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Insolvency law’s growth story

Insolvency and corporate reorganisation is one of the fastest-evolving areas of law today. And it soon could see more activity. There are strong signals that the US Federal Reserve will finally raise interest rates. That will have a global impact; companies borrowing in US dollar-denominated products will be affected, and less creditworthy companies may find it harder to refinance.

Commodities companies with outstanding debt have been hit especially hard by sharp commodity prices. They have sparked concerns for both US oil and gas companies and those farther afield in resources-rich jurisdictions, including Indonesia, Malaysia and Australia.

And while globalisation has provided corporates with more options in a restructuring scenario – especially with the growing popularity of forum-shopping – it has complicated matters when securing assets. These are now located across jurisdictions, often under entirely different local legal regimes. Negotiating those differences requires a deep understanding of creditors’ rights under local law – and when a restructuring is multi-jurisdictional, how that might intertwine with proceedings elsewhere; some companies seek to have their foreign restructuring proceedings recognised in the US under chapter 15 of the US Bankruptcy Code.

Harmonisation of various restructuring mechanisms globally, or even regionally, remains difficult. Companies – even those without a clear UK or US nexus – are turning to restructuring under chapter 11 of the US Bankruptcy Code, and, more recently, UK schemes of arrangement.

UK schemes are increasingly popular as they aren’t insolvency processes and instead allow for a single piece of debt to be restructured in separate proceedings. In a recent case, German company APCOA Parking amended its facility agreement from German law to English law with majority lender consent so that it could restructure its debt through a UK scheme. However restructuring practitioners have expressed mixed views on the relocation of centres of main interest (COMI).

And there are also developments in the resolution of financial institution. The EU’s Bank Resolution and Recovery Directive (BRRD) will come into force on January 1 2016, but it will require coordination with the Financial Stability Board’s total-loss absorbing capacity (TLAC) requirement; the FSB’s consultation on TLAC was completed earlier this year.

And as the final pieces of post-crisis regulation are implemented, regulators are now looking towards other systemically important financial institutions. Following an increased emphasis on clearing derivatives through central counterparties (CCPs), there is concern that they are the next repository of risk in the financial system, and therefore need a resolution framework. Other aspects of financial markets infrastructure are an increasing concern.

This is IFLR’s second-annual Insolvency & Restructuring report, launched in response to demand for greater clarification on regulatory developments in unfamiliar jurisdictions. Conducted on a global basis, this report provides insights on developing practice in key markets worldwide. IFLR also thanks lead contributors Linklaters, particularly partners Richard Buswell, David Kidd and Aaron Javian for guest editing this report and providing responses for three important jurisdictions. We hope you will find it an invaluable resource.

Ashley Lee
Asia editor
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Restructurings have become more challenging as more companies operate across borders, which necessitates working with a diverse set of regimes – often governed by vastly different legal systems.

The International Association of Restructuring, Insolvency and Bankruptcy Professionals, also called Insol International, has led efforts to coordinate cross-border restructurings. The organisation has 40 member organisations worldwide with over 10,000 members, and works to share knowledge across jurisdictions and establish best practices.

IFLR spoke with Insol International president Mark Robinson, whose tenure began in March this year, about his priorities for his presidency as well as challenges in cross-border restructurings – particularly in the Asia-Pacific and Australia.

**What are your priorities for your tenure of Insol president, which began in March of this year?**

I would first like to say that Insol is in great shape and has become truly international in its ethos, structure and activities. It has hosted highly-successful regional initiatives to improve insolvency systems and enhance institutional capacities in Latin America, Africa, the Middle East and Asia, and delivered international conferences and seminars that are very well attended, attract high profile presenters and provide tremendous networking opportunities.

It has also facilitated the Global Insolvency Practice Course, which is now entering its sixth year. In other thought leadership initiatives, it also produces technical publications that are an invaluable resource for professionals who are engaged in cross-border insolvency cases and promotes the United Nations Commission on International Trade Law (Uncitral) Model Law on Cross-Border Insolvency.

It is my absolute pleasure to have the opportunity to lead such a peerless organisation. Initiatives that I intend to focus on during my two-year ten-

**Setting standards**

*Mark Robinson*, president of *Insol International*, discusses his goals for Insol and restructuring developments in the Asia-Pacific
ure as president include adding more bank, funds management and debt trading professionals to our existing 10,000 strong membership base and expanding our regional initiatives in Asia-Pacific.

I also intend to continue the growth of Insol’s financial capacity and infrastructure so that we can undertake more and improved work.

**What are some of the biggest challenges in international cross-border restructurings, and are there any developments that you anticipate this year to help ease that process?**

There are a number of challenges exercising the minds of the restructuring professionals working on the larger cross-border cases. An example is the movement in the pendulum from the concept of universalism towards territorialism. In some important restructuring cases, the courts have ruled in favour of local creditors at the expense of foreign creditors’ entitlements to distribution from local assets.

Another challenge has been the slow take-up of the Uncitral Model Law. A special project initiated by the Insol Fellows, which comprises graduates of the Global Insolvency Practice Course, to push for the adoption of the Model Law in a number of countries who have not yet done so will give much-needed profile to this issue.

Also some legal jurisdictions complain that there is significant shopping for favourable forums to progress major restructuring work. This probably puts pressure on less popular jurisdictions to change their restructuring law, practice and procedures to become more favourable and to attract more professional work.

**Insol is supportive of all efforts to improve the certainty of outcomes, reduce risk and to improve commercial outcomes.**

**Looking more regionally, what are some of the biggest challenges in Asia-Pacific cross-border restructurings?**

The challenges relating to international restructurings also apply to Asia-Pacific cross-border restructurings. But there are additional challenges in the region.

In some countries and jurisdictions, local political and social factors have a significant impact on the likely outcomes. Accordingly, the optimal commercial outcome for a restructuring may be very difficult to achieve, and in some cases, unachievable. This adds uncertainty and complexity to restructuring endeavours which may ultimately affect the attractiveness of the jurisdiction to new investment. In my opinion, most jurisdictions are now alive to these issues and Insol is supportive of all efforts to improve the certainty of outcomes, reduce risk and to improve commercial outcomes.

The skills and experience of local insolvency and restructuring practitioners in some regions requires further development to approach best practice. Insol is helping to address this issue by delivering successful regional initiatives to improve insolvency systems, knowledge and to enhance institutional capacities.

**About the author**

Mark Robinson is the president of Insol International, a past president of the Australian Restructuring Insolvency & Turnaround Association (Arita), and a partner of PPB Advisory, a leading firm of 250 professionals with offices across Australia and New Zealand.

Robinson provides innovative restructuring, turnaround and insolvency advice to financiers, directors and advisers for both large and SME enterprises. He is regularly engaged by Australian trading banks, international finance institutions, company directors and their advisers. His recent experience includes acting as voluntary administrator to confectionary product manufacturer Darrel Lea, which involved successfully negotiating the support of trade unions, employees, banks, family members and a leading Australian food processor. He also successfully negotiated and achieved the support of Australian state and federal governments, banks, deed funders and the local community for Shearwater, the Mullumbimby Steiner School, to ensure that a large educational facility continued to operate.

He was also liquidator to Australian builder Reed Construction, and to Trio Capital. In the case of Trio Capital, he traced A$123 million ($98 million) of superannuation funds to offshore hedge funds and handled submissions to the Federal Parliamentary Inquiry into Trio Capital’s collapse.
There have been a number of landmark insolvency and restructuring cases in the past few years in Australia. How has the Australian market evolved?

Yes there have. Notwithstanding that there has been no major insolvency or restructuring reform in Australia since 1993, when the voluntary administration regime was introduced, Australian practitioners have become very skilled at employing stand-still agreements, court-approved schemes and the administrative voluntary administration regime to achieve large, complex and successful restructurings.

However, this ingenuity comes at a cost, including uncertainty of outcome and associated risk, prohibitively high legal fees and delays. Accordingly an educated and widespread debate needs to happen in Australia on the merits of international concepts such as safe harbours for directors and their advisors who are in the insolvency twilight zone, the temporary negation of ipso facto clauses in key contracts, the formal acceptance of the role of chief restructuring officers and the sanctioning of properly negotiated pre-pack agreements.

There’s also been a lot of discussion about the development of a secondary debt market in Australia. How has that directly affected the restructuring process, and do you expect it to continue? Is this something you expect to see more of across the Asia-Pacific region?

Yes, there is now an active and competitive debt trading market in Australia. This has directly affected the restructuring process by giving the holders of senior debt – mainly comprising the major Australian trading banks – the option to cash out early.

Australian trading banks are increasingly taking this option given the negative impact of continuing impairment on their cost of capital and capital adequacy ratios, and that they are making record profits by increasing their investment in what is perceived to be low-risk debt such as housing.

The impact on a restructuring is that the holders of the senior debt change often and each new entrant after a debt trade has a different motive, with some radically different. Ofteen the new entrants are large and sophisticated overseas investors and traders who may see an advantage in disrupting the agreed restructuring plan, consequently increasing uncertainty and risk and delaying final resolution. I expect this state of affairs to continue across the Asia-Pacific region.
European restructuring remains one of the most legally innovative practice areas globally. This year the European Commission (EC) announced that it had come close to finalising its revised Insolvency Regulation, which are meant to clarify issues around cross-border restructuring in the European Union.

One of the most significant developments in Europe has been the trend of shifting of the centre of main interest (Comi). In 2014, an English court decision held that an amendment from a German to English governing law clause in APCOA Parking’s facilities agreement by majority lender consent was enough to give the English court jurisdiction to sanction a scheme of arrangement. That trend is expected to continue.

Looking ahead, the EC is also looking to encourage harmonisation of national rules and processes. While that would be welcome, it would also be difficult to accomplish given the diversity of Europe’s legal systems.

Here, Robert van Galen, president of Insol Europe, speaks to *IFLR* about these developments as well as the role of the organisation in the European restructuring and turnaround market.

**What were some of the most significant restructuring developments in Europe in 2014? What do you expect to see in 2015?**

Robert van Galen, president of Insol Europe, reflects upon developments in European restructuring this year.

**The Insolvency Regulation has been very effective. Before it came into force insolvencies were essentially local matters**
It is important that we learn to respect each other’s systems

There are also quite a few initiatives on the legislative side. The EU has almost completed the revision of the European Insolvency Regulation, and in March of last year it published a recommendation for a new approach to business failure promoting confidential proceedings and debtor-in-possession proceedings.

It has also been working on a new project seeking convergence of the national insolvency laws. Such convergence will probably be primarily aimed at procedural matters and core insolvency issues, such as fraudulent transfers of assets on the verge of insolvency proceedings. It is difficult to achieve far-reaching harmonisation because the private law systems of the member states are very different and insolvency law is closely connected to many areas of private law.

Are there any particular sectors of interest? For example there have been concerns about commodities following price decreases globally.

I don’t see much of a problem in the commodities area right now. Instead there may be inverse effects. If, for example, the price of oil goes down, the demand for storage may go up. That would mean that storage businesses are actually becoming more profitable, so there may be a reverse movement there.

Sensitive areas are always construction and building. If a new downturn occurs they tend to be among the first to be hit.

How might the EU Insolvency Regulations affect insolvency and restructuring throughout Europe?

The EU Insolvency Regulation does affect insolvency and restructuring because it means that proceedings opened in one member state are recognised throughout the EU, but that has been the case since the regulation was introduced in 2001.

The Insolvency Regulation has been very effective. Before it came into force insolvencies were essentially local matters. A Dutch trustee, for example, could do very little in another member state like Luxembourg. Now that is quite different. An insolvency trustee that has been appointed in one member state can collect and sell assets in all the other member states, conduct proceedings and so on.

The revision of the 2001 Insolvency Regulation is almost agreed, but I don’t think that will have a significant impact on restructuring and insolvency throughout Europe.

While the new Insolvency Regulation applies across Europe, it doesn’t bring very significant changes and it doesn’t really repair the flaws of the present Insolvency Regulation. Furthermore, although the revised Insolvency Regulation introduces a regime for insolvent groups of companies, the provisions seem rather complicated, and it’s unclear whether they will be very effective.

What are your thoughts on increasing forum-shopping in restructurings, especially as the UK’s scheme of arrangement becomes more popular? Has this forced jurisdictions to revise their own restructuring laws?

Main insolvency proceedings must be opened at the centre of main interests (Comi) of the company. As far as forum shopping is concerned, two issues can be distinguished. There are some cases in which it is not very clear where the Comi is. It would be helpful if there were some rules that could give us some guidance here. The revision of the Insolvency Regulation tries to achieve that, but doesn’t do so very effectively.

The other issue is the real Comi shift. This is when a company is domiciled in one country first and then moves to another country with the purpose of opening proceedings there. It can be doubted whether that is a desirable procedure. It means that the rights of the different groups of creditors are changed at the last moment because the change of Comi entails that the insolvency laws of the new jurisdiction apply to the insolvency proceedings. Those who advocate Comi shifts say that by allowing them, the company will move to the member state with the best insolvency laws. However what is good for one stakeholder may not be good for another stakeholder. One can say at least that the possibility of Comi shifts will enable the stakeholders in charge (for example those that have personal guarantees from the managing directors) to move the Comi to the jurisdiction that is most favourable to them. The assertion that that jurisdiction is also best for the other creditors lacks convincing reasoning.

Furthermore an English court has determined that an English court determined that it had jurisdiction over a scheme of arrangement with respect to a company located in another member state. The crucial question is whether, under the Brussels Regulation, an English judgment sanctioning such a scheme of arrangement can be recognised in other European jurisdictions. That is to be decided ultimately by the European Court in Luxembourg.

Has this forced jurisdictions to revise their own restructuring laws?

Many member states are improving their insolvency laws, but I am not certain that this is due to fears for Comi shifts to other jurisdictions. My own government doesn’t seem to care at all about that.

Rather it seems that improvements are being made because of reception of the American outlook on insolvency proceedings, which has a much stronger emphasis on rescue procedures than the traditional European proceedings.

What are some of the challenges remaining in completing European cross-border restructurings?

The main challenge is that we do not have a good regime for trans-European rescue plans. It would be attractive if a plan involving a group of companies could be voted on in one set of proceedings and could be imposed on all creditors of the group by one court. There are several ways of doing that: one is to group all insolvency proceedings together under one court, and the other is to have a somewhat complicated scheme which is then to be dealt with by one court.

The US has a mechanism for grouping these companies together under one rescue plan. We need to introduce something similar in the European Union in order to remain competitive.
What are your priorities as president of Insol Europe in 2015?

It is important that we learn to respect each other’s systems. All systems have their strong points and flaws, and it is not productive to try to advertise one system as being the best. We have to look at what this diversity has to offer us. We should then try to find out where these laws can be made to converge so that unnecessary differences can be reduced.

How does Insol Europe work with Insol globally as well as restructuring and turnaround organisations in Europe?

We do work with Insol International, although they have a different focus.

We are interested in both having good connections with the insolvency practitioners and lawyers on the national level, as well as getting those lawyers involved in our projects and conferences. Insol Europe is also a networking organisation for insolvency practitioners and lawyers, and we strive for substantial representation from all the major jurisdictions in Europe.

We have a turnaround wing that is active and is working on a number of research projects. We also work with the national organisations for insolvency and turnaround professionals.

Insol Europe is a unique combination because it brings together academics, judges and practitioners at its conferences, but also in its projects and in its relations with the European community. It’s the only European insolvency organisation, and has been very successful in the sense that there is a large number of people involved in our projects and attending our conferences.

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About the author
Robert van Galen specialises in insolvency law with an emphasis on cross-border issues, and heads NautaDutilh’s insolvency and restructuring group. He has been involved in virtually all major cases in the Netherlands in the past 25 years, including Barings, Fokker, GTS, KPNQwest, Lehman, Yukos and OSX. He is admitted to the bar of the Dutch Supreme Court and has been involved in a number of important cases.

Van Galen is both president of Insol Europe and president of the Dutch association of insolvency lawyers, Insolad. He was a member of the Dutch State Committee on the implementation of the European Insolvency Regulation, and is a member of the experts group advising the European Commission on insolvency legislation. He is also part of the stakeholders group advising the Dutch government on insolvency legislation and of the expert group advising Uncitral Working Group V. He is a fellow of the American College of Bankruptcy and president of the Amsterdam lawyers society (Praktijksociëteit).
In November 2014 the Financial Stability Board (FSB) released its consultation on total loss-absorbing capacity (TLAC), widely believed to be the last piece of far-reaching regulation needed to protect the financial system in case the resolution of a global systemically important bank (G-Sib) is needed.

The past few years have been dominated by discussion of bank regulatory reforms, from the implementation of Basel III’s capital requirements to, more recently, its net stable funding ratio (NSFR) and its liquidity coverage ratio (LCR). And in 2015 focus has moved to bank resolution, as the FSB’s Key Attributes of Effective Resolution Regimes for Financial Institutions require G20 jurisdictions to have in place resolution and recovery plans by the start of 2016.

The Global Financial Markets Association (GFMA) has been one of the organisations at the forefront of these regulations. As an industry association, it works with the Association for Financial Markets in Europe (Afme), the Asia Securities Industry and Financial Markets Association (Asifma) and the Securities Industry and Financial Markets Association (Sifma) to represent industry participants’ global views on international initiatives, such as those proposed by the FSB.

Here, *IFLR* spoke with Carter McDowell, Sifma’s managing director and legislative counsel, and Gilbey Strub, managing director in Afme’s prudential division, about global regulatory reforms related to bank resolution and recovery.

**Gilbey Strub** of the Association for Financial Markets and **Carter McDowell** of the Securities Industry and Financial Markets Association discuss global bank resolution and recovery initiatives

The FSB released its Key Attributes in 2011. Since then, how far have jurisdictions come with developing bank resolution and recovery regimes?

**Strub**: Since the reform agenda really began in 2009 and the Key Attributes were being formed, substantial progress has been made in the US, EU, Japan and Switzerland in terms of adopting resolution frameworks. A letter from Bank of England Governor Mark Carney to the G-20 leaders last November – just ahead of the Brisbane summit – said that TLAC proposals and their endorsement by the G-20 leaders was a watershed and that with them, the job of reforming the financial system was substantially complete.

All the pieces of the puzzle are on the table and we’re in the process of trying to complete the picture.
Banks’ additional debt issuance will compete with all the other debt sold by end users and corporations generally.

McDowell: To echo Gilbey, I think we’ve made a lot of progress. Laws have been passed to put in place frameworks for cross-border resolution of systemic institutions. A lot of rulemaking has been done, and the International Swaps and Derivatives Association (Isda) protocol and TLAC are now on the table. It seems that all the pieces of the puzzle are now on the table and we’re just in the process of trying to complete the picture.

The hope is that all of the rules will be finally written by the G-20 meeting this year, and of course the implementation date is in 2019, but it’s a safe assumption that all of the G-Sibs will meet these requirements well in advance of 2019.

What are your priorities in regard to bank resolution and recovery regimes in 2015? Are there any areas or specific jurisdictions that you’re focusing on?

Strub: I focus on Europe and am based in London, and Carter is based in Washington DC so he focuses on the US. Together we co-chair the GFMA’s resolution committee which is the vehicle through which we respond to FSB resolution-related initiatives.

Our priorities for 2015 are the FSB’s Quantitative Impact Study (QIS) in relation to the TLAC proposal and then finalising that proposal so that institutions begin working to meet the new requirements and issuing TLAC instruments.

The main European priority is finalising the Level 2 measures under the EU BRRD on its version of loss-absorption capacity requirements, which is the minimum requirement for own funds and eligible liabilities (MREL). The EU has already embedded a loss-absorption requirement in the BRRD which has now been adopted, and the details around that are now underway with the European Banking Authority (EBA). How MREL will fit with TLAC is a major question right now.

McDowell: In the first instance, our priority is the finalisation of TLAC. We’ve just filed two comment letters: one with GFMA, and then one with the Clearing House focussing on the North American perspective. We’re hearing that the Federal Reserve is going to try to implement TLAC nationally concurrently with the FSB’s push to finalise its rules. The US has been gold-plating most of these accords, and that’s a concern to us.

TLAC will be an important issue to us, but the focus is getting it calibrated. We’re big supporters of it and understand that it’s necessary for cross-border resolution. But the QIS is important in making sure that we have the data to determine the right amount of loss-absorbing capacity.

We’re also going to start looking at how these rules interact, for example, how the TLAC works with the NSFR, the capital requirements or the LCR. There’s a lot of work to be done, especially since once the rules are finalised we can see how they all interact.

The finalisation of the Isda protocol is another area of interest. The 18 largest global banks have implemented it, but regulatory actions must be taken at the national level to make this applicable to end users.

Another area that Gilbey and I have spent a fair amount of time on is how the European regulations work with the single point of entry model. We’re also focused on the G-20, but realistically we’re looking closest at the jurisdictions that Gilbey outlined: US, UK Switzerland, Japan, and a handful of others, such as China, Hong Kong, Canada and Australia.

What are some of your concerns in relation to the development of local regimes (eg subsidiarisation requirements)?

McDowell: One of the things we’re worried about is the internal TLAC requirement that’s part of the TLAC proposal. The purpose of the internal TLAC is to help the host jurisdiction build trust in the host jurisdiction.

But what we’re worried about is that we get a lot of nervous host jurisdictions requiring more TLAC than would otherwise be required at the holdco level. When TLAC is locked in various geographies or financial centres, it removes flexibility that would be maintained at the group level.

There’s still some ambiguity on how cross-border regulation will actually work in some key jurisdictions, including Hong Kong.

What are some of your broader concerns regarding cross-border resolution for global entities?

McDowell: There are a lot of moving parts, but another important aspect is the living will, or the resolution and recovery plans. Those are global for the home country, and then there are generally host country chapters in those plans for material jurisdictions within that group. A lot of progress has been made in terms of where the liquidity is, how that’s held, and how that applies to the LCR or NSFR.

Going forward there will need to be focus on the colleges, or supervisory regimes for each bank, which will be looking at each individual institution, how it’s doing business and who will take the lead on the various parts.

Strub: A particular concern relating to the EU is the fact that the MREL requirements for European banks will apply in 2016 – in less than a year. TLAC won’t be required to be implemented until 2019, and it’s unclear what this means for G-Sibs operating in Europe. Will the European MREL requirement effectively pre-empt the global TLAC requirement at risk of creating an unlevel playing field?

How might the FSB’s consultation paper on TLAC further change bank resolution and recovery? Could it possibly add more risk to the financial system?

Strub: I think the consultation is the final jigsaw piece to the new global resolution framework, and will ensure effective resolution by having sufficient loss-absorbing capacity in the system. TLAC is designed to ensure the authorities would be able to resolve a G-Sib in an orderly way.
It is possible that we will have shifted some of the risk from financial institutions to FMIs

But one risk is brittleness if the internal TLAC requirements, that is the pre-positioning of loss absorbing capacity among operating subsidiaries within the group, traps capacity that cannot be relocated within the group if needed in a period of stress.

McDowell: The other thing I would add – and that was the focus of our comment letter – is that now that we have all the pieces of the puzzle, we need to consider the partnership between the regulators in the home and host country and how exactly TLAC will be calibrated.

The Clearing House pulled together US data and looked at it from two perspectives – one historic and one forward looking – to figure out the losses suffered over the last 30 or 40 years when a systematically important institution failed, as well as how much capital or loss-absorbing capacity it would have needed. Based on that, we think that when you add up the capital, buffers and TLAC requirement, we have somewhere in the neighbourhood of three to four times the capital and liquidity needed to resolve those institutions.

Looking forward, we looked at scenarios that banks prepare for when undergoing the stress-testing process. The US stress test was at 11.5% unemployment and a 50% drop in the Dow, as well as some other significant downturns that would be at a higher order of magnitude than what we experienced in the last crash. The firms were passing those tests with their current levels of capital and liquidity, and once all these rules are fully implemented, their capital levels will be doubled.

That’s about four times the amount of capital that we had in the system in the last crisis. We know that was too low, but we still need to figure out the appropriate amount. I think everyone agrees that if that level is too high, it will constrain the ability of these firms to act as financial intermediaries of the economy and consumers. We’ll also look at the liquidity rules and their impact on the liquidity of the sovereign and corporate bond markets.

There are always unintended consequences of these rules, and it’s possible to study and correct the system based on lessons learned. It’s about making sure that these rules are fact-based and that the calibration is not arbitrary.

Strub: The FSB has proposed that TLAC won’t apply to banks headquartered in emerging market economies (EME) but that it would apply to non-EME banks operating in EME countries. We oppose that for undermining the FSB’s own mission of achieving a globally level playing field. As far as the quantum to be raised by G-Sibs in EME countries, Standard & Poor’s has estimated it could total $500 billion if the calibration is at the low end of the range (which is 16% to 20% of risk-weighted assets). If it’s at the high end of the range, it could be double that.

In order to ensure that there is as deep of a market for TLAC instruments as possible, the GFMA response stressed that structured notes not be arbitrarily excluded given the eligibility criteria, and suggested ways in which the resolution planning process could make them more readily bail-in-able in a resolution.

McDowell: We’re also looking at instruments that qualify as TLAC. Depending on the size of the market, this additional debt issuance by banks will compete in the marketplace with all the other debt sold by end users and corporations generally.

The banks will be required to issue TLAC – it won’t be a matter of pulling the issue if the price isn’t right – so the debt will get issued. The question is whether it’ll crowd out other borrowers who might want to access the funds used to purchase TLAC.

It’s a capacity and price issue. If banks have to go to the market, it will impact the price paid for all corporate borrowings. And it’s unclear how much savings there is in a particular currency to absorb TLAC. Banks shouldn’t have to issue TLAC in the currency of another jurisdiction from their home country; that would inject currency risk.

What are some of the most significant risks remaining in the global financial markets?

McDowell: These rules weren’t written in haste. They were written five to six years after the crisis, and were written in silos. There are already revisions being made to different chapters of the rulebook.

While the Basel III capital standards have been set for some time, and banks are now largely compliant, there is ongoing work to look at calibrating trade books and setting the LCR. We’re writing a comment now in relation to the US’ implementation of the G-Sib surcharge, the counter-cyclical buffer and the capital cushion.

Then there’s a lot of work ahead in relation to the regulatory colleges. They’ll need to figure out how they’re planning to use the resolution and recovery plans on the regulatory and supervisory levels as they examine each of these banks on a cross-border level, considering both home and host jurisdictions.

Strub: From a resolution perspective in Europe, we’re expecting the European Commission to issue a proposal for resolving financial markets infrastructure (FMIs) this summer. Until we have a good system for resolving central counterparties (CCPs) and other infrastructure, we have likely shifted contagion risk from financial institutions to these infrastructure entities.

McDowell: I would underscore that. FMI and how that’s integrated in the system will be a problem on this side of the Atlantic as well. A lot of risk has been moved to those entities.

Strub: Interestingly Europe will lead in creating an FMI-specific resolution regime given the absence of any existing law. The US has a patchwork of different laws for resolving FMI and no plans to create a single law.

McDowell: We’ve had a resolution regime for a while regulated by the Federal Deposit Insurance Commission (FDIC), although that was largely built for resolving smaller and more regional firms. We’re trying to make this work on a global scale, and the connections with other jurisdictions are going to be critical.
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Strub has a JD from the University of Iowa College of Iowa (with distinction) and a BA in French from the University of Iowa College of Liberal Arts. Following law school, she was a law clerk to the Honorable Justice Linda K Newman of the Supreme Court of the State of Iowa.

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He was previously chief legislative counsel at the American Bankers Association and General Counsel of the ABA’s international affiliate, the Bankers Association for Finance and Trade. Before joining the ABA, McDowell served as the chief counsel of the US House Financial Services Committee from 2001 to 2007. Before joining the Financial Services Committee, he worked for Banc One Corporation in a number of positions, including as Washington representative, chief compliance officer for the non-bank subsidiaries and affiliates of the holding company, and manager within the legal department. Before joining Banc One, McDowell worked in the financial services group of Goodwin Procter in Boston.

McDowell holds a BA from the University of Texas, a JD from the Herbert School of Law at Louisiana State University and an LLM in banking law studies from the Morin Center at the Boston University School of Law.
Eight years after the financial crisis regulators are still rulemaking to stabilise and protect the global financial system. This year countries in the EU will implement the Banking Recovery and Resolution Directive (BRRD) ahead of the January 1 2016 deadline, while other countries in Europe may follow with similar mechanisms. And the Financial Stability Board (FSB) is expected to release its conclusions to its consultation on total loss-absorbing capacity (TLAC) later this year.

So far bank resolution has had a significant impact on bank ratings. For example BRRD and other bank resolution regimes have changed base cases regarding likelihood of government support, and how much support an institution might receive. Moody’s, for one, has published a new bank rating methodology that takes into account these changes, as well as to better assess losses expected from creditors throughout a bank’s capital structure.

Here, IFLR spoke with Carola Schuler, Moody’s managing director of financial institutions in Europe, the Middle East and Africa about the new methodology as well as the global regulatory environment.

What are the reforms to the global banking system that may affect Moody’s ratings most at this point, and what are the impacts on banks globally from the multitude of reforms?

There are two reforms that are partly still evolving. One is enhancing financial stability through more and higher quality of capital and other loss-absorbing instruments, and the other is the initiative for bank resolution regimes.

These are clearly a consequence of lessons learned during the global financial crisis, and are key to regulatory and legal initiatives impacting banks globally. They don’t only apply to banking systems where resolution regimes are about to be implemented or have been implemented, but given the efforts to enhance financial stability globally, these initiatives do also directly and indirectly affect other banking systems.

From the bank perspective, clearly the various structural reforms and higher loss-absorbing capacity are very complex, and increase the cost of capital generally. They also have broader implications on possible business or organisational realignment that may be necessary in the future. For instance largely diversified banking institutions will see continued pressure on a cost basis. They may also see increasing capital requirements across a variety of countries in which they are doing business, as well as taking into account different resolution regimes.

Large active institutions based in the US, EU and other parts of the world will have to adapt and reorganise themselves to respond to resolution requirements in the key markets that they’re operating in. It has cost implications and will challenge how banks set up their businesses globally, and how they operate within particular banking systems as well as across those systems. So far we’ve seen announcements by large globally-active
Creditors must make conscious decisions about where they are exposed in the capital structure of banking institutions

Institutions that they’re going to revisit their business setup, close down operations in countries, scale back certain business lines as well as other measures. Changes to resolution regimes or coming from resolution elements, as well as the requirements for higher capital and ringfencing certain operations within banking groups have significant implications for the way global banking institutions operate.

At the same time that may offer opportunities for more locally focused institutions to grab market share and expand their businesses locally, provided they have the capital to do so. We may see redistribution of market share and leadership positions in certain markets.

And from a creditor perspective, previously creditors had the option of either being exposed to insolvency or a bail-out. That was a relatively binary situation, but the bail-out was the option most often applied over the past few years.

With the introduction of resolution regimes in many countries and key banking systems, creditors must make conscious decisions about where they are exposed in the capital structure of banking institutions. They must understand what resolution regimes mean for their particular investments in a given country and in various entities of globally active banking groups, and they can no longer rely on a bail-out perspective. Instead they’ll have to bake in potential losses into their investment decision. The risk-return will be adjusted – if it hasn’t already been adjusted – when creditors make new investments.

How is Moody’s considering the FSB consultation on TLAC?
What are some of the aspects of the consultation that could affect Moody’s bank rating methodology?

The consultation period ended in February, so we may see some changes in the TLAC rules once the proposals are finalised later this year. Those changes may include more clarity on the required levels necessary for establishing the final TLAC rules, as well as a quantitative impact study and a market survey.

We also released a new bank rating methodology. Previously our methodology had two key components: the assessment of the fundamental credit strength of an institution, as well as a joint default analysis, which captured our expectation for systemic support made available for banking institutions. The combination of both led to the final ratings outcome.

The new methodology preserves those components and adds one more. As with the previous methodology, we will start with the fundamental assessment so that we establish a perspective on the probability of failure of the institution. But then we’ll add a second layer – the loss-given failure analysis. That involves an analysis of the entire waterfall of the capital structure, thereby assessing the expected losses of creditors as and when the institution is failing.

It clearly captures all the elements that are relevant under the new resolution frameworks. Creditors can now determine the expected losses they may incur depending on whether their securities lie in the capital structure – whether those are very low and are close to equity, or very high and close to secured obligations.

There is the third part of a joint default analysis which we preserved. In jurisdictions where resolution frameworks have been implemented, it now takes into account that the likelihood of government support being forthcoming has materially declined.

Our new methodology is very flexible to the extent that each security or debt class – and the losses related to those debt classes – can now be assessed on their own merit. So whatever the final TLAC rules may be, they can be easily reflected in our framework. It is independent on what new capital rules or other capital rules may bring. Our new methodology is flexible and can adapt to TLAC or new concepts that haven’t yet been put forward because we undergo an entire analysis of the waterfall of claims.

In a nutshell, the new methodology is TLAC-ready and ratings will respond to capital structures as banks adopt and respond to regulations.

In another reform, has the implementation of the BRRD changed Moody’s views on European banks? What lessons have been learned from the jurisdictions that have already implemented BRRD?

The implementation of BRRD has changed our view on European banks. Last year when the Directive was approved, we placed a negative outlook on ratings of EU banks that had some degree of government support baked into the ratings. Since then we have engaged in a very intense dialogue with all stakeholders in Europe, including those who crafted BRRD as well as banks and investors affected by BRRD.

We have now communicated that we have lowered our expectations of government support for European banks. That has affected banks in the EU but also those in Switzerland, Norway and Liechtenstein, which aren’t EU countries but have adopted or are likely to adopt similar frameworks.

Discussions with the regulators have indicated widespread commitment underpinning BRRD. Creditors, including senior unsecured creditors and junior depositors, will in most cases be expected to bear the full cost of recapitalising these banks.

Because of our discussions with the official sector as well as the market, we believe that there will likely be less government support – even for the most systemically-important banks – than what we initially expected.

In a nutshell, the new methodology is TLAC-ready
What are some of the risks remaining in the global banking system?

Principally we expect greater stability of banks’ fundamental credit strength in 2015, which is primarily a reflection of significant progress in repairing balance sheets and systems across the globe, which came with a much-enhanced level and loss-absorbing capacity in banks globally.

However the macroeconomic outlook is still an area of concern. The economic recovery is still fragile in many countries, and an unexpected shock, for instance, could undermine banks’ improved credit fundamentals. Areas of concern are slow and uneven economic growth, as well as the potential for interest rate setbacks in different regions.

Regional divergence and growth paths could also exacerbate challenges in some systems, particularly with the prospect of rising US policy rates in 2015. That always has the impact of influencing capital flows and interest rates globally, especially in emerging markets that have generally seen good bank performance over the past year but the impact of rising US interest rates could pressure debt service capacity of borrowers and also slow capital inflows. All those effects could weigh on banks’ asset quality and earnings.

And clearly the regulatory landscape continues to evolve. There have been many steps taken to require higher capital and loss-absorbing capacity. TLAC may not be the last; the Basel Committee has started consulting on the standards for assessing risk-weighted assets under the standard approach versus an internal rating-based approach. If new regulations come out, this could lead to higher capital requirements for banks basing their capital ratios on an internal ratings-based approach.

There are plenty of other regulatory reforms still ongoing. Another risk relates to large globally active institutions, and the implications on their entire business and organisational setup because of the large number of structural reforms that have taken place and are still ongoing.

About the author
Carola Schuler is co-head of the European banking team at Moody’s, covering financial institutions in Germany, Austria and Switzerland, as well as Spain and Portugal. She is also responsible for Moody’s banking analytical teams in Frankfurt and Madrid.

Schuler joined Moody’s in 2008. Her previous responsibilities at Moody’s included analysing financial institutions in France and the Benelux region, as well as Turkey.

Before joining Moody’s, Schuler was a director at the credit risk management division of Deutsche Bank, where she worked in a number of different analytical and managerial functions in Germany and abroad, covering corporate finance, financial institutions and sovereign risk across Europe.

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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

In Argentina, reorganisation and bankruptcy is governed by Law 24,522 (the Bankruptcy Law), which provides for the following insolvency processes.

A reorganisation process (similar to US chapter 11 reorganisations), that may only be commenced by an insolvent debtor, upon: a voluntary petition filed at any time prior to bankruptcy adjudication; or a petition for the conversion of a bankruptcy adjudication. The process is controlled by the court, who appoints a receiver and a creditors’ committee. The receiver supervises the process and receives submission of proof of claims. The purpose of the process consists in the reorganisation of the debtor’s pre-petition unsecured claims under a reorganisation proposal which, if endorsed by the court after approval by the required majorities of unsecured creditors, will be binding against all unsecured creditors.

An out-of-court restructuring agreement (similar to the US pre-package agreement) which consists of a private restructuring agreement with the debtors’ unsecured creditors. To the extent the agreement is executed by the required majorities of unsecured creditors the debtor may file it for court endorsement, upon which it will be binding on all pre-petition unsecured creditors. The out-of-court restructuring agreement has the following main differences with the reorganisation process: (i) the petition for endorsement does not require insolvency, but rather requires that the debtor is in a situation of general economic or financial difficulties; (ii) there is no receiver or judicial control of the restructuring process, except for the verification of the required majorities and court endorsement; (iii) there is no submission of proofs of claims; and (iv) there are no restrictions to the debtor’s management and disposition powers.

A liquidation process (similar to US chapter 7 liquidations) of insolvent debtors, which may be commenced by the creditor (involuntary liquidation), on filing of a petition providing summary evidence of its claim and the signs of the payments cessation; or, by the debtor (voluntary liquidation), on filing of a description of the causes of the financial distress, the signs and date of the payments cessation, a statement of assets and liabilities and, a listing of creditors. The liquidation is performed under the control and supervision of the court, who appoints a receiver who receives submission of proof of claims, takes possession of the state and seeks to liquidate the debtor’s assets and distribute the proceeds among the debtors’ creditors.

1.2 Is a stay on creditor enforcement action available?

Upon commencement of a reorganisation proceeding, all pre-petition unsecured monetary claims (excluding expropriations, ordinary proceedings pending, labour claims and claims where the debtor is joiner defendant) are stayed. However, the enforcement actions on claims secured with mortgage or pledge are not stayed; provided that in order to be able to realise the collateral or obtain precautionary measures on the collateral the secured creditor must first have filed proof of the secured claim. However, in the case of manifest need or urgency the court may order a temporary stay of a mortgage or pledge enforcement action and the effects of a precautionary measure on the collateral for a term of not more than 90 business days.

On the publication of notices informing the filing of an out-of-court restructuring agreement for court endorsement, unsecured claims (except those excluded above) are also stayed. Secured claims are not affected by the commencement of the out-of-court restructuring agreement, which does not provide for specific provisions for the request of a temporary stay; despite that, the court may order such temporary stay by analogous application of the provisions for reorganisation proceedings described above.

In liquidation cases, all proceedings (other than enforcement actions) on unsecured claims (except those excluded above) will continue with the control of the receiver until the bankruptcy adjudication becomes final and definitive, upon which all unsecured claims’ proceedings (except those excluded above) will be stayed. Subject to the filing of proof of the secured claim, creditors secured with mortgage or pledge may request to the court the realisation of the collateral at any time after granting a guarantee of preferred creditor. After giving notice to the receiver, the court will decide whether admitting or denying the request which, if admitted, will proceed at an ancillary proceeding (special liquidation proceeding). The receiver may request court authorisation to satisfy the secured credit in full with liquid funds available or through the sale of other assets or the granting of other securities. Upon bankruptcy, adjudication by the court may order the continuation of the debtor’s business activities for a fixed term, during which secured claims enforcement actions on collateral needed for the business activities continuation are stayed when: (i) the secured claim is not due as of the bankruptcy adjudication date and the receiver continues performing the obligations due after such resolution; (ii) the secured credits are due as of the bankruptcy adjudication date but the security is not admitted by a final and non-appealable resolution; or (iii) the secured creditor consented the stay. In addition, in case of continuation, the court may also order the stay of secured claims enforcement actions at the request of an employees’ cooperative (formed for purposes of bidding for the purchase of debtor’s equity in the competitive bidding process or otherwise requesting the acquisition of debtor’s equity prior to liquidation of the estate) for a maximum term of two years.

1.3 What are the key features of a reorganisation plan and how is it approved?

Reorganisation plans may include any variety of all available payment alternatives (including debt for debt, debt for equity or debt for cash proposals – or any combination) provided that the plan is subject to the following minimum requirements: (i) the plan must not discriminate between opposing classes by banning such creditors from choosing among the available...
payment alternatives or allocating to such creditors consideration of inferior value; (ii) the payment received under the plan by the opposing classes must not be less than the dividend such creditors would receive in the liquidation; and (iii) the plan must not be abusive towards creditors’ rights.

Reorganisation plans must include at least three mandatory categories of creditors (unsecured, labour and secured) and may include subcategories.

The debtor has an exclusivity period of 90 business days (extendable once for another 30 business days) within which the debtor must formulate a reorganisation plan for the unsecured creditors and obtain consent by the required majorities of unsecured creditors within each category, representing: a headcount majority of more than 50% of heads of all unsecured creditors and a principal majority of at least two-thirds of the aggregate principal amount of the unsecured claims. Holders of debt securities issued in series must grant their consent at a holders’ meeting or in such other manner as provided in the documents governing the securities (as admitted by the court). The headcount and principal majorities at the meeting are computed as follows: in respect of the headcount, all votes of the holders supporting the plan are computed as given by one person and all votes opposing the plan are computed as given by one person; and in respect of the principal amount, following broadly accepted case law, the principal amount of the securities held by the holders not attending the noteholders’ meeting or abstaining from voting at the meeting are not computed in the calculation of the principal majority.

Any reorganisation plan addressed to secured creditors (or other creditors with other special or general preference) requires the unanimous consent of all such creditors.

1.4 Can a creditor or a class of creditor be ‘crammed-down’?

Yes. If the required majorities are not reached the court may impose the plan over the objections of some classes of unsecured creditors and, therefore, confirm the plan if the plan was approved by both: (i) the required majorities within at least one of the impaired classes of unsecured creditors; and (ii) unsecured creditors representing at least three-quarters of the aggregate principal amount of unsecured credits.

If the court decides not to exercise its cram-down power, then in the case of certain debtors (such as corporations and limited liability companies), prior to declaring the debtor bankrupt, the court will open a five-day period for the registration of the creditors, workers cooperatives or other third parties interested in acquiring the debtor’s equity and formulating alternative competing reorganisation plans (the competitive bidding process). During this period the debtor may also file a new competing plan. These plans must be approved by the same required majorities of creditors (see 1.3).

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

No, except in liquidation. The assets of the estate are sold by the receiver, who may sell the assets jointly or separately, or the business as a single unit.

The assets may be sold through: one or more public auctions; direct sale; or, sale at securities exchange or market where trading or registered.

The sale of the business may be made through a public auction or a two-call bidding process.

1.6 What are the duties of directors of a company in financial difficulty?

The directors of a company in financial difficulty continue owing the general corporate law fiduciary duties, including the duty of loyalty, which embraces the obligation to act with the correctness of an honest person and in defense of the interests of the debtor. Further, the duty of diligence imposes the obligation to perform their responsibilities with the diligence of a good businessman. The good businessman standard requires that the directors have minimum qualifications and that they perform their responsibilities in accordance with such qualifications, including during the investigation and due diligence required to adopt any decision.

When the debtor becomes financially distressed, however, the directors will be required to adopt any available measure to overcome the financial difficulties or reduce the losses (including the filing for reorganisation, the negotiation of an out-of-court restructuring agreement, or even the petition for bankruptcy). Even if the Bankruptcy Law does not oblige the directors to file for bankruptcy or reorganisation, the directors may be subject to liability if the decision to avoid the filing for reorganisation or bankruptcy or the delay of such filing finally aggravated the financial situation of the debtor.

The directors must avoid any actions in fraud of the creditors’ rights and engaging in any deceit or negligent action affecting the creditors’ rights.

1.7 What priority claims are there and is protection available for post-petition credit?

In liquidation, claims have the following order of priority:

Claims with special preference

The following claims have priority in respect of the proceeds of the certain assets: (a) expenses for the construction, improvement or maintenance of property; (b) labour claims (credits for six-month salaries, severance payments and indemnification for health claims); (c) taxes on property and assets; (d) claims secured with mortgage or liens; (e) the amounts owed to a creditor retaining property of the debtor; (f) naval and aeronautical mortgages; and (g) the foregoing liens extend to the proceeds of the liquidation of any of the foregoing collateral or property. The priority extends only to the amount of principal owed, except for (x) the interests accrued in respect of the labour claims during the last two years after the claim became due and payable; and (y) the litigation costs and expenses, all interests accrued during the two years immediately preceding the bankruptcy adjudication and remunerative interests accrued since the bankruptcy adjudication and until effective payment, in respect of the secured claims described in (d) above.

Administrative expenses

Debt in connection with the administration of the case and the estate.

Claims with general preference

Including: (a) labour claims (credits for six-months salaries, severance payments and indemnification for health claims), including the interests accrued during the last two years after the claim became due and payable and litigation costs and expenses; (b) the amount of principal owed to the national, provincial or municipal social security system; (c) the amount of
principal of taxes; and (d) the amount of principal for up to Ps$20,000 ($2,200) on credit bills accepted for each vendor or lessor. These claims will only have priority on the amount equal to 50% of the proceeds of the estate property after payment of the claims with special preference, the administrative expenses and the principal amount of any labour claims described in (a) above. Any distribution among the creditors holding claims with general preference will be made pro rata until their payment in full up to the maximum amount.

Unsecured claims

Subordinated claims

Generally, unsecured post-petition financing does not enjoy any priority, except where the proceeds of such financing are used for the payment of any costs and expenses relating to the maintenance and administration of the estate, in which case the court may grant to such financing the priority of the administrative expenses.

1.8 Is there a different regime for banks and other financial institutions?

Financial institutions may not apply for a reorganisation proceeding or file a petition for its own bankruptcy under the Bankruptcy Law; and may not be adjudicated bankrupt until the Argentine Central Bank first revokes its licence.

When a financial institution is insolvent or has liquidity problems, prior to revoking its licence, the Argentine Central Bank may authorise the financial institution’s restructuring through different alternatives, including the exclusion, transfer and assignment of assets and liabilities (which remarkably, has been the option adopted in all cases). The main features of this option may be summarised as follows: deposits are excluded from the distressed financial institution and transferred to another financial institution. Further, all or almost all the assets of the distressed financial institution are transferred in trust to a trustee who in turn, issues: (i) a senior certificate of participation in an amount equal to the amount of the deposits it holds less the amount of the senior certificate of participation, which is delivered to the distressed financial institution and transferred to another financial institution. The assets of the trust are realised by the trustee, and most of the distressed financial institution’s employees are rehired by the financial institution that assumed the deposits, which is also allowed to open branches in the same places as the distressed financial institution.

If the restructuring fails, the Argentine Central Bank may revoke the financial institution’s licence and, unless the revocation resolution includes the order to file a petition for bankruptcy or the institution’s creditors file a petition for bankruptcy after 60 days from the revocation resolution, the financial institution will be subject to a judicial liquidation procedure.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

Under the Bankruptcy Law, foreign residents may become debtors in full plenary insolvency cases in Argentina with respect to such foreign resident’s property within Argentina. For the commencement of an insolvency case against a foreign resident, it is required that all the eligibility requirements of the Bankruptcy Law must be met, that is, the filing of evidence showing that the foreign resident holds property within Argentina, that the creditor holds a claim past due and payable, and that the foreign resident is in payments cessation.

Upon commencement of a liquidation case in Argentina an estate will be created comprising all of the foreign resident’s property located in Argentina.

The venue for the insolvency proceedings of a foreign resident in Argentina will be the court of the place of the foreign resident’s administrative office in Argentina or, in the absence of any such administrative office, the court of the place in Argentina where the foreign resident has its main business, commercial activities or exploitation.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

Argentina has not yet adopted the Model Law on Cross-Border Insolvency of the United Nations Committee on International Trade Law (Uncitral) and, except for residents of Bolivia, Brazil, Colombia, Chile, Paraguay, Peru and Uruguay (parties with Argentina to the Conventions of Montevideo of 1889 on International Procedural Law or of 1940 on International Procedural Law and Insolvency), cross-border insolvency cases are governed by the Bankruptcy Law.

Except under the Montevideo Conventions, Argentina does not provide for the recognition of foreign insolvency proceedings nor for any mechanism or ancillary case to aid foreign creditors or bankruptcy trustees to obtain the turnover of the foreign residents’ property within Argentina. It holds to the voidance of effects of foreign insolvency proceedings against creditors holding claims payable in Argentina in connection with the dispute of any rights of such creditors on the foreign residents’ assets located in Argentina, or the annulment of any agreements executed by such creditors with the foreign resident. The commencement of an insolvency proceeding in a foreign jurisdiction constitutes grounds for the filing of a petition for the commencement of a full plenary liquidation case in Argentina in respect of debtor’s assets within Argentina; provided that the foreign insolvency proceeding commencement resolution must be first recognised by the Argentine courts through the exequatur proceedings.

The Bankruptcy Law includes three additional principles in cross-border insolvencies:

- The principle of preference for creditors participating in the Argentine liquidation process. Creditors participating in a foreign insolvency process will only have the right to get the turnover of the debtor’s remaining assets balance after all the claims of the creditors participating in the Argentine liquidation process have been fully satisfied.

- The principle of reciprocity. In which participation in an Argentine liquidation case of creditors holding claims payable outside of Argentina, and not participating in a foreign insolvency process, is conditioned on filing evidence that, reciprocally, creditors holding claims payable in Argentina are permitted to participate in an insolvency process commenced at the jurisdiction where such claims are payable in equal conditions with the domestic creditors of such jurisdiction. An exception is made for creditors holding claims secured by liens on property.
The principle of dividend parity. In which payments received by unsecured creditors in a foreign liquidation process will be computed on account of the general distribution available to such creditors under the Argentine liquidation process.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

Taxes on property and assets enjoy special preference and the principal amount of other taxes enjoys general preference. Therefore the amount of all such taxes is excluded from the unsecured reorganisation plans or out-of-court restructuring agreements, and cannot be crammed down. In addition, the tax authorities do not consent to any payment proposals. However, federal taxes (and other local taxes) are subject to a special payment plans regime for debtors under reorganisation proceedings.

Labour claims enjoy different treatment and benefits in insolvency proceedings. On commencement of a reorganisation proceeding, the court may authorise the immediate payment of labour claims based on indemnifications, penalties or severance payments, without the need to file proof of claims. The payment will be performed immediately if there are funds available or with an amount equal to up to three percent of the debtor’s net monthly income.

In liquidations, labour claims for six-months salary, severance payments and indemnification for health claims enjoy special preference in respect of the proceeds of inventory, raw materials and equipment located at the facilities where the employees rendered services, and general preference for all other assets of the estate. The priority extends to the principal and interests accrued during the last two years after the claim became due and payable. The general preference labour claims will enjoy priority on the amount equal to 50% of the proceeds of the estate property after payment of the claims with special preference and the administrative expenses. Distribution among the general preference labour claims will be made pro rata until their payment in full up to the maximum amount described above; and any unpaid remaining balance will be paid pari passu with the unsecured claims.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

In 2001, Argentina suffered the greatest economic crisis in history. As a consequence, the Argentine Congress passed a major change to the Bankruptcy Law, under which it now grants to already existing out-of-court restructuring agreements (approved by the required majorities and endorsed by the court) an effect on non-consenting unsecured creditors. In addition, the courts developed a new calculation for the required majorities to approve a reorganisation plan or an out-of-court restructuring agreement, excluding from the calculation the principal amount of all unsecured debt securities issued in series held by those holders that do not express their rejection of the plan or restructuring agreement.

A more recent amendment increased the rights of employees in insolvency proceedings through their inclusion in creditors’ committees, and allows employees’ cooperatives to participate in the competitive bidding process, and to set off their member’s labour claims against the purchase price for the acquisition of the debtor’s shares, business or assets.

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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

Part 5.1 of chapter 5 of the Corporations Act 2001 (Cth) contains provisions for compromises or arrangements between a company and its creditors or the company and its members. These are generally called schemes. The scheme approval process is controlled by the court that orders the holding of meetings of creditors, classes of creditors or members. The court must also approve the information to be sent to creditors in relation to the scheme. A liquidator can also promote a scheme.

Once a corporate entity is insolvent and in administration under part 5.3A of the Corporations Act, the mechanism for a corporate reorganisation is a deed of company arrangement (Doca). The entire administration and the entry into the Doca can be done without actually involving a court.

1.2 Is a stay on creditor enforcement action available?

If not in liquidation and a scheme has been proposed for a compromise or arrangement between the company and its creditors or any class of them, then an application can be made to the court for an injunction to restrain proceedings in any current action or other civil proceedings against the company except with leave of the court.

In administration there is an automatic stay on proceedings against the company in relation to its property, and in relation to proceedings against the company unless the administrator gives written consent or leave of court is obtained. The stay prevents third parties such as secured creditors and lessors of property used, occupied by or in the possession of the company from exercising their rights.

A secured creditor with a security interest in the whole or substantially the whole of the company’s property is not necessarily bound by the stay and can enforce its security in relation to all the secured property, or on or before the 13th business day after the administration begins or later if the administrator consents.

1.3 What are the key features of a reorganisation plan and how is it approved?

A scheme of arrangement or compromise can provide for a number of options. These include a payment that compromises creditors’ debts for less than 100 cents in the dollar, an assignment of creditor debt in return for a payment, a debt for equity swap limited to a certain class of creditor, such as a secured creditor, to ensure that the secured creditor can effectively take control of the shareholding of the company. In a corporate group scheme a court can order the transfer of assets and liabilities from entities within the group to a new entity or another entity in the group. Creditors owed debt by the subsidiary whose assets are transferred to the new holding company could be given a compromise sum or shares in the new holding company.

The required scheme vote involves majority creditors, whose debts or claims against the company aggregate to at least 75% of the total amount of the debts and claims of creditors, voting in favour of the scheme. Once that vote is obtained, final approval of the scheme depends on the court reviewing the meeting results and approving the scheme.

In administration, a Doca can be put forward by any person. The administrator can propose it as the most effective way of dealing with creditors’ claims which may be released or compromised under the terms of the Doca. A party interested in reviving or acquiring the company, such as the group’s major secured creditor looking to convert its debt to equity in a loan to own scenario will propose a Doca. Under a Doca, shares may only be transferred if the owners of the shares consent or the court provides leave. Shareholders often resist the transfer. The court may only give leave for the share transfer to occur if it is satisfied that the transfer would not unfairly prejudice the interests of members of the company. This is feasible if the shares would be worthless if liquidation occurred.

In administration, a resolution can be decided on the voices of creditors unless a poll is demanded. However if a poll is required, the resolution will only be carried if it is passed by a majority in number and the value of the debts owed to creditors who vote in favour is more than half of the total debts owing to creditors who vote. If a majority of creditors in number vote for it while the majority of creditors in value vote against it then the resolution is not carried. If that deadlock occurs, the person presiding at the meeting, generally the administrator, has a casting vote and can vote either for, or against, the resolution. In this case, the resolution will be carried or lost depending on which way the casting vote is exercised.

1.4 Can a creditor or a class of creditor be crammed-down?

In relation to a scheme of compromise or arrangement, its terms are binding on the creditors provided the necessary meetings are convened in compliance with the court order and the requisite majority vote is achieved. The vote requires the majority in number of creditors whose debts or claims amount in aggregate to at least 75% of the debts and claims of those voting at the meetings. The scheme will have the effect of cramming down the 25% minority who vote against it and any creditor that doesn’t vote.

A Doca, when passed by the required majority (in both number and value) will bind all creditors including those in the 49% minority in number and in value that voted against the deed. The Doca will also bind creditors that did not vote. A secured creditor cannot realise, enforce or deal with its security interest unless the Doca provides that the secured creditor is bound by it and in favour of the Doca. A secured creditor that votes against the Doca can still be ordered by the court to be bound by the Doca, on the basis that allowing the secured creditor to realise or
deal with its security interests would have a material adverse effect on the Doca if the court is satisfied that the secured creditor's interests will be adequately protected.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

Australia has no equivalent provision to section 363(k) of the US Bankruptcy Code, which permits a secured creditor to buy property sold during the bankruptcy by a credit bid that sees the secured debt offset against the purchase price of the property. There is no regular practice of credit bidding in Australia. Nor is there a legislative justification for a stalking horse bid, where a first bidder is identified as a possible buyer who can place a bid creating a floor for the price of the assets.

Statutory constraints on Australian insolvency practitioners engaged in the sale of assets during an insolvent administration must be complied with. For example, in a receivership, the receiver is obliged under section 420A of the Corporations Act to take reasonable care to sell the property for its market value, or if there is no market for the property, for the best price reasonably obtainable. The receiver will have to go through a proper sale process to achieve the sale at market value. Administrators are given the power to dispose of all or part of the company’s business and property. They are not bound by s 420A, but still have to act in accordance with their statutory duties of care, diligence and good faith. They are given broader scope in the exercise of their powers of sale than receivers. In Australia, it is difficult for receivers or administrators to engage in pre-packaged sales. There is no formal process or mechanism in Australia that enables the use of a pre-pack.

1.6 What are the duties of directors of a company in financial difficulty?

In Australia, one of the major drivers if the company is facing financial difficulty is the director's duty to prevent insolvent trading under section 588G of the Corporations Act. A breach of that duty can lead to a civil penalty of up to A$200,000 ($161,000) but also personal liability for the loss or damage suffered by the unsecured creditor as a result of the company’s insolvency for debt that was incurred at a time when the company was insolvent.

Under the Corporations Act and under the general law, when a company is approaching insolvency directors must, in their fiduciary position, take into account the interests of creditors. This is because their interests may be potentially adversely affected by the directors’ choices for the company.

1.7 What priority claims are there and is protection available for post petition credit?

Australia has statutory priorities that apply in liquidation that include the costs and expenses that an administrator has personal liability for. This includes money borrowed by the administrator together with interest and costs, as long as the secured creditor with a circulating security interest has consented to the administrator having priority over it.

The statutory priority takes priority over all unsecured creditors and ranks the administrator’s expenses and remuneration and those of the liquidator ahead of employee entitlements. Employee entitlements are also given priority over unsecured creditors. If there is a circulating security interest, the employees’ claims also have priority over the secured creditor.

1.8 Is there a different regime for banks and other financial institutions?

Under the Banking Act 1959 (Cth), Australian Prudential Regulation Authority (Apra) can appoint a statutory manager to a bank (Authorised Deposit Institution – ADI) who has the power to sell or dispose of the whole or any part of the ADI's business but also has the power to issue, cancel or reduce the company's share capital, cancel shares and vary or cancel rights attached to shares. If Apra has appointed a statutory manager, there is a stay in respect of beginning or continuing a court proceeding and creditors cannot apply to appoint an external administrator unless Apra approves the appointment.

If an ADI statutory manager is in control of the business and Apra considers that the company is insolvent, Apra can apply to the Federal Court for an order that an ADI be wound up. Once wound up the ADI will be liquidated in accordance with the Corporations Act 2001.

Under the Insurance Act 1973, Apra or a general insurer can apply to the Federal Court for an order that the general insurer be placed under judicial management. Judicial management brings with it a stay against proceedings, and has the power to recapitalise the company and to sell or dispose of all or any part of the property of the insurer or issue shares in the company.

In the winding up of an insurer, the insurer's assets in Australia must not be applied in discharge of its liabilities other than its liabilities in Australia unless it has no liabilities in Australia. That is not the case for a normal company being wound up under the Corporations Act.

Section 2 – INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

The winding up of a foreign company that is a part 5.7 body may be subject to winding up under the Corporations Act. A part 5.7 body is a registrable, foreign company and is either registered under division 2 of part 5B.2 of the Corporations Act or is not registered but carries on business in Australia. The Australian part 5.7 body can be wound up despite the fact that it is being wound up or has been dissolved, deregistered or ceased to exist under the laws of its place of incorporation. There is also the possibility that an Australian court can order the winding up of a foreign body corporate if approached with a request for assistance by a court from another jurisdiction.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

The Uncitral (United Nations Commission on International Trade Law) Model Law on Cross Border Insolvency is now part of Australian law in the Cross Border Insolvency Act 2008 (Cth) (CBIA). Under Australia’s CBIA, a foreign representative, as defined in article 2(d) of the Model Law as a person authorised in a foreign proceeding to administer the reorganisation or the liquidation of the debtor's assets or affairs or authorised to act as a representative of the foreign proceeding, can apply for recognition of the foreign proceeding in Australia and be granted relief under the Corporations Act in respect of a corporate entity or the Bankruptcy Act in the case of an individual.
For example, in Australia a US chapter 11 proceeding has been recognised as a foreign proceeding on at least a couple of occasions, one of which occurred in relation to a Australian-listed company, Buccaneer Energy, where the centre of main interests of the listed company was found to be the United States.

Section 3 – OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

If the company is indebted to the Australian Taxation Office (ATO) then there needs to be an agreement with the ATO about the outstanding debt. Failure to observe an arrangement with the ATO can lead to the ATO pressing for liquidation of the company.

Further, if the company goes into liquidation and subsequently into administration and the unpaid employees claims have been paid under the fair entitlements guarantee scheme by the government department involved. Once those payments are made, the government department has the same priority as a creditor in liquidation and administration as the employees would have had and will have a right to vote on what is proposed.

Section 4 – CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

Australia’s insolvency law does not readily facilitate reconstruction and turnarounds. If a formal step is taken into the insolvency process the business could be affected by *ipso facto* clauses in contracts that will be terminated as a result of the insolvency event, that will cause potential damage to the business and the value of its assets. Australia’s climate for troubled companies is influenced by secured creditors that, rather than enforcing securities, regularly allow the debtor time to achieve the sale, disposition or restructuring of its business or assets.

Australia is also facing a series of insolvency law reforms contained in the Insolvency Law Reform Bill 2014 that was introduced in November 2014. They are meant to increase efficiency and remove unnecessary costs in insolvency administration and to align and modernise some of the rules relating to both personal bankruptcy and corporate insolvency. The bill has not yet been passed in Parliament, but if passed in the second half of 2015 it will commence in February 2016. Under the Bill, there will be amendments to both the Corporations Act and the Bankruptcy Act. As yet there are no changes proposed to Australian insolvency laws to facilitate restructuring and turnarounds.

About the author

Ian Walker is one of Australia’s leading insolvency and reconstruction specialists. He has more than 25 years’ experience in security enforcement for all types of creditors, banking litigation, and insolvency, reconstruction and work-out issues, including drafting schemes of arrangement and deeds of company arrangement. His practice spans a wide range of industries and private and public sector clients, including those in the financial services industry.

Walker advises insolvency appointees including liquidators, receivers, administrators and deed administrators on creditors’ rights, their powers and duties, and on the full range of commercial and legal issues that insolvency practitioners may face during the course of an insolvency administration. He advises third parties affected by insolvency such as creditors and directors, such as advising company directors on governance issues when insolvency is imminent.
Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

The Brazilian Bankruptcy and Restructuring Law (BRL) establishes three major mechanisms that may apply to troubled companies: (i) judicial reorganisation proceedings; (ii) out-of-court reorganisation proceedings; and (iii) bankruptcy or forced liquidation. As one of its main features, the BRL offers the corporate debtor flexibility and continuity of management and an opportunity for rehabilitation.

The mechanisms of judicial reorganisation and out-of-court reorganisation, which replaced the old concordata (a court-relief system for debtors), are used when a particular business, although facing difficulties, is still viable and may overcome its financial crisis. In these situations, it is deemed that the preservation of going-concerns would ensure the survival of productive businesses and better serve the interests of employees, creditors, and society as a whole.

Bankruptcy or forced liquidation proceedings apply when a particular business is no longer viable. In this case, the debtor is removed from its activities and the existing assets are collected and sold. Any proceeds derived from the sale of assets are distributed among the creditors according to a preference order established by law.

Any debtor facing financial difficulties (insolvent or not) and meets certain conditions specified in the BRL not directly related to accounting tests (such as not have been in another judicial reorganisation proceeding for the past five years) may apply for judicial reorganisation proceedings. The request must be accompanied by several documents and information, including: explanations about the financial difficulties faced by the debtor, financial statements, a list of creditors and a list of employees.

Out-of-court reorganisation is simply a private arrangement between a debtor and some of its creditors. Any debtor that meets the same requirements for judicial reorganisation proceedings specified by law may propose and negotiate with its creditors an out-of-court reorganisation plan, and request its ratification.

Debtors that are facing a financial crisis and do not meet the conditions to benefit from judicial reorganisation or out-of-court reorganisation proceedings should request the declaration of their own bankruptcy. In addition, any creditor may request the forced liquidation of a debtor in certain circumstances.

In a judicial reorganisation proceeding, the court appoints a judicial administrator (trustee) in charge of supervising the company's activities and accomplishment of the reorganisation plan. The judicial administrator is named by the court, and the debtor and the creditors do not have any power to select it. The judicial administrator does not manage the company.

In the course of judicial reorganisation proceedings (the main mechanism used in Brazil) there should be no change in the management of the debtor company. Therefore, the managers of the debtor will retain their positions, although working under the supervision of the creditors committee (if any) and the judicial administrator appointed by the court.

In certain circumstances, however, managers will be removed from their positions, including when: (i) there are signs of bankruptcy crime; (ii) they have acted with willful misconduct or engaged in fraudulent schemes against creditors; (iii) they have made personal expenditures that are not compatible with their income; or (iv) their removal is specified in the reorganisation plan.

1.2 Is a stay on creditor enforcement action available?

In a judicial reorganisation proceeding, with respect to all credit subject to it, a suspension of 180 days will apply to all legal proceedings under way against the debtor. On the expiration of such term, all creditors will automatically regain the right to initiate or proceed with their lawsuits against the debtor. However, it is relatively common for courts to extend this period, on the grounds that the expiration of the stay would bring considerable challenges for the recovery of the company, thereby harming the group of creditors considered as a whole.

There are two exceptions to the 180-day suspension rule: lawsuits where there are no pre-defined amounts being claimed, and labour claims, which will continue their course in the Labour Courts until the amount of labour credits are defined. In these two cases, once such amounts are finally determined, they will be included as credits in the reorganisation proceedings.

1.3 What are the key features of a reorganisation plan and how is it approved?

In judicial reorganisation, the debtor should submit a reorganisation plan (or be declared bankrupt) within 60 days of the publication of the court order authorising the initiation of the proceeding. Debtors are not allowed to present a plan.

The plan must contain: (i) a detailed description of restructuring mechanisms to be used, which may include debt rescheduling, corporate reorganisation, transfer of corporate control, partial sale of assets, leasing of going-concerns, and a series of other measures; (ii) a demonstration of the economic feasibility of the debtor’s business; and (iii) a report on the debtor's assets prepared by an expert appraiser or company. The plan should provide that overdue labour credits and credits deriving from accidents at work will be paid in no more than one year.

Creditors will be informed about the reorganisation plan and the applicable term to challenge the plan through a public notice. If any objection
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to the proposed plan is submitted by any creditor, the court will call a general meeting of creditors (GM). In the meeting, creditors may: (i) approve the plan as originally proposed; (ii) approve a modified version of the plan, as long as there is no opposition from the debtor and no harm to absent creditors; or (iii) reject the plan, in which case the debtor should be declared bankrupt.

Any reorganisation plan must be approved by the following categories of creditors in a GM: labour creditors and creditors related to accidents at work; secured creditors; unsecured creditors, creditors with special or general preference, and subordinate creditors; and, small businesses.

In the first and last class of creditors (labour-related claims and small businesses), approval is achieved with the favourable vote of the majority of creditors present at the meeting, regardless of the amount of their credits. In the other two classes, approval is achieved with the favourable vote of both: creditors representing more than half of the credit amounts represented at the meeting; and, the majority of creditors present at the meeting.

If certain vote combinations specified in the BRL are recorded in the GM, the court may approve the reorganisation plan even if it was not approved under the quorum requirements (cram-down).

1.4 Can a creditor or a class of creditor be ‘crammed-down’?

Yes, a creditor or a class of creditor can be crammed-down. In a judicial reorganisation proceeding, for a reorganisation plan to be approved, it should be accepted by the four classes of creditors present at the GM: the majority of labour creditors; the majority of small business creditors; the majority of secured creditors and the majority of secured credits; the majority of unsecured creditors and the majority of unsecured credits.

However, if all requirements are not fulfilled, the BRL provides that the court may still ratify the reorganisation plan if, at the GM: (i) half the total amount of credits at the meeting approved the plan; and (ii) two classes of creditors approved the reorganisation plan or, if there are only two classes, at least one of them approved the plan; and (iii) in the classes of creditors that rejected the reorganisation plan, at least one-third of the creditors voted in favour of the reorganisation plan.

For out-of-court reorganisation, the plan must be ratified by a court in order to produce effects to all creditors contemplated in the plan, including those that have not expressly adhered to the plan.

In order to be ratified, the plan must have been approved by creditors representing more than three-fifths of credits in each category of creditors contemplated by the plan. This is considered a crucial provision of the reorganisation representing more than three-fifths of credits in each category of creditors.

Creditors that did not adhere to the plan may challenge the ratification. Nevertheless, any challenge may be based solely on an alleged illegality or a failure by the debtor to comply with all necessary legal requisites or formalities.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

According to the BRL, a reorganisation plan presented by a debtor company may provide for a judicial sale of branches or business units belonging to the debtor. A judicial sale, also according to the BRL, may: (i) take the form of an auction; (ii) be effected through proposals submitted in sealed envelopes; or (iii) be a combination of these two methods.

Once a judicial sale is effected in accordance with the BRL, the relevant branch or business unit will be free and clear of any liens and encumbrances, and the purchaser will not succeed the debtor with any indebtedness. As a consequence, creditors of a debtor that is subject to judicial reorganisation are not able to claim any amounts from the purchasers of branches or business units, and the corresponding assets cannot be enforced upon to satisfy the debt. Instead, creditors simply retain their original claims against the debtor.

There are no stalking-horse bids. However, an evaluation provides for a minimum value for the sale of an asset (first section) or, if the auction is not successful in the first section, the law forbids the sale to be performed at a token price.

1.6 What are the duties of directors of a company in financial difficulty?

In Brazil, directors and officers have no duties directly to creditors of the insolvent company or third parties. They have duties to shareholders of the company, even though the company is facing financial difficulties. Nevertheless, the actions of the directors and officers in relation to the company may be analysed if they harm other parties. Article 158 of Law 6,404/76 (the Brazilian Corporations Law) establishes that there are two basic hypotheses of civil liability of managers of corporations: for damages caused to the corporation by virtue of negligence or willful misconduct, even within their powers; and, for actions carried out beyond their authority, or contrary to the provisions of the law or the company’s by-laws.

Article 50 of Law 10,406/02 (the Brazilian Civil Code) provides for the disregard of the corporate veil in order to enable attachment of the manager’s assets in case of deviation of the company’s purposes or commingling between the company’s and the manager’s assets.

According to article 82 of the BRL, the liability of directors, officers or shareholders of a debtor company will be accurate in the Bankruptcy Court, not being relevant if the assets of the company are enough to pay the debts, and the investigated parties may have its assets frozen by the court until judgement of the case. Directors, officers and shareholders may also face criminal liability if their actions fall within the specific definition of a given crime established by Brazilian laws, including certain bankruptcy-related crimes (such as providing false information during reorganisation proceedings with the intention of misleading the court or creditors). These bankruptcy-related crimes are disposed between sections 168 and 178 of the BRL.

In the event there are signs of any act of fraud, wilful misconduct or negligence, which leads to civil liability or crime, such acts tend to be closely analysed and investigated to verify their nature and penalise the responsible parties.

1.7 What priority claims are there and is protection available for post-petition credit?

In principle, all credits existing at the date of the filing of the request for judicial reorganisation are submitted to the proceeding, even if it is not ma-
tured. Post-petition credits are not subject to the reorganisation proceeding. However, depending on their nature and characteristics, some other credits may not be submitted to the effects of the proceeding.

Tax credits are not affected by judicial reorganisation proceedings, and tax collection can continue their due course. The BRL indicates that a separate law will establish the conditions for the rescheduling of tax debts owed by debtors utilising judicial reorganisation proceedings.

Judicial reorganisation proceedings are also not applicable to: creditors secured by fiduciary transfers of assets; lessors; sellers in irrevocable real estate purchase agreements with installment payments; and sellers of goods with title retention. In all such situations, the creditor is the actual owner of the assets, even when the assets are being used by the debtor. Therefore, the original contractual arrangements and corresponding debts remain in place.

The only difference is that, for a period of 180 days from the initiation of judicial reorganisation proceedings, the sale or removal of assets that are essential to the activities carried out by the debtor is prohibited. In other words, the BRL obviously recognises that creditors remain entitled to their ownership rights, but at the same time, the debtor receives some breathing room, since essential assets will remain in the debtor’s possession for 180 days, even if there is a payment default.

Any amounts disbursed to the debtor under an advancement of foreign exchange agreement, as long as the applicable banking regulations pertaining to this type of advancement are observed, are also not affected by judicial reorganisation proceedings.

1.8 Is there a different regime for banks and other financial institutions?

As creditors, banks and other financial institutions have no specific or different regime, and their ranking or classification will depend on whether there is collateral or not, and if it is submitted or not to the effects the proceeding. As debtors, considering the large impact of the situation of financial institutions upon the national economy, there are several governmental strategies that might be taken in order to avoid and prevent the financial institution from a crisis and a future liquidation or bankruptcy proceeding. The insolvency proceeding (liquidation) of these institutions is regulated in the Federal Law 6.024/1974, that also provides the intervention of the government in the financial institution or bank.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

There is no specific provision in the BRL regarding the application of reorganisation proceedings to foreign companies. Recently, courts have discussed the inclusion of foreign companies in proceedings together with other companies from the same economic group (in which the holding company is Brazilian), with different understandings on the matter.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

The BRL does not contain any specific rule dealing with extraterritorial bankruptcy or insolvency proceedings, with no provision regarding the recognition of other countries’ statutory processes, unlike chapter 15 of the US Bankruptcy Code. Reorganisation and bankruptcy proceedings involving Brazilian companies must be necessarily administered by a Brazilian court. As a result, any effects and consequences of possible ancillary or parallel proceedings in foreign jurisdictions will have to be dealt with on a case-by-case basis, subject to applicable conflicts of law provisions in cross-border matters.

There are provisions in Brazil that allows recognition by the Superior Court of Justice of foreign decisions once legal requirements are fulfilled, but not recognition of the processes themselves.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

In the insolvency proceedings provided in the BRL, the government does not have a regulated active role. On the other hand, to enable a more active participation of the government in the insolvency of some entities, the BRL is only applicable to debtor companies who pursue economic activities, while some entities are prohibited from filing a request for bankruptcy in any situation. Government-controlled companies or public companies, clearing agents and companies that deal with financial liquidation are prohibited from going bankrupt under the BRL.

There are some entities that are only relatively excluded from the insolvency proceedings: insurance firms; companies that deal with health insurance; and, financial institutions. Broadly speaking, they must be liquidated out of court, but, if some special requirements are fulfilled, they can go bankrupt (forced liquidation).

Governmental or regulatory institutions may be requested to assist the court, depending on the activity developed by the debtor company.

Labour credits should be paid in within one year (term established by law) of the approval of the reorganisation plan or the definite recognition of the credit. In forced liquidation proceedings, labour credits are first in the ranking of credits submitted to it, up to the limit of 150 minimum wage salaries. Shareholders of the bankrupt company, as well as affiliates, controlled or controlling entities, may participate in the GM, but they are not allowed to vote.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

No important amendments in the BRL are currently envisaged, and so far, the volatility in the global market and rise in corporate restructurings has had no impact on Brazil’s insolvency regime. However, these events have had a significant impact on the analysis made by the courts when judging
appeals related to insolvency proceedings; they have been stricter and have been taking greater control over companies.

The BRL was recently amended in relation to small businesses (categorised as such under Brazilian law based on yearly revenues).

Considering that the existing BRL came into effect relatively recently, a solid track record has not yet been established in terms of successful or unsuccessful reorganisations. In terms of the proceeding itself, smaller companies tend to be more successful in reorganisations, since the smaller company structure and number (and size) of creditors tend to facilitate the process. However, for both small and large companies, the financial conditions in which the company entered the reorganisation proceedings will be the decisive factor for a possible recovery.

Recently, the Brazilian Investigation known as Operação Lava-Jato (Operation Car Wash) led to an economic crisis for construction companies and infrastructure sector companies involved in the investigation, with several of them requesting judicial reorganisation.

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**About the author**

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British Virgin Islands

Ben Mays, partner, and Sharon Mungall, associate, Carey Olsen

Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

The Insolvency Act 2003 (Act) and the Insolvency Rules 2005 set out the various insolvency proceedings available in the British Virgin Islands (BVI). Although included at Part III of the Act, the administration provisions are not yet in force. The BVI Business Companies Act (BC Act) includes provisions for reorganisation.

In insolvent liquidation a liquidator may be appointed: (i) by resolution of the members of the company approved by at least 75% of the members (or such higher threshold as required under the memorandum and articles of association of the company); or (ii) on application to the BVI High Court (Court) by the company, a creditor, member, a supervisor of a creditors’ arrangement of the company, the BVI Financial Services Commission (Commission) or the Attorney General. The Court may appoint a liquidator if: (i) the company is insolvent; (ii) the Court believes it is just and equitable to do so; or (iii) the Court believes that it is in the public interest to do so.

The directors and other officers of the company remain in office but cease to have any powers, other than those permitted under the Act. The liquidator’s principal duties are to collect in and liquidate the assets of the company in order to satisfy creditors’ claims.

In a company creditors’ arrangement, the directors (except when the company is in liquidation) may propose an arrangement and nominate an interim supervisor to act in relation to a proposed arrangement if: (i) they believe the company is, or likely to become, insolvent; (ii) they approve a written proposal; and (iii) nominate an insolvency practitioner as interim supervisor. Where a company is in liquidation, the liquidator may make the proposal.

The proposal needs to be approved by a 75% majority in value of the creditors, following which the supervisor is appointed. Where a proposal is approved, it is binding on the company, each creditor and each member. The supervisor takes possession of the assets of the company included in the arrangement; however, the directors or the liquidator remain in control of the company.

In a scheme of arrangement, where an arrangement is proposed between a company and its creditors or between the company and its members, the Court may, on the application of the company, a creditor, a member or a liquidator, convene a meeting of creditors or members. If a majority in numbers representing 75% in value of the creditors or members, present and voting at the meeting agrees to any arrangement, once sanctioned by the Court, it will be binding on all creditors or the members, as the case may be and the company. If the application is by a liquidator, it will be binding on the liquidator and on every person liable to contribute to the assets of the company in the event of its liquidation. There is no statutory requirement that the company be insolvent to propose or enter into the arrangement. Unless the company is in liquidation, the directors of the company remain in control of the company.

In a plan of arrangement a company may: amend its memorandum and articles of association; reorganise, merge or consolidate or separate its businesses; dispose of any assets, business, shares, debt or other securities; and, approve dissolution. If the directors believe it to be in the best interests of the company, the creditors or the members, the directors may approve a plan of arrangement (or a voluntary liquidator appointed under the BC Act may approve a plan of arrangement if in office). An application is then made to the Court to approve the arrangement. The Court may approve, amend or reject the proposed arrangement. Unless the company is in voluntary liquidation, the directors remain in control of the company.

In voluntary solvent liquidation, a solvent company can be liquidated under the BC Act. A declaration of solvency, a statement of the company’s assets and liabilities and a liquidation plan for the company are approved by the directors of the company. Resolutions of directors and members are passed to approve the liquidation plan and appointment of the liquidator. The directors remain in office but have only limited powers.

1.2 Is a stay on creditor enforcement action available?

In a post-petition stay, where a liquidation application is filed with the Court but not yet determined, a request for a stay of an action or proceeding may be made by a person with standing under section 170(2) of the Act where an action or proceeding is pending against the company in the BVI Courts. The stay may remain until liquidators are appointed or the liquidation application is dismissed or withdrawn.

From the commencement of a liquidation under the Act, unless the Court otherwise orders, no person may commence any proceedings or exercise any right or remedy in respect of the company or its assets. The stay on proceedings will remain in place until the conclusion of the liquidation.

The stay does not affect the right of a secured creditor to deal with assets over which that creditor has a security interest.

There is no stay on proceedings available for a company creditors’ arrangement, a scheme of arrangement (other than where carried out within an insolvent liquidation), a plan of arrangement or a voluntary solvent liquidation.

A company creditors’ arrangement will not, without the express written agreement of the secured creditors or preferential creditors of a company concerned affect their respective rights.

1.3 What are the key features of a reorganisation plan and how is it approved?

Please see question 1.1.
1.4 Can a creditor or a class of creditor be ‘crammed-down’?

In a company creditors’ arrangement, where a proposal is approved by creditors, the arrangement is binding on the company, each member and each creditor of the company as if they were a party to the arrangement.

In a scheme of arrangement, an arrangement pertaining to creditors is binding on all creditors or class of creditors, and on the company. If a company is in liquidation the arrangement will bind the liquidator and every person liable to contribute to the assets of the company on its liquidation.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

One of the liquidator’s principal duties is to take possession of, protect and realise the assets of the company. The liquidator has the power to dispose of the assets or business of the company.

There is no specific prohibition in the BVI on credit bidding or stalking-horse bids. On the basis that most BVI companies do not hold assets in the BVI, this will frequently be determined, at least in part, by onshore requirements.

1.6 What are the duties of directors of a company in financial difficulty?

Once a company is insolvent or of doubtful solvency, it is the duty of the directors to take into account the interest of the creditors. On the insolvent liquidation of a company, the directors are subject to potential liabilities under the Act for: fraudulent trading; insolvent trading; fraudulent conduct; or misfeasance or breach of fiduciary duties.

The insolvent trading section of the Act provides that if before a company is liquidated, a director knew or ought to have concluded there was no reasonable prospect that the company would avoid insolvent liquidation and he was a director at that time, then the liquidator may apply to the Court for an order against such person to make a contribution to the company’s assets. The Court will not make such an order, if on realising there was no prospect of the company avoiding insolvency, the director took every step reasonably available to minimise loss to the company’s creditors.

1.7 What priority claims are there and is protection available for post-petition credit?

In liquidation, assets are applied in the following order: (1) in paying the costs of the liquidator; (2) in paying the preferential claims admitted by the liquidator; (3) in paying all other claims admitted by the liquidator; and (4) in paying any interest payable under the Act. Any surplus assets are distributed to the members.

Preferential claims charged by the firms are limited in amount but include: (i) BVI government for taxes and other sums up to $50,000; (ii) the Commission for any unpaid fees up to $20,000; (iii) employees’ claims for wages for the six months prior to the liquidation (capped at $10,000); (iv) employers’ contributions to social security for six months prior to the liquidation and employees’ contributions deducted from the employee (no limit); and (v) pensions contributions for 12 months (capped at $5,000 per employee).

Post-petition credit may be provided to the company but is afforded no legislative protection and the directors potentially run the risk of being liable for insolvent or even fraudulent trading in obtaining such finance while the company is insolvent or of doubtful solvency. It is common for financing to be provided to fund the liquidator’s costs and expenses, with such financing being repaid as a priority as part of the costs of the liquidation if assets are recovered.

1.8 Is there a different regime for banks and other financial institutions?

There is no specific insolvency regime in the BVI for banks and other financial institutions. Part VII of the Act, sets out additional steps that apply to the liquidation of insurance companies.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

The Court may, on application by a company, creditor, member, the Commission or the Attorney General appoint a liquidator to a foreign company if the Court is satisfied that the company has a connection with the BVI and satisfies one of the conditions set out at section 163(1) of the Act.

A foreign company has a connection with BVI if: (i) it has assets in the BVI; (ii) has carried on business in the BVI; or (iii) there is a reasonable prospect that the appointment of a liquidator will benefit the creditors of the company. Members of a foreign company are unable to appoint a liquidator under the Act by resolution of members.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

Under Part XIX of the Act (orders in aid of foreign proceedings), a foreign representative from certain designated countries (Australia, Canada, Finland, Hong Kong, Japan, Jersey, New Zealand, the UK and the US) may apply to the Court for an order in aid of foreign proceedings. The Court has wide powers set out under section 467(3) of the Act. No such order will affect the right of a secured creditor to deal with the property of the company over which the creditor has a security interest.

In Re C (a bankrupt) BVIHC 0080/2013, the BVI Court permitted common law recognition of a foreign bankruptcy trustee for the first time in the BVI. However, the Court held that such recognition is limited to foreign representatives from countries designated under Part XIX of the Act. In Singularis Holdings v PricewaterhouseCoopers (2014), the Privy Council determined that there is a power under common law to assist a foreign insolvency practitioner in obtaining information, but that such power is limited to assistance available under the law by which the foreign office holder is appointed. This is significant for the BVI, as it may permit foreign office holders from a non-designated country to apply to the BVI Court to obtain information under common law (provided such relief is also available in the jurisdiction in which they are appointed).

Part XVIII of the Act, enacts the United Nations Commission on International Trade Law (Uncitral) Model Law on cross border insolvency. However, this part of the Act has not yet been brought into force.
Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

If a company is, or was at any time, regulated in the BVI, then the Commission will need to be notified of an appointment of an interim supervisor or supervisor. If the members of a regulated company seek to pass resolutions to liquidate the company, then they must give the Commission at least five business days’ notice before doing so, otherwise the resolutions are void and of no effect.

With regard to employees and pensions please see question 1.7.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

There has been a drop-off in the number of liquidation applications filed in the BVI Court in 2014 after a record number in 2013. However, there remains a steady flow of significant high-value liquidations.

Government and the financial services industry are in consultation about updating and improving the Act, with resulting amendments expected during 2015.

As described above, the Singularis decision may have an important impact on how cross-border insolvencies are treated in the BVI.

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Ben Mays is a partner and head of Carey Olsen’s British Virgin Islands litigation and dispute resolution group. His experience includes all aspects of international commercial litigation, with a particular specialism in cross-border corporate insolvency. Mays’ practice covers corporate and commercial disputes and related advisory work including shareholder disputes, fraud and asset-tracing, corporate investigations, professional negligence, contractual claims and regulatory advice. He advises on insolvent and solvent liquidations and represents liquidators, shareholders, creditors, debtors and directors. He also has significant expertise in company and debt restructurings and in the enforcement of security. His recent representative work includes acting for a variety of clients on many of the most significant recent insolvency matters in the BVI; acting for investors and professional service providers in the Fairfield and Kingate funds, representing the liquidators in the Titan Petrochemicals liquidation and advising the liquidators in the Suntech insolvency. Mays has also provided advisory services in numerous shareholder disputes, including unfair prejudice claims, alleged breaches of shareholder agreements, rectification actions, minority squeeze-outs and just and equitable winding-up applications as well as in fraud and conspiracy claims and regulatory, anti-corruption and money-laundering.

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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

The Chinese Enterprise Bankruptcy Law (Bankruptcy Law) sets out three types of bankruptcy proceedings for firms in financial trouble: liquidation, reorganisation, and reconciliation. The debtor or any of its creditors may file for liquidation or reorganisation when the debtor becomes insolvent. Reorganisation may also be commenced if the debtor is in imminent insolvency. Only the debtor itself may file for reconciliation. Reconciliation is a process whereby the debtor renegotiates the terms of its debt with the creditors to reach a reconciliation plan, which will be binding upon all creditors once approved by the creditors’ meeting and the court. Reconciliation cases are very rare in practice.

Once the proceeding is commenced, an administrator will be appointed by the court to control the process and administer the estate under the supervision of the creditors’ meeting and creditors’ committee. In reorganisation, the debtor may apply to the court for administering the estate on its own and keeping control of its business, and if the court approves, the administrator will only take a supervisory role.

1.2 Is a stay on creditor enforcement action available?

Once a court accepts the bankruptcy filing, a stay is available in four respects: (i) any preservation measure on the debtor’s assets should be lifted; (ii) any enforcement proceeding against the debtor should be suspended; (iii) pending litigation or arbitration involving the debtor should be suspended until the administrator takes over the estate; and (iv) any preferential payment to individual creditors should be null and void.

Payment of debt secured by the debtor’s own assets is carved out from item (iv) where the value of the collateral is no less than the secured claim.

In reorganisation, the secured creditor’s right to collect on the collateral is also suspended, provided that the creditor may apply to the court for lifting the suspension if there is a possibility that the value of the collateral may diminish substantially to their detriment.

1.3 What are the key features of a reorganisation plan and how is it approved?

The Bankruptcy Law requires that the debtor or the administrator (whoever administers the estate and manages the business) propose a reorganisation plan within a six-month period, which may be extended for three months for cause. The law is silent on whether and how creditors or third-party sponsors may directly propose a plan. In practice, potential sponsors usually choose to work with the debtor or administrator to formulate a desired plan and propose via the debtor or administrator.

Creditors are put into classes to vote on the plan. Usual classes include secured creditors, employee creditors, tax creditors, unsecured general creditors, and small-claim creditors (if necessary).

The plan must be approved by each class, and within each class approval is by half in number of the creditors present and by two-thirds in terms of value of the claims. The plan must also be approved by a shareholder class if their interests are affected.

1.4 Can a creditor or a class of creditor be ‘crammed-down’?

The court may approve a plan over one or more dissenting class if all the following conditions are met:

i) the secured creditor class has approved the plan; or the secured creditors are fully paid to the extent of the value of the collateral, reasonably compensated for the delay of payment caused by the proceeding, and their rights in the security are not materially impaired;

ii) the employee creditors and tax creditors are paid in full, or the voting class concerned has approved the plan;

iii) the unsecured general creditors are paid no less than what they would have received from bankruptcy liquidation at the time of approval of the plan, or their class has approved the plan;

iv) adjustment of equity interests in the debtor is fair and equitable, or the shareholder class has approved the plan;

v) members of each class receive equal treatment and rankings of the classes are in line with the statutory priority in bankruptcy liquidation; and

vi) the plan contains a feasible business operation proposal.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

As a matter of principle, sale of the estate should be done through auction unless otherwise decided by the creditors’ meeting. Credit bidding and stalking-horse bids are not expressly prohibited by law, but rare in practice. Sale of the estate as a going concern is permitted.

1.6 What are the duties of directors of a company in financial difficulty?

Under the Company Law, directors of a company have a duty of care and a fiduciary duty to the company and its shareholders. However, they are not explicitly compelled by law to file for bankruptcy when the company becomes insolvent. One exception is that the liquidation committee in charge of a company wind-down proceeding is required to file for bankruptcy if it finds out that the company is insolvent.
In bankruptcy proceedings, the directors have a duty to cooperate and may be held liable to the creditors if they are responsible for avoidable transactions or other misconducts committed by the debtor that have caused losses to the creditors.

1.7 What priority claims are there and is protection available for post-petition credit?

Secured creditors get paid first on the collaterals. Apart from secured claims, the following claims have higher ranks than unsecured general claims (listed in the order of priority): (1) administration expenses and debts beneficial to the estate (the latter including, among others, debts incurred for confirming executory contracts and maintaining the debtor’s business); (2) specified employee claims; and (3) specified social security obligations and tax claims.

Certain types of post-petition credit may be regarded as administration expenses or debts beneficial to the estate and enjoy a high priority. The law also permits the creation of security for loans undertaken during the reorganisation period for the purpose of maintaining the debtor’s business.

1.8 Is there a different regime for banks and other financial institutions?

The general rules of bankruptcy are applicable to banks and other financial institutions, but there are two important features of bankruptcy of financial institutions. First, regulators have the power to take control of distressed institutions under its watch and file for their bankruptcy liquidation or reorganisation; second, the central government is authorised to issue implementation measures in respect of bankruptcy of financial institutions.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

Under the Bankruptcy Law, the debtor’s domicile is the only one and universal test to determine bankruptcy territorial jurisdiction in all cases. The domicile of a company is the place of its principal office, which in practice is presumed to be its place of registration. So, on a broad reading of the term ‘place of principal office’, opening proceedings in respect of a foreign debtor is possible. In reality, however, a court’s presumption of treating the

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place of registration as the domicile leaves little room for proceedings in respect of a foreign debtor.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

Article 5 of the Bankruptcy Law lays down the general framework for the recognition and enforcement by Chinese courts of foreign bankruptcy judgments and decisions. Under Article 5, Chinese courts may recognise and enforce foreign bankruptcy judgments and decisions affecting a debtor’s assets within China on the following conditions: (i) the request for recognition and enforcement is based on a treaty or convention to which China is a party or the principle of reciprocity; (ii) granting recognition and enforcement will not violate the basic principles of Chinese law and nor will it be against China's national sovereignty, national security or public interest; and (iii) granting recognition and enforcement will not do prejudice to domestic creditors.

In a number of cases (including a recent one decided by the Supreme People’s Court), the courts have decided that a foreign debtor’s administrator or receiver appointed in an offshore proceeding has the power to act on behalf of the debtor in China (in court proceedings in particular). This applies to the extent as permitted by the laws governing the debtor’s legal capacity, and dispenses with the recognition procedure under Article 5 of the Bankruptcy Law.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

A number of other major stakeholders could have a material impact on the outcome of a reorganisation proceeding, including (i) governmental and regulatory agencies, whose officials may be appointed by court as members of the administrator in cases that may have great economic or social impact; (ii) banks, which in many cases are among the debtor’s biggest creditors; and (iii) counterparties to key business contracts, who have the right to demand adequate security from the administrator if it wants to confirm the executory contracts with such parties.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

The current Bankruptcy Law only came into effect in 2007, before which the Chinese bankruptcy regime mainly focused on state-owned firms. Market-oriented bankruptcy proceedings remain nascent for many stakeholders, especially those in the less-developed parts of the country. The stigma of going bankrupt persists in some regions. However, as understanding of the Bankruptcy Law grows and appreciation of its indispensability for a healthy market economy deepens, we begin to see an increasingly open stance by both government and the judiciary towards bankruptcy proceedings across the country. Some courts have even seen a rapid increase in bankruptcy filings in the past several years, partly thanks to the slowdown of China’s economic growth. In the coming years, we expect the number of bankruptcy filings in China to continue to grow and bankruptcy proceedings to become an increasingly common and useful tool for both market exits and industry consolidations in a wide range of sectors, not least because of the central government’s pronounced policy of transforming the country’s investment-dominated economy to a consumption-led one.
Denmark

Boris Frederiksen, partner, and Morten Planthin, partner, Lawfirm Poul Schmith/ Kammeradvokaten

Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

The Danish Bankruptcy Act provides for three different jurisdictional insolvency procedures: bankruptcy, restructuring and debt relief. Outside the three judicial insolvency procedures, a variety of non-judicial rescue and reorganisation arrangements can be completed with creditor consent.

The bankruptcy procedure is based on a bankruptcy order by the bankruptcy court. The order can be based on a petition by the debtor or a creditor. Both natural persons and legal persons may be taken under bankruptcy. It is necessary that the debtor is insolvent (as per the definition in the Danish Bankruptcy Act) meaning that the debtor is unable to pay his obligations as they fall due and that the inability to pay is not only of a temporary nature. The bankruptcy court will appoint a trustee who is authorised to act in all matters on behalf of the bankruptcy estate. The trustee’s primary assignment is to liquidate the debtor’s assets and to distribute the proceeds between the creditors under an order of distribution as described in the Danish Bankruptcy Act. During the bankruptcy procedure – which can take from a few months to several years depending on the complexity of the bankruptcy estate – creditors will not be able to enforce their claims against the bankruptcy estate’s assets. Creditors may file their claim with the trustee who will assess the validity of the claim. The trustee’s assessment of a claim may be brought before court by the creditor who has filed the claim or by other creditors in the bankruptcy estate. The final distribution of proceeds to creditors and the trustee’s fee for administrating the bankruptcy estate is subject to approval by the bankruptcy court.

The restructuring procedure is based on decision by the bankruptcy court. The purpose of the procedure is to examine the possibility of a compulsory composition or a business transfer. The restructuring procedure can be commenced with respect to both natural persons and legal persons. It can be based on a petition by the debtor or a creditor; however, a restructuring procedure which is based on a creditor’s petition (and not endorsed by the debtor) may only be commenced with respect to legal persons. A non-judicial restructuring plan may be agreed between the debtor and one or more of his creditors. A non-judicial restructuring plan may contain the terms of a compulsory composition or a transfer of the debtor’s business. The proposal is considered adopted unless a majority of the claims (as per the size of the claims) represented at the meeting in the bankruptcy court vote to reject the restructuring plan and this group of claims represent at least 25% of the total known debt. If the plan is adopted, the restructuring procedure will continue and the restructuring administrator will prepare a restructuring proposal in accordance with the overall terms of the restructuring plan. The proposal will contain the terms of a compulsory composition or a transfer of the debtor’s business. The proposal is subject to a creditors’ vote on a meeting in the bankruptcy court which – as a general rule – shall be held no later than six months after commencement of the restructuring. The proposal is considered adopted unless a majority of the claims (as per the size of the claims) represented at the voting meeting in the bankruptcy court vote to reject the proposal.

Further, non-judicial restructuring plans can be agreed between the debtor and one or more of his creditors. A non-judicial restructuring plan may – but does not necessarily have to – describe a plan to sell in whole or in part of the debtor’s assets and business activities, it may describe how the proceeds from the sale of certain assets are to be distributed between the creditors, and it may contain provisions concerning extension of payment obligations (moratorium), a partial debt relief, a stay of the participating creditors’ right to commence enforcement proceedings, financing of the non-judicial restructuring process, the participating creditor’s consent with respect to the debtor’s payment of minor creditor claims, subordination of certain debt and the establishment of security in certain assets concerning new debt of the debtor. In order for a non-judicial restructuring plan to
be successful, the debtor – or perhaps a steering committee acting as a link between the debtor and his creditors – should seek accession to the plan from all of his major creditors.

1.4 Can a creditor or a class of creditor be ‘crammed-down’?

In bankruptcy, secured creditors will receive the proceeds from the sale of secured assets. Unsecured debt will be covered in accordance with the order of distribution described in the Danish Bankruptcy Act. A natural person that has been under bankruptcy will still be liable for the debt that has not been covered from the proceeds of the bankruptcy. A legal person that has been under bankruptcy will cease to exist after the bankruptcy procedure has been completed.

In a judicial restructuring procedure, secured debt can be comprised by a compulsory composition as part of an adopted restructuring proposal, meaning that the part of the debt which is not covered by the value of the assets in which the creditor holds a security interest will be reduced on the same terms as other unsecured creditors of the same class. The Bankruptcy Court may, on the request of the debtor, fix the value of certain secured assets with binding effect for a creditor who holds a security interest in these assets. This means that the unsecured part of the creditors’ claim which will be subject to the compulsory composition can also be fixed.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

A judicial restructuring procedure allows for the possibility of a sale of the debtor’s assets or business as part of the restructuring proposal.

During the first six months of a bankruptcy procedure, a forced sale of pledged assets can only be completed on the request of or with the consent of the bankruptcy estate. This period allows for the trustee to examine whether it is possible to sell the debtors’ pledged assets in a free sale at a higher price than what is to be expected if the assets are sold in a forced sale.

1.6 What are the duties of directors of a company in financial difficulty?

A large number of Danish court cases have involved the question of whether the management of a company is liable to pay damages due to the management’s actions or failure to take action during a period of financial difficulties. Three themes have – in particular – been addressed in Danish case law. The management of a company in financial difficulty may become liable to pay damages: (i) if the management sells the company’s assets at far below-market prices; (ii) if the management is responsible for an uneven distribution of the company’s assets in favour of certain creditors and at the expense of others; and (iii) if the management have failed to discontinue the company’s operations after the point in time where management should have realised that there was no reasonable prospect that the company would be able to continue.

1.7 What priority claims are there and is protection available for post-petition credit?

The ranking of claims in bankruptcy under Danish law is as follows: (i) the costs of the bankruptcy proceedings and debt that has occurred after commencement of the bankruptcy procedure; (ii) reasonable costs relating to an attempt to restructure the debtor; other debt incurred by the debtor during a judicial restructuring procedure with consent from the restructur- ing administrator; and reasonable costs relating to a liquidation of a company prior to the bankruptcy; (iii) employee claims and related tax claims; (iv) certain supplier claims regarding charges claimed in respect to certain goods; (v) all other unsecured debt; and (vi) interest claims concerning non-preferential unsecured debt; and fines and penalties. Secured creditors will receive the proceeds from the sale of the assets comprised by their security interest (after payment of costs, a sales fee and an administration fee to the bankruptcy estate).

A bankruptcy estate may obtain a loan during the bankruptcy procedure. A claim concerning repayment of such a loan will be considered preferential debt which should be covered at the same level as other costs relating to the bankruptcy procedure.

1.8 Is there a different regime for banks and other financial institutions?

The Danish Financial Services Act and the Danish Act on Restructuring and Winding-Up of Certain Financial Institutions contain specific rules concerning the winding-up of and bankruptcy of financial institutions.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

A foreign debtor who resides in Denmark or who operates a business in Denmark can – as a general rule – be taken under bankruptcy in Denmark.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

Denmark is not bound by the EU Bankruptcy Regulation because of Denmark’s ‘opt out’ with respect to the area of justice and home affairs; and Denmark has not implemented the United Nations Commission on International Trade Law (Uncitral) Model Law on Cross-Border Insolvency. According to the Danish Bankruptcy Act, the Danish Ministry of Justice has authority to grant binding effect to foreign court decisions concerning bankruptcy, restructuring and similar judicial insolvency procedures. This authority has, however, not been utilised by the Ministry of Justice. This means that most foreign court decisions concerning bankruptcy, restructuring and similar judicial insolvency proceedings are not recognised in Denmark. Creditors may therefore enforce their claims against the debtor’s assets in Denmark even if the debtor is subject to judicial insolvency proceedings in another country.

Denmark has acceded to the Nordic Bankruptcy Convention, which means that a bankruptcy in Sweden, Norway, Finland or Iceland will also comprise the debtor’s assets and liabilities in Denmark.
Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

Major stakeholders in many insolvency procedures include the Danish tax authorities (due to the size of their claim) and the Danish employee’s guarantee fund (due to the fact that the fund will cover most employees’ claims against a bankruptcy estate and consequently take-over the employees’ claims against the bankruptcy estate).

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

On March 17 2015, five of the major Danish political parties entered into a political agreement whereby they agreed to seek converting the opt-out system for justice and home affairs matters into an opt-in system to allow Denmark to opt in with respect to certain EU legislation. The five political parties identified the EU Bankruptcy Regulation as one of the EU regulations that Denmark should seek to be bound by if the opt-in system becomes a reality. In order for the opt-in system to materialise, a referendum will have to be held, the date of which is yet to be fixed.

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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

Only one formal collective insolvency procedure exists under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (the Act): liquidation.

Liquidation is a terminal procedure typically resulting in the piecemeal sale of assets (rather than the business), distribution of the proceeds to creditors and dissolution of the company. It may be compulsory or voluntary. Voluntary liquidations can be either a members’ voluntary liquidation (MVL) or a creditors’ voluntary liquidation (CVL). In any form of liquidation, a court supervised liquidator is appointed and the directors lose control.

There is no formal rescue procedure available, although there are proposals to introduce legislation in the consultation and drafting phase. In the absence of a formal rescue procedure, the court appointment of a provisional liquidator, which displaces the company’s directors and brings about a statutory stay on proceedings, has been used in the past as a means to facilitate a corporate rescue. It is often coupled with a scheme of arrangement. However this is a somewhat limited rescue device as the court has made it clear that a provisional liquidator can only be appointed where the company’s assets are in jeopardy.

A compulsory liquidation is commenced by filing a winding-up petition at court. A creditor generally presents the petition. A petition is usually presented on the grounds of insolvency (which is tested on a current or near future inability to pay debts as they fall due or, on a longer-term basis, where the company’s liabilities exceed its assets).

MVLs and (subject to one limited exception) CVLs are commenced by shareholder resolution. MVLs are a solvent liquidation process - all creditors are to be paid in full and any surplus distributed to shareholders. CVLs are (generally) insolvent liquidations.

The Banking Ordinance and Insurance Ordinance contain special provisions in respect of authorised institutions and insurers respectively which supplement, modify or disapply general corporate insolvency laws.

A statutory scheme of arrangement may also be used to achieve a corporate rescue. The scheme is a creature of general company law rather than insolvency law (a state of insolvency is unnecessary to support a filing for a scheme), but it provides an important tool where there are minority dissenting creditors.

In the absence of a scheme, any restructuring will need to be achieved consensually, whether using the contractual powers under an intercreditor agreement to implement the solution or otherwise.

Receivership is a secured creditor’s enforcement remedy; it is not a collective insolvency procedure. A receiver is typically appointed out of court by the holder of the security under the contractual powers contained in the relevant security agreement. The receiver’s principal role is typically to sell the secured asset and account to the secured creditor for the proceeds.

1.2 Is a stay on creditor enforcement action available?

When a court makes a winding-up order or a provisional liquidator is appointed over the company, section 186 of the Act provides that no action or proceeding may be commenced or continued against the company, except by leave of the court. Leave will generally be refused if the issues in the action or proceeding can be dealt with more conveniently and with less expense and delay in the winding-up proceedings.

However, section 186 will not prevent a secured creditor enforcing its security through any out of court process. For example, by appointing a receiver under contractual powers within the relevant security agreement. Where a secured creditor’s security enforcement involves an action or proceeding, and is caught within section 186 of the Act, leave will usually be given.

No automatic procedural stay applies: (i) in the period between the presentation of a winding-up petition and the court making a winding-up order (except where a provisional liquidator has been appointed). The company, any creditor or contributory can however apply to the court to stay or restrain pending proceedings (but not the commencement of new proceedings) against the company; or (ii) in a voluntary winding up. However a liquidator, contributory or creditor may apply to the court for a stay on any action or proceeding.

In either case, a stay will not usually be granted where a secured creditor is seeking to enforce its security.

While a scheme of arrangement contains no moratorium preventing creditor action, the appointment of provisional liquidators allows the company to benefit from the automatic procedural stay on proceedings described above. The court may, in any event, be prepared to grant a temporary stay of creditor action where a scheme is being implemented and appears to have a reasonable chance of success with majority creditor support.

In an informal restructuring where provisional liquidators have not been appointed, there are no procedures applicable in respect of stays. However, for large financial restructurings, financial creditors tend to refrain voluntarily from bringing disruptive action or may agree to a temporary stay contractually to assist stability during the negotiation of a consensual deal.

The proposed provisional supervision rescue procedure is expected to include a moratorium on creditor action for a finite period during which the company and its creditors would need to negotiate and implement a proposal for restructuring.
1.3 What are the key features of a reorganisation plan and how is it approved?

A scheme of arrangement may be proposed by the company or any of its creditors with the company’s consent. For the most part, the terms of a scheme are not restricted by legislation and offer a lot of flexibility. For example, debt write-offs, debt for equity conversions and asset disposals are all possible. Further, a scheme may bind secured creditors without their individual consent. In a scheme, creditors are divided into classes. For each class, approval of the scheme requires a majority in number representing 75% in value of the creditors in that class present and voting at the relevant creditors’ meeting, either in person or by proxy, to vote in favour. The scheme will also need to be sanctioned by the court and a copy delivered to the registrar of companies before it becomes binding. The rules regarding identification of classes have evolved in the course of recent English court decisions and are likely to be highly persuasive in Hong Kong.

1.4 Can a creditor or a class of creditor be ‘crammed-down’?

A scheme of arrangement can bind dissenting or non-voting unsecured and secured creditors. While creditors within a class may be crammed-down in a scheme, it is not possible to cram-down an entire class, since each class must vote in favour of the scheme for the court to sanction it and for it to take effect against that class. If the relevant creditors’ meetings vote in favour of the scheme, the court will then need to decide whether to sanction it. In particular, the court needs to be satisfied that the relevant statutory requirements have been complied with, the classes of creditors were properly identified, each class was fairly represented by those attending the creditors’ meeting, the statutory majority was acting bona fide in the interests of the class and the approval of the scheme is reasonable.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

There is no specific legislation permitting pre-packaged sales. Pre-packaged sales by provisional liquidators have only been allowed in exceptional circumstances and there is no way in which the scheme timetable can be truncated. While there is no legislation which expressly permits credit-bidding or stalking-horse bids, they are generally permissible. The liquidators, provisional liquidators, receivers or directors as applicable have discretion to determine the way in which a sales process is conducted.

In a liquidation, a liquidator may sell, by auction, tender or private treaty, the whole or any part of the business or assets of the company without court approval and without sanction from the creditors’ committee of inspection. However the liquidator may seek court approval to ensure that their actions in dealing with the assets are not vulnerable to a subsequent claim that the transaction was invalid.

A provisional liquidator will need to apply to the court for permission to sell the company’s asset, if such power is not included in the appointing order.

A receiver appointed out of court by the holder of the security under the contractual powers contained in the relevant security agreement will derive his powers from that security agreement, and will typically include the power to sell the secured asset without court approval.

There is no legislation which permits liquidators, provisional liquidators or receivers to sell the company’s assets free and clear of existing claims.

1.6 What are the duties of directors of a company in financial difficulty?

Directors of a solvent company have a duty to act in the interests of the company and its shareholders. When the company nears insolvency, creditors’ interests intrude on this duty; the duties of the directors shift from advancing the interests of the shareholders as a whole towards protecting the interests of creditors as a class.

In addition, section 275(1) of the Act provides that the court has the power on the application of the liquidator or any creditor or contributory of the company to declare that any persons who were knowingly parties to carrying on the company’s business with an intent to defraud creditors will be personally responsible for all or any part of the company’s debts. Such civil liability only arises where the company has entered liquidation. There is a similar criminal offence under section 275(3) of the Act that applies whether or not the company has been, or is in the course of being, wound up. Successful actions under section 275 and their equivalents elsewhere are rare, due to the need to establish actual dishonesty or fraud.

This issue has been addressed in respect of directors in England following the introduction of a wrongful trading provision under section 214 of the Insolvency Act 1986 that imposes personal liability on directors without the need to prove fraud. Directors (including shadow directors) can be personally liable to contribute to an insolvent company’s assets if, before the commencement of the winding up, the director knew or ought to have concluded that there was no reasonable prospect that it would avoid going into insolvent liquidation, and, once aware (or deemed aware), the director failed to take every step with a view to minimising the potential loss to the company’s creditors which they ought to have taken. The government is looking at introducing similar legislation.

1.7 What priority claims are there and is protection available for post-petition credit?

(a) Liquidation

Where a company has entered liquidation, a secured creditor may elect to enforce their security, rather than leaving the liquidator to realise the secured asset. Regardless, secured creditors’ claims, in respect of the proceeds of realisation of assets secured in their favour, rank ahead of all other claims, save for: (i) costs of preserving and realising such assets; and (ii) preferential claims, when the proceeds of realisation of assets are subject to floating security (if the free assets are insufficient to pay those preferential claims). Any balance owed to secured creditors are unsecured claims and will be subject to the priority claims described below.

Preference claims primarily comprise certain amounts owed to employees and the government. There are additional categories of preferential claims in the winding up of banks and insurance companies.
For proceeds of realisation of unsecured assets, the payment order in a liquidation is as follows: (1) the liquidation’s costs and expenses; (2) preferential claims; and (3) unsecured claims (which rank pari passu).

All sums owed as a result of mutual dealings between each creditor and the company must be set-off; the creditor pays to or claims from the company only the net sum. Such set-off is wide-ranging, automatic, self-executing as at the commencement of the liquidation and cannot be excluded by contract.

For post-petition credit, a liquidator can raise money on the security of the company’s assets without court approval and without sanction from the committee of inspection. A provisional liquidator can raise funds on the security of the company’s assets if granted this power by the court. Such funds rank as an expense of the liquidation (unless raised by the provisional liquidator and his appointment is not followed by a liquidation; such funds would need to be repaid as a condition of his discharge from liability).

Within the category of expense claims, such new funding will be a super-priority expense claim, payable in priority to the liquidator’s remuneration. Unlike the US Bankruptcy Code, there is no legislation permitting the security granted in respect of such new money to have priority over existing security; any such priority would require the agreement of the relevant secured creditors.

(b) Receivership

Whether or not the company is in liquidation, where a receiver is appointed over assets secured by a floating charge, the proceeds of realisation of those assets will be used to satisfy the claims of the secured creditor in whose favour that asset is secured, which will rank ahead of all other claims, save for those described in 1.7(a) (i) and (ii). Any surplus is paid to the company.

1.8 Is there a different regime for banks and other financial institutions?

The Banking Ordinance gives the Hong Kong Monetary Authority (HKMA) the authority to exercise certain powers in relation to an authorised institution (AI) that is likely to be unable to meet its obligations, is insolvent or is about to suspend payments.

These powers include, following consultation with the Financial Secretary, the right to: (i) impose restrictions on such AI; (ii) appoint an adviser from whom the relevant AI will be required to seek advice on management of its affairs, business and property; and (iii) appoint a manager who will manage the affairs, business and property of the AI. Where the courts have granted an order for the winding-up of an AI, the right to appoint an adviser or manager cannot be exercised by the HKMA.

There have been consultations on establishing an effective resolution regime for financial institutions (FIs), including financial market infrastructures (FMIs). The proposed resolution regime seeks to bring Hong Kong in line with the Financial Stability Board’s Key Attributes of Effective Resolution Regimes for Financial Institutions, which put in place reforms so that future banking failures can be safely managed without recourse to public funds. The first consultation was released on 7 January 2014 by HKMA, the Securities and Futures Commission (SFC) and the Insurance Authority (IA). The second consultation was launched on 21 January 2015 and one more consultation is expected this year with the aim to introduce legislative proposals into the Legislative Council by the year-end.

The scope of the resolution regime should cover: (i) all AIs; (ii) licensed corporations designated as non-bank non-insurer global systemically important FIs; (iii) licensed corporations that are subsidiaries or branches of groups which are identified as being or containing global systemically important FIs; (iv) FMIs designated under the Clearing and Settlement Systems Ordinance or recognised as clearing houses under the Securities and Futures Ordinance; and (v) certain insurers.

A single resolution framework would be established for FIs in different sectors, with the HKMA, SFC and IA designated as the resolution authority for FIs operating under their respective purviews.

Section 2: INTERNATIONAL/CROSS-BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

The court has jurisdiction to wind up a foreign debtor as an unregistered company, based principally on a sufficient connection test.

Exercise of the winding-up jurisdiction remains discretionary. The same approach applies in respect of the court’s jurisdiction to appoint provisional liquidators to unregistered companies.

For a foreign debtor, the most common ground on which a petition is usually presented is insolvency.

There is no ability for an unregistered company to be wound up voluntarily under the Act.

The court has jurisdiction to sanction a scheme for any company liable to be wound up under the Act. While the Act specifies three grounds, including insolvency, on which a foreign company may be wound up, it seems unlikely based on the English position and obiter comments from Judge Lam in Re LDK Solar [2015] that the court would require these to be met. Nevertheless, it appears that the court will generally only exercise its discretion to take jurisdiction where there is a sufficient connection. While the court accepted that the sufficient connection test was met on the basis of a Hong Kong governing law provision in the relevant agreement, it remains to be seen whether it will follow the English court’s approach to the sufficient connection test, which has gradually weakened over time.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

There are no statutory provisions for the courts to provide assistance on cross-border insolvencies and Hong Kong is not party to the Uncitral Model Law on Cross-Border Insolvency.

The courts have an inherent power to recognise and grant assistance to foreign insolvency proceedings under the common law principle of modified universalism. In Joint Official Liquidators of A Co and B (2014), it was held that the courts have the power under common law to recognise and grant assistance to foreign insolvency proceedings, but only if a number of conditions are met, including that: (i) the law of the foreign insolvency proceedings is substantially similar to Hong Kong insolvency law; and (ii) the order sought is available under Hong Kong insolvency law. However, recent judicial authority has shown the common law power of assistance to be limited and any assistance provided must be available in the jurisdiction of the foreign insolvency proceedings. In a recent case, the court declined
Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

Employees, the government or regulatory bodies may have an impact on the outcome of a restructuring depending on the particular situation. For example, on a transfer of a business, the transferee may in certain circumstances become liable for employment claims of the transferor under the Transfer of Businesses (Protection of Creditors) Ordinance (TOBO).

TOBO is a piece of legislation that is perhaps unique to Hong Kong: its effect is, subject to certain exceptions and requirements, to make the transferee of a business liable for the debts of (including employment claims against) the transferor. TOBO will not apply where the business is sold by a court-appointed liquidator or by a receiver who is selling under a charge which has been registered for at least one year. However, no such exemptions apply for the sale of a business by a liquidator in a CVL or MVL.

Restructuring a listed company dependent on the listed status being retained will often depend on persuading the SFC that the company should be allowed to resume trading on the reorganisation’s completion.

There could also be sector-specific or political issues to consider.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

The Law Reform Commission first recommended that corporate rescue laws were needed back in 1996. The latest attempt to translate that recommendation into reality seems to be gathering momentum. In May 2014, the Financial Services and Treasury Bureau and the official receiver’s office jointly released a framework of proposals and quickly set up meetings with market participants to discuss outstanding issues. In its 2015 policy address, the Legislative Council Panel on Financial Affairs said that it hopes to introduce an amendment bill in this legislative session.

Under the proposals, companies in financial difficulty will be able to appoint provisional supervisors out of court. A mandatory stay on proceedings and other legal processes will immediately result, providing a window to facilitate the preparation of a voluntary arrangement (VA). The process is conditional on written consent from any major secured creditor. Employee rights are protected by the requirement that all pre-appointment employee claims should be paid in instalments within set periods after the process begins and a VA is approved.

Another impending legislative addition is the introduction of an insolvent trading law under which a director or shadow director may be ordered to pay compensation to a company in liquidation where the company incurred debt while insolvent (or which caused insolvency) and the director knew or ought reasonably to have known of the insolvent state or potential insolvent state. A defence will be that the director took all reasonable steps to prevent the company from incurring the relevant debt.

This law is intended to encourage directors to act on insolvency earlier and take steps to protect creditors’ interests. Both the provisional supervision and insolvent trading laws will be welcome tools with which to rescue distressed companies where possible and hold directors accountable. This aims to incentivise better behaviour in a market where companies have often been allowed to trade long past the point at which remedial action should have been taken.

About the author

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Kidd has acted on some of the world’s largest restructurings and insolvencies including GDE, Evergrande and Lehman in Asia and Dubai World/Nakheel in the Middle East. He has worked in all the significant Asian jurisdictions including China, Korea, Thailand, Philippines, Indonesia, Vietnam and India. His more recent restructuring work includes acting for the bondholders and provisional liquidators of China Sun, the payment-in-kind noteholders Asian Aluminium, the trustee and receivers of the Lehman minibonds, Suzlon on the restructuring of its foreign currency convertible bonds (the largest Indian bond restructuring to date) and Shandong Iron and Steel Group (China) on the protection of its $1.5 billion investment in a Sierra Leone iron ore project.
Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

Under the existing legal regime, the main procedures of reorganisation and rehabilitation for companies in financial difficulties include schemes for compromise, arrangements and reconstruction under the Companies Act 1956, or revival and rehabilitation under the Sick Industrial Companies (Special Provisions) Act 1985 (SICA).

There are also guidelines issued by the Reserve Bank of India (RBI) for restructuring of corporates facing distress. The corporate debt restructuring (CDR) mechanism was introduced in 2001, a voluntary, non-statutory system that allows a financially distressed company with two or more lenders and debts of more than Rs100 million ($1.6 million) to restructure its debts with the super-majority consent of its lenders.

1.2 Is a stay on creditor enforcement action available?

SICA envisages stay of coercive recovery proceedings including suits, without the express approval of BIFR or the Appellate Authority in terms of section 22(1) of SICA. The protection is automatically available to a sick company from the date of registration of its reference with the BIFR and continues till the continuation of implementation of the sanctioned scheme.

Sarfaesi (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Act 2002), RDDDB (Recovery of Debts Due to Banks and Financial Institutions Act 1993) and the SFC Act (State Financial Corporations Act 1951) empower the secured creditors to enforce their security interest in each process. However, in case of proceedings pending under SICA, coercive recovery proceedings – except through the mechanism of Sarfaesi – are not permitted without the express approval off the BIFR or AAIFR (Appellate Authority for Industrial and Financial Reconstruction) as per section 22(1) of SICA.

In cases where winding-up proceedings have been initiated, the pending suits, if any, are stayed under the terms of section 446 of the 1956 Act (section 279 of 2013 Act) and the only option available to the unsecured creditors is to file their claim before the liquidator.

1.3 What are the key features of a reorganisation plan and how is it approved?

Under SICA, the BIFR may appoint any one of the secured lenders or some independent bank or FI as the operating agency (OA) to formulate a scheme for the revival of the company. The reorganisation or rehabilitation plan under SICA may provide for: the financial reconstruction of the sick industrial company; or the proper management of the sick industrial company by change in or takeover of its management, its amalgamation with any other company, sale or lease of a part or whole of any of its industrial undertaking, the rationalisation of managerial personnel and workmen in accordance with law and such other preventive, ameliorative and remedial measures as may be appropriate. The said measures may also include: reduction in the interest or rights of the shareholders of the company; reduction of the debts of the company to a sustainable level and re-scheduling of the same to synchronise with the cash flow of the company; relief and concession from statutory creditors; reduction and payment of dues of unsecured creditors; lease of the industrial undertaking of the sick company to any person including a co-operative society formed by the employees of such undertaking; and, sale of the industrial undertaking of the sick industrial company, free from all encumbrances and all liabilities of the company or free from specified encumbrances and liabilities to any person, including a co-operative society formed by the employees of such undertaking.

The scheme prepared by the OA is examined by BIFR and, thereafter, a draft rehabilitation scheme (DRS) is formulated and published by BIFR to seek suggestions and objections from all concerned. The DRS is also required to be circulated to the central government, state government any schedule or other bank, a public FI or state-level institution, or any other institution or authority from which any financial assistance has been sought under the DRS, for their consent. In case the DRS has the consent of three-quarters or more of the secured creditors, in value terms, then upon sanction by the BIFR, the restructuring of debts in terms of the DRS becomes binding on all concerned. For the purpose of the consent of the said parties, a time period of 60 days is allowed which may further be extended by BIFR by another 60 days. BIFR may, after considering the objections and suggestions of the various parties, sanction the scheme for the revival of the company. The implementation of the sanctioned scheme is monitored by BIFR and a monitoring agency is appointed by BIFR for this. The sanctioned scheme may be modified by the BIFR, and the scheme sanctioned by the BIFR is binding on all the concerned parties. There is no requirement under the provisions of SICA to seek any specific consent from any of the unsecured creditors.

Chapter XIX of the 2013 Act provides for consent by 75% of the secured creditors and 25% of the unsecured creditors for sanctioning the scheme. Under the Companies Act 1956, in a compromise or arrangement between a company and its creditors or between a company and its members, the Company Court will order a meeting of the creditors (separate class for secured and unsecured) or members to be conducted in such manner as the court directs. If the scheme of compromise or arrangement is approved by creditors representing three-quarters in value of the creditors of each class and members of each class, and if the court deems fit, it will sanction the same which will be binding on all the creditors or members, and also on the company (or the liquidator and contributories of the company).
1.4 Can a creditor or a class of creditor be crammed-down?

In case of a scheme of arrangement (section 391-394 of the Companies Act 1956), minority creditors who have less than 25% exposure in the dues of the company can be crammed down and directed to fall in line with the majority of creditors.

In a restructuring scheme sanctioned by the BIFR under SICA, the minority secured lenders (banks and FIs) can be crammed down to accept the terms of restructuring agreed to by the secured lenders representing three-quarters or more of them in value terms. Although there is no specific provision dealing with the unsecured creditors for a scheme under SICA but in the interest of the revival of a sick company, the BIFR may reduce the interests of unsecured creditors. However, as per a recent judgment of the Delhi High Court (Continental Carbon India v Modi Rubber 2012) such unsecured creditors may not consent for such reduction in interest and may opt to stand outside of the scheme and seek recovery of their entire dues after the expiry of the scheme period.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

Credit bidding or stalking-horse bids are not allowed. For secured assets, where the lenders have a security interest, they can enforce the sale of the secured assets under the provisions of the Sarfaesi Act 2002, without the intervention of the court. If the company is being wound up, the secured creditors can choose to stand out of the proceedings and the amount realised through the sale of the secured assets will be appropriated in accordance with the provisions of the Companies Act. Under the SICA provisions, the sale of assets can only happen in a transparent manner through an asset sale committee constituted under the aegis of the BIFR, as is envisaged in a scheme to be sanctioned by the BIFR.

1.6 What are the duties of directors of a company in financial difficulty?

SICA requires that, if a company becomes a potentially sick industrial company, its board of directors should declare this (with reasons) to the shareholders by convening a meeting, and to the BIFR by filing a report.

SICA further requires that if a company becomes a sick industrial company, it should file a mandatory reference with BIFR within 60 days of the date of finalisation of the accounts for the relevant period, seeking adoption of necessary remedial measures for its revival. In case of non-compliance, the directors of the company are liable for strict penal action.

In a voluntary winding up of the company, the directors of the company are required to make a declaration verified by an affidavit to the effect that they have made full inquiry into the affairs of the company and to the insolvency of the company.

The directors are further required to give a notice of the appointment of the liquidator of the company at its general meeting to the registrar of companies. The directors of the company will cease to exercise all powers of the board, and the managing directors and other full-time directors will cease to exercise their powers for winding up the company. In a creditors’ voluntary winding up, the directors must convene the meeting of the creditors of the company, where they must present a statement of the position of the company’s affairs together with a list of the estimated amount of each creditor’s claim.

In the winding up by court the directors have a duty to defend the company in the winding-up petition filed by the creditor. The directors will also file a statement on the state of affairs of the company, upon appointment of an official liquidator.

Directors must act honestly, without any negligence and in good faith in the bona fide best interest of the company, or they may be made liable for breach of trust and be required to compensate the company for losses or damages.

As per section 542 of the Companies Act 1956, if in the course of the winding up of a company, it appears that the business of the company has been carried on with intent to defraud creditors of the company or any other persons, the court may direct that the person responsible will be personally liable without any limitation of liability for all or any of the debts or other liabilities of the company as the court may direct.

1.7 What priority claims are there and is protection available for post-petition credit?

In winding up, the claims of various stakeholders will be settled in order of priority as provided in sections 529A, 530 of the 1956 Act (sections 326 and 327 of the 2013 Act). The dues of the secured creditors and workers’ dues have a priority, on pari-passu basis, followed by crown debts and other dues (even if creditors have enforced their security interest under the applicable statutes such as Sarafesi, RDDB, and the State Financial Act). As per some state enactments, some of the statutory dues (such as VAT) have overriding first charge over the assets of a company, the workers’ liabilities and the crown debts, and need to be appropriately dealt with prior to the appropriation of any amounts by the secured creditors. In proceedings pending under SICA, the statute does not provide any priority per se; however, the consent of secured creditors, statutory authorities, for example, who are section 19(1) parties, are specifically sought.

In winding up petitions, there is a stay on all pending suits and under the SICA provisions. Protection under section 22(1) of the Act is available against coercive recovery measures for all dues outstanding by the cut-off date (as may be determined by the BIFR under the sanctioned scheme for restructuring and reconstruction) until the continuation of the implementation period of the sanctioned scheme. Schemes sanctioned by the BIFR invariably provide that dues after the cut-off date should not have protection against recovery proceedings. The High Court of Judicature at Allahabad has, in the matter of Modi Spinning and Weaving Mills, held that an electricity supplier is entitled to disconnect the power (even during the period in which protection is available) if the sick company does not pay for the electricity being supplied to it, after the date of registration of reference of the company with the BIFR.

1.8 Is there a different regime for banks and other financial institutions?

The Banking Regulation Act 1949 applies to the reorganisation of banks. The RBI has discretionary powers to approve the voluntary amalgamation of two banking companies under the provisions of section 44A of the Banking Regulation Act 1949. Large cooperative banks with paid-up share capital and reserves of Rs100,000 ($1,570) were brought under the purview of the Banking Regulation Act 1949 with effect from March 1 1966 and within the ambit of the RBI’s supervision.
Section 44A of the Banking Regulation Act 1949 requires that the draft scheme of amalgamation be approved by the shareholders of each banking company through a resolution passed by a majority in number representing two-thirds in value of the shareholders, present in person or by proxy at a meeting called for the purpose. Before convening this meeting, the draft scheme of amalgamation needs to be approved individually by the boards of directors of the two banking companies. Section 44A of the Banking Regulation Act 1949 also requires that after the scheme of amalgamation is approved by the shareholders, it should be submitted to the RBI for sanction.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

Indian insolvency laws do not have any extra territorial jurisdiction, and as such the provisions of SICA are not applicable to a foreign debtor. However, a company incorporated in a foreign country may be wound up as an unregistered company as per the provisions of sections 583 and 584 of the 1956 Act (sections 375 and 376 of the 2013 Act) if it has office and assets in India. The pendency of a foreign liquidation does not affect the jurisdiction to make winding up orders. The winding up procedure as laid down in sections 426 to 483 and 528 to 559 of the Companies Act (chapters XX and XXI of the 2013 Act) has to be followed in respect of the assets of the company.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

A judgment or proceeding in a foreign court can be recognised in India under sections 13 and 44-A of the Civil Procedure Code. India has neither adopted UNCITRAL (United Nations Commission on International Trade Law) Model Law, nor do EC regulations apply to it. As per the provisions of the Companies Act 1956, Indian courts exercise jurisdiction over the winding-up proceedings in spite of the fact that that the place of main activities of the particular companies may be outside Indian boundaries. Foreign entities with dues recoverable from the said companies may, however, approach the Indian court conducting the winding up, to lodge their claims over the estate of the company being wound up.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

In the event of winding up, claims of various stakeholders will be settled in order of priority as provided in sections 529A, 530 of the 1956 Act (sections 326 and 327 of the 2013 Act). The workers’ dues, which include salary, wages, accrued holiday remuneration, pension, gratuity or any other workmen welfare fund, are a priority and they rank pari-passu with the dues of the secured lenders of the company. In proceedings pending under SICA, the statute does not provide any priority per se. However, the consent of secured creditors and statutory authorities are specifically sought. The workers’ dues and statutory dues can be restructured only with the consent of the workers or the concerned statutory authority.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

In the recent budget speech, the finance minister suggested setting up a Model Bankruptcy Code to deal with the issues of restructuring and reorganising sick companies. The Bankruptcy Law Reform Committee (BLRC) set-up by the Government of India for submitting a report on the corporate bankruptcy legal framework in India has vide its interim report (February 2015) made a large number of recommendations for reforming the existing regime. The recommendations include initiating rescue proceedings based on inability to pay criteria; allowing creditors representing 25% of the debt of all unsecured creditors to initiate rescue proceedings; specifying the grounds on which a moratorium may be withdrawn; reducing time lines; allowing secured creditors to appoint company administrators directly; specifying the grounds on which the NCLT may direct a company administrator to take over the management or assets of the sick company; and, granting of super-priority status to rescue financing.

It is expected that the Government of India will, based on these recommendations, prepare a bill to be introduced in parliament for amending the existing provisions under the Companies Act 2013 for the rescue of distressed companies.

Overall, the legal framework in India, with respect to insolvency and reorganisation of financially distressed companies, is under transition. Efforts are being made to align them with best international practices.
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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

There are a number of principal corporate insolvency and reorganisation proceedings available under Irish law.

Liquidation
Liquidation or winding-up is the formal procedure for the dissolution of companies under Irish law and is available in both cases of solvency and insolvency. It involves the appointment of a liquidator whose function is to take control of all the property vested in the company, to realise the assets and if possible to pay the creditors. In fulfilling these obligations the liquidator is subject to a varying degree of supervision by the court, creditors, shareholders and the director of corporate enforcement depending on the type of liquidation. At the end of the liquidation process, the company is dissolved.

There are three different types of liquidation under Irish law: compulsory liquidation by the court, which is typically commenced by a creditor of an insolvent company by way of a petition to the High Court; creditors’ voluntary liquidation, which is started by shareholders’ resolution where the directors of the company have decided that the company cannot, by reason of its liabilities, continue to trade; and members’ voluntary liquidation, which is a winding up by a liquidator initiated by the members of a company where the directors believe the company to be solvent. If the liquidator forms the view that the company is in fact insolvent during a members’ voluntary liquidation process, the process will convert into a creditors’ voluntary liquidation.

Examinership
Examinership is a court protection procedure available to companies with their centre of main interests (Comi) in Ireland that are insolvent or likely to become insolvent on a cash-flow or balance sheet basis. It is considered to be a highly effective restructuring process for trading companies that have accumulated excessive liabilities and where the restructuring of those liabilities would allow a viable business to survive. It involves the appointment of an independent accountant as examiner of the company for the purpose of formulating proposals for a compromise or scheme of arrangement between the company and its members or creditors. The examiner has no executive role and the company’s directors and management will remain in control of the company and of its day to day operations during the protection period. The process is overseen by a judge of the High Court and is designed to ensure that all key stakeholders are treated fairly and in accordance with their respective rights under Irish law.

A petition for the appointment of an examiner can be brought by the insolvent company itself, by its directors, by any creditor or by certain shareholders where no members’ resolution subsists, or order has been made, for the winding-up of the company or where a receiver has not been appointed over the assets of the company for more than three days.

Receivership
Receivership is a method of enforcing security. In general terms a receiver is appointed pursuant to a debenture/charge under which the secured creditor is entitled to appoint its own receiver for the purposes of realising the assets secured by the debenture where the company has defaulted in the repayments of the loan secured. A receiver can be appointed only over assets which have been charged. The appointment of the receiver does not change the status of the company and although the directors cease to control the charged assets, their normal powers and duties continue in respect of the other assets and liabilities of the company. The receiver’s principal task is to realise the secured assets to discharge the debt owed to the secured creditor.

Schemes of arrangement
Schemes of arrangement under chapter one, part nine of the Companies Act, 2014 allow a company to formulate proposals to compromise the rights of either members or creditors or any class of them including for the purposes of the reconstruction of any company or the amalgamation of any two or more companies and to petition the High Court for an order approving any such scheme of arrangement. Under the legislation the directors of the company may convene the meeting of creditors or shareholders to approve the proposed scheme. If the directors fail to convene a meeting where a scheme is proposed, then the High Court may do so on application of the company, or a creditor or member, or a liquidator. The High Court may and sanction a scheme where a majority representing 75% in value of each class of creditors approve of the scheme. Such a scheme would be binding even on dissenting, absent or untraceable creditors. Schemes of arrangement are rarely used in insolvency scenarios because the threshold that must be met for the scheme to be binding on dissenting creditors is higher than what is required in an examination.

1.2 Is a stay on creditor enforcement action available?

Examinership
From the date of presentation of the petition, the company is effectively protected from specified actions which may be taken by its creditors including the commencement of winding-up proceedings, the appointment of a receiver, the attachment of assets, the repossession of goods under hire purchase or retention of title arrangements and generally any action to realise security except where the consent of the examiner is obtained. No proceedings may be instituted against the company without leave of the court. The examiner may also apply to court for an order staying any existing proceedings.

The moratorium is ineffective in relation to rights in rem by way of security in assets outside of Ireland. Creditors are able to exercise set-off rights during the moratorium period. This has an effect on a company’s proposed funding during the protection period as its ability to use cash in its bank accounts is effectively removed where there is a net debit balance after the exercise of set-off.
The initial period of court protection is 35 days, which can be extended by the court for further periods of 35 days and 30 days - up to day 100. That enables the examiner to formulate his proposals for a scheme of arrangement and present them to the court. The examiner must present a report to the court, with a scheme of arrangement that has been approved by one class of impaired creditors, by the end of day 100, otherwise the period of court protection will expire. However, the court may extend the period of court protection beyond day 100 if it considers it necessary to enable it to make a decision on the examiner's proposals. If the examiner cannot find new investment or otherwise bring forward proposals for a scheme of arrangement, he is under a duty to apply to court to have the court's protection lifted and the company will then either go into receivership or liquidation.

### Scheme of arrangement

There is no automatic moratorium where a scheme is being convened under chapter one, part nine of the Companies Act, 2014. However, the court is empowered to stay all proceedings and restrain further proceedings against a company for such period as it sees fit. The application for a stay on proceedings can be made by the company itself, the directors of the company, any creditor or member of the company and in the case of a company being wound up, the liquidator.

#### 1.3 What are the key features of a reorganisation plan and how is it approved?

In an examinership, the scheme of arrangement is formulated following discussions with potential investors and will normally include new investment, a write-down of creditors' claims or a transfer of the entire issued share capital to the new investor. Once the scheme is prepared, the examiner convenes meetings of shareholders and each different class of creditors. The examiner will generally class creditors by reference to their priority for payment in a winding-up. The proposals are deemed to be accepted by a class of creditors if passed by a simple majority in value and number of that class of creditors.

#### 1.4 Can a creditor or class of creditor be “crammed down”?

**Examinership**

The court can cram down or render the scheme binding on the company, its members and creditors if at least one class of creditors whose rights are adversely affected has voted in favour of the scheme. Any creditor or shareholder whose rights would be affected by the scheme may make representations at the confirmation or approval hearing. The Court cannot confirm a scheme of arrangement unless it is satisfied that it not unfairly prejudicial to any interested party. While there is no statutory definition of unfairly prejudicial, it is generally regarded as meaning that the interested party would receive less from the scheme that he would on a liquidation or enforcement of security.

In the case of a secured creditor it is open to the examiner to place a value on the secured asset and for the scheme of arrangement to cram down the debt due to the secured creditor to just above the value of the secured asset. In such circumstances as the secured creditor is to receive more than it would on a receivership or liquidation, it is unlikely that a court would take the view that the secured creditor was being unfairly prejudiced.

The examiner can apply to court to seek approval for the sale of assets that are subject to a fixed charge. Where granting such an order, the court must be satisfied that such disposal is likely to facilitate the survival of the whole or any part of the company as a going concern. In the event of any such disposal, the company must apply the net proceeds of sale to discharge the debt to the chargeholder. The court can determine the open market value of the assets sold and oblige the company to make good any difference between the proceeds and that value. Again the examiner’s fees, costs and expenses would be payable in priority to any sum due in respect of the charged assets sold.

**Scheme of arrangement**

In a traditional scheme of arrangement, if a majority in number representing three-fourths in value of the creditors or class of creditors or members or class of members present and voting at the meeting, vote in favour of a resolution agreeing to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the court, be binding on all the creditors or the class of creditors, or on the members or class of members. It will also on the company or, in the case of a company in the course of being wound up, on the liquidator and contributories of the company.

#### 1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

There is no specific process matching this description but loan-to-own strategies are increasingly appearing in the Irish market. This involves an investor acquiring a company's secured distressed debt with a view to converting that debt into an equity stake, which can often involve taking control of the borrower. The conversion into equity can take place by corporate restructuring or through an insolvency procedure such as receivership, pre-pack receivership or even examinership.

When there is a pre-pack sale to a company’s secured creditor, a SPV ultimately owned by the company’s existing secured creditors is used to acquire the company’s business. A receiver is first appointed by the secured creditor who then sells the business to the SPV. Often these are cashless transactions where the SPV agrees to assume certain of the company’s liabilities in return for the transfer of the business. This is then distributed to the lender facilitate a conversion of part of the assumed debt into equity. The balance of the transferred debt that is not converted is rescheduled and reconfigured.

#### 1.6 What are the duties of directors of a company in financial difficulty?

The guiding principle for the directors of a company which is or is likely to become insolvent, is that to avoid the potential of being made personally liable for the debts of the company or be subject to criminal sanction, they should ensure that no further credit is incurred by the company except in circumstances where the directors have an honest belief based on reasonable grounds that the credit to be incurred together with the credit already extended to the company will be repaid. It is permissible for the directors of a company to incur further credit if they honestly believe that by doing so the company will be in receipt of further monies and will allow time for negotiations with counter-parties to be successfully concluded (and assuming that this is a reasonable belief in the light of all of the circumstances).

The duty owed in circumstances where the company is insolvent is principally to have due regard to the interests of the creditors. From the moment of insolvency the directors hold the assets of the company in trust for the benefit of the creditors.
Seeking professional advice, retaining good records of decisions taken and keeping proper books of account are all demonstrable evidence of the directors seeking to act responsibly and should mitigate against the risk of personal liability on the directors should the company subsequently be wound up.

1.7 What priority claims are there and is protection available for post-petition credit?

Funds are distributed in the following order upon a company’s insolvency:

(a) Fees, costs and expenses of an examiner;

(b) Mortgage or fixed charge holders (paid up to the amount realised from the assets covered by the security);

(c) Amounts certified by an examiner under section 529 of the Companies Acts 2014;

(d) Costs and expenses of the winding-up which are subject to their own rules in relation to priority;

(e) Certain social insurance deductions;

(f) Preferential debts (rates, taxes, wages and salaries);

(g) Floating charge holders;

(h) Unsecured debts ranking equally with each other;

(i) Return of capital to shareholders.

1.8 Is there a different regime for banks and other financial institutions?

There is a legislative framework which empowers the Central Bank of Ireland to use a variety of mechanisms to address and resolve financial institutions that find themselves in distress. Where certain pre-conditions are met, this triggers the Central Bank’s resolution powers.

The central bank is able to propose an order for the transfer of all or any specified part of the assets or liabilities of an authorised credit institution or propose an order for the appointment of a special manager to an authorised credit institution. It can also establish bridge banks to hold assets or liabilities transferred pursuant to a transfer order or present a petition to the High Court for the winding up of a credit institution, and direct that an authorised credit institution prepare and implement a recovery plan, and empowers the central bank to prepare a resolution plan for the institution.

The governing legislation also establishes a Credit Institutions Resolution Fund to provide a source of funding for the resolution of financial instability in, or an imminent serious threat to the financial stability of, an authorised credit institution.

The Single Resolution Mechanism, which is due to take effect from January 1 2016, will apply to the large credit institutions. Insurance undertakings can also be placed in administration under the Insurance No. 2 Act 1983. This is similar to the liquidation process discussed above.

Section 2: INTERNATIONAL / CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

European Commission Regulation 1346/2000 on insolvency proceedings (Insolvency Regulation) forms part of Irish law. Insolvency proceedings can only be commenced in the member state in which the company has its centre of main interests. Non-EU companies can be liquidated in Ireland if there is sufficient connection to Ireland, e.g. it carries on trade within the jurisdiction.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

If a judgment specific to insolvency proceedings, such as the opening of insolvency proceedings, is obtained in an EU member state other than Denmark, Ireland must recognise and give effect to that judgment with no further formalities. A foreign judgment is recognised in Ireland with no further formalities if two conditions are met. First the judgment must have been handed down by a court whose judgment relating to the opening of insolvency proceedings is recognised under the Insolvency Regulation and it must concern the course or closure of insolvency proceedings and compositions approved by that court.

For other foreign proceedings recognition is possible on the basis of principles of judicial comity.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation? Are there special protections for employees?

Where a company’s assets are unable to satisfy certain basic redundancy and other entitlements owing to employees, it is normally possible in Ireland for a claim to be paid by the Irish State from the Social Insurance Fund or the Insolvency Payments Scheme. The scheme then subrogates to the employees position as creditor.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

The sale of Irish pillar bank loan books of distressed debt to private equity houses is a growing trend which has resulted in high levels of activity for Irish corporate insolvency and restructuring. Loan book sales have resulted in markedly high levels of subsequent enforcement and also consensual restructuring. It has also meant that mechanisms such as pre-pack receiverships and loan-to-own structures, heretofore relatively novel on the Irish market, are being employed with increasing frequency.
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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

Italian bankruptcy law provides that businesses in distress or that are insolvent can make use of: judicial insolvency processes whose principal purpose is the liquidation of the company’s assets, such as winding-up and liquidation, and non-judicial rescue arrangements whose purpose is instead to restore financial stability to the business via a reorganisation with creditor assent, such as a certified rescue plan and debt restructuring agreement.

Two further judicial procedures exist under the Italian restructuring and insolvency regime: (i) the settlement with creditors procedure, a pre-bankruptcy arrangement with creditors that, although a judicial procedure, requires creditor consent to the borrower’s proposal; and (ii) the so-called extraordinary administration for large insolvent companies, which applies to companies exceeding certain indebtedness thresholds and with more than a certain number of employees. The purpose of the latter is the preservation of the asset base of the business with a view to financial and economic recovery.

Italian law safeguards the borrower during the insolvency process by providing that: payments effected or acts undertaken by it in pursuance of a certified rescue plan, debt restructuring agreement or settlement with creditors cannot constitute certain offences under Italian bankruptcy law; and such payments and acts are not subject to clawback or being set aside.

The settlement with creditors procedure is a judicial process which allows a borrower to restructure its debts subject to reaching an agreement with its creditors. The borrower must first present its proposal to the court having primary jurisdiction over it and then obtain creditor approval. The proposed settlement with creditors plan must be accompanied by an appraisal of a suitably qualified and independent professional. A borrower may be made subject to a settlement with creditors, whether it is technically insolvent or merely in distress. The day-to-day management of a business subject to a settlement with creditors lies with the borrower itself, albeit under the supervision of a court-appointed insolvency practitioner (commissario giudiziale), while certain transactions are subject to approval by the court. The settlement with creditors is the only consensual Italian insolvency procedure under which a dissenting creditor can be crammed down (see 1.4).

A company in financial distress may avail itself of a debt restructuring agreement in order to restructure its debts and recover economically. It requires the agreement of such creditors as represent 60% of a company’s debts, and an appraisal of a suitably qualified and independent professional as to feasibility. The borrower has the freedom to contract with dissenting creditors as regards the content of the debt restructuring agreement. However, the borrower is bound to satisfy the claims of any dissenting creditors in full by the statutory payment deadline. The borrower retains full and unsupervised control of its business during the implementation of a debt restructuring agreement.

A certified rescue plan is an agreement reached between the borrower and its creditors without the intervention of the courts, the purpose of which is the restructuring of the borrower’s debt exposure in order to stabilise its financial position. The financial data on which the plan is based and its feasibility must be independently certified by a suitably qualified professional. Again, the borrower retains full and unsupervised control of its business during the implementation of a certified rescue plan. Examples of certified rescue plans include a moratorium, a debt rescheduling and an industrial plan.

Winding-up is a judicial liquidation procedure. It consists of the certification of the borrower’s state of insolvency, the quantification of its liabilities, and the subsequent distribution of its assets in satisfaction of such liabilities. This requires the liquidation of all assets of the insolvent estate and the application of proceeds according to the principle of equal treatment of creditors taking due account of statutorily and other preferred creditors. Under this procedure, the management of the company and administration of the company’s assets becomes the responsibility of the official receiver. The winding-up process may be commenced by the borrower itself, the creditors, or by the public prosecutor. It may conclude with a settlement with creditors (subject to rules differing slightly from those applying to the settlement with creditors procedure), in which case it must receive creditor approval.

Extraordinary administration for large insolvent companies is a judicial process intended to preserve asset value. As noted above, it only applies to companies exceeding certain thresholds. Its purpose is the recovery and restructuring of significant businesses in order to preserve the value of the business’ assets and avoid widespread redundancies. A special receiver is appointed by the Italian Department for Economic Development (Ministero dello Sviluppo Economico) to manage the day-to-day affairs of the company and its assets, and it is required to restructure the company via the assumption and implementation of measures to dispose of selected business divisions or to restructure the business.

The Italian Department for Economic Development is required to supervise the procedure, which is initiated by the borrower. Special measures apply under the Marzano Law (legge Marzano) for very large companies and those companies considered to provide essential public services (such as Italy’s national carrier, Alitalia, which was subject to extraordinary administration).

1.2 Is a stay on creditor enforcement available?

Except for a few limitations, a stay on creditor enforcement action is available under a number of Italian insolvency procedures, including settlement with creditors, winding-up, debt restructuring agreements, and extraordi-
nary administration. The effect of such stay is that creditors (whose debts arose prior to the commencement of proceedings) are prevented from enforcing any rights as against any company property.

Stays of action do not apply to certified rescue plans.

1.3 What are the key features of a reorganisation plan and how is it approved?

The features of any particular reorganisation plan can vary considerably depending on the structure of the transaction and the nature of the borrower.

In summary, a reorganisation plan may include: (i) actions to reinforce the financial or internal structure of the company, such as a recapitalisation by existing shareholders, a debt issuance, or the provision of third party equity; (ii) a debt restructuring and (iii) a reorganisation of the business of the borrower, for example, via one or more business sales, via further investment to improve productivity, or via a re-focusing of the company from a strategic perspective, such as exiting unprofitable markets, re-deploying staff, and making redundancies.

The reorganisation plan under a settlement with creditors must be approved both by: a simple majority of voting creditors and a majority of classes of debt (for example, if there are three classes of debt, at least two classes of debt must approve).

1.4 Can a creditor or a class of creditor be ‘crammed-down’?

The settlement with creditors procedure is the only consensual Italian insolvency procedure under which a dissenting creditor can be crammed down. Indeed, the court can approve the settlement with creditors where it holds that the debt of the creditor belonging to a dissenting class (or to dissenting creditors representing 20% of qualifying claims) will be discharged as a result of the settlement with creditors to no lesser an extent than would be the case under other alternative procedures available in the circumstances.

A settlement with creditors may also proceed on the basis that the debts of secured or preferential creditors will not be discharged in full; this is provided that the plan contemplates that the extent of the discharge will not be less than would otherwise have been obtained were the relevant assets sold upon a winding-up. A professional valuation will be required to attest the value of such assets in such case.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

In the case of winding-up and extraordinary administration proceedings, the official receiver or special receiver must liquidate the insolvent company’s assets and/or businesses via procedures that are competitive and well publicised, so as to generate wide market interest. A purchaser for the value of a business purchases it free of the debts of the business that arose prior to the sale. In a winding-up procedure, the official receiver may proceed with the transfer of the assets of the business prior to the final determination of company indebtedness.

A settlement with creditors procedure may contemplate the liquidation of company assets, the company, or the company’s businesses. Whether it is necessary to undertake a competitive tender process or a pre-packaged procedure may vary depending on the courts. Often, prior to the sale of the company or business, the purchaser will run the business under a lease arrangement. The settlement with creditors procedure favours the sale of the company or of its businesses: since it provides that a purchaser for value of a business takes free of the debts of the business that arose prior to the sale and it may permit a partial-only transfer of the employees of the seller.

1.6 What are the duties of directors of a company in financial difficulty?

The directors of a company in financial distress are required: (i) to manage the company in a prudent manner; (ii) not to do anything that may worsen the financial position of the company; (iii) to take steps to overcome the state of financial distress and (iv) to treat equally the creditors, avoiding any preferences. In the event that the company suffers a reduction in its share capital to below the legally required minimum, the directors must promptly call a shareholder meeting to increase them to or above the legally required minimum, or to resolve to liquidate it. In the case of settlement with creditors procedures and debt restructuring agreements, recent legislation stays the obligation to liquidate the company in the event the share capital is not increased.

1.7 What priority claims are there and is protection available for post-petition credit?

The ranking of creditors’ claims upon liquidation under Italian law is as follows: (1) debts arising during or for the purpose of an insolvency procedure (administrative costs and expenses associated with the insolvency procedure itself and any other claim arising in connection with such procedure); (2) Italian tax and national insurance contributions, and employee arrears of salary and (3) unsecured creditors. Secured creditors have a priority claim (subject to the priority of certain claims by operation of law) to the proceeds of liquidation of the assets securing their debt.

Italian insolvency proceedings also deal with debts arising after the judicial proceedings have been commenced and those arising as a result of such proceedings. Such debts, conceptually, are considered preferential and must be discharged in preference to other creditors (provided that the proceeds of sale of any assets securing claims of secured creditors are satisfied in priority to the claims of preferential creditors). Debts against the insolvency estate resulting from the administration of the insolvency procedure itself and claims against a borrower arising from acts done after the commencement of the proceedings are both examples of preferential claims.

1.8 Is there a different regime for banks and other financial institutions?

When a bank becomes insolvent, a specific Italian compulsory winding-up regime known as liquidazione coatta amministrativa applies under the supervision of the Italian Department of Economy and Finance. This procedure also applies to co-operatives and insurance companies and its purpose is to liquidate the relevant entity.

A bank may also be made subject to this compulsory winding-up regime for serious management failures.

Special procedures apply to insurance companies, investment funds and financial intermediaries.
Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

The EU Insolvency Regulation (EC 1346/2000) applies to trans-national insolvency procedures in the EU. It provides that insolvency proceedings can only be commenced in the member state in which the company has its centre of main interests (Comi), which is the jurisdiction from which the borrower manages its business.

Italian insolvency law provides that extraordinary administration and winding-up proceedings can be commenced against a business headquartered outside Italy, provided that the transfer abroad of the headquarters took place after the lodging of the winding-up request or request for extraordinary administration.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

The EU Insolvency Regulation provides that in the event there is an establishment in Italy (any place of operations where the debtor carries out a non-transitory economic activity with human means and goods) of a foreign debtor subject to main insolvency proceedings outside Italy (on account of its Comi; see 2.1) then such proceedings shall also apply to the Italian establishment. The insolvency official of the foreign state is entitled to exercise in Italy all the powers they have under the law applicable to the main insolvency proceedings, provided that they do so in accordance with Italian law and Italian liquidation procedures.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

A number of major stakeholders could have a material impact on the outcome of the reorganisation. For example: in extraordinary administration proceedings, the Italian Department of Economic Development plays a central role through its supervision of the special receiver. The rights of a company’s employees may also represent a deterrent to third party investors intending to buy a business subject to insolvency proceedings. The Italian Tax Authority (Erario) or lending banks may also have a material influence over insolvency proceedings due to the sheer size of the debts owed to them.

In the case of settlement with creditors procedures and debt restructuring agreements, the insolvent company may be able to mitigate the impact of tax liabilities by entering into a settlement agreement with the Italian Tax Authority. This can provide, among other things, for the partial write-down or payment in instalments of tax as regards the part of the debt which is not preferred by law. As regards outstanding VAT payment obligations, it may be agreed that the debt should be paid in instalments (but it cannot be written-down).

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

In recent years, the Italian restructuring and insolvency market has undergone a shift; the past prevalence of certified rescue plans and debt restructuring agreements has given way to an increase in the use of the settlement with creditors procedure. This trend is due to legislation favouring the use of the latter (for example, the ability to lodge the recovery plan with the court but deliver the underlying documents at a later date). The widespread use of settlement with creditors procedures has seen increased activity from opportunistic investors such as distressed funds who are attracted by the prospect of purchasing Italian companies with drastically reduced debt exposures.

The number of Italian real estate finance restructurings are also increasing on account of the banks being more willing to assume real estate risk and more resilient to write-downs.

Finally, it should be noted that banks are taking an ever more active role in restructurings, including as a result of debt-to-equity swaps and investment in other equity-linked instruments.
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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

There are four types of insolvency proceedings available in Japan for the rehabilitation of companies in financial difficulty: corporate reorganisation proceedings (kaisha kosei); civil rehabilitation proceedings (minji saisei); bankruptcy proceedings (hasan); and, special liquidation proceedings (tokubetsu seisan).

Corporate reorganisation proceedings are typically used in complex insolvency cases involving stock companies (kabushiki kaisha), and comes with the mandatory appointment of a reorganisation trustee by the court and with a stay against enforcement by both secured and unsecured creditors. The court typically appoints a third party lawyer (bengoshi) with substantial experience in restructuring cases as the trustee. Since 2009, however, the Tokyo District Court (TDC) has begun the so-called quasi-debtor in possession (DIP) type practice, under which the debtor’s director or counsel is appointed as the trustee. In quasi-DIP proceedings, the court appoints an examiner to supervise the trustee’s administration of the reorganisation.

Civil rehabilitation proceedings (minji saisei) are used for the rehabilitation of companies of almost any size and type, and for the rehabilitation of individuals. In civil rehabilitation proceedings, the DIP administers the rehabilitation under the supervision of a court-appointed supervisor. In addition to the authority to approve or reject certain of the DIP’s activities that are outside of the ordinary course of business, the supervisor has the power to void fraudulent transfers of the debtor’s assets or preferential transactions entered into by the DIP. In civil rehabilitation proceedings, enforcement by secured creditors is not stayed, in principle. Accordingly, the debtor has to enter into settlement agreements with secured creditors in order to continue using the relevant collaterals for the conduct of their businesses.

Bankruptcy (hasan) and special liquidation (tokubetsu seisan) proceedings are used when the liquidation and dissolution of the debtor is contemplated.

In bankruptcy proceedings, the court appoints a lawyer as trustee to administer the bankruptcy proceedings. Enforcement by secured creditors and creditors with statutory priority are not stayed; rather, such creditors can freely exercise their claims outside of the bankruptcy proceedings. Notwithstanding, the trustee will usually attempt to sell secured collaterals with the agreement of these creditors and contribute a certain percentage of the sales proceeds to the estate. The estate of the debtor is distributed to creditors in accordance with prescribed statutory priorities without any need for voting by the creditors.

Special liquidation proceedings are used for stock companies (kabushiki kaisha). Under such proceedings, a liquidator is appointed by a debtor’s shareholders or the court. Distribution of the debtor’s estate to creditors has to be approved by creditors with claims to 75% or more of the debtor’s total debts or by way of settlement among the creditors. Special liquidation is typically used when the debtor’s shareholders are confident of obtaining creditors’ cooperation for the liquidation process and wish to control the liquidation process without the involvement of a trustee.

There are certain facts that a court is required to find in respect of the company, and of the insolvency proceedings before they can be commenced:

- Bankruptcy – the company: insolvent on a balance sheet basis; or unable to pay its debts as they become due generally and on a continuing basis (and therefore insolvent on a cash flow basis).
- Special liquidation – the company: faces severe difficulties with its liquidation process; or is threatening to be insolvent on a balance sheet basis.
- Corporate reorganisation – the company: faces the threat of a bankruptcy event (as described above); or would likely significantly impair its own operations if it pays its debts as they become due.
- Civil rehabilitation proceedings – the company: faces the threat of a bankruptcy event (as described above); or is unable to pay its debts as they become due without significantly impairing its operations.

Under each of the four types of insolvency proceedings, there is usually a so-called gap period between the date of filing and the date of commencement of proceedings during which the court examines the grounds for commencement of proceedings. The duration of such gap period varies from case to case, but is generally about one month for corporate reorganisations and one week for other proceedings.

1.2 Is a stay on creditor enforcement action available?

Additional filing for an injunction order is necessary to obtain a stay of creditor enforcement for the gap period. Such injunction order expires at the commencement of the proceedings, when creditor enforcement is automatically stayed.

Enforcements of secured claims are stayed in corporate reorganisations but are generally not stayed in other types of proceedings. The exercise of rights of set-off cannot be stayed, although such rights have to be exercised by the claim bar date in corporate reorganisation and civil rehabilitation proceedings.

1.3 What are the key features of a reorganisation plan and how is it approved?

The plan is proposed by the trustee or the DIP in corporate reorganisation and civil rehabilitation proceedings. Although creditors are also entitled to file a plan in such proceedings, it is uncommon for the creditors to file a plan and sometimes it is not easy for a Japanese court to approve a plan
that is filed by creditors. This is because the involvement of, and disclosure of financial details to, creditors are generally limited in Japanese insolvency proceedings.

In corporate reorganisations, creditors are categorised into the classes of secured creditors and unsecured creditors for voting. The passing of a plan of reorganisation requires the approval of secured creditors representing two-thirds or more of the value of secured claims and of unsecured creditors representing a simple majority of the value of unsecured claims. Under plans of reorganisation, secured claims are usually paid in full up to the valuation of the relevant collateralised assets, with only the payment schedules amended. However, a plan that provides for a haircut or other amendments to secured claims requires the approval of secured creditors representing three-fourths or more of the value of secured claims.

In civil rehabilitation cases, where secured claims are freely exercisable outside of the proceedings, only unsecured creditors (including secured creditors with deficiency claims) vote on the plan of rehabilitation. Claims are generally grouped into a single unsecured class, although contractual subordinated claims are put into a separate class. A plan of rehabilitation requires the votes of a majority of creditors voting on the plan; provided they also represent a simple majority of the value of claims.

1.4 Can a creditor or a class of creditor be "crammed-down"?

Yes. Notwithstanding the disapproval of a plan by a class of creditors, a court has the power in both corporate reorganisation and civil rehabilitation proceedings to approve a plan if it finds it fair and equitable, as long as one of the classes of creditors approves the plan. Whether the best interest rule (payouts under the plan are larger than payouts in liquidation) is satisfied is a critical factor in assessing whether a plan is fair and equitable.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

To facilitate the sale of the debtor’s assets, the court can approve the sale of the debtor’s business outside of the plan, if a prompt sale is necessary to rehabilitate the debtor’s business. Although the court is obliged to take into account the views of creditors, no formal voting on the sale is required. This is similar to a 363 sale under chapter 11 of the US Bankruptcy Code, except that creditors have no right to file a formal objection to the sale in Japanese proceedings.

Credit-bidding is deemed prohibited under Japanese insolvency proceedings because it can constitute the set-off between pre-filing claims and post-filing obligations (in view of the fact that buyers’ obligation to pay the purchase price typically accrue post-filing). Although stalking-horse bids are not expressly prohibited under Japanese law, there are no precedents of such bids in Japanese insolvency proceedings.

1.6 What are the duties of directors of a company in financial difficulty?

The directors do not have obligations to file an insolvency proceeding when the company faces financial difficulty, because they have broad discretion on the company’s management. However, the creditor may pursue the director’s personal liability under a special provision in the Companies Act: if the creditor proves that the director permitted the company to enter into a transaction that the director knew or should have known that the company is subsequently unable to perform due to the company’s financial difficulty.

1.7 What priority claims are there and is protection available for post-petition credit?

Post-petition credits qualify as administrative claims that are required to be paid in full in accordance with the contractual terms. However, where proceedings transition from corporate reorganisation or civil rehabilitation to bankruptcy, administrative claims can be paid only on a pro-rata basis if the estate does not have sufficient cash to satisfy all administrative claims. There is no equivalent of the US chapter 11 priming-lien or super-priority systems in Japan.

1.8 Is there a different regime for banks and other financial institutions?

The Reorganisation Special Measures Act (Kosei Tokurei Ho) applies in the insolvency proceedings of certain financial institutions, such as banks and insurance companies. Due to the vast number of depositors and policyholders involved as creditors, claims filings and voting are typically handled by agents, such as the Deposit Insurance Bank of Japan (DICJ) and the Life Insurance Policyholders Protection Corporation of Japan. These agents provide financial support to protect insured deposits and insurance benefits, and also establish entities to succeed to the operations of the failed financial institutions or insurance companies if time is required to locate a buyer for the businesses or assets of the financial institutions. The Deposit Insurance Act of Japan was amended in 2014 to introduce a system for the orderly resolution of financial institutions in order to avoid systemic risks in the financial markets.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

Yes. In principle, however, only stock companies established under Japanese law are entitled to file for corporate reorganisation and special liquidation. A foreign debtor with business premises, offices or assets in Japan can also file for civil rehabilitation and bankruptcy in Japan.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

Yes. Under the Law on Recognition of and Assistance in Foreign Insolvency Proceedings (known as Shonin Enjo Ho), which is modeled on the United Nations Commission on International Trade Law (Uncitral) Model Law, the TDC has the power to recognise foreign bankruptcy and reorganisation proceedings, and provide assistance if certain conditions such as the applicability of a universality principle to the foreign insolvency proceedings and the necessity of the TDC’s assistance are satisfied.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

The involvement of regulators in reorganisation proceedings is generally very limited. In case of the reorganisation of financial institutions, regulators may have substantial control before the filing for reorganisation proceedings; however, once the proceedings are commenced by the court, the
regulators’ involvement in, and control over, the reorganisation becomes limited, unless a government entity (typically the DICJ) is appointed as the trustee in the reorganisation.

Most employees’ claims qualify as priority claims or administrative claims. The court is required to take into account the views of the labour union or the employees’ representative regarding corporate reorganisation and civil rehabilitation plans.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

Out-of-court workouts are increasingly preferred over corporate reorganisation and civil rehabilitation. There are several out-of-court workout schemes available in Japan, such as the Turnaround ADR (Jigyo Saisei ADR) the process of which is supervised by a mediator, and the scheme administered by the REVIC (a state-owned organisation which facilitates workouts by coordinating the activities of lenders and provides financing to the debtor).

The key differences between workouts and court proceedings are that: trade creditors are paid in full in out-of-court workouts; and the unanimous consent of the affected financial creditors is required in out-of-court workouts. In respect of trade claim protection, the scope of protected trade claims in court proceedings (such as small amount convenience claims or critical vendor claims) has been expanded to preserve the value of the debtor’s business. Regarding the requirement for the unanimous consent of affected financial creditors, new legislation to give effect to a workout plan that lacks the consent of a small number of creditors is under consideration.

About the author

Yuri Ide is a partner at Anderson Mori & Tomotsune, and has been principally involved in insolvency and restructuring cases, in which she represents debtors, investors and creditors. Her recent work includes the representation of ad hoc bondholders groups in corporate reorganisation cases, the representation of debtors’ out of court workouts, and the representation of the debtors of a Japanese corporation in parallel insolvency proceedings between the US chapter 11 and Japanese corporate reorganisation. She has extensive experience in M&A, litigation and crisis management matters, especially with in an international context.

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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

Bankruptcy is regulated by articles 437 to 592 of the Commercial Code. Bankruptcy may be initiated by the debtor itself, by the public prosecutor or by a creditor. The procedure applies to a debtor who meets both of the following criteria: (i) not being able to pay due debts; and (ii) not being able to raise credit. The Commercial Chamber of the District Court (court) will appoint a bankruptcy trustee in charge of the bankruptcy and a judge to supervise the proceedings on granting the petition. Its aim is to realise the debtor's assets and pay the creditors through the recovered assets.

The suspension of payments is regulated under article 593 of the Commercial Code. It has to be initiated by the debtor. The suspension of payment applies if extraordinary and unprecedented events mean that a suspension of payment is necessary, if it appears that the creditor will be paid in full or that the debtor's insolvency is temporary, and if the suspension of payment is approved by a majority in number of the ordinary creditors holding 75% of the debtor's outstanding liability. The court decides whether or not to apply such suspension. The objective is to provide to the debtor breathing space to pay its current debts and safeguard its activity.

Controlled management is regulated by the Luxembourg Grand Ducal Decree of May 24 1935, as amended. It may only be initiated by the debtor. Controlled management may be granted if the credit of the debtor is undermined, the settlement in full of the debtor's liabilities is in jeopardy and controlled management allows the recovery of the debtor's business or improves the position of the debtor in respect of the sale of its assets. It is the court's decision whether to apply controlled management or not. The procedure aims at providing the debtor with the time to restructure its business or to sell its assets and pay its creditors.

Preventive composition is regulated by the Luxembourg Act of May 14 1886, as amended. The debtor should file an application before the courts with documents justifying its state and which show the consent of the majority of its creditors representing three-quarters of the claims. This process is not available where the debtor meets both of the two criteria for bankruptcy. It is up to the court to decide whether or not to apply preventive composition. The objective is to avoid the bankruptcy of a debtor that has become insolvent for reasons other than fraud or negligence.

Specific insolvency procedures, which are similar to the above procedures, exist for professionals in the financial sector and in the insurance sector (see 1.8).

1.2 Is a stay on creditor enforcement action available?

In a controlled management procedure, the court's decision to delegate a judge suspends the enforceability of judgments. The court's decision pronouncing the suspension of payments or, in the case of preventive composition, the court's official decision applying preventive composition both have the same effect. The court's decision pronouncing the bankruptcy will stop the civil proceedings against the debtor. In the case of preventive composition, the court's official decision applying preventive composition will also stop the civil proceedings against the debtor.

These rules do not apply to secured creditors holding securities benefiting from the law of August 5 2005 on financial collaterals, as amended. Such creditors are allowed to continue the enforcement of their actions.

Involuntary reorganisation plans do not exist in Luxembourg. A voluntary reorganisation plan may exist under a controlled management. The court delegates one of its judges to examine the debtor's financial situation and determine if any prospect of reorganisation exists. The court decides whether or not to grant the application for controlled management of the debtor and then appoints administrators to draft a plan and deliver this plan to the creditors and to the court. The plan must be approved by more than 50% in number of the creditors representing more than 50% in value of the debtor's liabilities and also by the court. The creditors are not divided into classes. Once approved, the plan becomes binding on all creditors and the debtor. If the debtor does not perform its obligation, any creditor may institute court proceedings for cancellation. As mentioned above, the assignment of the delegated judge prevents creditors from enforcing claims and court decisions against the debtor.

1.3 What are the key features of a reorganisation plan and how is it approved?

Involuntary reorganisation plans do not exist in Luxembourg. A voluntary reorganisation plan may exist under a controlled management. The court delegates one of its judges to examine the debtor's financial situation and determine if any prospect of reorganisation exists. The court decides whether or not to grant the application for controlled management of the debtor and then appoints administrators to draft a plan and deliver this plan to the creditors and to the court. The plan must be approved by more than 50% in number of the creditors representing more than 50% in value of the debtor's liabilities and also by the court. The creditors are not divided into classes. Once approved, the plan becomes binding on all creditors and the debtor. If the debtor does not perform its obligation, any creditor may institute court proceedings for cancellation. As mentioned above, the assignment of the delegated judge prevents creditors from enforcing claims and court decisions against the debtor.

1.4 Can a creditor or a class of creditor be ‘crammed-down’?

The rank of a debtor is established by law and is as follows for assets which are not subject to any specific security interest: (i) claims in relation to the expenses of the bankrupt estate; (ii) employee claims (last six months' wages amounting to a maximum of six times the minimum social salary or indemnification resulting from the termination of the employment agreement); (iii) employee contribution to social security claims; (iv) direct and indirect tax claims; (v) employer contribution to the social security claims; landlord claims, pledgor out of the Financial Collateral Law claims and vendor's privilege claims and (vi) ordinary unsecured claims.

This ranking may not be altered and constitutes the minimum legal framework. Specific agreements between debtors and creditors are allowed subject to such legal framework. There is no legal provision allowing the court or the bankruptcy trustee to change this rank, and no way to cram down a creditor without his prior consent.

Finally, creditors holding securities benefiting from the law of August 5 2005 on financial collateral, as amended, are ‘out of the mass’, which means that they may enforce their securities and that they need not compete with the other creditors.
1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

No, there is no process for facilitating the sale of a distressed debtor’s assets or business. The bankruptcy trustee is in charge of the organisation of the sale of real estate property, goods and movable property and may therefore engage his own liability in the process of sale.

The concept of stalking horse bids during the sale of assets does not exist under Luxembourg law. Credit bidding in sales is not foreseen as such but legal compensation could be applicable if the legal compensation is the best offer.

1.6 What are the duties of directors of a company in financial difficulty?

Directors of companies in financial difficulties have to be prudent and diligent.

In general, directors are not liable for the company’s obligations, but they may be liable for the increase of a company’s debt if they did not file a petition for bankruptcy within a month of the conditions of the bankruptcy having been met.

Directors of a société anonyme also have the obligation to convene a general meeting so that it can be held within two months of the time when the loss of half the corporate capital was or should have been ascertained.

Directors may also be liable for not having paid the taxes. Articles 108 and 109 of the General Tax Act state the responsibility of the directors in the case of non-payment of taxes is a personal fault of these directors and they may be asked for payment in place of the company.

Directors have a duty to cooperate with the bankruptcy trustee, especially at the beginning of the insolvency proceedings.

From a criminal perspective, directors can be subject to wrongful or fraudulent bankruptcy.

1.7 What priority claims are there and is protection available for post-petition credit?

See 1.4 for the ranking of claims.

There is no special provision on post-filing credit. Nevertheless, in such a case a creditor providing a post-filing credit will be a creditor of the mass.

The law of August 5 2005 on the collateral, as amended, does not allow for taking security after the beginning of an insolvency procedure (the bankruptcy judgment for a bankruptcy, the first judgment appointing the delegated judge for a controlled management).

1.8 Is there a different regime for banks and other financial institutions?

Professionals of the financial sector and insurance companies are subject to specific insolvency procedures.

Two separate insolvency procedures are provided by the law of April 5 1993 on the financial sector, as amended. These procedures may apply to credit institutions and professionals of the financial sector:

• stay of payments: this may be applied by the entity itself or by the CSSF (the supervisory authority of the financial sector). The result of such a request is the suspension of all the payments by the entity and the prohibition of the entity from taking any action without the prior consent of the CSSF;

• judicial liquidation: this applies if the stay of payment procedure did not restore the financial situation of the entity or when the entity can no longer meet its commitments. The judicial liquidation is ordered by the district court following a request from the public prosecutor or from the CSSF.

The law of December 6 1991 on the insurance sector as amended states equivalent provisions for insurance companies.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

Entities that do not fall within the territorial jurisdiction of the Luxembourg court are excluded from Luxembourg’s customary insolvency proceedings.

Luxembourg courts will not exercise jurisdiction over proceedings aimed at companies domiciled outside of Luxembourg except in the following situations: (i) urgent or protective measures; (ii) no other competent jurisdiction; (iii) as secondary proceedings as part of the EU cross border insolvency system.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

There is no specific duty for the court and the bankruptcy trustee to cooperate with foreign courts and officers in the case of cross-border insolvency proceedings.

Luxembourg law is based on the universality of insolvency proceedings.

Luxembourg courts may recognise foreign proceedings when the conditions for recognition of foreign judgments are met and provided that such foreign proceedings do not conflict with domestic insolvency proceedings.

With regard to proceedings opened in another EU member state, the court of the member state in which the debtor’s centre of main interest (Comi) is situated has jurisdiction over the insolvency proceedings. The registered office is presumed to be the Comi of the company.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

The main impact on employees could be under a reorganisation. All default protections provided by the Luxembourg labour law (which are public order provisions) will apply.

As regards banks and professionals of the financial sector, the CSSF will be involved in the proceedings (see above 1.8).
Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

Major cases
Four Banco Espirito Santo (BES) related holding companies filed an application for controlled management and were admitted to the preliminary phase of the procedure. Later these applications for controlled management were turned down and all five companies were declared bankrupt.

The bankruptcy trustee of one of the companies filed lawsuits with the Lisbon Administrative Court on November 30, 2014 by challenging the hive-off of Novo Banco and the resolution of BES by Bank of Portugal.

In the bankruptcy judgments of Rio Forte and Espirito Santo International, the Luxembourg court made use of the option given to it by law to set, as a precautionary measure, the starting point of the claw-back period. The claw-back period is a fictional period during which the company will be deemed to have been insolvent and during which certain transactions may be subject to automatic or conditional nullity, six months prior to the date of admission to the procedure of controlled management.

Insolvency law changes
Changes in insolvency law are expected to be introduced by Draft Law No. 6539. The Draft Law proposes the introduction of certain preventive measures: (i) a conciliation process, which will allow an undertaking in difficulty to request the appointment of a business mediator to the secretariat of the Economic Committee; (ii) a reorganisation procedure by arrangement in order to facilitate an agreement; and, (iii) a court protection by a judicial reorganisation procedure. A company may request the grant of a stay by the court.

The Draft Law introduces a second chance for the unfortunate trader under the condition that this trader is deemed to have acted in good faith and assuming this person has not been held personally liable for the outstanding debts of the failed business.

The Draft Law also introduces an administrative dissolution without liquidation for the empty shells, which will enable the liquidation of a business which has no assets without opening bankruptcy proceedings.

Finally, a simple management fault instead of a serious misconduct will be the standard of proof for debt contribution actions or prohibition on carrying out commercial activities.

A new EU regulation on insolvency proceedings has been in preparation and will be enacted by 2017. It will contain new provisions, among others, regarding the cooperation between jurisdictions of the member states.

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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

When faced with financial difficulties, debtors are faced with two broad options: insolvency/ bankruptcy; or a voluntary reorganisation. The options available to a financially distressed debtor will inevitably depend on whether the debtor is a company or an individual or partnership.

Companies

Dissolution

A company may be dissolved and consequently wound up voluntarily or by the court. A voluntary winding up may be a members’ voluntary winding up or a creditors’ voluntary winding up.

In a members’ voluntary winding-up, which may only take place if the company is solvent, the emphasis is on simplicity and expediency. The directors of the company must make a declaration of solvency within one month preceding the date the extraordinary resolution for dissolution was passed by the company’s shareholders. The liquidator appointed by the shareholders will be responsible for winding up the affairs of the company and distributing its assets.

A creditor’s voluntary winding up is resorted to where the directors of the company are not in a position to draw up a declaration of solvency. In a creditor’s voluntary winding up, both the creditors and the shareholders have a right to nominate a liquidator, but in the case of a difference, the creditors’ nomination will prevail. The creditors of the company may also appoint up to five persons to form a liquidation committee.

The company’s shareholders may also resolve to have the company dissolved and wound up by the court.

Reorganisation

In terms of the Maltese Companies Act (CA), there are two broad options available to companies in order to restructure their businesses: the company recovery procedure (CRP) or the compromise or arrangement option.

An application for the CRP may be filed where a company is unable to pay its debts or imminently likely to become unable to pay its debts. Such application may be made by the company (following an extraordinary resolution), its directors or its creditors (representing more than one half in value). One of the core attractions of the CRP is the wide-ranging stay on creditor enforcement conferred by the court-imposed moratorium – this affords a company some leeway within which to restructure its liabilities as it prevents creditors racing to court to enforce their claims.

The compromise or arrangement option is a hybrid remedy that embodies a near verbatim replica of the UK scheme of arrangement, although in Malta it is only available to insolvent companies. Its most distinctive feature is that it allows the courts to sanction a compromise or arrangement, where it has been approved by a majority in number, representing three-quarters in value of creditors or members or separate classes thereof. This allows a company to cram down a restructuring plan against the will of dissenting minorities.

Traders

Bankruptcy

The bankruptcy of persons or commercial partnerships other than companies (traders) is regulated by the Commercial Code (CC). In terms of the CC, every Trader who suspends payment of their debts is deemed to be in a state of bankruptcy and can make a voluntary declaration of bankruptcy to the First Hall of the Civil Court. Bankruptcy proceedings may also be commenced by creditors. In terms of the CC, a curator will be appointed to take over the assets of the bankrupt and can also continue the business instead of the trader.

Composition

The CC contemplates the possibility of a composition or scheme of arrangement in the case of bankrupt traders, where they may propose the terms of a composition to their creditors. A majority in number representing three-fourths in value of the creditors is needed to approve such composition. The CC therefore allows recalcitrant minority hold-outs to be crammed down.

1.2 Is a stay on creditor enforcement action available?

Yes, a stay on creditor enforcement is available under the CRP.

The moratorium (article 329B(4) CA) enters into effect on the filing of a company recovery application. Unless the CRP application is dismissed by the court, the moratorium will apply during the period in which the company recovery procedure is in force and allows a broad range of creditor actions to remain held in abeyance. Its effects are the following: (i) any new or pending winding-up application against the company is stayed; (ii) no resolution for the dissolution and consequential winding-up may be made against the company; (iii) the execution of claims of a monetary nature against the company are stayed; (iv) the right to terminate a contract of lease due to failure to comply with any condition of tenancy is prohibited; (v) no measures may be adopted to enforce security against the company or to repossess goods acquired under a hire-purchase agreement; (vi) no precautionary or executive warrants may be enforced against the company; and (vii) no proceedings may be instituted or continued against the company.

Close-out netting provisions or any other contractual provision relating to the set-off or netting of sums in respect of mutual credits, mutual debts or other mutual dealings with the company survive insolvency, and upon entry into the CRP become enforceable against the special controller. Further, financial collateral arrangements remain enforceable notwithstanding-
ing the commencement of winding-up or reorganisation measures of the financial distressed company.

1.3 What are the key features of a reorganisation plan and how is it approved?

CRP
A CRP application may be made by the company (following an extraordinary resolution), its directors or its creditors (representing more than one half in value). It must give the full facts and circumstances which led to the company’s inability or likely imminent inability to pay its debts, together with a statement by the applicants as to how the financial and economic situation of the company can be improved in the interests of its creditors, employees, and of the company itself. Where the application is made by the company it must contain a recent (not older than two months) statement of the company’s assets and liabilities; and a list of the creditors, their addresses, the amounts due to them, and the security they hold over the company’s assets. Where the application is made by the creditors, the CA prescribes that such application must be accompanied by appropriate supporting documentation and statements.

The court will make its decision whether to dismiss the application or make a company recovery order within 20 working days of the filing of the application. The court will only issue a company recovery order where it believes that the proposed plan of reorganisation will achieve either: the survival of the company as a viable going concern in whole or in part; or the sanctioning of a compromise or arrangement between the company and its creditors or members.

In making a company recovery order, the court will take into account: (i) the best interests of the creditors, shareholders and of the company itself, and the possibility of safeguarding employment as appears to be reasonably and financially possible in the circumstances; and (ii) the cost that would have to be incurred by adopting the company recovery procedure.

The compromise or arrangement
The contents of a plan of reorganisation proposed under the compromise or arrangement route are not prescribed by the CA. Nonetheless, the CA does regulate the process to procure the approval of a compromise or arrangement. Such process is as follows.

First, where a compromise or arrangement is proposed between a company and its creditors or members (or any class of them), the court may order a meeting of the creditors or class of creditors, or members or class of members, on the application of: (i) the company; (ii) a creditor; (iii) a member; and, (iv) the liquidator in the case of a company being wound up.

If the compromise or arrangement is approved by the requisite majorities (half in number and three-quarters in value of creditors or shareholders or class of them) an application must be made to the court for its judicial sanction.

1.4 Can a creditor or a class of creditor be crammed-down?

Yes.

Article 327 of the CA provides that the courts may sanction a compromise or arrangement where it is supported by the above mentioned majorities (see question 1.3). However, the article 327 cram-down mechanism only has the potential of binding unsupportive minorities belonging to a class of creditors which has voted in favour of a plan (it applies intra-class and cannot be used by one class of creditors to cram-down another class of creditors into a restructuring plan).

The CC also envisages a cram-down mechanism in the case of bankrupt Traders. However, a composition under the CC merely requires the sanction of the majority in number and three-fourths in value of all creditors. The CC does not make reference to creditor classes within the ambit of schemes of arrangement — therefore, all creditor classes are subsumed into one. This makes it possible for a fragmented body of junior creditors to hold senior creditors to ransom where senior creditors are not able to meet the majority in number requirement.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

Maltese corporate recovery law does not have a mechanism similar to that of the US section 363 bankruptcy sale. Further, although credit bidding is possible within the ambit of local judicial sales by auction, the latter are not relevant within the context of Maltese corporate rescue law.

Nonetheless, within the local framework, pre-packaged asset sales (pre-packs) may be employed in order to achieve the swift sale of a distressed debtor’s business. Pre-packs are not formally codified under Maltese law, and practice has thus far not necessitated their judicial recognition. However, the local legislative architecture may indeed be stretched to accommodate pre-packs; if pre-packs were to enter into vogue locally as a result of developments in the Maltese restructuring market, they could be sanctioned under the CRP or the compromise or arrangement restructuring route.

Since pre-packs thrive on speed of execution and minimal court involvement, the CRP would seem to be the more appropriate route for their execution. Where all required consents to the pre-pack are solicited before entry into the CRP, the issuance of the company recovery order (approving the pre-packaged sale) may take place shortly after, and, in any event, within a maximum of 20 days of the CRP application being filed.

There would be no plausible grounds for a putting a pre-packaged restructuring plan to creditor or member meetings and subsequently applying to the courts to sanction its outcome under the compromise or arrangement option, unless such option is necessary to overcome hold-out within an impaired debt tranche.

1.6 What are the duties of directors of a company in financial difficulty?

Company directors are subject to a plethora of obligations, emanating principally from the CA. These provisions are supplemented by the Civil Code dispositions governing fiduciary duties, and in the case of listed companies, the Listing Rules and the Code of Good Corporate Governance.

The general duty underpinning the conduct of directors in terms of article 136A of the CA is to act honestly and in good faith in the best interests of the company. Creditors are afforded protection under a host of other provisions of the CA, most notably those governing fraudulent and wrong-
ful trading. Where a company is operating on the cusp of insolvency, the conduct of directors will be guided by fear of attracting liability under these two provisions.

A director may be held liable for wrongful trading where a company has been dissolved and it appears that a director knew, or ought to have known, prior to the dissolution, that there was no reasonable prospect of avoiding an insolvent liquidation. An action for fraudulent trading may be brought where it is proved that during the course of a winding up, the business of the company has been carried on with the intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose. Within the context of corporate restructuring, the risk of fraudulent trading comes to the fore where directors incur additional credit where there is no reasonable prospect of survival.

Further, directors must summon a general meeting when they become aware that a company is unable or imminently likely to become unable to pay its debts. At the meeting it may be determined that the company should be dissolved, or, that an application be filed for accession into the CRP. In the case of public companies, directors are also under a duty to summon a general meeting where the net assets of the company fall below half or less of its called-up share capital.

1.7 What priority claims are there and is protection available for post-petition credit?

The ranking of creditors’ claims will depend on the nature of the debtor’s outstanding liabilities and the security package in place and will be determined in accordance with general civil law principles.

The following are examples of claims which enjoy priority status: (i) costs incurred in the a winding up; (ii) wages of employees under the Employment and Industrial Relations Act (Chapter 452 of the Laws of Malta); (iii) claims by the director of social security under the Social Security Act (Chapter 318 of the Laws of Malta); (iv) claims made by the commissioner under the Income Tax Management Act (Chapter 372 of the Laws of Malta); (v) claims made by the commissioner under the VAT Act (Chapter 406 of the Laws of Malta); (vi) general privileges as the same are defined in the Civil Code (Chapter 16 of the Laws of Malta); (vii) special privileges, as the same are defined in the Civil Code (which include costs due to advocates and debts due to lessors for the rent of property); and (vii) secured creditors, to name a few.

There are no protections available for post-petition credit under Maltese Insolvency law.

1.8 Is there a different regime for banks and other financial institutions?

Yes.

Where a bank encounters financial difficulties, in addition to the CA, the following apply: (i) the Banking Act (BA); (ii) the Credit Institutions (Reorganisation and Winding-up) Regulations; and (iii) the Controlled Companies (Procedure for Liquidation) Act.

The Malta Financial Services Authority (MFSA) is granted wide-ranging powers to intervene in the event that a bank encounters financial difficulties. Further, the introduction of the Bank Recovery and Resolution Directive will have a profound impact on the manner in which local, financially distressed banks are restructured.

For financial institutions, the Financial Institutions Act grants special powers to the MFSA in the event that the financial institution in question is likely to become unable to meet its obligations or has insufficient assets to cover its liabilities.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

In terms of Council Regulation (EC) 1346/2000 on insolvency proceedings (Insolvency Regulation) which is directly applicable in Malta (and applies to all insolvency proceedings, whether the debtor is a natural person or a legal person, a trader or an individual), the Maltese courts may only open insolvency proceedings in respect of a debtor, if such debtor has its centre of main interests in Malta. In the case of companies or legal persons, this is presumed to be the place of the registered office.

Therefore, the process of: (i) a voluntary winding up (whether a members’ or a creditors’ winding up); (ii) a court winding up; and (iii) bankruptcy proceedings of a trader (each an insolvency procedure), may not be commenced in Malta in respect of foreign debtors which have their centre of main interests in another European jurisdiction. The re-domiciliation of a debtor into Malta immediately prior to entry into an Insolvency Procedure (in order to benefit from Malta’s insolvency regime) is impermissible. This is made clear in the preamble to the Insolvency Regulation which states that forum shopping should be prohibited, since it distorts the proper functioning of the internal market.

However, it is possible for secondary proceedings to be opened in parallel with the primary insolvency proceedings. These may only be opened in Malta in respect of foreign debtor with assets in Malta.

The Insolvency Regulation does not apply to debtors located outside the EU, or to restructuring procedures.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

Under the Insolvency Regulation, any judgment opening insolvency proceedings handed down by a court of a member state, or judgments concerning the course and closure of insolvency proceedings, and compositions approved by that court, will be recognised in Malta (unless contrary to Maltese public policy).

With respect to a request for the recognition of non-EU insolvency, bankruptcy, or reorganisation proceedings, Maltese courts would also recognise a judgment unless any of the grounds of non-recognition enshrined in the Maltese Code of Organisation and Civil Procedure (COCP) subsist.

Assistance by means of letters of request as enshrined in the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, to which Malta is a signatory, may be availed of to provide assistance in foreign bankruptcy and reorganisation proceedings.
Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

Where the financially distressed company is in possession of a licence under the laws regulating banking, insurance, investment services and financial institutions, the MFSA will have an impact on the outcome of the reorganisation. Under the CA, where a company recovery application has been filed under section 329B of the CA, the court will not make a company recovery order without first having consulted the MFSA.

Employees also enjoy significant clout under the CRP. Indeed in terms of section 329B of the CA, in making a company recovery order: (i) the court must take into account the possibility of safeguarding employment; and (ii) once a company recovery order has been issued, the special controller may not dismiss employees of the company in question without first obtaining express authorisation from the court. In addition, it should be noted that in the event that the company in question is eventually wound down, employee wages constitute a privileged claim over the assets of the company and are paid in preference to all other claims whether privileged or hypothecary.

Maltese law does not expressly contemplate how pension liabilities are to be treated in the event that a company is restructured under the CRP or the compromise or arrangement route.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

Owing to the resilience of the local economy, Malta has remained largely detached from the turmoil pervading the rest of the world. As a result, the CRP and the compromise or arrangement recovery route have lain largely dormant. Indeed, since the CRP’s inception in 2003, only four company recovery applications have been made. Further, the compromise or arrangement restructuring tool has, to the knowledge of these authors, never been employed.

Further, although the insolvency and bankruptcy procedures are engaged routinely to wind down distressed companies and traders, no particular trends have emerged which are worthy of note.
Montenegro

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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

Both bankruptcy and reorganisation processes are governed by the Montenegrin Insolvency Law.

In terms of this law, bankruptcy implies settlement of creditors by virtue of sale of the debtor’s assets or sale of the debtor as a legal entity. In the course of the reorganisation, creditors are to be settled in accordance with the adopted plan of reorganisation by redefining mutual debtor-creditor relations, changing the legal status of the debtor or some other process as determined by the reorganisation plan.

Reasons for the initiation of both types of insolvency proceedings are: permanent insolvency of the debtor (debtor cannot respond to his financial obligations within 45 days from the date of maturity of the obligation or has completely suspended all payments for more than 30 consecutive days); or over-indebtedness (value of the assets of the debtor is lower than the value of its liabilities).

Insolvency proceedings will be instituted before the competent (commercial) court in Montenegro at the proposal of a creditor, debtor or liquidator. Upon the initiation, the court will appoint a bankruptcy trustee to manage the insolvency proceedings and represent the debtor.

1.2 Is a stay on creditor enforcement action available?

A consequence of opening insolvency proceedings is the stay of all pending judicial and administrative proceedings in relation to the debtor and its assets (as of the moment of the opening of the insolvency proceedings). After the opening of insolvency proceedings, creditors may exercise their claims against the debtor only in the course of the insolvency proceedings.

Following the opening of insolvency proceedings, no compulsory execution or any other measure of enforcement proceedings can be determined or implemented against the debtor or its assets for the purpose of the settlement of claims, save for the enforcement of obligations of the insolvent estate.

Exceptionally, a court may issue an injunction or stay on creditor enforcement actions prior to the opening of the insolvency proceedings. The injunction is issued until a decision is made on the opening of the insolvency proceedings.

1.3 What are the key features of a reorganisation plan and how is it approved?

Reorganisation is to be implemented if it provides a more favourable settlement of creditors than the bankruptcy proceedings would, especially if there are economically justifiable reasons for the continuation of the debtor’s business.

A written reorganisation plan may be submitted simultaneously with the motion for the initiation of insolvency proceeding or after the opening of the insolvency proceedings. In the case of the latter, the plan of reorganisation should be submitted to the bankruptcy judge within 90 days of the day of opening the insolvency proceedings (the deadline can be extended for another 30 days maximally).

The reorganisation plan may be submitted by the debtor, bankruptcy trustee, secured creditors holding at least 30% of secured claims (out of the total amount of claims against the debtor), bankruptcy creditors holding at least 30% of unsecured claims (out of the total claims against the debtor), as well as persons owning at least 30% of the share capital of the debtor.

Voting on the reorganisation plan should be carried out within the classes of creditors (there are at least four classes). The plan will be deemed passed by one class if the creditors of the relevant class with a simple majority of the total claims of that class have adopted it. The reorganisation plan will be confirmed if a majority of the total number of classes voted in its favour.

If the plan of reorganisation does not have the required number of votes, the insolvency judge may offer an additional period, no longer than 30 days, within which the proposer of such plan may submit a revised plan of reorganisation.

If the revised plan of reorganisation is not adopted, the bankruptcy proceedings will be conducted over the debtor.

1.4 Can a creditor or a class of creditor be ‘crammed-down’?

If the reorganisation plan is adopted, creditors who have voted against the plan are entitled to the payment which they would have received in the event of bankruptcy in accordance with the level of priority of their claims.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

The three following methods of sale are recognised under the Insolvency Law: sale by auction, sale by public bidding and sale by direct negotiation. Proceeds received from the sale comprise the insolvent estate, which is protected and managed by the insolvency trustee.

When the property which is to be sold is the subject of security of the claims of one or more creditors, such secured creditor may propose a more favourable means of sale. Proceeds from the sale of such property will primarily cover sale expenses; only when such costs have been covered the remaining funds will be used for satisfying the claims of the secured creditors according to the priority determined under applicable law. The remaining (surplus) funds will be returned to the bankruptcy estate.
The Insolvency Law does not provide for the possibility of stalking horse bids. In terms of credit-bidding, Montenegrin law allows creditors (of the debtor) to participate in the bidding and the secured creditor is generally allowed to bid the amount of its debt as a credit bid.

1.6 What are the duties of directors of a company in financial difficulty?

According to the Montenegrin Companies Act, the executive director and other persons responsible for the management of the company are obliged to act with due care and diligence, in the reasonable belief that their acts are in the best interest of the company. If it is determined that there have been irregularities in the management or operations of the company, the company has the right to sue the responsible person before the Commercial Court and request damages.

In the case of opening of insolvency proceedings, authorisations of executive directors, representatives and proxies cease to exist, as well as the authorisations of governing bodies of the debtor. Such authorisations will be transferred to the bankruptcy trustee.

In addition, Section 5 of the Insolvency Law provides for the possibility of the insolvency trustee and insolvency creditors contesting legal actions of the debtor under the conditions and within the deadlines provided under the Insolvency Law (for example, contesting: legal affairs and other actions violating equal settlement of or harming the bankruptcy creditors; legal actions by which certain creditors are put in a more favourable position; certain transactions that the debtor entered into with the affiliated companies, providing security to a creditor in the last six months before filing for bankruptcy if such creditor knew or should have known about the insolvency of the debtor; and, actions of deliberate or wilful damage to the creditors).

1.7 What priority claims are there and is protection available for post-petition credit?

Costs and expenses of the insolvency proceedings and the obligations of the insolvency estate have priority in settlement.

Bankruptcy creditors are classified into the following payment priorities: (1) first payment priority includes unpaid gross salaries of employees and former employees and employees’ claims before and after the filing of the motion for the opening of the insolvency proceedings in the amount of minimal wages for the period of two years preceding the opening of the insolvency and claims in the name of injuries sustained at work with the debtor; (2) second payment priority includes claims based on all public revenues due in the three months preceding the insolvency proceedings, except for contributions for pension and disability insurance; and (3) third payment priority includes claims of other bankruptcy creditors.

Insolvency creditors of lower priority may be settled only after the settlement of insolvency creditors of higher payment priority.

1.8 Is there a different regime for banks and other financial institutions?

Bankruptcy and liquidation proceedings of banks are regulated by a separate law: the Law on Liquidation and Bankruptcy of Banks. Bankruptcy proceedings will be initiated against a bank of which the Central Bank of Montenegro has revoked the licence and which liabilities exceed its assets. Also, bankruptcy proceedings will be initiated upon the proposal of the liquidation administrator when, during the bank liquidation proceedings, it is determined that the bank’s assets are not sufficient to meet the claims of its creditors.

Liquidation proceedings will be taken against a bank if the central bank has revoked its licence, but the other conditions for initiation of the bankruptcy proceedings has not been met.

Bankruptcy and liquidation proceedings are opened and conducted before the Central Bank of Montenegro.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

Insolvency law does not provide for the possibility of insolvency over a foreign debtor. It stipulates that insolvency proceedings will be conducted by the competent court in which territory is located the seat or residence of the debtor. The debtor, in terms of this Insolvency Law, may be: (i) a legal entity; (ii) a company that does not have the status of legal entity; or (iii) an entrepreneur. The insolvency debtors, in terms of this Law, will not be considered the following: 1) body, organization or institution financed from the budget of Montenegro, budget of local government or state fund; 2) the central bank or an independent regulatory body; 3) legal entity whose insolvency is governed by separate regulations.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

Under the Insolvency Law, the provisions on international insolvency will apply if: (i) the foreign court or another foreign body controlling or supervising the assets or business activities of the debtor or the foreign representative requests assistance in connection with a foreign proceeding; or (ii) the court or insolvency trustee asks for help from a foreign country in connection with the insolvency procedure commenced in Montenegro; and (iii) the foreign proceedings are conducted simultaneously with the insolvency procedure in Montenegro. The recognition of foreign proceedings and cooperation with foreign courts and other competent authorities will be conducted by the competent Commercial Court in Montenegro. The competent court may refuse to take any action in relation to international insolvency proceedings if such action is contrary to the legal system of Montenegro.
Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

Employees’ claims have the first payment priority for the unpaid gross salaries (with included pension liabilities) in the amount of statutory minimum wages for the period of two years preceding the opening of the insolvency. For net salaries exceeding this amount, their claims have a third payment priority. The public revenue claims due in the three months preceding the opening of the insolvency proceedings are ranked as second priority claims.

As to voting on the reorganisation plan, when special classes of creditors are not established and there is only a minimum number of four classes (secured creditors, first ranked, second ranked and third ranked creditors), which is a common situation, the reorganisation plan will have to be voted in three out of four classes. These would include either the employees for their first priority claims or the Tax Authority for their second priority claims.

SECTION 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

The Insolvency Law does not provide a clear procedure for the appointment of members to the board of creditors, which is the source of most inconsistencies and debate. The law provides only that the board of creditors should have three to five members, but does not set out the procedure for their appointment or the procedure for determining the number of members to the board of creditors.

The board of creditors’ approval is required for all matters which are of high importance for the bankruptcy estate, including the taking and providing of loans and continuance of the debtor’s business during insolvency.

Common practice in major insolvency proceedings over the last few years involving a large number of employees is that most employees are re-employed by the bankruptcy trustee (even though the law explicitly provides that the bankruptcy trustee may re-employ only a number of employees required for conducting the commenced operations and the bankruptcy proceedings). The funds for the social programme for the reemployed were secured by the government. Also, the bankruptcy debtor usually continues its business during the course of insolvency proceedings without any prior analyses; this is usually conducted by the way of entering into a management agreement with a third party who is not always selected in a transparent process.

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**Section 1: PROCESS AND PROCEDURES**

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

There are two main categories of statutory bankruptcy proceedings in Norway both regulated by the Bankruptcy Act 58 of June 8 1984: winding-up proceedings and judicial debt negotiation proceedings. Judicial debt negotiation proceedings can be either voluntary or compulsory, subject to slightly different legislation.

It is only the debtor itself whom may petition for debt negotiation proceedings. Winding-up proceedings may be petitioned either by the debtor or by a creditor. The court decides whether the relevant conditions to open proceedings are fulfilled or not.

It is a requirement to file for statutory debt negotiation proceedings that the company is illiquid (in a position where it cannot meet its financial obligations as they fall due). It is, however, not a requirement that the company is insolvent (both illiquid and with negative net assets).

It is a requirement for the opening of winding-up proceedings that the company is insolvent.

In Norway, the court appointed administrator or liquidator is in practice always a lawyer. In judicial debt negotiation proceedings, the administrator has a supervisory function, while the board of directors maintains their duties and the company retains legal powers over its assets.

In winding-up proceedings, the bankruptcy estate is established as a separate legal entity with automatic seizure of all the debtor’s assets. The administrator controls and has legal powers over the bankruptcy estate and over the debtor’s assets and rights.

A creditor committee may be appointed with one or a few representatives for the creditors, with a function comparable to a board of directors with the administrator or liquidator as chairman.

1.2 Is a stay on creditor enforcement action available?

Upon the opening of judicial debt negotiation proceedings, there is an automatic stay of any bankruptcy petitions based on debt already incurred at that time. The stay lasts for three months from the opening of the proceedings, but may be prolonged at the discretion of the court upon request from the debtor. If compulsory composition proceedings are opened, the automatic stay lasts throughout the proceedings.

The stay is not effective against a bankruptcy petition filed by at least three creditors who together represent at least two-fifths of all claims entitled to dividend payment.

Further, execution liens may not be attached to the debtor’s assets after the opening of judicial debt negotiation proceedings or compulsory composition proceedings.

Finally, there is an automatic stay against enforcement of any collateral or security rights during the first six months after judicial debt negotiation proceedings are opened or winding-up proceedings are filed, unless the debtor negotiations committee agrees to such enforcement.

The above provisions of automatic stay are binding on all parties, except for financial institutions who are allowed to agree on alternative enforcement procedures with respect to financial collateral if the customer or lender is a professional party and the agreement is made in writing.

1.3 What are the key features of a reorganisation plan and how is it approved?

While under voluntary or compulsory judicial debt negotiation proceedings, the debtor has an exclusive right for a period of time to propose a reorganisation plan, though subject to approval of the administrator or creditor committee. The debtor has no right to propose a reorganisation plan while under winding-up proceedings, but may request the administrator to propose a compulsory composition.

In voluntary judicial debt negotiation proceedings, the reorganisation plan must be accepted by all the creditors.

However, a compulsory composition is only legally binding to all creditors if the following requirements are met (the numbers referring to creditors and claims that are granted voting rights, i.e. excluding certain secured claims, conditional claims and claims from certain closely related parties):

- If the dividend payment is a minimum of 50%, the plan must be accepted by at least three-fifths of the creditors with a total of at least three-fifths of the total debt;
- If the dividend payment is less than 50% but a minimum of 25%, the plan must be accepted by at least three-quarters of the creditors with a total of at least three-quarters of the total debt.

1.4 Can a creditor or a class of creditors be ‘crammed-down’?

In voluntary debt negotiation proceedings, an objecting creditor or class of creditors cannot be crammed down. In a successful compulsory composition, the minority voters are crammed down by the majority voters (see 1.3). However, claims ranking in priority and claims that are fully secured may not be crammed down as they are entitled to full payment.
1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

While under judicial debt negotiation proceedings, the debtor may initiate a sale of assets through a going-concern reorganisation plan, subject to the approval of the administrator and the creditor committee as well as from any security holder.

In winding-up proceedings, the administrator has the sole power to sell assets that are not encumbered. With a minor exception for certain going-concern sales, the administrator and the buyer must respect any security right in the asset. The administrator may, upon acceptance from a security holder, transfer ownership of a secured asset directly to the security holder, reducing the security holder’s claim in the estate with the estimated or actual market value of the transferred asset.

The bidding process upon the sale of assets during a bankruptcy proceeding is not specifically regulated.

1.6 What are the duties of directors of a company in financial difficulty?

The directors of an insolvent company must ensure that all creditors within each class are treated equally and that the company must not incur debt it is unable to pay. Further, the directors should take immediate action if the company’s equity is deemed insufficient considering the size and risk of the business operations, or if the equity capital is lower than half of the share capital. Such actions include, within a reasonable time, to call for a shareholders’ meeting to inform of and suggest solutions to better the company’s economic situation. If the board of directors finds that there are no grounds for improvement actions or such actions are not feasible and it is unlikely that the economic problems may be solved, the board of directors must suggest that the company is dissolved or file for bankruptcy proceedings.

After judicial debt negotiation proceedings are opened, the directors maintain their roles and duties, but they have to comply with the administrator or creditors’ committee and the legal framework regulating the proceedings.

After winding-up proceedings are opened, the directors are stripped of their powers, and their duties are no longer to manage the company. Instead the directors have a duty to assist the court and the administrator with providing information, such as information regarding the debtor’s assets and debts, and documentation, such as relevant correspondence, financial statements and agreements.

1.7 What priority claims are there and is protection available for post-petition credit?

In Norway, claims entitled to dividend payment from the estate are generally ranked in the following classes: preferential claims (such as costs incurred by the estate); claims ranking first in priority (mainly employees’ claims for wages); claims ranking second in priority (mainly recent tax and VAT claims); regular claims (dividend claims with none of the other priorities); and claims ranking last in priority (such as interest accrued after proceedings were opened). The remaining claims from security holders that are not covered by the proceeds of the secured assets will fall into the relevant above-mentioned categories.

While under judicial debt negotiation proceedings, a debtor may not incur new debt, establish new securities in or sell assets of a significant value, without the acceptance of the debt negotiations committee.

1.8 Is there a different regime for banks and other financial institutions?

Under Norwegian law, banks, insurance companies and certain other financial institutions as well as parent companies of such entities are subject to separate rules on insolvency proceedings, found in the Act on guarantee schemes for banks and public administration, of financial institutions (the Guarantee Schemes Act 75) of December 6 1996.

Subject to the Guarantee Schemes Act, the government has the authority to place such above-mentioned financial institutions under public administration either if they cannot fulfil their obligations as they fall due and they do not have sufficient funds to secure future operations, or if they are not capable of fulfilling capital adequacy requirements. The board of directors will be heard before such actions are taken, if possible. If public administration proceedings are opened in a financial institution that is a parent company in a financial group, the other companies in that financial group may also be included in the proceedings.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

Bankruptcy or reorganisation proceedings may only be opened in Norway for a foreign debtor if that debtor has its main office of business in Norway — similar to the centre of main interests (Comi) principle in the EC Insolvency Regulation 1346/2000. Note, however, that Norway is not a member of the EU and has not ratified the EC Insolvency Regulation.

On July 8 2014, the High Court of Norway passed a ruling in a case where a petition for winding-up proceedings against a Polish company was delivered to a Norwegian court. The creditor was the Norwegian Tax Authorities, and the claim referred to unpaid VAT claims arising from sales made by the company’s Norwegian branch. The court applied the Comi principle, and stated that bankruptcy proceedings may only be opened in Norway when the business’s Comi is located in Norway. The bankruptcy petition was declined because the company in this case was deemed to have its Comi in Poland.

It is quite common for a Norwegian entrepreneur to establish an empty foreign holding company without any other business than owning a Norwegian branch; a Norwegian-registered foreign business enterprise (NUF). Upon insolvency in such businesses the foreign holding company may be taken under judicial insolvency proceedings in Norway, since the actual operations of the company is based in Norway. The proceedings will include the Norwegian branch, and the notification of the opening of the proceedings will be registered in the Norwegian Company Register on the company number of the Norwegian branch.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

Norway has not ratified the EC Insolvency Regulation, but has since 1933 been part of a Nordic Convention on Bankruptcy between Norway, Den-
mark, Finland, Iceland and Sweden. This convention provides regulation on cross-border insolvencies within these member states, including rules on recognition, enforcement and choice of law in various situations.

The question of whether assistance in the form of ancillary bankruptcy proceedings to foreign main proceedings may be opened in Norway has no clear answer under Norwegian law. There have been very few cases before Norwegian courts relating to foreign bankruptcy proceedings. Old case law from the late 19th century implies that ancillary bankruptcy proceedings may be opened in Norway on request from a foreign bankruptcy estate, but these court decisions have somewhat limited legal effect today, being relatively old and passed by lower courts.

In 1994 a Norwegian district court opened sub-bankruptcy (ancillary) proceedings in Norway in a foreign entity with reference to Norwegian non-statutory bankruptcy law. The court pointed out that no matter where a debtor’s assets are located, these should be sold in the interest of all creditors, domestic and international. Ancillary proceedings are a useful instrument in that regard.

In a decision from 2013, the Supreme Court of Norway addressed the question of whether an established execution lien in a Spanish debtor’s assets in Norway could be clawed back due to a clawback claim from the debtor’s Spanish bankruptcy estate, or whether the debtor’s assets in Norway were protected by a stay on creditor enforcement actions due to the debtor being under Spanish insolvency proceedings. The court decided that the insolvency proceedings in Spain did not prevent separate debt recovery proceedings against the debtor’s assets in Norway (stating that a clawback claim from the Spanish bankruptcy estate would not be recognised) and allowing creditors to enforce execution liens established in the debtor’s assets in Norway while the debtor was under insolvency proceedings in Spain. The court stated that acknowledgement of insolvency proceedings in another state must primarily be based on international mutual agreements or legislation, and there was no such mutual agreement or legislation with Spain.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

While under judicial debt negotiation proceedings, the debtor and the administrator or creditor committee must respect the interest of the secured creditors and ensure that the continuing operations of the company does not significantly deteriorate their position.

A compulsory composition must involve full payment to claims ranking in priority (mainly wages and recent tax and VAT claims).

The tax authorities’ internal guidelines as to what dividend they may accept and the timeframe for payment for their claims that are not ranking in priority are often stricter than the minimum requirements for a compulsory composition under the Bankruptcy Act.

Most of the employees’ claims for wages rank first in priority. The same applies for certain pension liabilities, especially pension premiums.

With regard to termination and workforce cuts, the same rules are applicable for companies under debt negotiation proceedings and compulsory composition proceedings as for companies which are not under any insolvency proceedings.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

Due to a drastic drop in the oil prices during the fall of 2014, and continuing low oil prices in 2015, a number of companies operating in this area have enforced cost reduction measures and executed large workforce cuts. This in turn has negative implications on the oil services industry, with a decreasing demand and lower prices of goods and services related to the oil industry. So far there has been an increase of non-judicial reorganisation and refinancing in this sector, as well as in the shipping sector, and if the situation continues we expect to see an increase in the number of winding-up proceedings within the oil services industry in the next few years.

There is an interesting development with regard to the judicial restructuring scheme in Norway. The Department of Justice has authorised a review of the provisions in the Bankruptcy Act on voluntary and compulsory judicial debt negotiation proceedings. The mandate is to evaluate whether the rules should be amended to facilitate a more flexible restructuring scheme, aimed at saving more businesses and preserving more jobs. The mandate has been given to Judge Leif Villars-Dahl at the Oslo court of probate and enforcement, supported by attorneys Knut Ro, Stine Snertingdal and Ståle Gjengseth, as well as professor of economics Nils-Henrik M von der Fehr. The report will be submitted by March 1 2016.
About the author

Stine Snertingdalen is a partner at Kvale Advokatfirma DA. She gives legal aid to some of the largest banks in Norway in the area of banking and finance, insolvency regulation, refinancing, credit assurance and credit recovery. Furthermore, she assists clients with restructuring, and is also frequently appointed as bankruptcy administrator by the Oslo Bankruptcy Court. In this way, Snertingdalen has experience looking at a case from both sides of the table when working with refinancing, restructuring and debt recovery. She regularly holds lectures for Norwegian lawyers and financial institutions, and she is highly ranked both in Norwegian and international rankings; quoting from *Chambers and Partners*: “Sources admire the ‘outstanding and very efficient’ Stine Snertingdalen, who has developed an impressive reputation in the insolvency field. ‘She is one of the brightest talents I have ever seen at such a young age,’ enthuses one interviewee.”

About the author

Ingrid Tronshaug is a senior associate at Kvale Advokatfirma DA, specialising mainly in insolvency law, including restructuring, bankruptcy and mortgage law, but has also experience with real estate and construction law. She has several years of experience with various insolvency proceedings, including working on some of the largest bankruptcy proceedings and judicial debt negotiation proceedings in Norway. Further, she assists clients with various acts of enforcement of Norwegian and foreign claims.

Tronshaug has an LLM in Corporate and Commercial law from the University of Southampton in addition to a master’s degree in Law from the University of Oslo. She wrote her master’s thesis on European cross-border insolvencies.
Slovak Republic

Peter Vrabel, managing partner and Robert Vasko, lawyer, Legate

Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

Slovak law provides for two particular processes for debtors in financial difficulties: bankruptcy and restructuring. Both proceedings are initiated solely upon the petition (proposal) and are divided into two phases. Bankruptcy is commenced upon the declaration of bankruptcy by the court and is preceded by bankruptcy proceedings (initial phase) where ascertainment of the debtor’s property is carried out by a trustee (in the Slovak Republic, the administrator). On the other hand, restructuring is commenced upon its permit by the court and is preceded by restructuring proceedings (initial phase) where the evaluation of all prerequisites is executed by the court.

Should the debtor file a petition to declare bankruptcy, its insolvency is presumed. A creditor is entitled to initiate a bankruptcy proceeding only if the debtor is insolvent (the debtor is unable to fulfil at least two monetary obligations to more than one creditor within 30 days of their due date).

Unlike bankruptcy, where insolvency of the debtor is a prerequisite, the process of restructuring may be carried out even if insolvency of the debtor is impending, provided the process is recommended in a restructuring opinion and the maintenance of at least a substantial part of the operation of the debtor’s enterprise and a higher degree of creditor satisfaction than in bankruptcy may reasonably be expected. However, a creditor is only authorised to initiate restructuring after the debtor’s endorsement.

The bankruptcy process is generally supervised by the bodies of creditors and the competent court while the estate of the debtor is administered by the trustee appointed by the court. On the other hand, restructuring is commenced upon its permit by the court and is preceded by restructuring proceedings (initial phase) where the evaluation of all prerequisites is executed by the court.

Conversion of all residual property of the debtor and its liquidation to prove the highest possible satisfaction of the creditors is the main feature of bankruptcy. That is to say, bankruptcy is general collective execution (liquidation) of a debtor’s property. In contrast to bankruptcy, the maintenance of at least a considerable part of the operation of the debtor’s enterprise, the enforcement protection of the debtor, the prolongation of maturity of respective parts of the debtor’s obligations and the greater creditor satisfaction than in bankruptcy, are the main aims of the restructuring process.

1.2 Is a stay on creditor enforcement action available?

Each and every already initiated enforcement proceeding towards property of the debtor is ex lege (by operation of law) terminated upon declaration of bankruptcy. Therefore, no additional filings are needed. There are no exceptions regarding the ban of enforcement.

However, within the initial phase of bankruptcy enforcement actions are only suspended, as opposed to bankruptcy where enforcement proceedings are terminated. This will equally apply to restructuring, where enforcement proceedings are only suspended and after permit of restructuring terminated. Should the bankruptcy not be declared or the restructuring is not permitted, already-initiated enforcement proceedings will be resumed.

A stay on creditor enforcement cannot be lifted and it expires upon termination of bankruptcy or restructuring.

1.3 What are the key features of a reorganisation plan and how is it approved?

In general a reorganisation plan includes two main sections: the descriptive part and the binding part.

Conversion of all residual property of the debtor and its liquidation to ensure the highest possible satisfaction of the creditors is the main feature of bankruptcy. That is to say, bankruptcy is general collective execution (liquidation) of a debtor’s property. In contrast to bankruptcy, the maintenance of at least a considerable part of the operation of the debtor’s enterprise, the enforcement protection of the debtor, the prolongation of maturity of respective parts of the debtor’s obligations and the greater creditor satisfaction than in bankruptcy, are the main aims of the restructuring process.

The restructuring plan adopted by the creditors at the approval meeting is binding. If the plan is not approved, the creditors proceed to liquidate the debtor. The unregistered receivables subject to restructuring or denied claims be -
1.4 Can a creditor or a class of creditor be ‘crammed-down’?

Restructuring

If the voting requirements for the plan adoption are not met, the submitter of the plan may demand substitution of approval within respective groups (classes) through a decision of the court. However, there are few conditions to be fulfilled in order to demand the substitution of approval prescribed by law. The substitution of approval of an unsecured receivables group may not be awarded if creditors of the group obtain fulfillment in a period exceeding five years; this will not apply to so-called subordinated claims. All in all, even if a group (class) of creditor is crammed-down or outvoted, the plan may be confirmed by the court through the substitution of its consent.

Further, 50% of the ascertained claims will not cease to exist and the remaining part converts to other proprietary right. The debtor may not distribute profit between its members until receivables of unsecured creditors are not satisfied to the extent of 50% of their ascertained amount; this will not apply in relation to subordinated claims. Infringement of the debtor’s duty under a previous sentence establishes the inefficacy of the plan towards affected unsecured groups (classes).

Bankruptcy

Unsecured receivables of a related person, unsecured claims consisting of contractual penalties and receivables connected with the obligation of subordination are deemed as subordinated claims. They should be satisfied from proceeds remaining after the full settlement of other unsecured receivables.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

Within bankruptcy, the trustee usually draws up a sales plan of the debtor’s property. Any sale is subjected to authorisation of the creditor body or the court; real estate may be realised only by auction and after expert opinion on its value is submitted.

Credit-bidding or stalking horse bids are not allowed.

Within the framework of bankruptcy, a forfeiture of pledged property and blocking of other offers to buy property of the debtor are not allowed and the trustee is not bound by any contractual pre-emption rights.

1.6 What are the duties of directors of a company in financial difficulty?

First, the debtor is obliged to prevent its insolvency and systematically monitor its financial situation as well as the status of its assets and obligations. If the insolvency is impending, the debtor is obliged to take appropriate measures to avert it without undue delay.

The insolvent debtor is obliged to file petition on a bankruptcy declaration within 30 days of the day of ascertainment of its heavy indebtedness; otherwise statutory representatives of the debtor are obliged to pay in favour of a bankruptcy mass a sum in the amount of the debtor’s registered capital, but not exceeding double the minimum amount of a company’s registered capital stipulated by law. When assessing heavy indebtedness, so-called going concern value is taken into account and obligations are reduced by subordinated claims.

1.7 What priority claims are there and is protection available for post-petition credit?

Receivables against assets (such as costs of property realisation, remuneration of the trustee, wages of employees and expenses connected with proceeding) are priority claims within bankruptcy.

Claims arising during restructuring proceedings, labour receivables to which entitlement arises in the month in which the restructuring process was initiated, remuneration of the trustee and non-monetary receivables, are priority claims within restructuring, which are not affected by the restructuring proceeding. Such claims are fully redeemable and are not included in the restructuring plan unless creditors grant consent.

Post-petition credit is not affected by the restructuring plan if it is provided to the debtor after commencement of the restructuring proceeding.

1.8 Is there a different regime for banks and other financial institutions?

No other regime applies to banks and other financial institutions, if they are in position of unsecured creditor.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

EU

Insolvency proceedings (bankruptcy or restructuring) may be opened in the Slovak Republic under Council Regulation (EC) 1346/2000 on insolvency proceedings (Regulation).

If a centre of main interests (Comi) of the debtor is situated in the Slovak Republic, the main insolvency proceeding may be opened in the Slovak Republic and is governed by Slovak law (lex fori concursus). The main insolvency proceedings have extraterritorial effects and affects the entire property of the debtor across the EU.

The secondary insolvency proceeding may be opened in parallel with the main insolvency proceeding provided it is initiated after the commencement of the main proceeding and establishment of the debtor is situated in Slovak Republic. The secondary insolvency proceeding is governed by laws of the Slovak Republic and its effects are limited only to the assets located in the Slovak Republic. This does not apply to restructuring, which cannot be opened as the secondary insolvency proceeding.

International

For an insolvency proceeding with a foreign element (outside of the EU), the reciprocity principle applies, unless an international treaty stipulates otherwise. The competence of the Slovak court applies if the debtor has property in the territory of the Slovak Republic, regardless its amount.

Bankruptcy declared by a Slovak court affects property of the debtor situated abroad, if legal regulations of the respective state permit it.
2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

**EU**

According to the Regulation, all member states court decisions in insolvency proceedings are recognised in other member states without any further formal requirements. Therefore, the trustee is entitled to exercise all powers and competencies under the law of the state where the insolvency proceeding is commenced.

**International**

Foreign bankruptcy is recognised by Slovak courts on petition of a foreign trustee provided: the reciprocity principle applies; and the foreign trustee proves its appointment, initiation of foreign bankruptcy and legal interest of such recognition (unless an international treaty stipulates otherwise).

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

The Tax Offices and Social Insurance Companies have a specific status within the framework of restructuring as providers of state aid. For this reason, they are considered creditors not consenting with the plan who have the possibility possibility of substituting their approval (see 1.4).

Protection of employees is ensured through guarantee insurance, which is mandatory for any employer operating in Slovak Republic. If an employer is unable to settle claims of employees due to its insolvency, such claims are satisfied through guarantee insurance benefits. Pension liabilities are covered by guarantee insurance benefits, which can be disbursed for three months provided the employment lasted for the 18 months preceding the employer’s insolvency.

Moreover, labour claims of employees arising after bankruptcy is declared are considered receivables against assets and have priority claim status; they will be satisfied before unsecured receivables.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

A significant amendment of insolvency law became effective on April 29 2015 through Act 87/2015 Coll. This act strengthens the legal position and increases the satisfaction of unsecured creditors in restructuring and establishes a register of disqualified statutory bodies who have breached their statutory duties. The amendment prevents a merger, an amalgamation and a split-up of a company during bankruptcy or restructuring, which are ways the debtor and its statutory bodies may avoid their liabilities. Moreover, it tightens obligations of statutory members of insolvent companies or companies facing impending insolvency by diversion of insolvent and a ban on drawback of fulfillment substituting a company’s own resources.
About the author

Peter Vrabel is a managing partner and the leader of the Legate team. His previous experience, acquired mainly at Squire Sanders & Dempsey, make him an expert in various practice areas of law. He is a fully licensed security broker, mediator, arbitrator and trustee.

Peter Vrabel’s expertise involves particularly M&A, gas and oil, insolvency law, litigation and arbitration, construction law, international public and private law, aviation law and public procurement as well as related cross-border matters. He is working on legal assistance for four companies that are rated among the top 20 non-financial enterprises in the Slovak Republic.

About the author

Robert Vasko has been a junior lawyer associated with Legate since 2013 and is a rising star for insolvency and restructuring issues. He focuses mainly on insolvency law, litigation and corporate matters.

Robert Vasko was involved in resolving cross-border restructuring issues in relation to the restructuring of a leading construction business in the Slovak Republic, as well as the successful representation of a real estate developer in incidental proceedings invoked by restructuring. He works on insolvency cases on both sides of the process: cooperation and backing of the trustee and on the one side and representation of the creditors in insolvency proceedings on the other.

Robert Vasko also gives advice on conformity assessment matters, consumer protection issues from the trader’s perspective and receivables recovery. He also provides sole representation in civil litigation matters for domestic clients.
United Kingdom

Richard Bussell, partner, and Paul Sidle, lawyer, Linklaters, London

Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

Formal collective insolvency procedures under the Insolvency Act 1986 (Act) consist of company voluntary arrangements (CVA), administration and liquidation. Receivership is a secured creditor’s limited enforcement remedy.

A CVA may be used to rescue a company and, more recently, has been used to deal with particular problematic liabilities (such as obligations under unprofitable leases). Its use in financial restructurings is limited as proposals are unable to bind secured creditors without their consent. The primary purpose of administration is corporate rescue, but in recent years the rescue of a corporate entity through administration is rare. It is more often used to rescue the business through a going concern sale frequently arranged in advance of filing (known as a pre-pack). Liquidation is a terminal procedure typically resulting in the piecemeal sale of assets (rather than the business), distribution of the proceeds to creditors and dissolution of the company. Members’ voluntary liquidations (MVLs) are commenced by shareholder resolution and not by court order and are a common process used in circumstances where a company is no longer trading, has been dormant for some time or as a step prior to dissolution. An MVL is a solvent liquidation process in which all creditors are paid in full and any surplus distributed to shareholders. By comparison, creditors’ voluntary liquidations (CVLs) are (generally) insolvent liquidations. They are also commenced by shareholder resolution but the liquidator is chosen by the creditors. They are a simpler and less expensive procedure than applying to the court for a winding-up order (a compulsory liquidation).

Large financial restructurings are usually achieved consensually without recourse to an insolvency filing, often using contractual powers under an inter-creditor agreement to implement the solution. In the absence of contractual mechanisms, a statutory scheme of compromise or arrangement (known as a scheme of arrangement) may be available.

A state of insolvency is unnecessary to support a company’s filing for a scheme of arrangement or a CVA and while the directors remain in control, each process is under the general supervision of the court. A CVL and administration require the company to be insolvent which is tested on a current or near future inability to pay debts as they fall due or on a longer term basis where the company’s liabilities exceed its assets. In both procedures, a court-supervised officer is appointed and directors lose control.

1.2 Is a stay on creditor enforcement action available?

Filing for administration automatically gives rise to a broad stay preventing, for example, the commencement or continuation of legal proceedings or secured creditor enforcement action. The moratorium remains in place for the life of the administration and may only be lifted with the consent of the administrator or the court. The stay does not, however, apply to certain financial collateral arrangements. There is a more limited procedural stay in liquidation but this does not generally prevent secured creditor enforcement. Other than for qualifying small companies, a CVA does not give rise to a stay. The court may be prepared to grant a temporary stay of creditor action where a scheme of arrangement is being implemented and appears to have a reasonable chance of success with majority creditor support, although the grant of a stay is at the discretion of the court.

1.3 What are the key features of a reorganisation plan and how is it approved?

The terms of a CVA or scheme of arrangement are not generally restricted by legislation. For example, debt write-offs, debt-for-equity conversions and asset disposals are all possible. However, only a scheme of arrangement may bind secured creditors without their individual consent, making them more suited to large-scale financial restructurings than CVAs.

There are no creditor classes in a CVA. The plan must be approved by 75% in value of all the unsecured creditors present and voting at the creditors’ meeting, either in person or by proxy (provided that not more than 50% of the unconnected creditors present in person or proxy vote against the CVA). While an ordinary resolution (50%) of the members is also needed, the decision of creditors will prevail over any contrary decision of members.

In contrast, in a scheme, creditors are divided into classes. For each class, approval of the scheme requires a majority in number representing 75% in value of the creditors in that class present and voting at the creditors’ meeting, either in person or by proxy, to vote in favour of it. It will also need to be sanctioned by the court and a copy delivered to Companies House before it becomes binding. The rules regarding identification of classes have evolved in the course of recent court decisions.

1.4 Can a creditor or a class of creditor be crammed-down?

Both a CVA and a scheme of arrangement can bind dissenting or non-voting unsecured creditors, but only a scheme of arrangement may do so in respect of secured claims. While creditors within a class may be crammed-down in a scheme, it is not possible to cram-down an entire class, since each class must vote in favour of the scheme for the court to sanction it.
There are two statutory grounds on which a CVA, once approved, may be challenged: that it unfairly prejudices the interests of a creditor, member or contributory; and, that there has been some material irregularity at, or in relation to, either of the meetings of the creditors and members.

For schemes of arrangement the court will, at the convening hearing, consider whether the class or classes of creditors put forward are appropriate and a scheme will not be allowed to proceed if they are not. If the relevant creditor meetings vote in favour of the scheme, the court will then need to decide whether to exercise its discretion to sanction it.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

A pre-pack sale is not a special type of insolvency procedure and no reference is made to pre-pack sales in English insolvency legislation. The term pre-pack is generally used to describe a sale of the business or assets of an insolvent company (usually by an administrator) where the preparatory work (such as identifying the purchaser and negotiating the terms of the sale) takes place before appointment. The sale is then concluded almost immediately after the appointment without the sanction of either the court or creditors, and often with little or no formal marketing of the business or assets being sold.

Administrators must be able to explain to the company’s creditors why the insolvency sale was entered into. In a pre-pack situation, guidance as to the information which they should provide is contained in Statement of Insolvency Practice 16: Pre-packaged sales in administrations.

In practice, sales to former management and shareholders and to secured creditors are likely to be implemented as pre-pack sales, while sales to third parties are more likely to involve a post-appointment process of marketing and consideration of competing offers. A pre-pack to a secured creditor would usually involve the purchase by a special purpose vehicle owned by the secured creditors.

1.6 What are the duties of directors of a company in financial difficulty?

While solvent, directors of a company have a statutory duty to promote the success of the company. This is subject to any enactment or rule of law requiring directors to consider or act in the interests of creditors of the company. The common law provides that the interests of creditors intrude as the company nears insolvency. There is a shift in the duties of the directors away from advancing the interests of the shareholders as a whole towards protecting the interests of creditors as a class. In addition, section 214 of the Act imposes personal liability on directors to contribute to the assets of an insolvent company if at some time before the commencement of the winding-up of the company, the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. Liability arises if, once aware, the director failed to take every step with a view to minimising the potential loss to the company’s creditors.

1.7 What priority claims are there and is protection available for post petition credit?

In administration proceedings, administration expenses rank ahead of: preferential debts (primarily certain amounts owed to employees); the so-called prescribed part (an amount, not exceeding £600,000 ($890,000) which statute requires to be set aside from floating charge realisations to satisfy claims of unsecured creditors); floating-charge (but not fixed-charge) claims; and unsecured claims. The same order of priority applies in a liquidation. Amendments are made to the order of priority when security involves financial collateral.

There are different categories of expense claims and a waterfall of priorities between categories of claims. However, in general terms, if a company in administration enters into a new contract for the supply of goods or services, or agrees new funding, the resulting liability to pay for those goods or services, or to repay the funding, will be a so-called super-priority expense claim and payable in priority to the administrator’s own remuneration.

1.8 Is there a different regime for banks and other financial institutions?

Implementing the requirements of the EU Bank Recovery and Resolution Directive 2014, the Banking Act 2009 (as amended from January 1 2015) consists of a special resolution regime (SRR) for failing UK banks (including their UK and foreign branches) and certain other financial institutions. The SRR extends also to a UK bank’s parent and subsidiaries, and certain group subsidiaries (broadly, financial institutions or subsidiaries of financial institutions). The powers under the SRR are extremely wide and capable of affecting a bank’s property, rights and liabilities.

The SRR consists of five stabilisation options for banks that get into financial difficulties, as well as special bank insolvency and bank administration procedures. The stabilisation options consist of transfer powers (to a private sector purchaser, a bridge bank or an asset management vehicle) and bail-in (which, for example, allows the Bank of England to recapitalise the bank through conversion of debt liabilities into equity). Resolution may involve the exercise of one or more stabilisation options. There are various protections and safeguards for creditors under the Banking Act (BA) 2009, notably the principle that no shareholder or creditor should be worse off in resolution than they would have been in insolvency. The BA 2009 reflects international efforts, led by the Financial Stability Board, to put in place reforms to tackle the too-big-to-fail problem, so that future banking failures can be safely managed without recourse to public funds.

Section 2: INTERNATIONAL/CROSS BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

The EC Insolvency Regulation 2000 (EIR) creates rules under which the insolvency law jurisdiction of courts within EU member states (excluding Denmark) depends on the location of a debtor’s centre of main interests (Comi) or the existence of an establishment within a member state. The EIR creates a common regime for the taking of insolvency law jurisdiction and the recognition and effect of insolvency proceedings throughout the EU. It does not, however, purport to create uniform insolvency laws. The
2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

There are four main methods under which the English courts may provide assistance in insolvency matters:

First, section 426 of the Act enables the English court to provide assistance to the courts of certain designated jurisdictions. These are mainly common law countries, so this does not include the US. The form of assistance the English court might give is wide and subject to judicial discretion. In granting assistance, the English court can apply any combination of the insolvency laws of England and the insolvency laws of the requesting state.

Second, as already described, the EIR provides for rules on the insolvency law jurisdiction of the courts of EU member states (excluding Denmark).

Third, the Cross Border Insolvency Regulations 2006 (CBIRs) focus on recognition of and co-operation between foreign insolvency proceedings, but unlike the EIR do not allocate insolvency jurisdiction. The concept of Comi is also used by the CBIR, but in order to determine the effect of recognition, essentially whether it is automatic or discretionary. A foreign main proceeding – one taking place in the state where the debtor has its Comi – will receive automatic recognition and specific forms of relief. The CBIRs complement section 426 in that they encourage the British courts and insolvency practitioners to co-operate with foreign courts and foreign practitioners, providing this does not conflict with their other duties under British law.

Fourth, the court has an inherent power to recognise and grant assistance to foreign insolvency proceedings under the common law principle of modified universalism. However, recent judicial authority has shown the common law power of assistance to be limited in scope. In practice, it is quite difficult to conceive of a circumstance in which the English courts would feel able to provide assistance under the common law, where they were not permitted to provide such assistance under any of the bases above.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

Employees, pension trustees, government or regulatory bodies could all have an impact on the outcome of a restructuring depending on the particular situation and what is proposed. For example, obligations to consult with employees on a business transfer or where there may be redundancies could have an impact on timing. There could also be sector-specific issues to consider such as licences in heavily regulated industries. There might even be a political backdrop to be aware of in certain sensitive matters which, while not directly impacting on the terms of a restructuring, may do so indirectly by affecting the attitude of stakeholders.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

A significant trend over the last few years has been the use by foreign debtors of schemes of arrangement to implement a restructuring. Although the English court will only sanction a scheme in respect of a foreign debtor if it has a sufficient connection with England, the test does not require Comi to be located here or for there to be assets in England. Case law has developed the requirements for “sufficient connection” which can be less stringent than a Comi test. It may be tested simply by reference to whether the finance documents are governed by English law and have an English jurisdiction clause (exclusive or non-exclusive).

There is a continuing trend of innovation in restructuring techniques, in particular through the deliberate creation of jurisdiction in England, to implement a successful restructuring by using English law.

Insolvency law reform also remains an area of interest, both nationally and at the European level, with a recast of the EIR due and a desire for greater consistency of insolvency processes and outcomes among member states.
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About the author
Richard Bussell leads on many of the firm’s key restructuring and insolvency deals in the UK and internationally. He has significant experience acting on some of the markets’ most complex financial and corporate restructurings, distressed M&A and formal insolvency proceedings. He acts for a wide selection of market players on their most important transactions. Bussell has considerable recent cross border and international experience and has been engaged on transactions in Europe, Israel, Africa and the UK in the past year. Recent transactions include advising on insolvencies including Woolworths, Republic, McCarthy & Stone and Lehman Europe; financial restructurings of European LBOs including Primacom, Terreal, Seat Pagine and Foxtons; bank failure and resolution planning in Europe and EMEA (Snoras AB, African Bank Limited) and multi-creditor/stakeholder financial restructurings and recoveries including Zim, VSZ, Parmalat, Tiscali, Railtrack plc/Network Rail and Metronet.
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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and bankruptcy processes are available for financially troubled debtors?

There are two primary types of business insolvency proceedings under title 11 of the United States Code (Bankruptcy Code): chapter 11 and chapter 7 proceedings.

Chapter 11 cases are typically reorganisation proceedings, although liquidation is also possible. Generally, a debtor subject to chapter 11 continues to be operated by existing management. However, the bankruptcy court can appoint a chapter 11 trustee who can replace management if the court finds sufficient cause, including fraud, dishonesty or gross mismanagement. It is rare for a chapter 11 trustee to be appointed (for example, there was no chapter 11 trustee in the mega-fraud cases of Enron or Worldcom because existing management had already been replaced).

Chapter 7 bankruptcies are liquidation proceedings. US law does not automatically require liquidation (although the court may order a chapter 11 case to be converted to a chapter 7 liquidation against the debtor's wishes if, for example, the debtor is unable to confirm a chapter 11 plan). In a chapter 7 case, a trustee is appointed by the bankruptcy court to liquidate the assets. Although the trustee can obtain court authority to operate a business, in most cases they prefer to shut down operations as soon as possible and liquidate the assets. As a result, it is less common for a large company to file a chapter 7 case as its stakeholders will usually experience a greater recovery in a chapter 11 case.

1.2 Is a stay on creditor enforcement action available?

On filing a petition, the Bankruptcy Code imposes a worldwide automatic stay on creditor enforcement action available for financially troubled debtors. Chapter 11 bankruptcy proceedings automatically require liquidation (although the court may order a chapter 11 case to be converted to a chapter 7 liquidation against the debtor's wishes if, for example, the debtor is unable to confirm a chapter 11 plan). In a chapter 7 case, a trustee is appointed by the bankruptcy court to liquidate the assets. Although the trustee can obtain court authority to operate a business, in most cases they prefer to shut down operations as soon as possible and liquidate the assets. As a result, it is less common for a large company to file a chapter 7 case as its stakeholders will usually experience a greater recovery in a chapter 11 case.

1.3 What are the key features of a reorganisation plan and how is it approved?

A debtor has the exclusive right to propose a plan of reorganisation within the first 120 days of filing the bankruptcy petition and to solicit acceptances for such plan within 180 days of filing. Courts may extend these periods up to 18 months and 20 months, respectively, if the debtor can show cause. A creditor may file a plan only if the debtor's exclusive period has been terminated by the bankruptcy court, or if a trustee has been appointed in the case.

A chapter 11 plan can adjust all debt, equity and contractual relationship between the debtor and its various stakeholders. The plan specifies the treatment that each class of creditors and shareholders will receive. Some plans are sponsored by third parties who wish to acquire the debtor's assets or at least a majority of the equity interests in the reorganised company; others can be standalone plans where existing creditors convert their debt into equity interests in the reorganised company.

Creditors are grouped into classes with similarly situated creditors and may vote on the plan if the plan impairs (alters) any of their legal rights. For a plan to be approved by the court, each impaired class must vote to accept the plan, or where a particular class does not accept the plan, the plan must meet the statutory requirements for cram-down as to that class. Even if all classes entitled to vote on the plan have voted to accept the plan, the court must still determine whether the plan is in the best interests of any individual dissenting creditors or shareholders. The best interests test requires the court to determine that the dissenting creditors or shareholders are receiving under the plan at least as much (in present value terms) as they would receive if the debtor were instead liquidated under chapter 7 of the Bankruptcy Code.

1.4 Can a creditor or a class of creditor be crammed-down?

A plan can be crammed-down against an objecting class of creditors if certain statutory requirements are met: (i) at least one impaired class has voted to accept the plan; and (ii) the court finds that the treatment provided for the objecting classes does not unfairly discriminate against them and is fair and equitable.
The prohibition against unfair discrimination means that similar claims or equity interests must be treated similarly. There are examples of fair discrimination, however. For example, the enforcement of a contractual subordination provision to subordinate the claims of one class to the claims of another class does not discriminate unfairly against the subordinated class.

The precise determinations required for meeting the fair and equitable test turn on whether the class is secured or unsecured. Cram-down of a secured class will be permitted if the plan provides: (i) that the objecting secured creditor classes will retain a lien to the extent of their secured claims and will receive deferred cash payments which have a present value equal to at least the value of the creditor’s interest in the collateral; (ii) for the sale of the secured creditors’ collateral with the creditors’ lien attaching to the proceeds; or (iii) for the realisation by the secured class of the indubitable equivalent of their secured claims.

Generally, a class of unsecured claims can be crammed down if the plan provides either that the creditors in the class receive (over time) cash payments equal to the present value of their unsecured claims, or that junior classes (such as subordinated creditors or stockholders) receive nothing under the plan. Equity security holders may be crammed down along similar lines.

1.5 Is there a process for facilitating the sale of a distressed debtor’s assets or business?

The Bankruptcy Code contemplates that a debtor may wish to sell certain or even substantially all of its assets outside the ordinary course of business as part of its reorganisation. Such asset sales must be approved by the bankruptcy court after notice and a hearing. Courts typically defer to the debtor’s business judgment in scrutinizing the debtor’s decision to sell assets outside of the ordinary course of its business. Although the Bankruptcy Code does not require an auction process, in many cases, the debtor obtains court approval after an auction is conducted because it provides a market test of any bids to purchase the assets and a public opportunity for the debtor to obtain the highest and best price. The process and timing for soliciting bids from qualified bidders is itself typically subject to court approval.

A debtor-in-possession may sell its assets free and clear of interests in such property, including a secured creditor’s lien on such assets and certain other claims, provided certain statutory requirements are met. The secured creditor’s lien in the property will attach to the sale proceeds in the same order of priority as it enjoyed prior to the sale.

Secured creditors have a general right to credit bid up to the face amount of their claim in a sale of their collateral. As part of the sale process, stalking-horse bidders are often able to negotiate protections, including break-up fees and expense reimbursements, into the sales contract.

1.6 What are the duties of directors of a company in financial difficulty?

In general, directors and officers owe fiduciary duties of loyalty, care and good faith to the company for which they serve. Unlike in some other jurisdictions, directors and officers cannot be personally liable under Delaware law if the company becomes insolvent or enters bankruptcy, as long as they have discharged their fiduciary duties. As a company begins to experience financial distress, it is important that the board of directors hire legal and financial advisers to assist them in discharging their various duties. Although those duties do not shift to a particular group of stakeholders when a company is in the zone of insolvency, the board’s actions will often be scrutinised by creditors concerned about their recoveries. If there is a subsequent bankruptcy, creditors may seek to bring a derivative suit on behalf of the company to recover from any available directors and officers’ insurance. In general, directors and officers of a company in financial distress are well-advised to act in a manner that seeks to maximise the value of the enterprise.

1.7 What priority claims are there and is protection available for post petition credit?

The US Congress has designated certain claims that would otherwise be pre-petition unsecured priority claims. Priority claims include employee wages earned within 180 days of the bankruptcy case (subject to a statutory cap), contributions to an employee benefit plan and taxes owed to governmental authorities. Like administrative expenses, priority claims can only be satisfied from unencumbered assets, but they are senior in right of payment to general unsecured claims.

The Bankruptcy Code provides several inducements to lenders to provide financing to a financially-distressed company. The debtor can grant a priming lien on its assets that is prior in rank to certain pre-bankruptcy liens. The Bankruptcy Code imposes limitations on the ability of a DIP lender to prime pre-petition liens so any priming debtor-in-possession (DIP) financing must be reviewed carefully before court approval is sought. In addition, the DIP lender is provided a superpriority administrative expense claim which ranks ahead of other administrative expense claims and must be paid in full in cash in order for the debtor to emerge from a chapter 11 reorganisation (unless the holder of such claim agrees to different treatment).

In general, the superpriority aspect of DIP financing does not extend to pre-petition loans. Accordingly, in the ordinary course, a creditor will not be able to improve the priority of pre-petition loans through DIP financing. In limited circumstances, however, bankruptcy courts have permitted DIP lenders to roll up some of their pre-petition loans into a DIP financing, thereby affording superpriority treatment to the rolled-up portion.

1.8 Is there a different regime for banks and other financial institutions?

Yes, national and state-chartered banks and other financial institutions, such as insurance companies, securities brokers and commodities brokers are subject to different US insolvency regimes under applicable federal and state law. Unlike filings under chapter 11 of the Bankruptcy Code, where existing management frequently retains its management role, insolvency regimes applicable to financial institutions generally require that a governmental regulator or trustee assume management control of the business, usually to wind down the business and satisfy claims in accordance with statutory priorities. In addition, the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in the aftermath of the financial crisis introduced another insolvency regime, known as the Orderly Liquidation Authority, that is potentially applicable to financial institutions identified as systemically important.
Section 2: INTERNATIONAL/CROSS-BORDER ISSUES

2.1 Can bankruptcy or reorganisation proceedings be opened in respect of a foreign debtor?

Yes, foreign companies are eligible to be debtors under the Bankruptcy Code, provided that they meet certain jurisdictional requirements. US bankruptcy courts may assert jurisdiction over a legal entity so long as it has residence, domicile, place of business or property in the US.

US bankruptcy courts have interpreted the property requirement broadly, holding, for example, that maintaining a bank account in the US is sufficient to establish US jurisdiction over the debtor, even if it does not conduct business or have other assets in the US. The threshold for establishing US bankruptcy court jurisdiction is, therefore, very low.

Once a case is commenced, US bankruptcy courts exercise jurisdiction over the debtor and its property, regardless of where in the world its property is located. Foreign courts, however, may decline to recognise and enforce US bankruptcy court orders, particularly if the US is not the debtor’s centre of main interests. While experience has shown the automatic stay is generally respected by global financial institutions, local creditors without US contacts may fall outside the reach of the US court. This, in turn, limits the practical ability of the US bankruptcy court to assist a foreign debtor in restructuring debts of its local creditors.

2.2 Can recognition and assistance be given to foreign bankruptcy or reorganisation proceedings?

Yes, chapter 15 of the Bankruptcy Code incorporates the Model Law on Cross-Border Insolvency to facilitate cooperation between US and foreign courts in cross-border insolvency. Recognition will be granted if certain statutory conditions are met and affording comity would not be manifestly contrary to US public policy. Requirements for recognition primarily involve confirming that a foreign insolvency proceeding is a judicial or administrative process, collective in nature, authorised or conducted under a law related to insolvency or the adjustment of debts in which the debtor’s assets and affairs are subject to the control of supervision of a foreign court and for the purpose of reorganisation or liquidation. US bankruptcy courts will assess whether a foreign proceeding is pending in the jurisdiction of the debtor’s centre of main interests. If it is, then certain mandatory relief, such as the imposition of a stay on actions against the debtor or its property located within the territorial jurisdiction of the US, automatically goes into effect upon recognition. If it is not, then the extent of relief is left to the discretion of the bankruptcy court.

Once a foreign proceeding is recognised, the foreign representative may seek additional assistance from the bankruptcy court, which is charged with assessing the propriety of granting any such additional assistance by balancing the interests of the debtor and its creditors. US courts differ on, among other things, whether a chapter 15 debtor must meet US jurisdictional requirements to be eligible for relief, the extent to which courts are permitted to defer to a foreign proceeding with respect to assets located within the territorial jurisdiction of the US and on the propriety of enforcing non-consensual, non-debtor releases. Chapter 15 has proven, however, to be a flexible mechanism through which the recognition and assistance of US courts may be obtained.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

Various governmental or other stakeholders could have a material impact on the outcome of a reorganisation. Existing and former employees, labour unions, the Pension Benefit Guaranty Corporation (PBGC), government or regulatory agencies (including state and federal taxing authorities) the Federal Trade Commission, and the Federal Communication Commission, the Environmental Protection Agency, could all have an impact on the outcome of a restructuring depending on the circumstances of each case. For example, a debtor must satisfy certain statutory requirements in order to reject collective bargaining agreements. A debtor’s failure to satisfy minimum funding requirements or attempts to terminate pension plans may result in significant claims by a plan trustee or the PBGC, a government agency that regulates pension plans and guarantees certain pension benefits. Other specific issues, such as obtaining necessary anti-

About the author

Aaron Javian's practice focuses on advising creditors, debtors and new money investors on all aspects of domestic and cross-border in-court and out-of-court financial restructurings.

He has been involved in advising Towergate Finance on obtaining chapter 15 recognition of its English schemes of arrangement adjusting approximately £1bn of debt; an ad hoc group of exchange bondholders seeking an inter-creditor resolution of the litigation involving the Republic of Argentina and certain holdout bondholders; the joint administrators of Lehman Brothers International (Europe) on one of the largest and most complex insolvencies in history; and the lenders on the $1.88 billion restructuring of Ontario Teachers’ Pension Plan’s acquisition of marine container terminals in New York, New Jersey and Vancouver from Orient Overseas (International) Ltd.

Javian was named a rising star in restructuring and insolvency in the 2015 edition of IFLR1000.
trust approvals, maintaining federal licensing rights, preserving government reimbursements for health care expenditures, and seeking to address potential environmental liabilities, would directly implicate applicable government agencies whose cooperation could make or break a potential restructuring.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction.

While default rates in the US remain low and low interest rates persist, there are pockets of distressed activity across a number of sectors, including energy, retail, shipping, gaming and healthcare. Declining oil prices have strained the balance sheets and liquidity positions of North American exploration and production and oil field services companies. At the same time, outside of the oil and gas space, US domestic distress has been limited, there has been a proliferation of New York law-governed financing being raised by European and other non-US companies. We expect the introduction of New York law-governed debt into the capital structures of non-US entities to lead to the increased use of the US as a restructuring destination for foreign companies, either seeking to implement agreed restructurings through a pre-packaged or pre-negotiated chapter 11 case or to obtain chapter 15 recognition of restructurings approved through foreign insolvency proceedings. Finally, we anticipate that bankruptcy practitioners will continue to engage in a robust debate over the comprehensive bankruptcy reforms proposed by the American Bankruptcy Institute to ensure that the Bankruptcy Code remains fit for purpose in an environment where secured creditors are the norm, not the exception, and debt is freely traded by sophisticated investors.