in Singapore*", International Insolvency & Restructuring Report 2020/21 at pages 65 to 68 (accessible at https://www.iiiglobal.org/sites/default/files/media/International%20Insolvency%20%26%20Restructuring%20Report%202020-21%20e-book.pdf).

[5] Section 64 of the IRDA.

[6] Section 65 of the IRDA.

[7] Section 67 of the IRDA.

[8] Section 70 of the IRDA.

[9] Section 440 of the IRDA.

[10] Section 63(3) read with section 246(1)(d) and (2) of the IRDA.

[11] *Re PT MNC Investama TBK* [2020] SGHC 149.

[12] https://www.sgx.com/fixed-income.

[13] *Re Swiber Holdings Ltd* [2018] 5 SLR 1358 at [33].

[14] *Re Swiber Holdings Ltd* [2018] 5 SLR 1358 at [37] to [41], [45].

[15] Orders of Court granted on February 21, 2019 by the High Court of the Republic of Singapore, HC/ORC 1515/2019 (Hyflux Ltd), HC/ORC 1512/2019 (Hyflux Engineering Pte Ltd), HC/ORC 1516/2019 (Hyflux Membrane Manufacturing (S) Pte Ltd), HC/ORC 1527/2019 (Hydrochem (S) Pte Ltd).

[16] Orders of Court granted on March 16, 2020 by the High Court of the Republic of Singapore, HC/ORC 1983/2020 (MEO Finance Company Limited), HC/ORC 1988/2020 (Miclyn Express Offshore Pte Ltd) and HC/ORC 1989/2020 (Miclyn Express Offshore Limited).

[17] Order of Court granted on January 28, 2021 by the General Division of the High Court of the Republic of Singapore, HC/ORC 531/2021 (Pacific International Lines (Private) Limited). A direction was made by the Court for the scheme manager to preserve the instructions of the beneficial owners received by the nominees for the Court's consideration at the scheme sanction stage. This left open the possibility that if the beneficial owners' votes did not meet the threshold for the headcount test, the Court might have exercised its discretion not to approve the scheme.

[18] *Re Swiber Holdings Ltd* [2018] 5 SLR 1358 at [69] to [72].

[19] For a more detailed discussion on the practical aspects of bond restructurings, see Smitha Menon, Clayton Chong and Muhammed Ismail Noordin, 'Singapore' in The Art of the Ad Hoc (Morris, Peck and Van de Graff eds, 2nd ed, 2020), pages 151-162 (accessible at https://www.wongpartnership.com/upload/medias/KnowledgeInsight/document/14125/GlobalRestructuringReviewTheArtoftheAdHocEdition2-SingaporeChapter.pdf).

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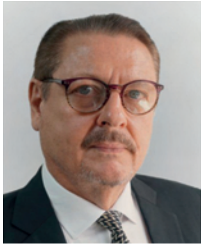

Thailand's answer to Chapter 11

by Dr. Paul Crosio, Dr. Jason Corbett and Supanisa Rattanachevakul, Silk Legal Co., Ltd

Thailand's Bankruptcy Act was first promulgated in 1940. Until 1999, any civil court in Thailand could hear bankruptcy cases, and the outcome was almost always liquidation. The Asian Financial Crisis of 1997-99 forced a rethink of the bankruptcy laws due to the sheer number of cases. The end result was a US-style rehabilitation procedure to allow companies to attempt to trade their way out of bankruptcy.

Generally, Thai courts do not recognise any foreign reorganisation or insolvency procedures relating to a local debtor in Section 177 of Thailand's Bankruptcy Act, B.E. 2483 (1940) (the 'BA'). Also, Thai courts do not co-operate with foreign courts in proceedings in other jurisdictions. *id.* Further, Thailand is not a party to any international treaties regarding reorganisation and insolvency procedures. *The UNCITRAL Model Law on Cross-Border Insolvency 1997* (the '*UNCITRAL Model Insolvency Law*') has not been adopted.

The 1997 Asian financial crisis forced Thailand to adopt laws closer to international concepts of bankruptcy practice. A major amendment to the BA to allow for corporate reorganisation was promulgated. This amendment broadly followed the US Chapter 11 Bankruptcy process and is mostly found in Section 90 BA, which took effect in 1998.

Under Thai law, bankruptcy is an involuntary act whereby the law causes the property of a company/debtor to be distributed among its creditors. Thai law does not allow voluntary bankruptcy to be commenced by the debtor. An insolvent debtor owing a definite amount of not less than THB10m to one or more creditors is entitled to file a reorganisation petition under section 90/4 and 90/5 of the BA.

In 2018, Bankruptcy Act No. 10 B.E. 2561 (2020) added further amendments. This allowed cash flow insolvent businesses unable to repay the debt to reorganise quickly and continue conducting business operations to generate cash flow. This amendment moved Thailand closer to the "US Chapter 11 Bankruptcy" process. Parties who have assets but are unable to pay debts (due to assets being illiquid or of the incorrect type) could file for reorganisation without having to wait until they were insolvent.

Section 90 of the BA and later amendments allow a business to restructure its debts, re-negotiate overly burdensome agreements, and restructure itself to become profitable. The aim is always to resolve the financial difficulties of a company by allowing the company to continue operations and thereby preserve greater value for all stakeholders, employees, creditors and investors.

Section 90/2 of the BA states: "*The creditor…. under section 90/4 may file a petition for the reorganisation of the debtor's business…*"[1]

Section 90/4 states: "*the following persons are entitled to file a petition with the Court for the business reorganisation: (1) one creditor or several creditors altogether, with a definite amount of debt of not less than THB10m…*"[2]

Filing the petition: The process commences when a petition is filed with the Central Bankruptcy Court by the company (a voluntary petition) or the creditor(s).

After the petition for the rehabilitation of the debtor's business has been filed and reviewed, the court may issue an order accepting the petition if it appears to the court that;

1. The debtor is insolvent.
2. The debtor is indebted to creditors for THB10m or more.
3. The debtor is not subject to absolute receivership or dissolution.
4. There are reasonable grounds for rehabilitating the business and confirm the petitioner has filed in good faith.[3]

At the filing: A stay of creditor actions against the filing company automatically goes into effect when the petition is filed. This automatic stay under section 90/12 is a statutory order that protects the company and property and prohibits actions by creditors after the filing.[4] In general, it applies to all creditors (both secured and unsecured).[5]

Despite the automatic stay, the debtor is allowed to continue its normal business operation during the reorganisation.[6]

Once the petition is filed with the Bankruptcy Court, "the petitioner may not withdraw the petition unless upon allowed by the Court."[7] In case "the Court has issued a business reorganisation order, the Court shall not grant permission for a withdrawal of the petition."[8]

Disclosure statement: Once the filing has been made, "the Court shall proceed with an inquiry as a matter of urgency and shall publish the order accepting the petition as well as the date and time of the appointed inquiry in at least one widely circulated daily newspaper at least twice not more than seven days apart."[9]

Meanwhile, the Court will then send copies of the petition to the known creditor(s).[10]

Notice to creditors: The court will arrange for notice of the filing of the petition to all creditors on the list of creditors. Creditors included in the list are creditors according to Thai Financial Reporting Standards ('TFRS'). The TFRS are based on the International Financial Reporting Standards.

Usually, the Central Bankruptcy Court requires that notices are sent via registered mail, with return receipts to prove that the mail has been delivered. However, COVID-19 has severely curtailed services offered by post. Email notices that have delivery and read reports, that track read status, are currently accepted due to considerations given during the COVID-19 Pandemic and one of the first mass email campaigns was carried out under the Thai Airways Bankruptcy proceedings in June 2020.[11]

Creditors who want to object to the petition, "may submit an objection not less than three days before the date of the first inquiry."[12]

Planner: According to section 90/6 of the BA paragraph 2, "A plan preparer may be a natural person, a juristic person, a group of persons, a creditor or the debtor's executive."[13]

Once the plan preparer has been appointed, there is a 90-day period from the date of the publication of the order appointing the plan preparer in the Government Gazette to when the Planner must file the Reorganisation Plan. This period can be extended twice, each time up to 30 days. As a result, the plan preparer has a maximum of five months to prepare the plan.

The contents of the Rehabilitation Plan must include a classification of claims (debts) and must specify, among other things, how each class of claim will be treated under the plan as well as means to address short-term liquidity, fund raising and management of the debtor's assets (s. 90/42).

Repayment of debts: All types of creditors must file an application for repayment of debt in rehabilitation. The application must be submitted to the Official Receiver within one month from the date of the publication of the order appointing the plan preparer, and the Official Receiver shall furnish the copy of the application for repayment of debt to the plan preparer.[14]

Plan of rehabilitation: Section 90/42 of the BA lists the mandatory and discretionary provisions for the Rehabilitation Plan. The plan must contain at least:

- the reasons for reorganising;

- details of assets, liabilities and encumbrances; and
- principles and methods for reorganisation.

Voting on the rehabilitation plan: A creditors meeting must be held to discuss and approve the plan.[15] The plan must be approved by a special resolution of the creditors' meeting. The requirements for which are set out under section 90/46 consisting of either:

1. each group of creditors; or
2. at least one group of creditors where the total debt of the creditors who have approved the plan at the meeting of all the creditor groups is not less than 50% of the total debt owed to the creditors attending the meeting in person or by proxy and voting on such resolution.[16]

Where the creditors do not pass a resolution accepting the plan or do not pass any resolution, or the creditors do not attend the meeting, the court will issue an order cancelling the business rehabilitation order and possibly order the bankruptcy and liquidation of the company's assets.[17]

Confirmation hearing: The BA requires the court to hold a hearing on confirmation of the plan after the notice is given to all interested parties. If the creditors have passed a resolution accepting the plan, the court will consider the plan and will issue an order approving the plan after determining that (s. 90/48 and 90/58, BA):

1. the plan contains all required items;
2. the rights of the creditors within the same group are treated equally, and the proposals for repayment of debt under the plan are under the sequence stipulated by the law regarding the distribution of assets in a bankruptcy case except where those creditors have given their consent for another arrangement; and
3. when the plan has been successfully implemented, creditors will receive debt repayments in amounts that are not less than would be the position were the court to adjudge the debtor as bankrupt.

Post-confirmation administration and modification: After the plan is confirmed, the creditor is required to make payments according to the plan and is bound by the provisions of the plan.[18]

Final decree and end of the rehabilitation: A final decree closing the case must be entered after the company has fully administered the plan of rehabilitation. Companies with many creditors can take years to reach a final decree.

Where, it is found that the business rehabilitation has been completed under the plan, the court will order the termination of the business rehabilitation.[19] When the business rehabilitation is terminated, the debtor, the creditors and other parties are affected as follows:

1. Debtor and creditors: The debtor can continue its business as normal and will be free from all debts occurring before the court-ordered business reorganisation, except for debts owed to eligible creditors who have applied for repayment in business rehabilitation (s. 90/75, BA).
2. Debtor's executives: The debtor's executive will again have the authority to manage the debtor's business operations and assets (s. 90/75, BA).
3. Debtor's shareholders: The debtor's shareholders will resume their legal rights (s. 90/75 BA).
4. Debtor's employees and trading partners: Although there are no specific provisions concerning how the debtor's employees and trading partners are affected by the termination of the business rehabilitation, since the rehabilitation procedure never causes the debtor's business to cease to operate, the debtor's employees and trading partners are not affected by the initiation or termination of the rehabilitation procedure.

Another option for SMEs: Data from the Office of Small and Medium Enterprises Promotion ("OSMEP") shows that Small to

Medium Enterprises ("SMEs") account for over 45% of the country's total GDP.

Amendments to the BA came into force on May 25, 2016, to assist SMEs with rehabilitation. To be eligible, the SME must register with OSMEP and have a debt of not less than THB3m (approx. US$100,000) and not more than THB10m (approx. US$3,300,000).[20]

The amendments open the rehabilitation process to natural persons, juristic bodies, and partnerships, while also lowering the minimum threshold of debt. For a private limited company, the debt must be not less than THB3m, but not more than THB10m. For a natural person, this is reduced to a debt not less than THB2m.[21]

To apply for rehabilitation, a debtor or a creditor of the debtor must file a petition to rehabilitate, along with an approved rehabilitation plan for at least two-thirds of the total amount of debt, to the Central Bankruptcy Court and comply with other procedural requirements. The Court then considers whether or not to accept the petition. If the Court issues an order to accept the petition to rehabilitate, an automatic stay goes into effect. This stops the creditor(s) from claiming or seizing the debtor's assets, and it stops the ongoing seizure process and the auctioning off of the debtor's assets.

In summary, the reorganisation for SMEs is a prepacked plan. The petitioners need to file the petition with the plan that has already been approved by the creditors. Therefore, from filing the petition to obtaining court approval could be accomplished within 30-45 days.[22]

Notes:

1 Section 90/12 of Thailand's Bankruptcy Act, B.E. 2483 (1940).

2 s. 90/4.

3 s. 90/3.

4 s. 90/12.

5 *id.*

6 s. 90/12(9).

7 s. 90/8 para 1.

8 *id.*

9 s. 90/9 para 1.

10 s. 90/6 para 3.

11 *Thai Airways* (case no. fofo 10/B.E. 2563 [2020]), The Central Bankruptcy Court. https://cbc.coj.go.th/

12 s. 90/9 para 3 "The debtor or the creditor may submit an objection not less than three days prior to the appointed date of the first inquiry. In the case of an objection to the plan preparer, the debtor or the creditor may elect to or not to nominate any other person as a plan preparer In nominating a plan preparer, the letter of consent of the person nominated to be a plan preparer must also be submitted."

13 s. 90/6.

14 s. 90/26.

15 s. 90/46.

16 *id.*

17 s. 90/48 para 3-4.

18 s. 90/60.

19 s. 90/70.

20 s. 90/1.

21 s. 90/92.

22 Kunkeaw, Auen. *Reorganisation Law* (B.E. 2561 [2018]). Krung Sima Publishing Co., Ltd. Bangkok, Thailand.

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Keeping directors in suspense: Wrongful trading under the UK Corporate Governance and Insolvency Act 2020

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The suspension of wrongful trading under the Corporate Governance and Insolvency Act 2020 was introduced to allow directors to trade during the pandemic without the unwanted distraction of potential liability. This article considers whether that objective is likely to be achieved in circumstances where there has been no modification to the common law rules governing duties owed to creditors, and in light of the Court's power to award compensation in disqualification proceedings.

Introduction

The Corporate Governance and Insolvency Act 2020 ("CIGA") received Royal Assent in the UK on June 25, 2020. Almost all of its provisions came into force on June 26, 2020.

Despite making important changes to the UK insolvency landscape, including new moratorium[1] and restructuring[2] regimes, and restrictions on contractual termination provisions triggered by insolvency[3], it passed through both houses of Parliament rapidly in just over a month, with only modest amendments.

This was because of the two measures contained within CIGA relating to COVID-19. The first concerned restrictions on the making of winding up orders. The second, and the subject of this article, was the so-called "suspension of wrongful trading".

The authors first consider whether the temporary measure can genuinely be called a suspension at all, before looking at the additional liabilities to which directors may nevertheless be exposed as a result of their duties to creditors in times of financial difficulty, and the relatively new compensation provisions contained within the Company Directors Disqualification Act 1986 (the "CDDA")[4].

The authors suggest that this suite of potential liabilities means that those advising directors involved in companies which have failed during the pandemic will be able to offer little succour from the suspension.

The position is further complicated because the original suspension provided for by CIGA, s.12 was only in operation from March 1, 2020 until September 30, 2020[5]. It was then reintroduced (but not retrospectively extended) on November 26, 2020[6], at the same time as further lockdown measures started to be imposed. As originally reintroduced, the extension was to April 30, 2021. This was then further extended to June 30, 2021[7]. There is therefore a period between October 1, 2020 to November 25, 2020 during which its protective effect may not be relied upon.

Wrongful trading

IA1986, ss.214 (insolvent liquidation) and 246ZB (administration) provide that a Court may, on the application of a liquidator or administrator, declare that the director is to be liable to make such contribution to the company's assets as it thinks proper where, at a point in time before the company goes into insolvent liquidation or administration, the director *"knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation / entering insolvent administration"*. A director will avoid liability if, after that point in time, he or she took every step with a view to minimising the potential loss to the creditors as ought to have been taken.

The Courts have treated s.214 as a compensatory provision, with the maximum contribution set by reference to the increase in the company's net deficiency between the date when the directors should have concluded there was no reasonable prospect of the company avoiding insolvent liquidation/administration, and the commencement of the liquidation/ administration[8]. The Court then has a wide discretion to order a lower amount, the limits of which it has been held ought not to be spelt out[9].

Where a Court makes a declaration that a director is liable to make a contribution to the company's assets as a result of wrongful trading, it may also make an order for disqualification of up to 15 years, whether or not such an order is applied for (CDDA, s.10)[10].

The "suspension"

Pursuant to CIGA, s.12, in determining the contribution that is to be made to the company's assets, *"the court is to assume that the person is not responsible for any worsening of the financial position of the company or its creditors that occurs during the relevant period"*. The relevant period, as a result of the extensions described above, is March 1, 2020 to September 30, 2020, and November 26, 2020 to June 30, 2021.

Although the statutory heading preceding s.12 describes this as: *"suspension of liability for wrongful trading"*, it will immediately be seen that the power of the Court to make a finding that there has been wrongful trading is not in fact suspended.

This may have significance if, for example, the Court were to hold that a director ought reasonably to have concluded that a company had no reasonable prospect of avoiding insolvent liquidation/administration at some point during the first period of suspension (March 1, 2020 to September 30, 2021) which continued into the period October 1, 2020 to November 26, 2021, with the company then entering insolvent liquidation/ administration during this period or thereafter. On the face of the statute such a director would be liable for any worsening that occurred in the period when the suspension was not in force. That said, in the authors view it is likely that a Court would take into account the fact that such worsening occurred between the two periods of suspension in exercising its remedial discretion.

The wording of the statute also raises the question whether the assumption may be displaced. CIGA, s.12 uses the language of assumption rather than presumption, and there is no express statement that such assumption is incapable of rebuttal. This may well be tested before the Courts in a suitable case. In the authors' view it is likely that it will be found to be irrebuttable having regard to the parliamentary intention behind s.12 expressed in paragraph 28 of the explanatory memorandum:

"This measure would mean that, when the court is considering whether to declare a director liable to contribute to a company's assets under wrongful trading provisions and is considering the amount to be contributed, it will not take into account losses incurred during the period in which businesses were suffering from the impact of the pandemic. The deterrent to continuing to trade during that period will therefore be removed".

Accordingly, and notwithstanding the potential issues described above, directors will be prevented from having to make a contribution under the wrongful trading provisions even if they ought to have realised there was no prospect of avoiding insolvent liquidation/administration during the relevant periods, and did not take every step that ought to have been taken to minimise loss to creditors.

However, in the authors view this is likely to be of little great significance. Successful wrongful trading cases are rare because of the latitude that is extended to directors faced with the *"real and unenviable dilemma"* of either taking *"the cowards' way out"* and closing down the company, or seeking to trade on and turn the corner[11].

Duties to creditors

In the authors' view a clearer and more present danger arises as a result of obligations directors will come under to creditors when insolvency is looming.

While it has long been clear that where a company is actually insolvent a director's duty to act in the best interests of the company[12] will be treated as a duty to take into account the interests of its creditors (whose interests are at this stage paramount[13]), there has been a considerable degree of uncertainty in the authorities as to when exactly this duty arises.

After a variety of formulations (such as where the company is of doubtful solvency, or there is a real risk of insolvency) the Court of Appeal held in *BTI 2014 LLC v Sequana SA*[14] that the duty arises *"when the directors know or should know that the company is or is likely to become insolvent"*, with *"likely"* meaning *"probable"*.

The Court of Appeal was not required to determine, and left open, the question whether, in circumstances where the company is not presently insolvent but is likely to become so, the interests of the creditors become paramount, or whether there is some sort of sliding scale by which their interests increasingly obtrude. While that uncertainty is regrettable, it is nevertheless clear that a director may face liability at common law notwithstanding the suspension of wrongful trading.

Further, while the wrongful trading regime is focused on the prospects of avoiding insolvent liquidation/administration (as opposed to the company simply being insolvent on a cash flow or balance sheet test), the common law looks at insolvency *simpliciter*. In the authors view the common law test is certainly no less forgiving, and is actually likely to be more strenuous, than that for wrongful trading.

It is also likely that the measure of compensation to be paid for breach of the common law duty will ordinarily be set by reference to the increase in the net deficiency occasioned by the director failing to act in the interests of the creditors, and therefore in many cases will lead to a comparable or, indeed, greater measure of liability than in wrongful trading. Moreover, the broader discretion provided for by IA1986, s.212 (summary remedy for misfeasance) allows for restorative awards of a kind not accommodated by s.214.

True, it is, that a director may be granted relief if acting honestly and reasonably under CA2006, s.1157, and that the duty under s.172 only requires a director to act in what he or she subjectively believes in good faith to be the best interests of the company (here equated with those of the creditors to a greater or lesser degree).

However, where a director has failed to have any regard to the interests of the company an objective test is commonly treated as applying[15], with the Court looking at whether an intelligent and honest man or woman in the position of a director of the company concerned could, in the circumstances, have reasonably believed that the steps taken were for the benefit of the company.

It is unfortunately all too commonly the case that the directors of companies in financial difficulties do not appreciate that their duty to act in the best interests of the company involves taking account of the interests of creditors when the company is likely to become insolvent. Such inadvertence will result in the objective test being applied, and the director in question in all probability failing to meet it.

Compensation in the disqualification context

Finally directors should be made aware of the risk of facing financial liabilities as a result of the provisions introduced into CDDA, s15A by the Small Business Enterprise and Employment Act 2015, s.110 permitting the court to order compensation to be paid at the same time as making a disqualification order.

CDDA, s.6 provides that the Court must disqualify a director for "unfitness". There is longstanding authority that this covers a broad range of conduct and does not require finding that a director is in breach of a specific duty[16]. Further, CDDA Schedule 1 expressly provides that one of the matters to be taken into account is the director's responsibility for the causes of insolvency. Accordingly, there is an obvious risk that a director failing to take steps to protect creditors when a company is in financial difficulties may be disqualified.

The remedial discretion is broad, and includes requiring a director to pay an amount to individual creditors or classes of creditors who have suffered loss, or to make a contribution to the assets of the company. Therefore, recoveries can be made in cases where there is no overall loss to the company, and where particular creditors (such as HMRC) are prejudiced by virtue of a director robbing Peter to pay Paul[17].

Conclusion

Despite the Government's stated intention to allow directors to trade through the pandemic without being inhibited by the spectre of liability, the authors consider that this objective is very unlikely to be achieved having regard to the broader, and more stringent, bases of liability outlined above.

It remains to be seen whether there will follow a spate of breach of fiduciary cases brought against directors who have been seduced by the inaptly named suspension of wrongful trading, and how the Courts appraise unfitness in respect of actions taken during these unprecedented times.

Notes:

1 Under Part A1 of the Insolvency Act 1986 ("IA1986"). Introduced by CIGA, ss.1-6 and Schs 1-8.

2 Under Part 26A of the Companies Act 2006 ("CA2006"). Introduced by CIGA, s.7 and Sch.9, Part 2 of which also makes consequential amendments to a number of further acts.

3 IA1986, s.233B. Introduced by CIGA, ss.14-19.

4 The suspension also has no impact on fraudulent trading under IA1986, ss.213/246ZA. However the number of successful fraudulent trading claims are vanishingly small. While this is a potential liability that must be considered, it is unlikely to be established where a director has acted honestly, even if he or she is at fault in failing to take appropriate steps at a time of financial difficulty.

5 CIGA, s.12(2).

6 Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020 (SI 2020/1349).

7 Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2021 (SI 2021/375). The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Change of Expiry Date) Regulations 2021 (SI 2021/441), in force from 1 April 2021, confer upon the government a 'Henry VIII power' to amend CIGA so as to apply its provisions (including the wrongful trading suspension) for further periods of up to six months for Covid-19 related reasons.

8 *Re Produce Marketing Consortium Ltd (No.2)* [1989] BCLC 520; *Re Continental Assurance Co of London plc (in liquidation) (No.4)* [2007] 2 BCLC 287; *Re Ralls Builders Ltd* [2016] EWHC 243 (Ch) and [2016] EWHC 1812 (Ch).

9 *Re Produce Marketing*, ibid.

10 The Court may instead refer the matter to the Secretary of State to consider whether or not to commence disqualification proceedings *(Re Idessa (UK) Ltd* [2011] EWHC 804). A finding of wrongful trading, but with no liability to make a contribution to the company's assets, will not suffice (*Re Ralls Builders Ltd* [2016] EWHC 1812 (Ch)).

11 Colourfully described by Park J in *Re Continental Assurance* ibid. at 409. In paragraph 260 of the Government's April 2014 response to the "Transparency and Trust" discussion paper published by the Department of Business, Innovation and Skills in July 2013, it was recorded that since 1986 there had only been 30 reported wrongful trading cases.

12 Originally as a common law fiduciary duty and now under CA2006, s.172, which does not expressly provide for a duty to creditors but preserves (by s.172(3)) any existing rule of law requiring directors to consider or act in the interests of creditors of the company.

13 *Colin Gwyer & Associates v London Wharf (Limehouse) Limited* [2003] 2 BCLC 153

14 [2019] 1 BCLC 347. An appeal to the Supreme

Court was heard on 4-5 May 2021. Judgment is awaited.

[15] *Charterbridge Corpn Ltd v Lloyds Bank Ltd* [1970] Ch 62; *Re HLC Environmental Projects Limited, Hellard v Carvalho* [2014] BCC 337. Cf *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1016 and *Re Blackwood Hodge plc* [1997] 2 BCLC 650.

[16] *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch 164

[17] The compensation regime was analysed in detail by ICC Judge Prentis in *Re Noble Vintners* [2020] BCC 198.

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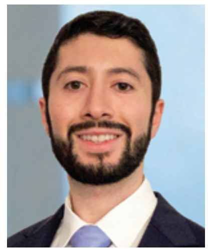
Enforcing third-party releases through chapter 15 in the US

by Ryan Preston Dahl and Eric Sherman, Ropes & Gray LLP



A third-party release may be implemented in a restructuring to, in effect, extend the discharge granted to the debtor to an affiliated, non-debtor co-obligor. Commonly, the debt of a corporate conglomerate will be issued and/or incurred by one corporate entity and one or more of its affiliates will guarantee that same debt. Where one obligor becomes the subject of a restructuring, a key question becomes how the obligations of its affiliate-obligors, such as guarantors, will be addressed.

Third-party releases in bankruptcy

Indeed, a comprehensive approach is essential for any complex restructuring: "*Without releasing those guarantees, it would be difficult to restructure the debt because the collective assets and earnings of the group are needed to support the restructured debt without the risk of some creditors that hold the guarantees separately reaching the assets of the affiliates, endangering the ability of the group to meet its restructured debt obligations.*" *In re Avanti Commc'ns Grp. PLC*, 582 B.R. 603, 606 (Bankr. S.D.N.Y. 2018).

At the same time, the treatment of so-called "third-party releases" remains a hot-button topic in US insolvency law. *See, e.g. In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126 (3d Cir. 2019); *SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.)*, 780 F.3d 1070 (11th Cir. 2015).

Recently, in the case of *In re PT Bakrie Telecom Tbk*, the question of enforcing certain third-party releases granted by an Indonesian Commercial Court via the "recognition" mechanism of chapter 15 was addressed by the United States Bankruptcy Court for the Southern District of New York. No. 18-10200 (SHL), 2021 WL 1439953 (Bankr. S.D.N.Y. Apr. 15, 2021). As detailed below, the court in *Bakrie* declined to enforce the third-party releases that were authorised by a main proceeding that occurred in the Indonesian court. However, *Bakrie* may be read as consistent with prior US jurisprudence addressing the enforcement (or not) of third-party releases in non-US proceedings.

What is chapter 15 and what relief is available?

As a baseline matter, "uniformity" is a fundamental principle of US bankruptcy law. Indeed, the federal bankruptcy power was granted through the United States Constitution in 1789 in recognition that a bankruptcy system could function effectively only through a uniform system that could cut through the separate commercial law regimes imposed by the soon-to-be United States. *See generally* Randolph J. Haines, *The Uniformity Power: Why Bankruptcy is Different*, 77 Am. Bankr. L.J. 129, 152–59 (2003).

If anything, this concern for "uniformity" is only heightened where the interaction between commercial regimes imposed by sovereign states is implicated. It is a truism, but true nonetheless, that complex capital structures are increasingly characterised by correspondingly complex overlaps across international borders.

Chapter 15 was, of course, added to the Bankruptcy Code in 2005 to address the unique challenge that may then be implicated by insolvency, and chapter 15's stated purposes include the cooperation between the courts and parties to US bankruptcies and courts and authorities of foreign countries involved in cross-border insolvency cases and fair and efficient administration of cross-border insolvencies that protects the interests of the parties involved. 11 U.S.C. § 1501(a).

Section 1517(a) of the Bankruptcy Code sets out the legal standard for recognition of a foreign proceeding. The court shall, after notice and a hearing, enter an order recognising a foreign proceeding if: (1) such foreign proceeding for which recognition is sought is a foreign main proceeding or foreign nonmain proceeding within the meaning of section 1502; (2) the foreign representative applying for recognition is a person or body; and (3) the petition meets the requirements of section 1515. 11 U.S.C. § 1517.

The Bankruptcy Code defines a foreign main proceeding as a proceeding pending in the country where the debtor has the centre of its main interests and defines foreign nonmain proceeding as a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment. 11 U.S.C. § 1502(4), (5).

Upon recognition of a foreign main or nonmain proceeding, chapter 15 provides certain privileges and pursuant to section 1521(a), a court may grant appropriate relief "*where necessary to effectuate the purpose of [chapter 15] and to protect the assets of the debtor or the interests of the creditors,*" so long as the "*interests of the creditors and other interested entities, including the debtor, are sufficiently protected.*" 11 U.S.C. §§ 1521(a), 1522(a). Additionally, per section 1507(a), the court "*may provide additional assistance to a foreign representative…*" 11 U.S.C. § 1507(a).

With this background in mind, then, the question turns to when and how a United States Bankruptcy court might grant recognition to third-party releases granted in a non-US insolvency proceeding.

In *In re Avanti Commc'ns Grp. PLC*, Judge Martin Glenn for the Bankruptcy Court for the Southern District of New York enforced third-party, non-debtor guarantor releases pursuant to a scheme of arrangement approved by a UK court. 582 B.R. 603, 619 (Bankr. S.D.N.Y. 2018). There, the court wrestled with whether it should recognise and enforce the scheme of arrangement that would bind non-voting impaired creditors to the third-party releases, notwithstanding the fact that the scheme of arrangement was approved by 98% of the impaired class of creditors.

After finding that the UK proceeding is a foreign main proceeding, Judge Glenn turned to whether to enforce the scheme of arrangement, and therefore the third-party releases. The court noted that "*[i]n deciding whether to grant appropriate relief or additional assistance under chapter 15, courts are guided by principles of comity and cooperation with foreign courts.*" *Id.* at 616. It also noted that third-party releases in the Bankruptcy Court for the Southern District of New York have been enforced in the chapter 15 context under section 1507 of the Bankruptcy Code.

In *Avanti*, the scheme of arrangement had near unanimous support and did not rely on insiders. Further, the bankruptcy court cited one of the pleadings that "*third-party non-debtor releases are common in schemes sanctioned under UK law, particularly for releases of affiliate guarantees of the debt that is being adjusted by the scheme*" and found other examples of UK courts approving schemes with third-party releases. *Id.* at 618.

Ultimately, the *Avanti* court approved the scheme of arrangement and enforced the third-party releases granted for the non-debtor guarantors. Along with such releases being common in other UK schemes, the *Avanti* court noted that creditors had a full and fair opportunity to vote on the scheme and afforded creditors a full and fair opportunity to be heard consistent with US due process standards. *Id.*

In contrast to *Avanti*, in *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031, 1042 (5th Cir. 2012), the Fifth Circuit affirmed the bankruptcy's courts decision to refuse to enforce a plan, and therefore the third-party releases incorporated therein, that was approved by a Mexican court. In *Vitro*, the plan approved by the Mexican court created one class of unsecured creditors and only by counting the votes of insiders was that class able to get the requisite majorities to approve the plan. Of the

75% of the unsecured debt that voted in favour of the plan, more than 50% of all claims entitled to vote were held by the subsidiaries of the company.

On this record, the Fifth Circuit refused to enforce the third-party releases approved by the Mexican Court because "*enforcement would amount to letting one discrepancy between our law and that of Mexico (approval of a reorganization plan by insider votes over the objections of creditors) make up for another (the discharge of non-debtor guarantors).*" *Vitro*, 701 F.3d at 1067.

In re PT Bakrie Telecom Tbk

Background

PT Bakrie Telecom Tbk (the "BTEL"), an Indonesian company that provides cellular telecommunications services, experienced financial difficulties and incurred defaults under certain senior notes (the "Notes"). The Notes were issued by Bakrie Telecom Pte. Ltd. (the "Issuer"), a wholly-owned subsidiary of BTEL, under an indenture and supplemental indenture (together, the "Indenture").

The Issuer then loaned the proceeds to BTEL and the Issuer assigned its rights against BTEL to the indenture trustee (the "Indenture Trustee") under the Indenture. BTEL and two of its other subsidiaries (the "Subsidiary Guarantors") guaranteed repayment on the Notes.

After a default, certain noteholders commenced litigation in New York against BTEL, the Issuer, and the Subsidiary Guarantors for breach of the Notes and accelerated payments and interest due and owing under the Notes. One month later, a different, Indonesian creditor initiated a "Penundaan Kewajiban Pembayaran Utang" proceeding (the "PKPU Proceeding") against BTEL. "*A PKPU proceeding is a court-enforced suspension of payments process in Indonesia that is designed to provide a debtor with a definite period of time to restructure its debt and reorganize its affairs under a composition plan with its creditors.*" *In re PT Bakrie Telecom Tbk*, 2021 WL 1439953, at *3 (Bankr. S.D.N.Y. Apr. 15, 2021).

In the PKPU Proceeding, the Indenture Trustee filed proofs of claim on behalf of the noteholders for amounts due under the Notes and the Issuer also filed a proof of claim for the entire amount due under the Notes. The Indenture Trustee and Issuer disagreed as to who was permitted to file a proof of claim for amounts due under the Notes because the Indenture stated the Indenture Trustee was permitted to file proofs of claim, but BTEL did not list the Indenture Trustee as a creditor on the record. Instead, BTEL listed the Issuer as the creditor that it owed amounts due under the Notes.

Eventually, the judge overseeing the PKPU Proceeding permitted the claim filed by the Issuer and permitted the Issuer to vote on the entire amount due under the Notes.

In total, the Notes represented 56% of the amount of unsecured debt. The Issuer, which voted on behalf of the Notes, was one of 325 creditors to vote in favour of the PKPU plan that was contemplated. Under Indonesian law, approval of a PKPU plan requires approval by a majority of creditors by number, provided that the majority represents at least two-thirds of all accepted claims. Because the Issuer voted in favour of it, and in total 325 out of 343 unsecured creditors voted in favour of it, the PKPU plan was approved.

The approved PKPU plan eliminated millions of dollars in past due interest and extended the time for which payment on the Notes was to be made. The PKPU plan further included third-party, non-debtor releases for the Issuer and the Subsidiary Guarantors, which would, of course, have had the effect of stripping guarantees that otherwise favoured third-party noteholders.

Around the time the Issuer was granted the right to vote on behalf of the noteholders, the noteholders commenced a second action in New York state court alleging fraud and other tortious conduct in connection with the Notes. This action was consolidated with the pending alleged breach of Notes action. The court granted summary judgment in favour of the noteholders and jurisdictional discovery was ordered in December 2017, about three years after the PKPU Proceeding ended.

Against this flurry of litigation, BTEL commenced a chapter 15 proceeding in the United States Bankruptcy Court for the Southern District of New York seeking recognition of the PKPU Proceeding as a foreign main proceeding and recognition of the PKPU plan.

The Chapter 15 proceeding

Judge Sean Lane for the United States Bankruptcy Court for the Southern District of New York first found that the PKPU Proceeding met the requirements for a foreign main proceeding. The court found that the PKPU Proceeding was "collective" as required of a foreign proceeding by section 101(23) of the Bankruptcy Code because the rights and obligations of all of the debtor's creditors were considered by the Indonesian court and the PKPU Proceeding did not focus on only one creditor or one class of creditors.

Additionally, the court found notice was provided to creditors, there was appellate review of the PKPU Proceeding, and the PKPU plan accorded to the priorities for the distribution of assets. Accordingly, the PKPU Proceeding was deemed a foreign main proceeding.

Next, the *Bakrie* court noted sections 1507 and 1521 as the applicable provisions for providing additional relief. Notwithstanding the interplay between the two sections, the court stated that providing relief under either section "*depends upon principles of comity.*" *Id*. at *12. "*Comity refers to the spirit of cooperation in which a domestic tribunal approaches the resolution of cases touching the laws and interests of other sovereign states.*" *Id*. (quoting *Societe Nationale Industrielle Aerospatiale v. U.S. Dist. Court for S. Dist. of Iowa*, 482 U.S. 522, 543 n.27 (1987)).

In assessing whether to extend comity, federal courts, including the United States Bankruptcy Court for the Southern District of New York, consider: "*(1) whether the foreign proceeding abided by fundamental standards of procedural fairness; (2) whether the foreign proceeding violated the laws or public policy of the United States; and (3) whether the foreign judgment was affected by fraud.*" *Id*. at *13. Further, the *Bakrie* court recognised the Supreme Court's holding in *Hilton v. Guyot*, 159 U.S. 113 (1895), that a clear and formal record is necessary for deference to a foreign court under principles of comity.

In determining whether to extend comity and enforce the third-party releases in the PKPU plan, the *Bakrie* court emphasised the absence of a clear and formal record. *Bakrie* found that there was no record of how the Indonesian court considered the creditors' rights, how information regarding the third-party releases was presented to the court, or if creditors had an opportunity to be heard. The *Bakrie* court was further troubled by the sparse record purportedly justifying such releases; conversely, testimony actually presented suggested that third-party releases are not standard in PKPU proceedings. On this record, the *Bakrie* court was unwilling to enforce the third-party releases otherwise approved through the PKPU plan.

Finally, the *Bakrie* court acknowledged the issue of having the Issuer vote on the Notes notwithstanding it being a wholly owned subsidiary and an insider of BTEL. The *Bakrie* court stated that "*American courts are nonetheless concerned about transparency, fairness, and due process as to the exercise of control by insiders in insolvency proceedings*." *Id*. at *21.

However, the *Bakrie* court did not deem it necessary to answer whether the voting arrangement would bar it from enforcing the third-party releases having already denied relief upon finding no formal record to support the basis of procedural fairness. "*But to the extent that the parties return to the Indonesian court to establish a more fulsome record as to the third-party release, they might also take the opportunity to further develop the record on the voting issue*." *Id*.

Bakrie is not a departure from *Avanti* or *Vitro*

Although the court in *Bakrie* did not enforce the third-party releases, *Bakrie* should not be read as a sea-change in US jurisprudence. *Bakrie* and *Avanti* both consider whether granting third-party releases are common in schemes or plans under the relevant foreign law, whether a majority of insiders approved the scheme or plan, and whether the foreign proceeding contained a formal record that sets forth the rights of creditors and their ability to be heard. And *Bakrie* and *Vitro* each consider the impact of a majority of insiders approving the plan or scheme. While the court in *Bakrie* focused more on the requirement of a clear and formal record, this analysis is wholly consistent with *Avanti* and other lines of cases enforcing third-party releases in chapter 15 cases.

In this regard, *Bakrie* should be a clear guidepost for practitioners looking to understand the record required by a US court administering chapter 15 of the Bankruptcy Code being asked to enforce third-party releases granted in a non-US insolvency proceeding.

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