
The main objective of the Colloquium will be to gather information to enable the Secretariat to delineate carefully the scope and nature of the work that UNCITRAL could undertake in this field.

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International Insolvency & Restructuring Report 2020/21

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Alan Bloom, Past President of the International Insolvency Institute, last offered a Foreword to this publication to coincide with the Institute’s conference in Barcelona in June of 2019 and this Foreword was intended to coincide with our annual meeting in New York that was scheduled for June of this year. What a difference a year makes! If someone would have told me a few months ago that I would be writing at a time when our global economy has been shut down with virtually no notice, our health is potentially at risk simply by leaving our homes, and our way of working has been completely transformed, I don’t think I would have believed it. As surreal as it is, this is where we find ourselves today. And at this critical time, there is no legal and financial industry more important than the restructuring industry.

The global pandemic has presented unique challenges. However, our profession’s swift response to these challenges is admirable. Courts and advocates around the world quickly modified their way of doing business and have been flexible in a way that is truly unprecedented. Academics and practitioners in the insolvency field have identified numerous ways that insolvency-related laws can be made more flexible to help struggling companies survive the disruption to their businesses. Governments in many countries, including the United Kingdom, Germany, Spain, the United States, India, Australia and Singapore, among others, have quickly adopted those recommendations, at least temporarily, in order to ease the impact of this crisis.

For the most part, these reforms involve lifting requirements to commence proceedings that under most insolvency regimes would likely result in liquidation. For instance, Germany and Spain have suspended the duty of corporate directors to file for bankruptcy. Such legislation is also in the works in Italy and Poland. In Germany, directors are required to file for bankruptcy within three weeks since they knew or should have known that the company is insolvent on a balance-sheet or a cash-flow basis. Its COVID-19 bill suspends the filing obligation until at least September 30, 2020 (though the reason for insolvency must be COVID-19). Likewise, in Spain, where corporate directors are required to file for bankruptcy within two months after they learn the company became insolvent, that duty was suspended, but only until the end of the state of emergency (which as of this writing has been extended to April 26, 2020).

Similarly, some countries have temporarily relaxed laws holding directors liable for trading when the company is within the zone of insolvency, such as Australia, the UK, Switzerland, Spain and Singapore. Australia now has a six-month safe harbour.

The ability of creditors to file involuntary bankruptcy petitions has been suspended in Spain, France and Singapore, at least, or has been restricted by increasing the debt requirements, such as in Australia, Singapore and India. For instance, in Australia the debt threshold was increased from A$5,000 to A$20,000, and in Singapore from S$10,000 to S$100,000, while also extending the period for responding to creditor demands from three weeks to six months. Hungary has increased the threshold for corporate debtors to US$130,000, and may suspend companies from being forced into bankruptcy for six months.

The French Emergency Act of March 23, 2020 suspended the ability to force companies to go into insolvency, and the application of the “Cessation of Payments” test, which requires debtors to file for bankruptcy within 45 days of the time that a company’s current debts exceed its liquid assets. This effectively extends the time in which French companies may commence a “safeguard” proceeding, similar to the regime provided under Chapter 11 of the US Bankruptcy Code. This proceeding, which can be initiated only prior to the “cessation of payments,” allows the company to get court protection...
and trigger payments for their employees. Numerous deadlines have been extended in connection with a “safeguard plan” or “recovery plan” (i.e. a plan approved by the court upon exit from “safeguard” or “judicial recovery” proceedings).

The United States has also expanded the opportunity to utilise bankruptcy laws for reorganisation purposes, at least for small businesses wishing to take advantage of new streamlined small business reorganisation provisions under the Small Business Reorganisation Act (SBRA). Previously limited to companies with debts of less than US$2.75m, the debt limit has been increased to US$7.5m under the CARES Act, effective for one year. The SBRA’s key provisions include: debtor exclusivity (but a 90-day limit for filing a plan except in certain circumstances); no creditors’ committees or their professionals (replaced by a standing trustee to oversee such cases); the ability to confirm a plan without any creditor support if certain requirements are met (principally the dedication of 3-5 years of projected disposable income).

In another step forward for reorganisation legislation, the UK government has announced plans to fast-track proposals that have been under study that would introduce a number of new restructuring tools, including a debt payment moratorium, a prohibition on suppliers exercising termination rights, and the ability to confirm a restructuring plan that is binding on dissenting classes of creditors.

These legal reforms are part of a global effort to preserve enterprise value during the months ahead. Of course, they are only part of much broader economic and financial initiatives by governments across the world, intended to help businesses stay afloat during this perhaps unprecedented interruption to global economic activity.

The Institute is harnessing the resources of its members and is creating a depository of information on worldwide reforms. We are also hosting open forums in each of our regions so that our members can share their respective experiences. Working together, we hope to mitigate this crisis.

I hope that by the time this goes to press, the health part of this crisis will be on the decline. However, I expect the economic fallout for our profession to continue. Perhaps we will be able to present a different picture next year.

Until then, I share the best wishes of the Institute with all of your readers.
Today, when a company is facing distress, three basic instruments for restructuring in and out of court are available. Depending on the degree of pressure for financial and operational restructuring, the following instruments are deployed by various European jurisdictions:

(i) Consensual solutions with all stakeholders outside of insolvency (e.g., based on an independent business review or restructuring concept);
(ii) early insolvency instruments (e.g. protective shield procedure, insolvency under self-administration) based on an insolvency plan and approved by the insolvency court; and
(iii) regular insolvency proceedings executed by the insolvency administrator and approved by the insolvency court.

A fourth restructuring option, which only comprises minor “in court” elements, has recently been developed by the EU. After lengthy negotiations, the EU Directive 2019/1023 on “Preventive Restructuring Frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt” was published in the Official Journal of the European Union on June 26, 2019.

The European Preventive Restructuring Framework aims at effective preventive restructuring of viable companies in financial distress by reducing the length of restructuring procedures. As such, higher recovery rates for creditors are achieved as, normally, the passing of time only results in a further loss of value for a company in distress.¹

In this context, the EU Directive explicitly focuses on small- and medium-sized enterprises (SMEs), which includes the vast majority of businesses in the EU, as these companies are more likely to be liquidated than restructured. SMEs are often unable to carry the higher restructuring costs that come with the more efficient restructuring procedures of some Member States, such as the early insolvency instruments² previously mentioned.

Member States have until mid-2021 to transition the EU Directive on preventive restructuring frameworks into national law. The national legislators are currently working on a “system-oriented” integration of the pre-insolvency restructuring plan, since a legal framework outside of the insolvency proceedings is planned in various jurisdictions.

Effects of COVID-19 on different groups of companies

The COVID-19 pandemic is having an immense effect on our economic ecosystem and is an unprecedented shock that will significantly impact future economic development.
As the first wave of the COVID-19 pandemic spread across the globe, lockdown and social distancing measures led to a plunge in demand and supply. Supply chains have been massively disrupted from the outset of the pandemic and continue to struggle even as regional clusters start to reopen. As the crisis has developed, four groups of companies in different sectors have emerged. There are companies that had a healthy and functioning business model before COVID-19 and companies with business models that were already under pressure going into the crisis; and these can be divided into those that are likely to be temporarily negatively affected and those for which the negative changes may be permanent.

Figure 1 illustrates these four groups of companies with a categorisation of sectors as described below, indicating their potential need for restructuring.

### Healthy business models
- Depending on industry and company, shocks from COVID-19 may be temporary. We are already starting to see demand returning in some sectors. In many cases, however, companies are struggling with ongoing disruption. This is expected to continue for the remainder of 2020, and any solution will depend largely on the availability of a cure or vaccine for COVID-19. Many sectors will see a return to a “new normal,” and will not need to change their existing business model. Such sectors may include hospitality (e.g. hotels and restaurants), advanced manufacturing, oil and gas, or technology, media and telecoms (TMT), which has seen some success in the COVID-19 crisis.
- Other sectors are experiencing a different impact. Shocks due to COVID-19 have been disruptive and may lead to permanent change due to changes in customer behaviour, due to fear, regulation or a shift in values. Their previously healthy business models will therefore need to adapt; for example, airlines are not only experiencing a drop in demand of more than 90% but also fear longer-lasting effects. Ongoing travel restrictions impacting personal travel, plus new ways of working, and the economic downturn causing businesses to defer travel, have the potential to reduce overall demand for air travel permanently.

### Stressed business models
- Other companies in various sectors, were already under pressure before COVID-19. These companies have been impacted by the current crisis in a different way. The pandemic has served as more of a catalyst...
for existing problems and in some cases revealed the true extent of their problems. The crisis has led to an immediate need for action, shortening the time available to react to underlying issues and to prepare a structured response. It may be a chance for many to address the need for structural change, but with a significantly more negative impact in the shorter term due to COVID-19. For example, the automotive sector has been struggling with overcapacity and the need for structural change for some time. To respond to the COVID-19 crisis and master what lies beyond, companies need to address these issues more urgently. Non-essential stationary retail has also been heavily impacted by an immediate drop in demand due to lockdown. Changes in consumer behaviour and the increasing shift to online channels presented challenges to this sector before the crisis. Companies need to take action to make the necessary changes in their business models to be able to compete during the crisis and to remain relevant in the future.

- Some companies will experience a similar acceleration of challenges as a result of the COVID-19 disruption but will not be able to restructure or turn their business around. They will find that the sustained changes caused by COVID-19 have rendered their business model obsolete, and it will remain so once the crisis has passed.

Regardless of the robustness or relevance of business models before COVID-19, the immediate impact of the crisis has created financial stress for affected companies. Short-term liquidity problems can be seen across almost all sectors, with operational cash requirements often remaining very high, while turnover is drastically reduced. Short-term financing instruments, often in the form of state aid, are being widely deployed to help companies survive the crisis.

This short-term financing “solution” leads to a significant change in debt levels, putting a burden on the financial stability of companies in the future. The ability of companies to generate a sustainable Earnings before Interest as Taxes (EBIT) for interest payments and repayment of debt will depend heavily on the underlying business models and their relevance throughout the crisis and beyond. This may lead to a significantly increased need for financial and operational restructuring, and requires a case by case view on the most appropriate instrument available.

As indicated earlier, the instruments currently available represent a valid basis for restructuring and addressing distress prior to default. However, identifying the appropriate instrument needs to be approached case by case. In these uncertain times, with a buildup of non-performing loans looming, the European Preventative Restructuring Framework could be a helpful instrument to complement those already available.

Relevance of European Preventive Restructuring Framework in times of COVID-19

The European Preventive Restructuring Framework focuses on financial restructuring measures, particularly capital measures, even though the definition of “restructuring” in the EU Directive also explicitly includes performance-related restructuring measures (“operational changes,” cp. Art. 2.1. (2) of the EU Directive). The need for financial restructuring is especially valid for companies with healthy business models that have had to increase debt levels due to COVID-19 and are facing temporary problems, rather than companies whose business models were under pressure before COVID-19 and that require operational restructuring measures.

The new framework could therefore be particularly suitable for companies whose increased level of debt is no longer covered by sustainable EBIT, but who do not have an acute liquidity problem and therefore do not qualify for an in-court restructuring procedure.

A pre-insolvency restructuring procedure under the framework could be appropriate for fundamentally viable companies in cases where a complete consensus cannot be reached, but where the vast majority of creditors prefer a restructuring over a formal insolvency procedure.

Where minority stakeholders are obstructing a solution, the possibility of a “cross-class cram-
"down" may be a valid argument for introducing the preventive restructuring framework.

It remains to be seen whether the new EU Directive can meet the official aim of creating a suitable restructuring instrument – especially for SMEs – with lower restructuring costs as compared to early insolvency instruments that are available in only a few Member States. To make restructuring a better option than liquidation in the eyes of the various stakeholders in SMEs, the rules of the European Preventive Restructuring Framework need to be easy to understand and follow.

Conclusion
Our appraisal of business models and the effect of COVID-19 show that the four groups of companies we have outlined in this article will involve restructuring via one of the available instruments. In many cases, financial restructuring measures will suffice to enable these companies with valid business models, in affected sectors such as hospitality, TMT or advanced manufacturing, to return to profitability. In other cases, more operational restructuring measures will be necessary to turn around business models, e.g., in the retail and automotive sectors, and the higher level of distress will require more formal restructuring procedures, including the involvement of the insolvency court.

In view of the expected significant increase in companies facing financial difficulties, the rapid enactment of the European Preventive Restructuring Framework into national law is necessary in order to compete against the UK Scheme of Arrangement and the US Chapter 11 as alternative restructuring locations. As a result, the implementation of the EU Directive would provide safeguards against abusive relocation of the debtor’s centre of main interests during cross-border insolvency proceedings.

Notes:
The views reflected in this article are the views of the author and do not necessarily reflect the views of the global EY organisation or its member firms.

1 EU Directive Explanatory Note (16).
2 EU Directive Explanatory Note (17).

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The current work by UNCITRAL in the area of insolvency law

by Samira Musayeva, UNCITRAL Secretariat, Office of Legal Affairs, United Nations

The United Nations Commission on International Trade Law (UNCITRAL) was established by the General Assembly in 1966 as the core legal body within the United Nations system in the field of international trade law. Considering that divergencies arising from laws of different States in matters relating to international trade constitute one of the obstacles to the development of world trade, the Commission was entrusted with the mandate to further the progressive harmonisation, modernisation and unification of the law of international trade.

Overview of UNCITRAL texts in the area of insolvency law

Since the early 1990s UNCITRAL has adopted various legislative texts in the field of insolvency law, addressing both domestic and cross-border aspects of insolvency. Those texts have been used worldwide as a benchmark for insolvency law reform.

The first of UNCITRAL insolvency text was the UNCITRAL Model Law on Cross-Border Insolvency with its Guide to Enactment (1997) (the MLCBI). It provides a legal framework for the cross-border recognition of insolvency proceedings involving a single debtor. The goal of the text is to minimise formality, time and costs for obtaining such recognition and to ensure the availability of appropriate relief and the protection of creditors. To the knowledge of the UNCITRAL secretariat, the MLCBI has been used as the basis for enacting domestic cross-border insolvency legislation in 49 jurisdictions.2

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

The MLCBI was a ground-breaking instrument not only because very few jurisdictions had, at that time, any legislation enabling cross-border judicial cooperation in insolvency cases, but also because insolvency law had long been considered to be too sensitive a topic for legal harmonisation. The positive experience with the development and subsequent implementation of the MLCBI encouraged UNCITRAL to tackle the substantive insolvency law and other aspects of international cooperation in insolvency.

Throughout the 2000s, UNCITRAL worked on its Legislative Guide on Insolvency Law addressing such key aspects of substantive insolvency law as liquidation, reorganisation, avoidance, treatment of claims, composition, protection and realisation of the insolvency estate, distribution of proceeds and discharge.

Parts one and two of the Legislative Guide adopted in 2004 were supplemented in 2010 by part three addressing treatment of enterprise groups in insolvency and in 2013 by part four addressing directors’ obligations in the period approaching insolvency.

The last two parts of the Guide were expanded in 2019 by the newly adopted UNCITRAL texts – the UNCITRAL Model Law on Enterprise Group Insolvency (MLEGI), its Guide to Enactment and a text on obligations of directors of enterprise group companies – designed to equip States with modern legislation addressing specific issues arising from the domestic and cross-border insolvency of enterprise groups (see below).

In 2018, UNCITRAL adopted the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgements (the MLIJ) with its Guide to Enactment, designed to allow
any foreign insolvency-related judgment to be enforced, including a judgment relating to the recovery of assets of the debtor located in a jurisdiction whose insolvency proceedings would be neither a main nor a non-main proceeding under the MLCBI.

By adopting the MLIJ, UNCITRAL addressed both the lack of an international instrument covering the recognition and enforcement of insolvency-related judgments, as well as some uncertainty as to whether the MLCBI explicitly provides the necessary authority for such recognition and enforcement. Article X of the MLIJ, addressed to States that have enacted legislation based on the MLCBI, clarifies that, notwithstanding any prior interpretation to the contrary, the relief available under article 21 of the MLCBI includes recognition and enforcement of a judgment.

In addition to the legislative texts, UNCITRAL has authored a number of practical tools of a particular relevance to judges in response to the experience with the use of the MLCBI. In 2009, UNCITRAL adopted the Practice Guide on Cross-Border Insolvency Cooperation, which expands on article 27 of the MLCBI, discussing the various ways in which cooperation in cross-border insolvency cases can be achieved and compiling experience with the use of cross-border insolvency agreements.

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

The UNCITRAL secretariat assists States with the use of UNCITRAL texts, in particular by providing technical assistance with drafting legislation based on those texts. Following the adoption of the MLJ and the MLEGI, the Commission requested the Secretariat to prepare materials explaining to States how three UNCITRAL model laws in the area of insolvency law interact. They are under preparation.

In addition, harmonised interpretation of UNCITRAL legal texts is facilitated by the Case Law on UNCITRAL Texts (CLOUT) system, under which the UNCITRAL secretariat publishes, in the six official languages of the United Nations, abstracts of judicial decisions (and, where applicable, arbitral awards) that interpret conventions and model laws emanating from the work of UNCITRAL. The full, original decisions are available, upon request. There are currently 127 case law abstracts on the MLCBI in the system. They are being systematised in a digest of case law on the MLCBI expected to be published soon. With the enactment of the MLJ and MLEGI by States and ensuing case law, the CLOUT system will also include the MLJ and MLEGI-related case law.

**Most recent developments**

The 2019 UNCITRAL Model Law on Enterprise Group Insolvency with its Guide to Enactment

At its 52nd session in 2019, UNCITRAL adopted the Model Law on Enterprise Group Insolvency (the MLEGI) and its Guide to Enactment, complementing the MLCBI and extending recommendations of part three of the UNCITRAL Legislative Guide on Insolvency Law. The MLEGI consists of two parts: Part A is a set of core provisions, dealing with matters that are regarded as key to facilitating the conduct of enterprise group insolvencies; and Part B, comprising articles 30–32, is a set of supplemental provisions included for States that may wish to adopt a more extensive approach with respect to treatment of the claims of foreign creditors.

The MLEGI is based upon several widely-agreed fundamental principles: preservation of the jurisdiction of the State in which each group member has its COMI; preservation of the ability to commence insolvency proceedings in respect of a group member as and when such proceedings might be required; and protection of the interests and expectations of creditors and other interested persons. What distinguishes the MLEGI from the MLCBI is the focus on insolvency proceedings relating to multiple debtors that are members of the same enterprise group.

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

The MLEGI introduces new terms not found in the MLCBI or part three of the Legislative Guide ("group insolvency solution", "group representative" and "planning proceeding"). Other terms, such as "insolvency representative", "insolvency proceeding", "main" and "non-main" proceeding, "enterprise", "enterprise group" and "control", are used in those other UNCITRAL insolvency texts or, like "group representative" are based upon definitions included in those texts.

MLEGI is similar to those other texts in other respects, in particular as regards provisions on public policy exception, cooperation and coordination, relief, recognitions and protection of creditors and other interested persons.

The Guide to Enactment that accompanies the MLEGI provides background and explanatory information on the MLEGI. That information is primarily directed to executive branches of Governments and legislators preparing legislative revisions necessary to enact the MLEGI but may also provide useful insight to those charged with interpretation and application of the MLEGI as enacted, such as judges, and other users of the text, such as practitioners and academics.

Text on obligations of directors of enterprise group companies

At its 52nd session, in 2019, UNCITRAL also adopted a text intended to serve as legislative guidance for policymakers and legislators on obligations of directors of enterprise group companies in the period approaching insolvency.

With the addition of that text, part four of the UNCITRAL Legislative Guide on Insolvency Law now addresses the key elements of directors’ obligations in both contexts: of an individual company when that company faces imminent or unavoidable insolvency, and of an enterprise group, when the group as a whole or one or more of its members are in such situation.

The need for the additional text arose because many States adhere to the separate entity approach under which directors are typically required to promote the success and pursue the interests of the company they direct, respecting its limited liability and ensuring that its interests are not sacrificed to those of the enterprise group. That is to be achieved irrespective of the interests of the enterprise group as a whole, the position of the director’s company in the enterprise group structure, the degree of independence or integration among enterprise group members and the incidence of ownership and control.

However, where that company’s business is part of an enterprise group and reliant, at least to some extent, on other enterprise group members for the provision of vital functions (e.g. financing, accounting, legal services, suppliers, markets, management or intellectual property), addressing the financial difficulties of that company in isolation is likely to be difficult, and, in some cases, impossible.

The requirement to act in the interests of the directed company may be further complicated in the enterprise group context when a director of one enterprise group member performs that function or holds a managerial or executive position in one or more other enterprise group members. In such a situation, it may be difficult for the director to separately identify the interests of each of those enterprise group members and treat them in isolation.

Moreover, the interests of those enterprise group members may be affected by the possibly competing economic goals or needs of other enterprise group members and those of the enterprise group collectively.

The newly added text, as the rest of part four, focuses on directors’ obligations in the proximity of insolvency that may be included in the law relating to insolvency and become enforceable once insolvency proceedings commence i.e. the liability of directors under criminal law, company
law or tort law is excluded from the scope of the text). It acknowledges that those obligations and the rationale for imposing them are the same in the enterprise group context as in the context of an individual company. At the same time, the text recognises complexities arising in the enterprise group context as well as threats and pitfalls that may result from overly draconian rules. Accordingly, it identifies the extent to which a director of an enterprise group member may take account of considerations beyond the enterprise group member managed by that director in the period approaching insolvency and the safeguards that should apply.

Additional recommendations have been included to address the situation where a director is appointed to, or holds a managerial or executive position in, more than one enterprise group member and a conflict arises in discharging the obligations owed to the different members.

**Simplified insolvency regime**

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

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

The UNCITRAL Legislative Guide on Insolvency Law serves as the starting point, assisting the Working Group to identify: (a) issues that are not addressed in the Legislative Guide but need to be addressed in the context of a simplified insolvency regime; and (b) issues that are addressed in the Legislative Guide but require a different treatment in the light of the MSEs insolvency specifics (e.g. unsophistication of MSEs, the lack of (sufficient) assets in the insolvency estate, creditor disengagement and concerns over stigmatisation).

At its most recent session (December 2019), the Working Group focussed on: (a) measures to ensure a proper use and functioning of a simplified insolvency regime; (b) appropriate ways to deal with “no asset, no income, no fraud” cases; and (c) mechanisms to protect creditors’ rights without jeopardising other equally important considerations in a simplified insolvency regime. The Working Group proceeds cautiously recognising that, in devising a simplified insolvency regime, the balance between competing goals and interests would need to be achieved and that insolvency law measures would need to be supplemented by other legislative and institutional measures (in particular, by making available standard forms, online procedures and assistance to MSEs throughout insolvency proceedings).

At its next session, the Working Group is expected to consider, in addition to revised recommendations and commentary, interaction of the text on a simplified insolvency regime with the UNCITRAL Legislative Guide on Insolvency Law and with the work of Working Group I on access of MSMEs to credit and financial services.

In the light of the impact of COVID-19 measures on businesses, in particular MSEs, the work on the subject by the Working Group has turned out to be especially relevant and timely. Although there may be an urge to complete that work as soon as possible, the May 2020 session of the Working Group had to be postponed because of COVID-19 travel and other restrictions, which means that the Working Group will have a chance to look into MSE insolvency issues again earliest at its December 2020 session in Vienna.

The time until the next session of the Working Group gives its delegates and observers an opportunity to reflect on the experience of States with COVID-19 insolvency-related legislative measures, which are being put in place in particular to address difficulties faced by MSEs. The Working Group’s end product on MSE insolvency, when it is presented to UNCITRAL for its finalisation and adoption, as scheduled, at its session in the summer of 2021, can only be enriched by results of the thorough assessment of that experience.
Notes:
1 The views expressed in this article are those of the author and do not necessarily reflect those of the United Nations.
2 A list of MLCBI enacting jurisdictions is available at unctital.un.org. As of March 2020, the Dubai International Financial Centre was the latest jurisdiction ascertained by the UNCITRAL secretariat as having enacted MLCBI. The UNCITRAL secretariat is currently ascertaining whether the new insolvency law of Myanmar, adopted in February 2020, had enacted the MLCBI as has been reported.
4 For the report of the session, see A/CN.9/1006, available at https://unctital.un.org/en/working_groups/5/insolvency_law

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According to the World Bank report, in 2020 advanced economies are forecast to shrink 7% and emerging economies and developing countries are forecast to shrink by 2.5% (which the World Bank said would be the lowest rate of growth for emerging and developing economies since at least the 1960s). However, in its baseline scenario, the World Bank forecast the possibility of a moderate recovery for the global economy in 2021.

Our focus in this article are the emerging economies, and the rather bleak outlook for the emerging markets in particular represents a sharp turnaround for the emerging economies since many of those economies have been performing fairly well in the last few years. But many of the gains the emerging economies have made in recent years risk being wiped out by the current COVID-19-related economic crisis — with the possibility, for example, that millions of citizens of these countries could be thrown back into poverty — and it is expected that the impact of the current economic slowdown on emerging economies could be long-lasting.

The COVID-19 pandemic has generally arrived in the emerging economies and developing countries later than it arrived in various advanced economies. But the public health impact of the COVID-19 crisis could be particularly pronounced if and when the pandemic makes major inroads into the emerging economies and developing countries. Many of these countries do not necessarily have strong healthcare infrastructure to begin with.

Furthermore, a number of emerging economies and developing countries enter the COVID-19 health crisis starting from a fairly low base of available medical supplies and may therefore eventually face shortages of vital equipment such as respirators, surgical masks, and other personal protective equipment.

COVID-19 arrived in the emerging economies at a particularly inauspicious moment, as there were already significant negative economic trends affecting the emerging economies. Most notably, there was already a collapse of key commodity prices underway, starting with the price of oil but extending to a broad array of other commodities such as various metals including copper and zinc. And the global economic slowdown associated with COVID-19 has led to decreased demand for a range of commodities, thereby putting further downward pressure on commodity prices.

Since many of the emerging economies are heavily dependent on commodity exports as one of the central pillars of their economies, the price collapse of commodities has been an especially serious blow to many emerging economies, particularly in many oil-producing countries around the globe. For example, in Africa, oil-producing countries such as Nigeria, Angola, and Algeria, among others, are likely to face major financial pressures since their economies and national budgets are so dependent on oil revenues.

Many emerging market economies also rely to a significant extent on the tourism sector. Indeed, in a number of emerging economies and developing countries, tourism may account for as much as 10% or more of GDP (and, in some cases, even 20% or more of GDP), and the tourism sector may also be a major source of employment in these countries. However, the lockdowns around the world and the closing of national borders essentially shut down most
international air travel which in turn led to a drying up in many emerging economies of the revenues generated from foreign tourists.

In recent months, there has been a significant weakening of the currencies of many emerging economies. For instance, there have been sharp declines in the value of emerging market currencies such as, among others, the Turkish lira, the Brazilian real, the Mexican peso, the South African rand, the Nigerian naira, the Colombian peso, and the Indonesian rupiah.

These widespread declines in the value of emerging market currencies could pose a serious challenge to emerging economies because many of these economies — both at the sovereign and corporate level — have incurred debt denominated in hard currencies such as the US dollar. These depreciations in the value of emerging market currencies threaten to make the servicing of foreign currency-denominated debt that much more difficult.

In this article, we will briefly discuss how the COVID-19 economic crisis could affect different types of emerging market restructurings involving sovereign debt, corporate debt, and infrastructure projects, and we will also discuss related issues concerning state-owned enterprises and non-performing loans.

**Sovereign debt restructurings**

Even before the COVID-19 crisis began, there were a number of emerging market sovereigns that were experiencing financial distress to one extent or another. Yet, the COVID-19 crisis is only likely to make these particular sovereign debt situations even more challenging.

In Latin America, there are several countries that had sovereign debt travails prior to the arrival of COVID-19. Venezuela, for instance, has been in default on its outstanding debt for over two-and-a-half years, and it has a huge stock of outstanding debt and other liabilities (estimated to be US$150bn or more). The pandemic only potentially aggravates the existing grave humanitarian/social crisis in Venezuela (which is also accompanied by a financial/economic crisis and a political crisis).

Argentina, with its well-deserved reputation as a serial defaulter, was already facing a debt crisis before the arrival of COVID-19, and the pandemic has only exacerbated the difficulties facing Argentina. The Argentine government must now make greater expenditures on health care as well as fund economic stimulus measures, thereby further unbalancing its budget.

With more of a whimper than a bang, Argentina entered into default once again on May 22, 2020, by some counts the ninth such default in its history as an independent nation. As of this writing in mid-June 2020, Argentina was still engaged in discussions with its creditors to see whether a restructuring deal could be reached.

Another Latin American sovereign, Ecuador, which has been dealing with the economic fallout from the drop in the price of oil as well as one of the worst coronavirus-related public health crises in Latin America, reached an agreement in April 2020 with its bondholders to postpone for four months debt service payments on bonds in the amount of US$800m.

Other non-Latin American countries were also experiencing financial distress prior to COVID-19, including countries such as Lebanon and Zambia. Lebanon defaulted on a US$1.2bn bond in March 2020, and Zambia, a copper-producing country which has been hard hit by the major drop in copper prices and the decline in its currency vis-à-vis the US dollar, is exploring options for restructuring its debt burden of approximately US$11bn.

As the COVID-19 crisis takes a greater toll on emerging economies with the passage of time, it is expected that many more countries will enter into debt distress, triggering either debt restructurings or debt defaults. As a possible harbinger of the troubles to come, approximately 100 countries have already approached the International Monetary Fund for emergency financial assistance.

It should be noted, though, that there are even concerns in some quarters that the IMF, which currently has resources of approximately US$1 trillion at its disposal, may nonetheless not have enough available firepower to deal with all of the financing requests it may ultimately receive from distressed sovereigns around the globe.

Moreover, in a further sign of the seriousness of the current situation, the G-20 countries, in their capacity as bilateral creditors, recently agreed to a debt service moratorium vis-à-vis the poorest 77 countries in the world that will last until December 31, 2020.
A number of recent issuers of sovereign debt were first-time issuers which were taking advantage of the ample supply of liquidity in the international capital markets and the relatively low interest rates associated with the Federal Reserve’s low interest rate policy in the years after the 2008-09 financial crisis. For example, in Sub-Saharan Africa, first-time issuers included, among others, countries such as Ghana, Gabon, Senegal, Namibia, Nigeria, Zambia, and Rwanda. However, in the current adverse global economic environment, countries such as these may now face serious debt sustainability issues, and this could ultimately give rise to the need for some form of debt restructuring and/or debt relief.

Traditionally, in the sovereign debt world, the International Monetary Fund (IMF) — the multilateral institution that financially stressed countries would invariably approach for financial assistance in their hour of need — has occupied centre stage in many, if not most, sovereign debt restructurings. Yet, in the current environment, there is a new player that cannot be ignored: China. China has become the world’s largest official creditor, and its global lending now apparently dwarfs lending from the World Bank and the IMF combined.

Nevertheless, China’s lending arrangements in the emerging economies and developing countries have been marked by a fair amount of opacity, and it is not clear what approaches or principles will guide China in dealing with sovereign debt restructurings in the current COVID-19-related economic environment. In some recent cases, China has apparently been willing to grant only limited debt relief to sovereign debtors (although in an article a year ago The Economist cited a study that found that China engaged in at least 140 restructurings and write-offs of external debt since 2000).

In other cases, such as in the case a few years ago of the Sri Lankan port of Hambantota, China essentially effectuated a debt-for-equity swap when the Sri Lankan government could not repay a loan from China. In that case, China effectively exchanged the debt owed by Sri Lanka for a 99-year lease of the Sri Lankan port (which happens to be strategically located on the Indian Ocean). In yet another set of cases, China is reportedly believed to be trying to take additional collateral to back up its loans in exchange for any debt relief that China grants to sovereign debtors.

China is not a member of the long-established Paris Club of bilateral creditors, so China does not need to abide by any of the Paris Club principles (e.g. the principle of transparency) nor does it need to feel obligated to work in concert with other bilateral creditors that are members of the Paris Club. Yet, in a multi-creditor situation, the non-China bilateral and multilateral creditors may well be disinclined to grant debt relief to a sovereign if they believe that China will not make any comparable sacrifices.

These non-Chinese creditors may be concerned that whatever debt relief they grant the sovereign in question will end up being used to repay debts to China (and, importantly, will not be used by the governments to fund necessary public health expenditures and economic stimulus measures).

A first test case of this multi-creditor scenario may arise in Zambia which as mentioned above is seeking to restructure its loans with external creditors. Zambia apparently owes approximately US$3bn on US dollar bonds, and it also owes approximately US$3bn to China. And at the same time Zambia has also sought financing under a so-called rapid credit facility from the International Monetary Fund to help it address the fallout from the coronavirus crisis.

How Zambia’s debt situation is ultimately resolved could shed light on whether China will be able to pursue a go-it-alone approach in debt restructurings even where there are other external creditors and financing sources, or whether China will eventually have to work with other parties in such multi-creditor situations in order to reach an overall debt restructuring solution.

Separately, another issue worthy of our attention is how holdout creditors — sometimes referred to as “vulture funds” — will seek to maximise their recoveries in the next round of sovereign debt restructurings. In connection with Argentina’s default in 2001 and the ensuing restructurings, a group of hedge funds pursued a strategy of fairly aggressive litigation focused on advocating a somewhat unconventional interpretation of the pari passu clause in the relevant New York law-governed bond documentation.
What will be their legal hook this time? It may be hard to say now with any specificity until some concrete sovereign debt restructuring disputes develop. Yet, distressed debt funds can be expected to scour the underlying bond documents to identify any clauses that they believe they might be able to use to their advantage in any potential litigation against the sovereign in question. Crucially, the willingness of some distressed debt funds to pursue bold and fairly aggressive — and even costly and drawn-out — legal strategies should not be underestimated, especially given the possibility of such funds achieving hefty returns if their strategies and plans work out successfully.

At a very practical level, to the extent that the situation presents itself, one could also look for holdout creditors to exploit series-by-series voting in the first-generation collective action clauses (CACs) adopted in the early 2000s. In pursuing such a strategy, a holdout creditor would seek to amass a blocking position in a particular series of the sovereign’s debt and thereby prevent the restructuring of the series of debt in question. That would free the holdout creditor to pursue litigation to recover the full face value of the debt of that series (notwithstanding the fact that the holdout may have purchased the debt at a substantial discount).

**Corporate debt restructuring**

In recent years, companies in the emerging markets borrowed heavily in the capital markets, particularly with interest rates being as low as they were. Even before the COVID-19 crisis, many of these companies were possibly overleveraged, and thus with COVID-19 related global economic slowdown, many of these companies may face financial distress as they navigate a landscape in which their revenues decline due to the overall economic slowdown.

This recalls in some respects the situation in the wake of the Asian financial crisis when there was widespread financial distress in the corporate sector in countries such as Thailand, Indonesia, the Philippines, and Korea, and numerous companies fell into default or sought a debt restructuring.

In a positive development in the last two decades — dating to the Asian financial crisis itself — insolvency laws have been reformed in many emerging markets around the globe. While creditors can take some comfort from the fact that the insolvency laws in many emerging market economies have been modernised, they must still reckon with the fact that there could be a gap, sometimes even a very substantial gap, between law and practice. For certain creditors which do not have extensive experience in the emerging markets or lack a sophisticated understanding of the restructuring dynamics in these markets, this realisation could come as a rude awakening.

Furthermore, creditors may be confronted with the harsh reality that some local courts in certain emerging market jurisdictions may suffer from a lack of independence and capacity, and that, in certain situations, some of those courts may even possibly be tainted by corruption.

It should be noted that, in response to the COVID-19 pandemic, numerous jurisdictions around the world have modified their insolvency laws in a variety of different ways, such as among things the steps taken in certain jurisdictions to temporarily suspend for the duration of the pandemic any mandatory duty to file for insolvency that would apply under normal circumstances. Thus, debtor companies and their creditors should familiarise themselves with any changes that have been made to the relevant jurisdiction’s insolvency law in response to the pandemic.

Creditors in emerging market jurisdictions — particularly foreign creditors — also need to recognise that, as a general matter, they may well not be playing on a level playing field with the debtor. In the emerging markets, a large number of companies are controlled by so-called controlling shareholders, who are often powerful and influential families in the local jurisdictions.

In certain emerging market restructurings, the controlling shareholders may strongly resist any restructuring plan, whether formulated in an in-court or out-of-court process, that seeks to diminish or set limits on their control of the company in question. This may be the case, for example, with restructuring plans involving debt-for-equity swaps that would give the creditors a large equity stake in the company and which would therefore diminish the control of the controlling shareholders over
the company. Accordingly, circumstances may force creditors to realign their expectations as to potential recovery values on their outstanding debt in light of these stubborn realities on the ground.

Foreign creditors, in particular, will also need to be mindful of the fact that they cannot simply extrapolate from their restructuring/insolvency experiences in their developed home country jurisdictions. Those experiences and their knowledge of the home country insolvency laws generally may be of little avail and/or relevance when these foreign creditors are addressing restructurings in emerging market jurisdictions, particularly where cases end up (or there is a possibility that they might end up) in a local insolvency proceeding. Moreover, strategies that might work in their home country jurisdictions — e.g. a “loan to own” strategy — may have difficulty gaining any traction in many emerging economy jurisdictions.

There is another pitfall that creditors in emerging market restructurings need to be aware of in certain emerging market jurisdictions, and that is the potential on the part of certain debtors/controlling shareholders for corporate frauds or malfeasance on a scale that can be truly mind-boggling. The debtor companies and in particular their controlling shareholders may have diverted corporate funds through sham sale transactions, the deposit of corporate funds in offshore banks wholly owned by the controlling shareholders, and/or various types of non-transparent related party transactions, and they may have earlier incurred substantial financial losses that were not previously disclosed to creditors. Yet, these diversions of funds and losses can literally run into the hundreds of millions of dollars (as was the case in several suspect transactions in the US$13.9bn Asia Pulp & Paper restructuring in the early 2000s), and these diversions and losses, of course, can represent a substantial loss of value for creditors. That is why creditors, to the extent possible, are well advised to press debtors/controlling shareholders early in any emerging market restructuring process to establish cash monitoring programs for the debtor companies so that the creditors can carefully and closely monitor future cash outlays by the company. Similarly, the creditors would also be well served by undertaking comprehensive and thorough due diligence on the debtor company.

In some restructurings in recent years, certain emerging market debtors have turned to foreign jurisdictions to take advantage of more favourable insolvency laws to reach a successful restructuring outcome. For example, such debtors have proceeded under a UK scheme of arrangement (as in a situation several years ago involving Vinashin, a Vietnamese state-owned shipbuilder, in which it was seeking to bind holdout creditors) and under Chapter 11 in the US (as in the recent filings by two of the largest Latin American airlines, Avianca Holdings SA and LATAM Airlines Group SA).

Of course, as is true in the world of international restructuring generally, many emerging market debtors have sought recognition of the local insolvency proceeding in a foreign jurisdiction. For instance, this has become fairly routine for many Brazilian debtors in recent years where those debtors, acting through a foreign representative of the local insolvency proceeding, have sought Chapter 15 recognition in the US in order to bind US bondholders to a plan approved in the relevant Brazil reorganisation [recuperação judicial] proceeding.

**Infrastructure project restructurings**

In the last decade or longer, many emerging economies have undertaken ambitious infrastructure projects, whether in the form of new power/renewable energy projects, ports, airports, toll roads, telecom projects, and so forth. Many such projects were structured as public-private partnerships [PPPs], where the host governments granted concessions of one type or another to private parties and where there was equity investment provided by private sponsors and debt financing provided by, among others, banks and bondholders.

Nonetheless, the COVID-19 crisis could put a great deal of pressure on these projects, just as the Asian financial crisis put a great deal of pressure on the infrastructure projects of that era, particularly those in Southeast Asia. Ultimately, many of those projects from that era required major restructurings, and the restructurings were often incredibly complex
and very messy and not infrequently took several years to complete.

There are two basic sources of potential pressure for the recent crop of infrastructure projects structured on a PPP basis. The first is that if the COVID-19 economic crisis plays out in the same way that the Asian financial crisis did, any severe slowdown in the affected national economies could lead to a sharply lower level of demand for the services provided by or the product produced by the infrastructure project in question.

For instance, such a scenario could lead potentially to a far lower level of demand from the offtaker for the power being produced by an independent power project (IPP). Thus, the basic economics of the affected projects could come under stress as the project may not be generating the expected revenues due to the lessened demand.

The second basic source of pressure could flow from any major depreciation of the local currency. If there has been a sharp depreciation of the local currency (and the currency risk has not been hedged), then it could become unaffordable for, say, an offtaker of power from an IPP to pay the tariff at the contractual rate set forth in the original power purchase agreement. The basic problem is that there is a currency mismatch: the offtaker receives revenues from its customers in the local currency, and yet the offtaker needs to pay the project effectively in a hard currency.

The scenarios described above of lower demand and a depreciated local currency could lead to serious pressures on the original contractual arrangements. The project may wish to hold its counterparty (e.g. the offtaker) to the original contractual arrangements, whereas the project’s counterparty may argue that it should no longer be bound by the original contractual arrangements since there has been a major change of circumstances since the relevant contracts were entered into.

These conflicting perspectives on the part of the project and its counterparties could result in a default under the relevant operating agreements (and even ultimately under the financing documents), a renegotiation/restructuring of the project’s operating and/or financing arrangements, or even a dispute between the parties in the form of litigation or arbitration.

Any discussion of infrastructure projects in the emerging economies would not be complete without a reference to China’s expansive and ambitious Belt and Road Initiative (BRI). China has financed and constructed BRI projects around the world, but in the current COVID-19 environment, many of these projects may be rendered uneconomic by the downturn in the local economies where the projects are based and may require renegotiation with the relevant Chinese parties.

Even pre-COVID, certain countries such as Malaysia were already trying to renegotiate some of their BRI projects with China. Malaysia, for example, claimed that the costs of the BRI projects in question in Malaysia were too high and needed to be renegotiated.

As China has BRI projects far and wide in so many emerging economies, it will be very interesting to see whether over time China develops a standard playbook for dealing with situations of distressed BRI projects, and if so, what that playbook entails. To be sure, the way that China deals with distressed BRI projects may be intertwined with China’s approach to dealing with sovereign debt issues where sovereign borrowers are experiencing financial distress.

**State-owned enterprises (SOEs) and non-performing loans (NPLs)**

As a final matter, two other areas bear mentioning in any discussion of emerging market restructurings: state-owned enterprises (SOEs) and non-performing loans (NPLs). We will highlight selected key issues related to SOEs and NPLs in the brief overview discussion that follows.

In many emerging markets, there may be a not insignificant presence of SOEs in the local economy. And yet many of these SOEs may be unprofitable, and, despite this, often the relevant national governments continue to pour money into these SOEs on an ongoing basis from year to year to keep them afloat.

Due to the pressures on a sovereign’s public finances from the COVID-19 crisis, a moment of reckoning may have finally arrived for a number of national governments in terms of how they handle unprofitable (and possibly even insolvent)
SOEs. Specifically, the governments may have to face a stark choice. They will have to decide whether such SOEs will need to be restructured (if that is possible) and/or privatised (either through a public sale of stock or by a sale to a private investor), or whether they will need to be liquidated.

A separate issue relates to non-performing loans (NPLs) in a national banking system. It is likely that, in view of the financial distress that many companies in emerging market jurisdictions are likely to face in the current crisis, the banks in the relevant emerging market jurisdiction will start to accumulate many non-performing loans on their balance sheets.

If the banks just sit on the NPLs and do not take any action to remediate the NPLs, the ability of the banks to lend will be curtailed to the extent that the banks are required to set aside loan loss reserves in connection with the NPLs. This will not be beneficial to the banks since after all they are in the business of lending, and it will not be beneficial to the national economy because lending is key to spurring new economic activity.

Thus, banks and national governments will have to develop effective strategies for addressing any significant build-up of NPLs in the national banking system. For banks, if they do not already have such a capability in place, they will need to establish a unit within the bank that is dedicated exclusively to handling the bank’s NPLs with the aim of maximising recovery on the NPLs.

In addition to considering recovery options based on litigation, restructuring, and/or an insolvency filing, banks might seriously explore whether there are any private investors interested in purchasing the NPLs at a discount from their face value (either individually or as part of a portfolio of NPLs). This would be a relatively straightforward way for the banks to clean up their balance sheets.

As to the national governments, they might consider an approach that has been used in prior situations where national banking systems are confronting a huge volume of NPLs: establishing a so-called asset management company (AMC). The AMC would acquire the NPLs from the banks for a negotiated purchase price, and the AMC would then be tasked with realising value on the NPLs it had acquired.

Perhaps the COVID-19 economic crisis will stimulate creative new thinking on innovative approaches for handling NPLs on a large scale beyond the tried-and-true approach of establishing AMCs. The bottom line, though, is that there will need to be effective ways to address the issue of NPLs so that, first, the health of the banks and the banking system can be preserved, and, second, new lending (and therefore new or renewed economic activity) can take place.

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I began my Presidency in Singapore at the conclusion of our annual conference with over 950 participants from 69 countries. Approximately 112 judges from those countries participated in a closed-door Judicial Colloquium, brainstorming ways to enhance cooperation within cross-border legal disputes. Like all of you, I never could have imagined we would be faced with a global pandemic within 12 months of that event.

As professionals within the crisis management and restructuring community, we are accustomed to approaching each new hardship as a challenge and that of COVID-19 is no different. It has been energizing and inspiring to work with the Board and staff at INSOL in rising to this challenge and building on the successes of my predecessor, Adam Harris to ensure we remain forward focused, relevant and achieve another year of valuable contributions to our members and the global insolvency and restructuring industry at-large.

While much of our focus is on the future and the uncertainty we are currently facing, I would like to take this opportunity to reflect on some of the positive achievements within the past 12 months, acknowledging how we excel in coordinating global programs and projects to facilitate greater international cooperation. Our growing membership and comprehensive global network are testament to the strength of our organisation and I am filled with pride to consider the depth of our membership of approximately 10,000 professionals through over 40 Member Associations. It is our members lending their deep expertise to our association which enables us to continue to strive to attain our vision.

This past year, we have made great strides in delivering more of the strategic recommendations of our Task Force 2021 strategic review, including opening a hub in Asia, and launching the online Foundation Course. Furthermore, we have continued to hold successful conferences and seminars, welcomed new Fellows, and published regular papers.

Asian Hub
Having operated solely from headquarters in London since 1982 we are delighted to have launched the INSOL Asia Hub at Singapore’s Maxwell Chambers Suites in August 2019. With a large membership in the Asia Pacific region, the INSOL Asia Hub has enabled INSOL to increase engagement with existing members and other key stakeholders and provided more opportunities to help with the education and training of practitioners in the region. Going forward, this will be the on-the-ground platform to assist in the development of best practices for insolvency and restructuring systems in Asia, and strengthen relations with government agencies, regulators, the judiciary, and global agencies operating on the ground.

The need for an office in Asia to broaden and deepen INSOL’s engagement in the region was identified as part of the strategic review undertaken by INSOL International in 2016 and we have been delighted by the enthusiastic response to this initiative from members across the globe, and especially in Asia.

Education
Our thriving Global Insolvency Practice Course (GIPC), the only route to becoming a Fellow of INSOL International, has now been running with great success for 10 years. In this time, we have seen 171 professionals achieve the accreditation of Fellow, INSOL International.
Twenty-five of these from 13 countries were welcomed in 2020, and we eagerly anticipate significant engagement in the future with them together with our existing Fellows. It is these highly engaged individuals who help to shape the future of INSOL and ensure that we maintain our position as thought leaders within the restructuring and insolvency community.

In 2019 we were proud to have launched a complementary qualification to sit alongside our GIPC. As part of our strategic review in 2016, leading to the adoption of Task Force 2021, we identified a void within the international insolvency profession, particularly in developing jurisdictions, for an introductory cross-border training course. This prompted the creation and launch of the postgraduate Foundation Certificate in Insolvency Law which is delivered entirely online. The certification represents the culmination of two years’ research, planning and hard work from a dedicated course committee and has already attracted 119 students from 35 countries who began studying in September 2019.

Candidates are required to complete eight modules which can be chosen to suit the interests and local needs of each individual, with three compulsory elements to ensure a core understanding of international insolvency law. Being wholly online means the course is open to anyone with regular access to a computer and internet connection. I am anticipating great things from these individuals who do this course, allowing younger practitioners entry into the industry, broadening our network into even more remote areas of the world and deepening our understanding of developing jurisdictions.

Events
Historically, INSOL has been known for providing the opportunity to bring together peers and colleagues from around the globe, to facilitate the sharing of ideas and building of cross-border relationships. Our events programme has been an instrumental part of this goal and, as ever, 2019 included a constructive roster of events.

Singapore was host to INSOL’s annual conference in April 2019, where we were delighted to welcome over 950 delegates from 69 countries. The conference saw filled-to-capacity ancillary programming for the Judicial and Academic Colloquia, the offshore, small practice and younger members meetings, and the fifth annual INSOL Fellows forum, in addition to a well-rounded technical programme built on the theme of looking to the future: what to expect and how to prepare.

Professor Richard Susskind provided an excellent and thought-provoking keynote session and the conference was closed with a dynamic question and answer panel featuring an array of market experts and chaired by broadcast journalist Rico Hizon. Conferences like this remind all of us how cooperation is critical to establishing seamless cross border insolvency and restructuring regimes which encourage lending and better global business practices.

Our global programme of one-day seminars was also highly successful in 2019, attracting over 850 delegates from 34 countries at seven individual seminars. We held our second Nordic European seminar with great success in Stockholm in May 2019 focusing on specific regional restructuring issues and the EU Directive. In June, Sandra Särav encouraged proactive thought on digital technologies’ differing use across countries, illustrating Estonia’s transformation from a soviet state at our Channel Islands seminar held in Guernsey.

We hosted four seminars in Eastern Asia throughout October and November. Highly successful seminars in Beijing and Shanghai were followed by our second annual seminar in Hong Kong and first visit in many years to Tokyo.

All these events received high praise for the interesting range of region-specific topics and selection of relevant and noteworthy speakers. Finally, our established Offshore seminar, in association with member association RISA Bahamas, welcomed 135 delegates to The Bahamas in December, with a keynote address from Hon. Judge Kevin Carey focusing on recent trends in cross-border insolvencies.

INSOL International Technical Publications
The regular production of technical publications is a valuable benefit to INSOL’s members and the technical library available on the INSOL International website is a comprehensive resource covering an array of topics and cutting-edge developments. The production of these
publications would not be possible without the knowledge and experience of our members, many of whom are instrumental in the creation of these publications which include books, special reports, a technical paper series, and a series specifically aimed at small practices.

In the past 12 months we have published books covering current employee entitlements and bank resolution. There have been special reports examining contemporary issues such as artificial intelligence and cryptocurrency, our technical papers have included aircraft repossession upon a default and the new bankruptcy laws in Morocco and Bahrain amongst many others, not to mention three additions to our small practitioners’ technical paper series. The wealth of expertise available is expansive and cannot be done justice here in one small paragraph. Suffice to say it is a worthwhile point of reference for any professional concerned with insolvency and restructuring, and it will continue to be so.

Looking ahead, I promise, INSOL International will grow from the challenges it and the world are facing. We will be more creative about online learning, find new ways to connect with our colleagues around the world and be reminded of why it is so essential that we all pull together to help rebuild the global economy. I am proud to be a part of a community which looks forward and concentrates on positive change instead of dwelling on things outside of our control. Together, we will get through these monumental times.

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A VIE Structure is akin to an agreement-based form of corporate control, designed mainly:

a) to allow foreign investors to hold a controlling interest in a business operating in China (typically in the e-commerce sectors); and

b) as a mechanism for Chinese domestic entities to gain access to international capital markets and foreign mergers and acquisitions through offshore listings.

In summary, through a VIE Structure, foreign investors together with one or more PRC persons (legal or natural) (PRC Founders) are able to control an onshore wholly foreign-owned enterprise (WFOE) which in turn may enter into arrangements with PRC domestic companies on exclusive licensing or distribution bases.

The key concept which underpins a VIE Structure is that the control and ownership of the domestic licensed company is obtained through various service agreements instead of through direct share ownership. The arrangements are often complex, with checks and balances by way of share pledges on-shore and guarantees offshore by those holding shares in the ultimate investment parent. Through the VIE Agreements, foreign investors are able to invest in, obtain access to and share in the domestic PRC company’s profits.

Foreign investment into a Chinese entity through VIE is typically structured as follows:

• the PRC Founders incorporate a company or companies in the British Virgin Islands (BVI);

• the BVI company and the financial investors incorporate a company in Cayman Islands (Cayman), and this Cayman company

may, if the business is successful or capable of promotion, later be listed on an international stock exchange, whether in China, or overseas;

• the Cayman company establishes a shell company in Hong Kong;²

• the Hong Kong company establishes a WFOE in China;

• the Chinese WFOE controls the Chinese target companies through a VIE structure. This is achieved by the WFOE signing a series of agreements (known as VIE Agreements) with a domestic licensed company in PRC which holds the necessary licences to operate in the PRC.

Cross-border insolvency issues may arise in such a structure if the founder or the group encounters financial difficulties. If the offshore entities in this structure enter insolvency proceedings, recognition and enforcement of foreign insolvency proceedings may be required in any of the relevant jurisdictions of incorporation – much will depend on where the value lies and how the debts are structured. Typically one finds that there will be a trigger default in the operational ultimate subsidiary or its VIE domestic company, which causes defaults further up the chain and may lead to calls on guarantees given by the Founders who are natural persons.

To facilitate access to capital markets and to ensure investment into China by international investors, increasingly the judicial trend in China has tended toward foreign creditor friendly approaches, to permit investors to have confidence in the safety of their investment, whether direct or via a VIE. Below we look at how that works in practice and how this impacts on the interplay with BVI and VIE structures.
Recognition of foreign insolvency proceedings in China

Article 5 of China’s Enterprise Bankruptcy Law (EBL) provides the basis and criteria for recognising foreign insolvency judgements and orders. Under Article 5, Chinese courts may recognise and enforce foreign insolvency judgements and orders affecting a debtor’s assets within China on the following conditions:

1) the request for recognition and enforcement is based on a treaty or convention to which China is a party or the principle of reciprocity;
2) granting recognition and enforcement will not violate the basic principles of Chinese law; nor will it be against the national sovereignty, national security or public interest, or prejudice the legitimate interests of the creditors in China.

The considerations are not atypical of many western insolvency recognition regimes. Whilst there has been no reported foreign insolvency judgement or order recognised by Chinese courts under Article 5 of the EBL, the reason for that may lie in the fact that China has not adopted the UNCITRAL Model Law on Cross-border Insolvency (UNCITRAL Model Law) nor entered into any treaties for the cross-border recognition of insolvency proceedings. However, Chinese courts have long adopted de facto reciprocity, albeit a stringent standard, to permit the establishment of recognition, which in recent years has gained prominence in China.

The 2018 meeting minutes of the Supreme People’s Court (SPC) on bankruptcy cases encouraged Chinese courts to explore a “new method” of applying reciprocity: this was taken largely to refer to the recent developments on the expansion of reciprocity in civil and commercial areas. For instance, the SPC issued opinions regarding the Belt and Road Initiative successively in 2015 and 2019, proposing a loosening of the criteria for reciprocity so as to promote mutual recognition and enforcement of judgements. That broadening of what was once a more restrictive approach in the civil and commercial judicial sphere may increase the chances of reciprocity in cross-border insolvency matters.

Consequently, Chinese courts are arguably more likely to acknowledge the existence of reciprocity as a principle for recognition of foreign insolvencies, particularly in the following circumstances:

• The relevant jurisdiction where the insolvency has been commenced has already recognised Chinese insolvency proceedings. A few jurisdictions have recently done so. Courts in the US recognised the Chinese bankruptcy proceedings of Zhejiang Topoint Photovoltaic Co, Ltd. and Reward Science and Technology Industry Group respectively in 2014 and 2019. More recently, a Hong Kong court recognised the appointment of bankruptcy administrators of a Chinese company, CEFC Shanghai International Group Limited in January 2020, which was the first cross-border insolvency case recognising Chinese bankruptcy administrators in Hong Kong.

• Even where a relevant jurisdiction has not yet recognised Chinese insolvency proceedings, the Chinese Court may also look to whether the jurisdiction could theoretically recognise Chinese insolvency proceedings where there to be a hypothetical application. For instance, jurisdictions that apply the UNCITRAL Model Law and certain common law jurisdictions may not require de facto reciprocity to be demonstrated for cross-border insolvency recognition to be effected; where such jurisdictions may incline to recognise Chinese insolvency proceedings, the Chinese Court may consider that a factor when determining recognition.

That being said, the standard of reciprocity for cross-border insolvency has yet to be tested before the Chinese courts and as such it is an area of increasing interest amongst academics, lawyers and the investment community alike.

In the VIE structure as mentioned above, financial investors as creditors (whether as redeeming shareholder or under the VIE arrangements) may initiate their recoveries against an individual founder. Typically, that will occur offshore given the prevalence of interests held through offshore entities. Given that the individual founder will usually have assets in China, an issue will arise as to whether the enforcement can be recognised or whether insolvency proceedings of the individual founder may be brought in China. However, in China, there is currently no personal bankruptcy law. Certain cities in Zhejiang Province are exploring a centralised clean-up of personal
debts, which system has characteristics consistent with a personal bankruptcy regime. Shenzhen City is exploring the question of personal bankruptcy system but the draft of the regulation remains at the time of writing under review.

Due to the lack of definitive personal insolvency regime, it is unlikely that a Chinese court will find itself able to recognise foreign insolvency proceedings brought against an individual. The Chinese court may find such recognition against the public interest and accordingly refuse to recognise any foreign personal insolvency order.

**Recognition of foreign insolvency officeholders**

Although Chinese courts have not yet recognised foreign insolvency proceedings under Article 5 of the EBL, they have recognised the status of a foreign insolvency officeholders’ appointment. The SPC meeting minutes on maritime and commercial cases with foreign elements issued early in 2005 made clear that, if the foreign party to the legal proceedings in China becomes bankrupt or enters liquidation during the proceedings, the court shall notify its insolvency officeholder to participate in the proceedings.

In judicial practice, Chinese courts have also recognised the capacity of foreign insolvency officeholders to represent the debtor in the legal proceedings. An important case is *Sino-Environmental Technology Group v Thumb Environmental Technology Group* heard by the SPC in 2014. Without specifically requiring the recognition of the appointment of the foreign insolvency officeholders, this case confirms that foreign insolvency officeholders can act on behalf of the debtor in the PRC in accordance with the law of the place where the debtor is registered.

This may facilitate foreign insolvency officeholders taking certain actions in China without applying for recognition. For instance, in the VIE structure as mentioned above, if the offshore company in liquidation has Chinese debtors, the foreign insolvency officeholders may, on behalf of the offshore company, initiate legal proceedings in China against its Chinese debtors, without applying to a Chinese court for recognition of the appointment of the foreign insolvency officeholders.

However, without a Chinese courts’ recognition of the foreign insolvency judgement/order, the foreign insolvency officeholders will not be granted judicial assistance and are therefore unable to perform their functions in full in China. For example, without the assistance granted by the court, the foreign insolvency officeholders are unable to protect the foreign debtors’ assets in China, such as by preventing any disposal of the debtors’ assets in China.

In order to perform their functions, the insolvency officeholders may apply to a Chinese court for recognition of the relevant foreign insolvency judgement/order. However, it remains unclear what assistance the court may grant to foreign insolvency officeholders if the court recognises the relevant foreign insolvency judgment/order. Other than Article 5, the EBL does not provide any detailed rules on cross-border insolvency. The SPC meeting minutes on bankruptcy cases issued in 2018 considered that cooperation on cross-border insolvency should be promoted, but did not provide any specific guidance on the extent and type of assistance that may be granted by the Chinese courts.

The specific guidance not having been promulgated, were a Chinese court to recognise foreign insolvency proceedings, assistance should be granted as if the foreign debtor had entered into bankruptcy proceedings in China. Given that this is not made clear by the EBL, the recommended approach is to ensure that powers and effects are included in the order of the Chinese court recognising foreign insolvency proceedings. For instance, once the Chinese court recognises the foreign court judgement/order on initiation of the foreign insolvency proceeding, a stay should be available as if this were a bankruptcy proceeding in China, in which case any preservation measures existing on the debtor’s assets would fall away, and any enforcement proceedings against the debtor should be suspended, etc.

Even if the Chinese court recognising foreign insolvency proceedings issues such a detailed order including therein specific powers and effects, it is still quite uncertain whether
and how other courts and arbitration institutions in China will honour such orders, due to lack of detailed rules and precedents. According to a speech of a SPC judge in a bankruptcy forum, the SPC is currently promoting amendments to the EBL, which will provide more detailed rules on cross-border insolvency, including but not limited to jurisdiction, status of foreign insolvency officeholder and foreign creditors, conditions and methods of provision of assistance.

Since the relevant laws at present preclude personal bankruptcy, this is only of interest where the debtor is a corporate as opposed to an individual natural person. So where does that leave enforcement of debts as against individuals domiciled in China with assets offshore but where the value is locked in the PRC?

The case of Industrial Bank Financial Leasing Co Ltd v Xing Libin BVIHC (Com) 0032 of 2018 (Industrial Bank) in the BVI is instructive on that point. The BVI Court not only recognised and enforced judgments from the Courts of the PRC but also appointed receivers by way of equitable execution to take control of a PRC judgment debtor’s assets being shares in a BVI incorporated vehicle, to maximise enforcement for a judgment creditor.

This case bodes well for comity between the BVI and the PRC and may very well pave the way for mutual recognition and assistance between the two jurisdictions, which, given the prevalence of BVI companies in offshore VIE structures and the issues in pursuing any personal recovery against individual natural persons in China, will be a useful tool for recovery. Once appointed, the receivers may use their powers, to realise the value from the shares by appointing themselves directors of the company and thereafter taking corporate steps to liquidate the assets of the company or put the company into voluntary liquidation to satisfy the judgment debt.

In permitting the appointment of receivers, the Court was especially persuaded by the fact that a direct sale where the value of the underlying assets was unknown could result in a discounted recovery, therefore prejudicing both the judgment creditor and debtor. Therefore, the appointment of a receiver was the only available realistic prospect for the judgment creditor to enforce its judgment in the short term.

In the absence of a personal bankruptcy regime in the PRC, the decision in Industrial Bank allows recovery as against individuals offshore as well as opening the door to comity for BVI judgments in the PRC. This is likely to be treated as the first step to permitting wider recognition of cross-border insolvency between both BVI and PRC, particularly where neither has enacted the UNCITRAL Model law.

In the event of any developments in terms of personal bankruptcy laws, cross-border recognition on the basis of comity will likely follow, if that regime is developed in the PRC. In the meantime, investors can take comfort that both China and the BVI have a clear path of actual comity to allow for enforcement should the need arise.

Singapore and Hong Kong approaches to facilitating cross-border insolvency proceedings

Since both jurisdictions are used as part of the VIE structure, it is useful for investors to know what available assistance there is for cross-border recognition at the mid-tier level, should such occasion arise.

Hong Kong is not a signatory to the UNCITRAL Model Law and so reliance is placed on principles of common law to assist with foreign insolvency proceedings, such assistance being determined on a case-by-case basis. The recent case of CEFC Shanghai International Group Limited [2020] HKCFI 1674 is the first case where the Hong Kong Court recognised PRC insolvency proceedings and made an order for assistance. The Court summarised common law recognition and assistance as follows:

a) The foreign insolvency proceedings must be collective insolvency proceedings, commenced in the debtor’s country of incorporation and the country of incorporation must be a jurisdiction with a similar insolvency regime to Hong Kong.

b) There is no requirement that the foreign jurisdiction must also recognise insolvency officeholders appointed by the Hong Kong courts, the country of incorporation must be one that aims to promote a unitary
approach in transnational insolvencies and the degree to which the foreign jurisdiction recognises officeholders appointed by the Hong Kong courts may be relevant to this determination.

c) The Hong Kong Court will offer assistance to the foreign officeholders by applying Hong Kong insolvency law, subject to certain parameters, on recognition.

d) The assistance sought should not enable the foreign officeholders to do something which they could not do under the law by which they were appointed and the power of assistance is only available to the extent that it is necessary for the performance of their functions.

e) An order granting assistance must be consistent with the substantive law and public policy of the assisting court.

In contrast Singapore has adopted the UNCITRAL Model Law to enhance Singapore’s status as an international centre for debt restructuring. Following its adoption, Singapore courts must recognise a foreign proceeding if certain stipulated conditions are met, unless recognition would be contrary to Singapore’s public policy. Foreign representatives can apply for recognition of foreign insolvency which will be recognised as a foreign main proceeding if it is taking place in the state where the debtor has its centre of main interests (COMI). This is presumed to be location of the registered office or habitual residence of the debtor.

In Re Zetta Jet Pte Ltd and others [Asia Aviation Holdings Pte Ltd, intervener] [2019] SGHC 53 (heralded by practitioners as Singapore’s landmark judgment on recognition of foreign insolvency proceedings under the UNCITRAL Model Law), the court held that the statutory presumption should not be considered a rebuttable presumption that must be disproved on the balance of probabilities, but rather be used as a starting location of the COMI, capable of displacement by furnishing evidence to the contrary. Re Zetta Jet held that the relevant date for such determination was the date of filing of the recognition application.

Particular weight is likely to be placed on factors such as [a] the location of control of the company, the analysis of which could include the activities of the entire group of companies and not just of the debtor company; [b] dealings with third parties (customers, creditors, vendors, suppliers) insofar as where these parties would have considered the debtor in question to have its base; and [c] the location of creditors. The Singapore court also made clear that the location from which a foreign representative was operating from is not a relevant factor in determining the COMI of a debtor.

Adoption of the Model Law more generally

Across Asia, adoption of the UNCITRAL Model Law has not been widespread. For example, Malaysia is not a signatory to, nor has it adopted the UNCITRAL Model Law in its domestic legislation. Since updating its companies law in 2016, which greatly enhanced tools for domestic insolvency matters, there is no codification of any cross-border arrangements or measures by which foreign courts could cooperate on insolvency matters.

The Courts are largely left to interpret the current legislation and to allow cross border judicial cooperation on the basis of comity. In the event of a winding-up in Malaysia of a company incorporated in another jurisdiction, Malaysian law requires that assets of the foreign company which are located in Malaysia to first be ring fenced and applied towards domestic liabilities, before the assets can be turned over to a foreign insolvency office holder.

Commentary from practitioners who have been consulted are hopeful that the well known case of Singularis opens a gateway for more information sharing and for foreign liquidators to obtain wider orders for examination of persons in connection with the affairs of a company, by evolution of the common-law in the future.

Another case in point is Thailand, which adopts a civil law system based historically on the French Civil Code. The Thai insolvency and restructuring regime does not recognise cross-border insolvency issues. Indeed, the key legislation in the area, the Thai Bankruptcy Act, [the TBA] expressly provides (section 177 of the TBA) that “the receivership or bankruptcy under the law of any other country has no effect on the debtor’s property located in [Thailand]” and practitioners consider that it is fairly clear
that Thai Courts are unlikely to cooperate with foreign courts in insolvency proceedings.

While some commentators are pushing for Thai adoption of the UNCITRAL Model Law, and the Thai government, through the Legal Execution Department, the Ministry of Justice has studied the effect of implementing some of those laws, this has not yet been adopted. Thailand is not presently a signatory to any international treaties or arrangements relating to insolvency and restructuring processes.

Ultimately if a foreign creditor wishes to, he or she will have to prove in the bankruptcy proceedings in Thailand, declaring any distributions that have been made to the creditor in respect of a Thai debtor’s estate outside of Thailand and agree for that to form part of the Thai debtor’s total estate to debtors in Thailand.

Notes:
This article is not intended as legal advice nor a substitute thereof and no reliance may be placed on its contents.

1 In this article, any reference to the PRC or China excludes Hong Kong, Macau and Taiwan.
2 Or, less, frequently Singapore.
4 Following Re Supreme Tycoon Limited (08/02/2018, HCMP833/2017).
In the 1990s, the World Bank promoted the idea that it was important for economies, especially those in early stages of development, to establish predictable and transparent insolvency regimes to attract financing. At about the same time, UNCITRAL recognised the need for increased coordination and cooperation across borders in large multi-national insolvencies. In the 1990s Insolvency Section’s representatives played a critical role in crafting UNCITRAL’s Model Law on Cross-Border Insolvency and in the early 2000s its Legislative Guide to Insolvency Law. In addition, in the mid-1990s, the Insolvency Section drafted and published the first Cross-Border Insolvency Concordat, which has since provided the basis for protocols for administering many of the world’s largest cross-border insolvencies.

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

Over time, the Section developed a practice of meeting twice per year – once at the International Bar annual meeting in autumn in conjunction with all other IBA practice groups and once all by itself at a focused mid-year meeting of Section members in May, with traditionally between 140 and 200 participants. In addition, the Section occasionally has held colloquia on special subjects. In 2007, the Section began to publish a semi-annual journal called the Insolvency and Restructuring International. Since then, the Journal has featured numerous scholarly articles contributed by hundreds of authors. The Section has also produced a number of valuable treatises, including one on Cash Pooling and Insolvency, one on Title Retention, and another on Financing Company Group Restructurings.

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

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

As of 2020, the Section has 71 officers from 31 countries in six continents, and there are still leadership positions that remain open.
The following are the Insolvency Section’s main goals:

1. to meet at least twice a year to provide:
   a) stimulating programming on important insolvency topics with leading thinkers; and
   b) networking opportunities to enable members to develop enduring business and social relationships;

2. to provide opportunities for members to disseminate new ideas, experiences and insights in insolvency through active participation in dialogues at meetings and publication of materials in the IS Journal and IS books, as well as by enhanced use of the Section’s website and social media;

3. to achieve cultural, gender and geographical balance among speakers at conferences and in leadership positions;

4. to participate in the important work of UNCITRAL, the World Bank and similar organisations in their efforts to promote more effective insolvency laws and cross-border cooperation and coordination; and

5. to increase membership of in-house legal counsel and non-lawyer insolvency practitioners.

The Insolvency Section endeavours to spread its mid-year conferences globally, aligned with the IBA’s annual conferences. In 2020 and 2021 the annual conferences will be held in Miami and Paris; the mid-year conferences will be in Edinburgh and Montreal.

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The changing face of the CVA and schemes of arrangement: A security agent’s perspective

by Juliette Challenger, Global Loan Agency Services Limited (“GLAS”)

The use of company voluntary arrangements and court sanctioned schemes of arrangement as tools to restructure the debts of a company in financial difficulties has continued to increase in popularity in recent times, particularly in the retail sector, as an alternative to formal insolvency procedures, with the aim of generating better financial outcomes for the company in question and its creditors.

However, there have been some interesting developments in recent case law that have clarified the parameters around such arrangements, specifically the recent judgments in the Debenhams and Instant Cash cases in the UK, which may have a significant impact on the future content and structure of such restructuring mechanisms.

As an experienced independent debt administration services provider, GLAS has been involved in various capacities in numerous restructuring transactions and processes, including CVAs and Schemes, as an active participant in the restructuring of the company’s financial arrangements, resulting, in some cases, in litigation, including in the Debenhams case. The recent legal developments raise key considerations for security agents collaborating with transaction parties to analyse and assist with achieving the goals of the transaction parties aiming to enable companies to continue as a viable going concern outside of a formal insolvency process.

What is a CVA?
A company voluntary arrangement (“CVA”) is a tool permitted under Part 1 of the Insolvency Act 1986 and is essentially a contract between a company in financial difficulty and certain of its creditors, which enables a company to restructure and compromise its debts and liabilities, with the aim of generating a better financial return and better prospects for the business than if the company entered into a formal insolvency procedure, such as liquidation. Unlike other insolvency procedures available, the directors of the company remain in control of the business, which continues to operate under the supervision of an insolvency practitioner, and under the terms of the arrangements agreed between certain of the company’s creditors.

A key benefit of a CVA is that, once in effect, a creditor cannot take any step against the company to recover any debts, or enforce any rights against the company that arise from failure to pay those debts in full, which are covered by the terms of the CVA.

There has been a recent increase in the use of CVAs, particularly in the retail sector, as the CVA can offer a mechanism for the company to restructure its rent obligations with landlords as a whole class of creditor, without the need to negotiate with each landlord individually, and has the potential to swiftly and significantly reduce rental outgoings of a company.

Additionally, a CVA typically allows greater flexibility than a formal insolvency process, and is often more cost effective to implement, therefore offering a more commercially attractive outcome.

The Debenhams case

Discovery (Northampton) Ltd v Debenhams Retail Limited [2019] EWHC 2441 (the “Debenhams case”) was a recent significant case relating to CVAs, in which GLAS had direct involvement due to its role on the wider transaction.

The Security Agent’s transactional role

Given its expertise in complex restructuring matters, GLAS was mandated as successor Facility Agent and successor Security Agent in March 2019 in respect of the existing loans and notes of Debenhams Retail Limited (the...
"Company") and other Debenhams group companies (the "Group Companies"), in addition to a subsequent new money facility and transfer of debt obligations of some Group Companies to a new funding vehicle (the "Restructured Facilities"). This appointment involved representing financial creditors whose total exposure to Group Companies was in excess of £700,000,000, providing administrative services in respect of the Restructured Facilities and taking a pragmatic approach to facilitating communications amongst lenders in respect of the proposed CVA arrangements.

Summary of the CVA proposals
Following consideration of its financial position and existing debt arrangements, the Company’s directors had proposed a CVA in May 2019 mainly to compromise unsustainable retail rental and business rate liabilities. The proposals principally affected the Company’s landlords and local authorities, and the proposals were approved by over 90% of the Company’s creditors.

The CVA proposal challenge
Despite this overwhelming approval, a minority group of landlords (the "Applicants") initiated a challenge to the CVA proposals on several grounds, including specifically relating to the proposals that would impact landlords and the treatment of rental payments due under existing lease arrangements.

At a hearing in September 2019 (the "September Hearing"), the main claims asserted by the Applicants (in blue type), and the court’s findings (in italics), were as follows:

1. Claims capable of compromise under the terms of a CVA do not include future rents and should not be included in the CVA as these are not correctly characterised as "debt" but as "unearned future rent payments; therefore the Applicants are not "creditors" for future rent within section 1 of the Insolvency Act 1986. The court did not agree with this argument and ruled that future rental payments can be caught within the terms of a CVA.

2. The Applicants should be paid rent under the CVA at the full agreed contractual rate, as it would be unfairly prejudicial not to do so, or there is no jurisdiction to reduce rents for any future period when the Company occupies the property. The court found that the fact that future rents may be reduced as part of the CVA would not be unfairly prejudicial or against the requirements of common justice, as it was noted that the purpose of a CVA would be to modify existing obligations, rather than create new ones.

3. The Applicants are treated less favourably under the terms of the CVA than other unsecured creditors without any proper justification. The court held that this argument failed as the differential treatment of landlords to other creditors was not inherently unfair and that market pressures and the need for business continuity may necessitate such differential treatment amongst creditors in certain circumstances.

4. The CVA proposals did not comply with certain requirements of the Insolvency (England and Wales) Rules 2016 (the "Insolvency Rules"). The court determined this argument failed on the basis that the proposals put to creditors had sufficiently detailed the Company’s efforts to source alternative financing.

5. The right of forfeiture is a proprietary right that cannot be altered by a CVA. On this point, the court found in favour of the Applicants, noting that Applicants’ proprietary rights cannot be abrogated and therefore landlords could not be prevented from forfeiting their leases under the terms of the CVA. Therefore, this last point highlights the one important ground on which the Applicants were successful in relation to the forfeiture of leases – i.e. a landlord’s right to terminate a lease before its stated termination date due to a breach of the lease terms by the tenant, allowing the landlord to re-enter the property.

Norris J therefore determined that the CVA was still valid and remained enforceable, but would be subject to certain amendments/deletions to sever the proposed forfeiture provisions from the remaining proposals in the CVA.

The further Debenhams proceedings
In February 2020, a further hearing was held before Norris J to deal with matters reserved at the September Hearing, and to deal with an application by the Applicants to challenge and vary the order made by the court at the September Hearing.
Norris J confirmed the findings in the September Hearing regarding the severance of the forfeiture provisions, upholding the decision that the CVA was valid and could proceed, albeit that the proposed forfeiture arrangements would need to be deleted from the CVA, as it is not possible to interfere with the forfeiture rights of landlords.

The judge also dismissed an application by certain of the landlord Applicants pursuant to the Insolvency Rules in connection with a request for the court to review the order made at the September Hearing in light of arguments on certain points of law that were not advanced by the relevant parties at the September Hearing, and made determinations as to costs.

However, leave to appeal the judge’s decision of all matters raised at this hearing was granted, potentially leaving the door open for further future challenges by the parties on these points.

The Security Agent’s role in litigation

In acting as Security Agent, it was necessary for GLAS to be joined to the litigation proceedings in the Debenhams case as a Respondent, in order for it to be bound by any court order delivered for the benefit of the secured parties and relevant financial creditors. As an active party to the proceedings, the Security Agent was involved at the forefront of the litigation process, which enables the Security Agent to add value by:

1. formulating and understanding all of the key legal and commercial issues, in collaboration with the instructing creditor group, and where necessary, the company;
2. taking proactive steps to appoint independent counsel to work with GLAS’ internal legal team to advise on matters relating specifically to the Security Agent’s role, preparing submissions in court of arguments in support of the relevant creditors’ position and attending court hearings; and
3. seamlessly working alongside creditors and the company and their respective counsel in order to adopt and support the arguments in the creditors’/Company’s position papers and skeleton arguments for trial in opposition to the CVA Challenge.

The Instant Cash decision

Shortly after the September Hearing, an analogous decision to that of Norris J’s in the Debenhams case was handed down by Zacaroli J in October 2019 in In the matter of Instant Cash Loans Ltd [2019] EWHC 2795 (the “Instant Cash” case).

The Instant Cash case related to a scheme of arrangement under Part 26 of the Companies Act 2006, being a court sanctioned arrangement between a company (the “Scheme Company”) and its creditors to achieve a compromise of the Scheme Company’s existing debts (a “Scheme”).

The court in this case had to determine whether the proposed Scheme, which amongst other things, purported to effect a surrender of leases between the Scheme Company and its creditors with the effect of replacing the liability to pay rent with a claim for damages by the relevant landlord, was valid.

The court determined that the provisions purporting to unilaterally and automatically terminate the lease arrangements between the Scheme Company and its landlords by surrender by the tenant was void, as this interfered with the proprietary rights of the landlord, and did not relate to a contractual right between the Scheme Company creditor and a debtor. The court made the distinction, as in the Debenhams case, that the Scheme can only deal with rights between a debtor and a creditor, not with proprietary rights, such as those arising from lease arrangements between a company and its landlord.

The court also found that a lease cannot be terminated by the will of the tenant alone, and that the surrender of the lease in this case was considered to be an unnecessary additional consideration, as it was ancillary to the compromise of a pecuniary liability, and not necessary to ensure the effectiveness of the compromise of debt effected by the Scheme. As such, the court found the surrender provisions in the proposed Scheme were out of the scope and jurisdiction of the court under a scheme of arrangement pursuant to the relevant provisions of the Companies Act 2006.

Therefore, the court determined that it could sanction the proposed Scheme, provided that the lease surrender provisions were removed. The approach of the courts in this case shares significant similarities with the decision in the Debenhams case, that whilst it is possible to vary contractual provisions as between a debtor and creditor, it is not possible to unilaterally interfere with the proprietary rights of a landlord.
A new way forward for CVAs and schemes of arrangement?
The Debenhams and Instant Cash litigation produced two judgments in quick succession on different restructuring procedures where the court has sought to clarify and confirm aspects of the law in respect of creditors’ (and specifically landlords’) rights. These decisions may well have far-reaching consequences for the scope and content of future CVAs and Schemes, given the potential implications on the ability of creditors to dictate or determine arrangements in respect of forfeiture or surrender of leases, which is often a key consideration for the creditor group in the decision to implement a debt restructuring using these methods.

Given the role played by the Security Agent on behalf of the secured parties in these transactions, it will be essential to continue to follow these developments in order to be ready to anticipate future challenges or issues arising where CVAs or Schemes are contemplated.

Postscript: On April 9, 2020, the directors of Debenhams appointed FRP Advisory as administrators over Debenhams Retail Limited and Debenhams Properties Limited with the aim of protecting the UK businesses from creditors, and potential liquidation, due to the current COVID-19 pandemic.

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Managing uncertainty: Australia’s response to COVID-19 for distressed businesses

by Peter Bowden and Anna Ryan, Gilbert + Tobin

In the wake of the global pandemic and in response to the unprecedented economic threats posed by the developing COVID-19 pandemic, on March 23, 2020, the Australian Federal Government announced dramatic temporary reforms to Australia’s corporate insolvency laws culminating in the Coronavirus Economic Response Package Omnibus Act 2020 (Cth) (Economic Response Bill). The overarching objective of the Economic Response Bill is to implement measures (and amendments to existing legal frameworks albeit temporary) to minimise the economic impact of COVID-19 and promote business continuity in uncertain times.

Background to the new legislation

Over the last four years, a series of reforms have been introduced to Australia’s insolvency laws. The background to the laws has been a push to modernise the previous legal framework which was often criticised for failing to adequately focus or facilitate corporate restructures.

The Economic Response Bill demonstrates the quick economic response of the Australian Federal Government in the wake of the global COVID-19 pandemic. In an incredibly condensed time period, the Federal Treasurer announced the proposed amendments to the Corporations Act 2001 (Cth) (Corporations Act) on March 22, 2020, the Economic Response Bill passed in both Houses of Parliament on March 23, 2020, received Royal Assent on March 24, 2020 and then came into effect the very next day (from March 25, 2020). It should be noted that these provisions do not apply retrospectively.

The Economic Response Bill seeks to implement immediate economic and other relief measures to ensure continuity for Australian businesses and jobs during these incredibly uncertain economic times. Included in the relief measures are very specific and considered amendments to parts of the Corporations Act, which operate in parallel to the various other legislative reforms over the last four years to Australia’s insolvency landscape. Arguably, these new measures demonstrate a continued development of Australia’s insolvency laws to promote corporate rescue and restructuring.

With effect from March 25, 2020, the amendments seek to relieve financially distressed business for a temporary period of six-months. It is intended that the specific changes related to Australia’s insolvency law will operate in parallel with recent reforms aimed at protecting directors, being the safe harbour regime.

Australia’s existing safe harbour

Following the introduction of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017 (Cth), a “safe harbour” defence for directors, in the context of insolvent trading, became part of Australian law. The relevant provisions took effect on September 19, 2017 and are set out at section 588GA of the Corporations Act. The effect of section 588GA(1) is that it provides a defence to the insolvent trading provisions (section 588G(2)) if, ‘at a particular time after the director starts to suspect the company may become or be insolvent, the director starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company’ than the ‘immediate appointment of an administrator or liquidator to the company’.

A director who seeks to rely upon section 588GA(1) of the Corporations Act bears the evidential burden in relation to that matter. That is, providing evidence that suggests a reasonable possibility that the matter exists or does not.

The safe harbour protection does not apply in certain circumstances, including where, at the time the debt is incurred, the company has...
failed to pay employee entitlements or comply with certain reporting or taxation requirements.

In order to assist directors in seeking to ensure they obtain the benefit of the safe harbour protection, the Corporation Act lists some indicia for a director to regard when determining whether a course of action is reasonably likely to lead to a better outcome for the company.

These include whether the relevant director is:

a. properly informing himself or herself of the company’s financial position;

b. taking appropriate steps to:
   (i) prevent any misconduct by officers or employees of the company that could adversely affect the company’s ability to pay all its debts; or
   (ii) ensure that the company is keeping appropriate financial records consistent with the size and nature of the company;

c. obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; or

d. developing or implementing a plan for restructuring the company to improve its financial position.

To date, there has been no case law providing judicial interpretation of section 588GA as a defence to insolvent trading, including guidance as to how some of the important concepts and terminology associated with the safe harbour provisions should be applied.

COVID-19 provisions – The new laws

The changes to Australia’s insolvency law are contained in Schedule 12 to the Economic Response Bill and relate to the key challenges facing directors, businesses and individuals, being insolvent trading, statutory demands and bankruptcy.

As at the time of writing this article, it is expected that the changes will remain in place for a six-month period, alongside the existing safe harbour regime. This period could be further extended by regulation.

The temporary provisions which seek to provide a safety net for businesses in financial difficulty can be summarised as follows:

a. Relief for directors and holding companies from any liability for new debt incurred during the period a company trades whilst insolvent provided the debt is incurred in the ordinary course of the company’s business.

b. An increase in the threshold at which creditors can issue a statutory demand (from A$2,000 to A$20,000) and the time companies have to respond to a statutory demand (from 21 days to six months).

c. The ability for the Treasurer to provide targeted relief for classes of persons from provisions of the Act (by legislative instrument), in order to enable companies to deal with unforeseen events and Government actions resulting from the Coronavirus.

Insolvent trading

Directors of Australian companies have a statutory duty to prevent insolvent trading as prescribed in section 588G of the Corporations Act. A director is taken to have breached this duty if, during the period when they were a director:

a. the company incurs a debt;

b. the company is insolvent at the time, or becomes insolvent by incurring the debt, or by incurring at that time debts including that debt; and

c. the director suspected at the time when the company incurred the debt that the company was insolvent or would become insolvent as a result of incurring that debt or other debts.

The Australian solvency test is governed by section 95A of the Corporations Act, which provides:

“A person is solvent if, and only if, the person is able to pay all the person’s debts, as and when they become due and payable. A person who is not solvent is insolvent”

Australian courts have not applied section 95A as a rigid rule but rather as a factual question to be determined as a matter of commercial reality and in light of all the surrounding circumstances.

The position in Australia is that the key test of solvency is the “cash flow” test, rather than the “balance sheet” test. That is, a company must have sufficient cash flow available to it in order to meet its debts as and when they fall due.

Section 588H of the Corporations Act
provides that a director is not liable for a breach of section 588G of the Corporations Act if it is proved that at the time the relevant debt was incurred the director had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt as well as any other debts which it incurred at the same time. Further, a director is not liable if it is proved that he or she took all reasonable steps to prevent the relevant debt being incurred.

There are statutory defences available. Together with relatively new safe harbour defence (see above) the statutory defences available to a director for a breach of the duty to prevent insolvent trading as set out in section 588H of Corporations Act include the following:

a. A director is not liable for a breach of duty if it is proved that at the time the relevant debt was incurred the director had reasonable grounds to expect and did expect that the company was solvent at that time and would remain solvent even if it incurred that debt as well as any other debts which it incurred at the same time.

b. Further, a director is not liable if it is proved that he or she took all reasonable steps to prevent the relevant debt being incurred.

In this context, the Corporations Act states specifically that matters to which regard is to be made in considering this defence include any action the director took with a view to appointing an administrator when such action was taken and the results of that action.

A holding company has the same duty that a director has to prevent insolvent trading and is exposed to the same prospective liabilities for compensation.

A breach of the duty to prevent insolvent trading by a director will expose that director to prospective liability for:

a. a civil penalty order, which could result in a fine of up to A$200,000;

b. an order for payment of compensation to the company; and/or

c. an order for payment of compensation to the creditor.

The amount of compensation awarded against a director who breaches such a duty will be calculated by reference to the actual loss that the company or the creditor suffers by reason of the debt being incurred.

Where it can be proved that the director’s failure to prevent the company from incurring a debt was dishonest, ASIC may commence criminal proceedings against a director. If found guilty, the director may be liable for a penalty of up to 2,000 penalty units, or five years imprisonment, or both.

Under the amendments in the Economic Response Bill, directors and holding companies will be relieved from liability with respect to debts that are incurred:

a. during the six-month period from March 25, 2020;

b. in the ordinary course of the company’s business; and

c. before any appointment of an administrator or liquidator over the company.

The Explanatory Memorandum of the Economic Response Bill provides guidance as to what is meant by a debt to be incurred “in the ordinary course of business”. A debt necessarily incurred in order to facilitate the continuation of a business during the six-month period (such as the taking out of a loan in order to move some of the businesses’ operations online, or to continue to pay employees), would be regarded as a debt incurred “in the ordinary course of business”.

Statutory demands

A creditor may issue a formal demand for payment of a debt (in excess of A$2,000) on a debtor company pursuant to a statutory scheme set out in the Corporations Act. The failure to comply with a statutory demand is a presumption of insolvency under the Corporations Act that can be relied upon by the creditor in an application to wind up the debtor company.

The amendments set out in the Economic Response Bill will (as above), which increase the threshold amount for which creditors can issue a statutory demand (from A$2,000 to A$20,000) and the time for compliance of a statutory demand (from 21 days to six months) only apply to statutory demands served on or after March 25, 2020. The increased dollar threshold and increased time frame will only be in place for a six-month period (that is, unless extended, these changes will be repealed six months after March 25, 2020).
By both increasing the minimum debt required and increasing the time in which a creditor has to comply with a statutory demand, the Government is seeking to provide “breathing space” for companies to deal with their creditors.

Creditors will still have the right to enforce debts against companies or individuals through the courts; however, they will not be able to rely upon a failure to pay to initiate winding up proceedings until the end of the six-month period.

Flexibility in the Corporations Act and Treasurers instruments-making powers

While the amendments are welcomed, it cannot be ignored that these relief changes may have the potential to disrupt the operations of businesses or create unforeseen issues that will need to be dealt with quickly by company officers during a period in which business-continuity is important.

Accordingly, in recognising the likelihood of significant business disruption in the current circumstances [particularly where businesses may have limited ability to plan or mitigate against issues that might arise], the Treasurer has been granted a temporary power to, by legislative instrument, relieve specified classes of persons from obligations owed under the Act and/or the Regulations, by either exempting them from specified obligations or modifying their obligations (generally or by specified conditions).

At this stage, any relief granted by the Treasurer under this power will only have effect for a maximum period of six-months from the date on which the instrument is made.

Directors should be aware that these temporary safe harbour measures do not alter the director’s duties that are owed to the company itself when it is nearing insolvency.

Concluding remarks

While these legislative changes mark a positive and swift approach by the Australian government to relieve the issues presented by COVID-19, they should be approached with caution.

Directors must continue to consider the financial circumstances of the company, the impact on creditors continuing to incur debts, and other potential personal liability of directors that remain in place to avoid alternative claims for breaches of director duties.

The amendments to the Corporations Act only apply temporarily and have been implemented to resolve a unique scenario. Importantly, the relief measures operate alongside existing provisions in the Corporations Act.

It remains to be seen whether any of these temporary measures will be extended by the Federal Government beyond their current six-month lifespan.

Notes:
2 This article does not consider in any detail the Federal Government’s response (and consequential amendments via the Economic Response Bill) to bankruptcy laws relating to personal insolvencies.
3 See section 588V, Corporations Act.
4 Explanatory Memorandum to the Bill, 12.18.
5 See Explanatory Memorandum to the Bill, 12.12.

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The probability of the Uncitral Model Law being approved in Brazil in 2020

Proposals are under way in the National Congress for a reform of the Insolvency Law (LFRE), Bill of Law nr. 10.220/2018 (now PL 6229/2005), tabled in May 2018 by the Administration, adopts, among other provisions, the model law on cross-border insolvencies of the United Nations Commission on International Trade Law (UNCITRAL).

After almost 15 years in effect, expectations in relation to reforms in the LFRE are high, considering that several provisions no longer meet the current needs of the business world.

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

With the intention of overcoming this legislative gap, the Bill contains a chapter dedicated to international insolvency and proposes the adoption of the UNCITRAL rules, created in 1997, with the purpose of providing greater strength to nations in their ability to resolve cases involving insolvency of transnational nature.

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

The bill also has other provisions, many of which are positive, such as: an improvement in the tax treatment of distressed companies; a possible replacement of the judicial monitoring of insolvent companies by private monitoring; healthy reforms of the liquidation in bankruptcy system; a possible fresh start for insolvent companies and related individuals; a new treatment for debtor-in-possession (DIP) financing; the presentation of an alternative plan by creditors if the plan presented by the insolvent company is rejected; possible option to replace in-person creditor meetings by virtual meetings; and new rules for substantive consolidation.

Despite the positive changes proposed, several legal experts have expressed their concern in relation to certain alterations addressed in other chapters of the Bill, especially the increase of the prerogatives conferred on the tax authorities in insolvency proceedings. In addition, the Bill addresses matters which are efficiently addressed by current legislation and case law and do not require change.

The Bill has already been analysed by the Permanent Commissions and currently is under examination of the House of Representatives since November. In case of approval by the commissions, it will be appreciated by the Senate and, once approved by both chambers, it will be subject to President’s sanction or veto, something that will hardly occur in 2020 because of the pandemic and the legislative proceedings possible delays.
The representation of bondholders in the General Meetings of Creditors and the individualisation of their credits
The raising of financial resources through the issuance of trade currency on the international markets has become common practice in Brazil since the 1990s. According to available data, hundreds of billions of US dollars have been raised by companies or government entities over the past few years through the issuance of fixed income securities, including bonds, medium term notes and securitisation transactions.

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

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

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

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

The foreclosure of credits which are not subject to a court reorganisation
Credits that hold title to assets or rights which were granted by an insolvent company as security are, in principle, not affected by an insolvency filing and are therefore authorised to enforce their rights.

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

In those terms, in 2019, the Court of Appeal of São Paulo (AgInt nr. 2236949-78.2018.8.26.0000) recognised that a creditor may not remove its security if it is essential to the debtor’s activities. Nonetheless, this decision does not represent the consolidated understanding of the Superior Court of Justice.

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

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

Government credits against companies under judicial reorganisation
Law 11.101/05 establishes that the processing of judicial reorganisation shall not suspend the course of tax enforcements filed against the debtor (art. 6, § 7) and, in parallel, the National Tax Code (art. 187, lead paragraph) excludes tax credits from any insolvency proceeding.

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

However, government non-tax credits, have received different treatments by the courts, because statutory law is not clear in this respect.

In the Celpa and Oi8 [0057446-63.2017.8.19.0000] cases, penalties imposed by their respective regulators have been classified as unsecured credits in insolvency proceedings. Yet in the Viracopos case, according to the Court of Appeal of São Paulo, these same credits were treated as tax credits, overturning a contrary decision made by the lower court.

It is important to stress, however, that the Higher Courts have still not made their position clear with respect to this issue, and there is a recent precedent from São Paulo recognising that a public credit arising from contractual non-compliance should be subject to the judicial reorganisation of the Libra Group.

Credits in foreign currency within the judicial reorganisation

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

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

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

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

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

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

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

Notes:
Court of São Paulo.

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

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

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


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Overview of China’s bankruptcy regime

by Audry (Hong) Li, Zhong Lun Law Firm

China’s bankruptcy system mainly consists of laws and relevant judicial interpretations and normative documents formulated by the courts.

Legal framework of China’s bankruptcy regime

The Bankruptcy Law

The Enterprise Bankruptcy Law of the People’s Republic of China (“Bankruptcy Law”), issued by the Standing Committee of the National People’s Congress of China and effective as of June 1, 2007, is the main legislation that governs mainland China’s insolvency and reorganisation regime. The Bankruptcy Law applies to the legal entities in China, including state-owned, private and foreign invested companies in the form of limited liability companies or joint stock limited companies. The Bankruptcy Law does not apply to individuals.

Judicial interpretations and normative documents of the Courts

The judicial interpretations formulated by the Supreme People’s Court is an important basis with legal effect and governs the judicial activities of courts in China. The judicial interpretations in relation to the Bankruptcy Law mainly include the Provisions of the Supreme People’s Court on Appointing Administrators for Hearing Enterprise Bankruptcy Cases (effective as of June 1, 2007) and Provisions of the Supreme People’s Court on Determining Administrators’ Compensation for Hearing Enterprise Bankruptcy Cases (effective as of June 1, 2007) as well as Provisions (I), (II) and (III) of the Supreme People’s Court on Several Issues Concerning the Application of the Bankruptcy Law issued and came into force respectively in 2011, 2013 and 2019.

In addition to the judicial interpretations, the Supreme People’s Court and local courts have also formulated some normative documents which play an important role in guiding China’s bankruptcy practice. For instance, the Supreme People’s Court issued Minutes of the National Court’s Work Meeting on Bankruptcy Trials in March 2018 and Minutes of the Conference on Civil and Commercial Trials Heard by Courts in China in September 2019. Some local High People’s Courts and Intermediate People’s Courts have formulated guidelines applicable to their respective jurisdictions, such as Guidelines for Trials of Bankruptcy Cases (Trial) formulated by Shanghai High People’s Court on August 31, 2018 and Guidelines for Trials of Reorganization Cases (Trial) formulated by Shenzhen Intermediate People’s Court on March 25, 2019. Such normative documents are not judicial interpretations and shall not conflict with laws and judicial interpretations of the Supreme People’s Court. However, the rules and principles included in such normative documents can be applied by courts in judicial trial of bankruptcy cases in practice, which harmonise the judicial standards and adjudications in practice.

Statutory bankruptcy regimes

There are three types of proceedings under the Bankruptcy Law including liquidation, reorganisation and settlement. Liquidation is a straightforward process of disposal of debtor’s property in a short space of time following the order stipulated by law and the debtor shall be deregistered after the procedure has been concluded. Reorganisation and settlement may regenerate a company, but they have different emphasis and apply under different situations.

Reorganisation is a more complicated and comprehensive procedure with an emphasis on maintaining the debtor’s going-concern value. A debtor in reorganisation proceedings is allowed to obtain new financing according to the Bankruptcy Law.

Settlement is a simpler and faster procedure focusing on negotiation between the debtor and
unsecured creditors. Settlement is not applied to secured creditors. During the settlement procedure, a secured creditor may still request the administrator to dispose of the collateral and repay debts owed in priority to other subordinate creditors with the proceeds obtained from the proposal.

**Commencement of bankruptcy proceedings**

The statutory circumstances triggering bankruptcy proceedings under the Bankruptcy Law are (1) the debtor is unable to pay off the debts due and the assets owned by it are not sufficient to pay off all the debts; or (2) there is a clear lack of ability to pay off debts by the debtor; or (3) there is a possibility of losing its ability to pay off debts.

Under the first or second circumstance, the debtor shall have the right to apply to the competent court to initiate a proceeding of either liquidation, reorganisation or settlement. But under the third circumstance, the debtor may only apply for a reorganisation proceeding. Where a debtor is unable to repay the due debts to a creditor, the creditor may also apply for reorganisation or liquidation of the debtor. Therefore, subject to who initiates the proceedings, reorganisation and liquidation may be voluntary or involuntary for the debtor.

In a special circumstance whereby a company is found not to have sufficient assets to pay off all its debts during the liquidation process for a voluntary dissolution, or it has been dissolved before completion of liquidation, the liquidation committee shall apply to the competent court with jurisdiction for bankruptcy liquidation.

**Control of bankruptcy proceedings**

Bankruptcy proceedings in China are judicial proceedings subject to the direction and supervision of the court. In a liquidation or settlement procedure, the administrator takes over the debtor, while in a reorganisation procedure, upon application of the debtor and approval of the court, the debtor may manage its own assets and operate its business under supervision of the administrator.

The administrator is appointed by and report to the court and performs its duties in accordance with law under supervision of the creditors’ meeting and the creditor committee, which include taking over the property, seals, account books, documents and other data of the debtor, managing and disposing of the debtor’s property, deciding on matters of internal management of the debtor and its daily expenses and other necessary expenditures, participating in litigation, arbitration or any other legal procedure on behalf of the debtor, etc.

During the bankruptcy proceedings, creditors may exercise their rights via the creditors’ meeting or the creditor committee, whose establishment is contingent on the decision made at the first meeting of creditors.

**Special regimes for financial institutions**

The bankruptcy of commercial banks, securities companies, insurance companies and other financial institutions has special features according to the Bankruptcy Law. Where either of the statutory circumstances for bankruptcy proceedings occurs to a financial institution, the financial supervision and administration authority of the State Council of China, may choose to apply the takeover and custody procedures by itself, or apply to the competent court for reorganisation or liquidation according to the Bankruptcy Law.

In addition, as financial institutions are different from general companies, and have high requirements in having corresponding supporting facilities to resolve potential social risks caused by their bankruptcy, while applying the general rules of bankruptcy system, the Bankruptcy Law has also authorised the State Council of China to formulate implementation measures for the bankruptcy of financial institutions.

After the effectiveness of the Bankruptcy Law in 2007, with the government’s focus on comprehensive management of financial companies of high-risk, some securities companies withdrew from the market through liquidation proceedings and several trust companies regenerated through reorganisation procurees according to the Bankruptcy Law. So far there have not been any bankruptcies of commercial banks according to the Bankruptcy Law.

**Trends and development of bankruptcy practice in China**

**Growing number of bankruptcy cases**

The bankruptcy practice in China has a process of development. In the first several years after the Bankruptcy Law came into force in 2007, the
number of bankruptcy cases had not increased and even showed a retrogression. However since 2015, the number of cases accepted and concluded by the courts has risen rapidly, which might be linked to the cleaning up of “zombie enterprises” and the policy of “promoting structural reforms to build a modern economic system” by the Chinese government.

A series of influential cases have emerged, of which the reorganisation case of Bohai Steel Group, involving a debt in total of RMB280bn (approximately US$40bn at an exchange rate of 7:1), has been the largest bankruptcy case in China up till now.

Development of cross-border bankruptcy

Another development of China’s bankruptcy practice is the increasing number of cross-border bankruptcy cases. Currently, the Bankruptcy Law has only set forth the principle of cross-border bankruptcy by providing that (1) the bankruptcy proceeding initiated under the Bankruptcy Law shall be binding on the debtor’s property outside China; and (2) for the bankruptcy proceedings conducted in foreign courts involving debtor’s property located within the territory of China, the Chinese court shall review the valid judgement or ruling made by the foreign court and decide whether or not to recognise and enforce it in accordance with international treaties concluded or acceded to by China, or on the basis of the principle of reciprocity.

In practice, courts in some foreign countries and regions have already given recognition and assistance to the enforcement of judgements of bankruptcy cases made by China’s courts. However, so far there are few cases where Chinese courts have recognised and enforced the judgments or rulings of bankruptcy cases made by foreign courts. According to the public data search, we have only found one case since the Bankruptcy Law came into force in 2007, where the Wuhan Intermediate People’s Court recognised the ruling on a bankruptcy case made by Montabaur Court in Germany in 2012.

Given the increasing presence of Chinese investment globally, it has become imperative for China to recognise and enforce foreign rulings on bankruptcy cases. Against this background, the Supreme People’s Court issued the Minutes of the National Court’s Work Meeting on Bankruptcy Trials on March 3, 2018, which requires the courts to actively participate in and promote the negotiation and signing of international treaties on cross-border bankruptcy and explore new ways of applying the principle of reciprocity, so as to promote the health and orderly development of international investment.

Exploration of mechanism of bankruptcy for individuals

It has always been a hot topic discussed in China’s bankruptcy practice to establish a mechanism of bankruptcy for individuals. In China’s judicial practice, there are a considerable number of cases where the person...
involved subjected to enforcement is in a status of no property available for enforcement. For legal entities involved, they can be withdrawn through bankruptcy liquidation, while a large number of enforcements cases involving individuals currently have no effective withdrawal mechanism, which has caused the accumulation of cases and the consumption of judicial resources.

On June 22, 2019, the Supreme People’s Court, and 12 other China ministries and commissions, jointly issued the Plan to Accelerate the Improvement of Reform of Exit Mechanism of Market Entities, according to which the departments involved are requested to promote establishment of a bankruptcy system for individuals step by step.

Later in 2019, there were cases of individual debt liquidation in Zhejiang Province, and local Wenzhou Intermediate People’s Court issued the Implementation Opinions on Centralized Liquidation of Personal Debt (Trial) on August 13, 2019 to regulate such debt liquidation of individuals.

The bankruptcy system for individuals is being explored now in practice and it can be expected that the bankruptcy regimes in China would be expanded to individuals in the near future.

**Improvement of supporting system for bankruptcy practice**

In order to adapt to the development of China’s bankruptcy practice, the supporting system has been developed and improved constantly.

Guided by the Supreme People’s Court of China, some intermediate or high courts in China have successively set up bankruptcy tribunals within the courts to handle bankruptcy cases since 2016. The number of bankruptcy tribunals nationwide has increased from five in early 2016 to 97 by the end of 2017. In January 2019, Shenzhen Intermediate People’s Court took the lead in setting up the first special bankruptcy court in China and after that, more bankruptcy courts have been established in Beijing, Shanghai, Tianjin, Guangzhou, Wenzhou, Chongqing and Hangzhou.

In addition, the Supreme People’s Court of China is also committed to construction of network informatisation for bankruptcy proceedings. In 2016, the Supreme People’s Court set up a National Enterprise Bankruptcy Information Disclosure Platform (“the Platform”), where the trial process information on bankruptcy cases including announcements, legal documents, debtor information, etc., were published in a unified manner. The Platform can also be used to convene creditors’ meetings and online auction of property. When hearing the bankruptcy case of Jadeite Airlines, the Shenzhen Intermediate People’s Court auctioned two aero-engines through the online auction platform, which was participated by foreign companies from the United States and Israel.

**Conclusion**

With the needs of the Chinese government to build and develop a modern economic system, bankruptcy regime has been regarded as a powerful tool in achieving this goal due to its crucial role in improving and accelerating marketing-exit efficiency. It can be expected that the number of bankruptcy cases will continue to rise in the future and a comprehensive bankruptcy regime, which includes a domestic and cross-border system to cover both corporate entity and individual, will be gradually set up.

The current Bankruptcy Law, effective in 2007, has been implemented for more than 12 years and has lagged behind the growing bankruptcy practice in China. On September 7, 2018, the Standing Committee of the National People’s Congress of China has added the revision of the Bankruptcy Law into its legislative plan. Currently the revision work is in progress and has not been completed.

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India: Liability of directors for ‘wrongful trading’ under the Insolvency & Bankruptcy Code

by Bahram N Vakil, Suharsh Sinha and Ashrita Gulati, AZB & Partners

The Insolvency and Bankruptcy Code, 2016 (“IBC”) was notified by the Indian government in November 2016. The IBC was a major financial sector reform and has been instrumental in resolving a large proportion of non-performing assets, given a fillip to the secondary loan market and led to successful turnaround of several ailing companies. Another benefit has been the improvement in the standards of corporate governance due to imposition of post facto liabilities on erstwhile directors of the company. In this note we examine the issues surrounding directors’ liability particularly for ‘wrongful trading’ under the IBC.

To provide a brief overview, under IBC, creditors or the company itself, may file an insolvency application before the National Company Law Tribunals (“NCLT”). Once the application is admitted, a restructuring period – the Corporate Insolvency Resolution Process (“CIRP”) – commences which is intended to lead to a going concern resolution within a maximum of 330 days.

The NCLT passes an order for liquidation of the company in the event the company is not resolved within this timeline. On admission of an application for insolvency, the powers of the board of directors are suspended, and an insolvency professional assumes control over the affairs of the business. Under the IBC, the insolvency professional has a positive obligation to examine certain specified transactions under IBC, including transactions that give rise to the liability of directors under IBC.

Wrongful trading under Section 66(2) of IBC

The general duties of directors of solvent companies are contained in Section 166 of the Companies Act, 2013, which provides that directors must act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment. Though the ambit of stakeholders to whom directors owe a fiduciary duty under Section 166 of the Companies Act, 2013 is cast broadly, it is widely understood that the primary duty of directors is towards shareholders.

The new provision of ‘wrongful trading’ under the IBC modifies this position such that the duty of directors shifts away from shareholders and towards creditors of the company once it enters the twilight zone of insolvency. As per the report of the Bankruptcy Law Reform Committee (which was instrumental in drafting the IBC), the objective behind introducing the provision of wrongful trading under IBC was to accord protection to creditors who may suffer from information asymmetry while dealing with a distressed company.

Wrongful trading has been defined under Section 66(2) of IBC. Under this provision, on an application made by an insolvency professional a director is liable to make contributions to the assets of the company and the NCLT may disgorge such amounts from the director’s personal assets if:

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Wrongful trading has been defined under Section 66(2) of IBC. Under this provision, on an application made by an insolvency professional a director is liable to make contributions to the assets of the company and the NCLT may disgorge such amounts from the director’s personal assets if:
a) the director knew or ought to have known that there was no reasonable prospect of avoiding the commencement of a CIRP against the company; and

b) the director did not exercise due diligence in minimising the potential loss to the creditors of the company.

Note that a director is said to have exercised sufficient due diligence if such diligence was reasonably expected of a person carrying out the same functions as the director.

The wrongful trading provision has been borrowed from the UK Insolvency Act, 1986 ("1986 UK Act"). Criminal liability for directors for defrauding creditors existed in the UK even prior to the 1986 UK Act. However, the 1986 UK Act introduced a new standard to accord compensation-based remedy to those creditors who suffered a loss due to the mismanagement of the company in the zone of insolvency – even if such mismanagement by the directors of the company fell short of the level of criminality.

The wrongful trading provision enabled contribution orders against a culpable director to be made without proof of actual dishonesty and without a criminal standard of proof. For instance, a company would be trading wrongfully if it incurred liabilities with no reasonable prospect of meeting them or when a company continued trading even when the value of its equity was heavily eroded.

Scope for liability of directors

The bankruptcy courts have wide discretion in imposing personal liability on directors found to be guilty of wrongful trading. It is worth mentioning that Section 66(2) of IBC does not distinguish between executive, independent or shadow directors and applies uniformly to all types of directors of a company. Therefore, this provision would be of greater concern to non-executive or nominee directors who typically play a more passive role in the affairs and operations of the company.

The most vexed issue under Section 66(2) of the IBC is the threshold at which courts will determine the 'zone of insolvency' to have commenced, thereby triggering the shift in directors' duties. The wrongful trading section of the 1986 UK Act applies only when the directors should have known that there was no reasonable prospect of avoiding an insolvent liquidation of the company, whereas Section 66(2) of IBC applies when there was no reasonable prospect of avoiding the commencement of a CIRP against the company. It is worth noting that under IBC, a CIRP may be commenced on a mere payment default of INR10m (approximately US$132,000) – which is a comparatively low threshold especially for large companies.

There may be sound logic for diluting the high trigger point of an insolvent liquidation (i.e. the UK standard) to a lower level of a payment default (i.e. the IBC standard) so as to incentivise directors to take corrective action at the first onset of any financial distress rather than waiting till a time where saving the company as a going concern is no longer commercially viable. At the same time, advancing the threshold at which directors need to take corrective action increases the prospect of personal liability.

Given this onerous standard, the question is what steps directors can take to mitigate potential losses to creditors. Section 66(2) creates a safe harbour for directors' actions taken to mitigate losses with sufficient due diligence. The bankruptcy court is entrusted with the task of deciding if the mitigating actions taken by the directors meet the standard expected of a hypothetical person carrying out the same functions as are carried out by such director.

Therefore, a directors’ liability will depend on the subjective assessment of the NCLT as to whether their actions meet the "due diligence" standard. As a result, directors may not know a priori if their actions will meet the scrutiny of the judiciary.

UK case law considers several actions on the part of the directors as being reasonable and prudent so as to meet the due diligence test under the safe harbour. The takeaway seems to be that on one end of the spectrum, voluntarily filing for an administration procedure under the 1986 UK Act is certainly a safe and legally tenable course of action. Drawing an analogy, in the absence of judicial precedents or any further guidance from IBC, the safest option for directors facing an imminent payment default by a company also seems to be to voluntarily file for CIRP.

However, a voluntary CIRP filing raises two issues. The first issue is a procedural one. By
way of an amendment to Section 10 of IBC, in
effect from June 6, 2018, voluntary filing for
CIRP of a company must be supported by a
special resolution passed by the shareholders.
In companies where the directors also happen
to be the majority shareholders, obtaining
a special resolution may not be difficult.
However, where this is not the case, the
directors must satisfy the shareholders that a
voluntary bankruptcy filing is beneficial to the
shareholders as well.

In practice, this may be difficult to achieve
since during the CIRP of a company, there is
no legal requirement to make any payments
equity shareholders unless they are in the
money. Moreover, during the liquidation of
a company, equity shareholders are at the
bottom of the liquidation waterfall mechanism
in the order of priority. Therefore, a situation
may arise where a director, in satisfaction of
her fiduciary duties towards the creditors of
a company in the zone of insolvency, is
convinced of the benefits of voluntarily filing
for insolvency under Section 10 of IBC but
fails to convince the equity shareholders of
the company.

The second issue is more commercial in
nature. Even if the directors can overcome
the threshold requirement of the special
resolution by shareholders of the company,
Section 66(2) will nonetheless put directors
in the position of making a difficult choice
between filing for CIRP against the company at
the first signs of distress and thereby avoiding
personal liability; and making a genuine and
good faith attempt to remedy the default and
continue trading. Directors fearing wrongful
trading liability may act in a risk-averse
manner and may be tempted to file for a CIRP
hastily instead of endeavouring to weather
the temporary financial difficulty and preserve
long-term value. This raises a possibility of
premature CIRPs against fundamentally sound
businesses, causing disruption to consumers,
suppliers and employees.

Further, if any action by the directors with
a view towards protecting creditors’ interests
turns out to be precipitous or without adequate
basis, shareholders could hold the directors
liable under Section 166 of the Companies
Act, 2013.

Means of mitigating liability
of directors

Directors need to maintain a fine balance
in preserving value in a sound business
while avoiding personal liability for wrongful
trading. It is not an easy choice, especially
for companies that are clearly solvent but
could potentially be dragged into a CIRP
owing to temporary liquidity issues. In the
absence of any clarity on how the concept
of wrongful trading will play out in Indian
bankruptcy courts, boards must proactively
device strategies to reduce the scope
for liability.

Some of the steps that directors may
consider are:

a) negotiate all debt contracts and material
supply contracts such that any payment
default entitles the counterparty to initiate
an insolvency resolution process only after
affording the company an adequately long
notice period to consider all viable options,
to help directors buy time to consider their
options carefully;

b) put in place processes in consultation
with the company’s auditors to ensure
availability of adequate and timely financial
information about the company;

c) regularly discuss and review the cash flows
of the company and closely monitor all
actual and contingent claims against the
company;

d) review the director and officer insurance
policies to ensure that they cover any
liability arising as a result of wrongful
trading;

e) engage independent and reputed merchant
bankers to formally opine on the business
prospects and solvency of a company in
the near future at the earliest onset of
distress; and

f) obtain a legal opinion from a reputed law
firm to ensure that the mitigating steps
taken at the onset of a potential CIRP meet
the test of “due diligence” under Section
66(2) of IBC.

Conclusion

IBC has radically altered the insolvency law
landscape in India and has drastically reduced
the scope for misfeasance by directors and
promoters. However, mandating directors to take creditor-focused action at the early stages of a financial difficulty could create pitfalls for professional managers and directors who may not have any fraudulent or criminal intent. Additionally, the added requirement of shareholders’ special resolution prior to voluntarily filing for insolvency could create barriers to those directors that genuinely believe such voluntary filing is the best way forward for the company.

Till such time as the dust settles on the law around wrongful trading, directors will be well advised to take all possible steps to eliminate personal liability without compromising their fiduciary duties towards shareholders of the company.

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The individual debtor embarked upon his ship owning business in or around August 1998, and over some 17 years of endeavours in the business had come to own a group of companies owning vessels for chartering in maritime transport ("Individual Debtor").

These group companies are organised as follows:
1. one Japanese company engaged in transaction facility services by providing offices and secretarial services for loan transactions, loan repayments, ship building contracts, and chartering agreement ("Japan Company");
2. one Singapore company engaged in operating all vessels including navigating and manning services and providing all provisions for sea transport business for the group vessels ("Vessel Operating Company");
3. one British Virgin Islands financing company engaged in cash holding ("BVI Financing Company");
4. one Indian company supplying workers to the Vessel Operating Company; and
5. 40 vessel owner companies established in Singapore and Panama ("Vessel Owner Companies"). Such Vessel Owner Companies are each organised as single asset entities owning one vessel registered in their incorporation territory, and owing money liabilities to one lending bank and owing fees and expenses to the Vessel Operating Company.

These Vessel Owner Companies were financed in their ship building contracts with Japanese builders by Japanese mega banks ("Lender Banks"). Each of the Lender Banks separately and exclusively made a loan to each of the Vessel Owner Companies. The delivery of the loan proceeds and repayment were made through a bank account held with the Lender Banks.

The Vessel Owner Companies each entered into time charter agreements solely with one leading Japanese logistics enterprise transacting worldwide on various forms of marine transport ("Time Charterer"). The terms of these time chartering agreements, though, were never fully negotiated or agreed, or executed, before the closing date on the loans from the Lender Banks. The execution of time chartering agreements usually took place post-closing. Lender Banks respectively secured their loan repayment rights by a mortgage in the vessel, a charge in the Vessel Owner Company, and a security interest in the time charter agreement.

Additionally, the lead bank ("Lead Bank") alone among the Lender Banks, obtained a personal guarantee of the Individual Debtor on all its bank debts. This personal guarantee was secured by a security interest, i.e. a pledge, in all of the shares held by the Individual Debtor in respective debtor Vessel Owner Companies. Any shares in the Non-Debtor Companies, such as Vessel Operating Company and BVI Financing Company, were free of pledge. There were given no cross-guarantees among the Vessel Owner Companies to the Bank Lenders.

The relevant key terms in the uniform loan agreements are those provisions setting forth:
1. conditions precedent that the borrower furnish a drawdown notice before closing, and a time charter agreement on closing;
Figure 1: Parties and transactions among or with bankruptcy debtor group entities

<table>
<thead>
<tr>
<th>Territory</th>
<th>Japan</th>
<th>British Virgin Islands</th>
<th>Switzerland</th>
<th>Singapore</th>
<th>Panama</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>International bankruptcy cases</td>
<td>51 separate involuntary bankruptcy proceedings are opened, against Sharma and 40 Debtor companies. (No consolidation)</td>
<td>Recognition sought, and granted; (appealed to High Court; (appeal dismissed)</td>
<td>No recognition sought, (Lenders’ legal action and enforcement to satisfaction against Swiss entities)</td>
<td>No recognition sought</td>
<td>(no recognition sought)</td>
<td>(no recognition sought)</td>
</tr>
<tr>
<td>DebitoR:</td>
<td>Sharma (individual 100% shareholder) of Indian Nationality</td>
<td>(tax permanent resident)</td>
<td>(tax permanent resident)</td>
<td>(tax permanent resident)</td>
<td>(of Indian nationality)</td>
<td></td>
</tr>
<tr>
<td>Group owners</td>
<td>(non-resident)</td>
<td>(non-resident)</td>
<td>(non-resident)</td>
<td>(non-resident)</td>
<td>(non-resident)</td>
<td></td>
</tr>
<tr>
<td>Group companies</td>
<td>(immigration status: permanent resident)</td>
<td>100% share holding</td>
<td>(Sharma is replaced by Individual trustee taking directorship on record)</td>
<td>100% share holding</td>
<td>100% share holding</td>
<td>100% share holding</td>
</tr>
<tr>
<td>Financial agreements</td>
<td>Loan Guarantee under Japan law (secured by shares in ship owners)</td>
<td>Non-debtor Financing Company</td>
<td>40 separate Loans (ship building financed under Japan law (secured by ship mortgage, and time charter payment)</td>
<td>50: 28 Debtor Vessel Owner Companies</td>
<td>Panama: 12 Debtor Vessel Owner Companies</td>
<td>Non-Debtor Personnel Company</td>
</tr>
<tr>
<td>Non-debtor Financing Company</td>
<td>Debtors Relations Facilitating Company</td>
<td>(Sharma is replaced by Individual trustee taking directorship on record)</td>
<td>(Sharma is replaced by Individual trustee taking directorship on record)</td>
<td>Non-debtor Operation Managing Company</td>
<td>Operation Managing Agreement</td>
<td></td>
</tr>
<tr>
<td>Non-debtor Personnel Company</td>
<td>Non-Debtor Personnel Company</td>
<td></td>
<td>Non-debtor Operation Managing Company</td>
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</tbody>
</table>

2. covenants that the borrower keep unchanged during the life of the loan the specific charter terms as provided in the loan agreement; and
3. acceleration of repayments, either automatically or upon advance notice, depending upon the nature of the breach in question.
In reality, with regard to the key term [1], the borrowers did not in most cases provide the drawdown notice as required, and the borrower did not provide in any case a copy of the executed time charter agreement on the closing, namely the Lender Banks all waived the condition precedent and supplied the loan funds on the closing date; with the key term [2], the time charter agreements were executed subsequent to the closing date, but some deviated from the loan agreements, more favourable or less favourable, but the borrowers delivered a copy counterfeit bearing
the untrue and should-be terms, after repeated requests by the Lender Banks. However, it was fiercely disputed whether the Lender Banks were aware or should have been aware of such deviation, or even the counterfeit nature of the submitted copy charter agreements, around the presumption affecting knowledge arising from the fact that the borrowers’ account with the Lender Banks showed each monthly in-coming hires.

With regard to key term (3) (acceleration), in reality, (a) the borrowers have been meeting their repayment obligations fully and timely on principal or interest, and hence no default; and (b) no bankruptcy event has occurred; but (c) the Lender Banks, based upon their theory of breach of covenant of the charter term, and the act of counterfeiting, rather elected to take immediate acceleration by notice on November 10, 2015 ("Acceleration Notice"), rather than seeking rectification, of which the validity came to be fiercely disputed.

The bird’s eye description of the foregoing factual statement concerning the United Ocean Case is reproduced in Figure 1.

**Involuntary petitions**

Involuntary petition is provided equally in Japan’s three independent bankruptcy laws, Bankruptcy Law, Corporate Reorganization Law and Civil Rehabilitation Law.

Under the Bankruptcy Law, an involuntary petition (for straight bankruptcy) to a division of the court is permissible by only one creditor, even fully secured (but with a split in opinions), when his claim is proven, and where the debtor is insolvent, or has ceased payment, or in case of a corporate debtor, if it has more debts than assets ("Grounds for Bankruptcy Petition").

Under the Corporate Reorganization Law, an involuntary petition (for corporate reorganisation) to another division of the court is permissible by only one creditor, having a claim in the amount of one-tenth or more of the debtor’s paid-in capital, even fully secured (but with a split in opinions), when his claim is proven, and where the existence of the Grounds for Bankruptcy Petition as to the debtor is proven or suspected to exist. However, the filing of an involuntary petition does not commence a bankruptcy or corporate reorganisation proceeding. A separate formal adjudication by the court ordering commencement of the proceeding is required. But, at the same time, an involuntary petition does not secure the debtor rights of his continuing control of assets or business. Before a formal adjudication of commencement, the court in which the involuntary petition is pending may issue several provisional orders.

In case of straight bankruptcy, the court may order provisional orders staying, specifically or generally, creditor actions, including execution on judgement, garnishments or attachments, on-going litigation, and generally tax enforcement, and prohibiting the debtor from disposing of his assets. In case of corporate reorganisation, stay orders may expand further to order against pending straight bankruptcy proceedings, enforcement of security interest, and specific tax enforcement, all in addition to the broad stay orders against non-secured creditor actions.

Further, in a harsh and drastic action, the court may order preservation management order replacing the existing management with a court appointed preservation trustee. The preservative order replacing the existing management is critical and can cause devastating effects that are irreparable, if made. This devastation completes nominally when the court issues commencement order.

**Remedies lender banks petitioned for and responsive orders of the court**

The Lender Banks simultaneously but separately filed an involuntary reorganisation bankruptcy petition against each of the 40 Vessel Owner Companies and the Japanese Company with the Tokyo District Court, Civil Division No.8, on November 10, 2015. The following day, November 11, 2015, the Lead Bank filed an involuntary liquidation bankruptcy petition for straight bankruptcy against the Individual Debtor with the Tokyo District Court, Civil Division No. 20. The theory employed is simple: because of the acceleration, all debtors, whether principal or secondary are insolvent.

On November 11, 2015, the day after the filing date, without any notice to the Vessel Owner Companies, the Japanese Company, or the Individual Debtor, both Divisions issued
bankruptcy preservative orders against the debtors, containing those provisions aforesaid. These orders combined to expel the Individual Debtor on November 11, 2015 from his group enterprise, namely, the management of the Vessel Owner Companies and the Japanese Company, and of his own property, including, most importantly, his shares in his group companies.

The enforcement process involved other elements as follows: the preservative trustee in reorganisation on November 11, 2015, came to be appointed as director of the Vessel Owner Companies replacing the Individual Debtor by enforcement of the Lead Bank’s security interest in the shares; it is known and undisputed that the nominee shareholder entity for the Lead Bank entered into a contract in writing with the preservative trustee for reimbursement of costs in acting as the nominee shareholder; and the preservative trustee appeared surprisingly in person in Singapore to demonstrate his control as director of the Vessel Owner Companies on the very same date of November 11, 2015, and as such ordained there to indirectly control the affairs of the non-debtor Vessel Operating Company.

The power change in the management of the Vessel Operating Company took on an additional layer when the bankruptcy trustee for the Individual Debtor exercised trustee’s power to vote on shares and appointed himself as its director.

Similar power change was effected as to the BVI Financing Company when the bankruptcy trustee became director on April 1, 2016 to expel the Individual Debtor. This action of expulsion in BVI took place before the bankruptcy of the Individual Debtor was recognised in BVI on May 26, 2016, subject to appeal and stay for lack of due notice, though this appeal was later dismissed.

Also, as can be easily speculated, one will understand that each involuntary petition in this case was preceded by an informal customary counselling off record with the court. In any event, the commencement order in the involuntary reorganisation was issued on December 31, 2015, and in the involuntary straight bankruptcy on January 4, 2016. All these preservative orders and commencement orders survived the appeals to the High Court and the Supreme Court by the Vessel Owner Companies and the Individual Debtor.

**Post commencement issues**

First, the court in its commencement orders did not take time to differentiate their proceedings between main or non-main even though their cases involved abundant international elements. Since the Japanese Law on Recognition and Assistance to Foreign International Insolvency, enacted following the principles of UNCITRAL Model Law, does differentiate main from non-main proceedings, the court should have been better advised to identify whether it acted in main or non-main proceedings. Such intended differentiation would have been helpful to foreign countries.

Second, the salient point of interest is that the reorganisation trustee for the Vessel Owner Companies never filed an application for recognition in any foreign jurisdiction, including Singapore and Panama, and yet he acquiesced in becoming director of the Vessel Owner Companies. Likewise, the straight bankruptcy trustee did not file an application for recognition in Singapore and Panama. And yet, the straight bankruptcy trustee, by exercising the voting rights in the shares in the non-debtor Vessel Operating Company (incorporated in Singapore) and in the non-debtor BVI Finance Company (incorporated in BVI), was appointed as director and managed and controlled these entities.

He had not filed an application for recognition in India, nor in Switzerland where the Individual Debtor kept a bank account in his name with the Lead Bank’s affiliate, and where the bank’s main office was located with whose Singapore branch the BVI Finance Company had an account. The only exception is the straight bankruptcy trustee’s subsequent filing for recognition in BVI (and in Hong Kong where no known assets are located).

Third, the Lender Banks initiated, after the commencement of straight bankruptcy of the Individual Debtor, several debt collection procedures in Switzerland against all the bank accounts aforesaid, going after not only the Individual Debtor’s named personal account, but also the BVI Finance Company’s account, claiming the latter account is just part of the Individual Debtor’s property because the BVI Finance Company is owned 100% by him, not necessarily arguing the application of the alter-ego theory.
The Individual Debtor disputed these procedures by asserting automatic stay of such post-bankruptcy creditor actions against the Individual Debtor because of the worldwide effect of the Japanese bankruptcy, emphatically more so where the acting creditors in Switzerland are Japanese creditors.

The bankruptcy trustee, while aware of these procedures, took no action to carry into effect the automatic stay there, and even consented to the Lender Banks’ actions by agreeing to some sharing of the proceeds of such actions. The Individual Debtor, after some objection, decided for insufficient funds to give up this Swiss battle.

In lieu of the Swiss battle, he filed an action in Japan to seek an injunctive judgement against the Lender Banks prohibiting them from pursuing the creditor action in Switzerland. Naturally, the Swiss collection proceedings kept going in the absence of the Individual Debtor’s opposition there, and the Lender Banks successfully obtained a money judgement and enforced on it to their satisfaction.

The Japanese court dismissed the Individual Debtor’s injunction complaint, simply saying the bankruptcy debtor has no right to seek such an injunction. The Individual Debtor filed a plenary action post-bankruptcy for damages against the Lead Bank, alleging the filing of both the involuntary petitions were tortious, in breach of good faith, and fraudulent, arguing in essence that the alleged acceleration was unlawful.

The court here did not agree with the defendant as to res judicata, but dismissed the claim reasoning the acceleration was justifiable under all circumstances.

Fourth, it is theoretically of particular attention that all Lender Banks and courts concerned here take an approach that where a debtor in bankruptcy owns 100% shares in a corporation, then the debtor’s bankruptcy trustee may merely thereby exercise direct control and dominance of each asset of the issuer corporation, i.e. reverse corporate veil piercing, without a separate intervention of a new bankruptcy for the issuer or its liquidation, and perhaps disregard the elements of the alter ego.

Fifth, the bankruptcy trustee of the Individual Debtor filed several plenary actions of avoidance in India where he has not filed application for recognition by resorting to the Japanese Bankruptcy Law. Avoidance action in an international bankruptcy context has been and is still a big item to be researched and studied. Here, it seems that without prior recognition, such a claim may not stand per se.

**Accounting and tax issues**

The Individual Debtor’s estate has been threatened by the Japanese tax authorities with suspected tax evasion of Japanese Income Tax for undistributed company income of the group companies withheld, which if proven would exceed ¥50bn. Most of such income was related to these companies’ accounting practice in US dollars of their corporate affairs including their Japanese yen loans in particular from the Lender Banks, and emerged as the deemed exchange valuation income for exchange rate fluctuation.

This threat was critical because such tax claims enjoy super priority as administrative claims or priority as preferred claims. Not much objection was raised except residency issue for the Individual Debtor. But, new arguments were presented that (1) if these companies’ location of the centre of main interests for purposes of international insolvency are in Japan, then the formal accounting currency would be Japanese yen, producing no exchange income or loss; (2) the company reorganisation trustee prepared all financial papers required under the Reorganization Law in Japanese yen currency, which formed the basis of the plan; and (3) these companies engaged in crucial positive activities in Japan such as ship building, financing, and time chartering contracts, which would recognise their permanent establishment here, and their possible income Japan sourced, thus subjecting these companies directly to Japan foreign company taxation rules under the Corporate Tax Law, without resorting to Japanese BEPS measures.

These new voices persuaded the tax authorities to release the bankruptcy estate of huge tax liabilities. Similar accounting and tax issues may arise in other jurisdictions, and the United Ocean Case could present some solution.

**Wrap Up**

The United Ocean Case has given rise to old issues, such as notice and ex-parte issues,
and new issues, discussed above. It is a fair statement that Japan has not seriously, or at most insufficiently, tackled these old issues, whereupon this agony of new issues has befallen. Whether lawyers here by learning more can bring themselves to a new norm and practice is to be seen.

Notes:
- The author represented and represents the debtors in the involuntary bankruptcy proceedings that are made the subject of this report. The author has tried to be objective in making factual statements. The author has refrained from expressing the author’s personal legal opinion without referring to different or confronting views or practice, if any. Failure to comply with these self-ordained rules is the author’s responsibility.

1 Tokyo District Court, Case No. (hu) 9711 of 2015; Tokyo District Court, Cases No. (mi) 3 through 41 of 2015.
2 The following is a short list of several of these Vessel Owner Companies totalling 40 or more in number: Rams Wood Chip Carrier S.A., Rams Shipping S.A., Rams Challenge Shipping Pte. Ltd., Rams (PCTC) Pte. Ltd., United (PCTC) Pte. Ltd., etc.; as non-debtors, United Ocean Ship Management (SG) Pte., Ltd., and United Ocean Ship Management (BVI) Limited.
3 Law No. 75 of 2004.
4 Law No. 154 of 2002.
5 Law No. 225 of 1999.
6 Bankruptcy Law sections 15, 16 and 18.
7 Corporate Reorganization Law section 17.
8 Bankruptcy Law section 30, Corporate Reorganization Law section 41.
9 Bankruptcy Law sections 24, 25, and 28.
10 Corporate Reorganization Law sections 24, 25, and 28.
11 Bankruptcy Law section 91, Corporate Reorganization Law section 30.
12 Law No. 129 of 2000.
13 Claim No. BVIHC [COM], 62 of 2016, In the matter of part XIX of the Insolvency Act of 2003, and In the matter of Sharma Vipan Kumar (a bankrupt).
14 For example, initial action of sequestration order by the Geneva Debt Enforcement Office in case 15 070 553 N, dated December 4, 2015.
15 Bankruptcy Law sections 34 and 42.
16 Vipan Kumar Sharma v. Mitsubishi UFJ et al., Tokyo District Court Case No. (wa) 21431 of 2017.
17 Vipan Kumar Sharma v. Mitsubishi UFJ, Tokyo District Court Case No. (wa) 10271 of 2016.
18 The new argument was obviously offered by the Individual Debtor.
19 The pattern emerged in the United Ocean Case, formulating the lack of notice, the lack of recognition, the taking of direct foreign directorship, and the reverse corporate veil piercing would be remembered as “United Ocean Great Shortcuts.”

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In Nigeria, there is no specific Insolvency Act. There is no definition of who an Insolvency Practitioner is, and there is no statutory framework for the proper regulation of the profession. The Companies and Allied Matters Act (CAMA) enacted as a Decree in 1990 provides the general legal framework for corporate asset recovery or realisation. Whilst the provisions of CAMA have been inadequate in addressing issues bothering on cross-border insolvency, netting, co-operation between domestic and foreign courts, coordination of concurrent proceedings or communication of information in insolvency etc, there is currently a new bill for the amendment of CAMA which has been passed by the National Assembly, but President Buhari withheld assent to the same leading to a revision and return to the National Assembly for further consideration. There is also a new Investments & Securities Bill submitted to the National Assembly by the Nigerian SEC which addresses issues in relation to insolvency rules and netting for financial contracts. Further the Bankruptcy and Insolvency Bill passed by the National Assembly a couple of years ago has not received presidential assent to have force of law. With the advent of the COVID-19 global pandemic, general Insolvency and reorganisation rules need, as a matter of urgency, to be relaxed in order to provide a conducive framework for business rescue and foreign investments which would stimulate the Nigerian economy. The passage and implementation of these new Bills would also provide necessary certainty for the legal framework for insolvency proceedings in Nigeria.

The UK 1948 Companies Act strongly influences the legal framework for corporate insolvency found in a few parts of the Companies and Allied Matters Act (CAMA), a statute drafted by the Law Reform Commission and enacted as a Decree in 1990. The Decree became an Act under the civilian regime and was consolidated in the 2004 Laws of the Federation of Nigeria. The Act makes provisions for the general legal framework for asset recovery or realisation. It recognises three broad types of insolvency procedures, to wit: Receivership, Liquidation/Winding-up and Arrangement and Compromises ("A & C").

The insolvency procedures recognised by the Act are, in that sense, either collective or non-collective and undertaken by Insolvency Practitioners ("IP"). In terms of personal insolvency law, there is the Bankruptcy Act of 1979 consolidated in the 2004 Laws of the Federation of Nigeria, but this law has not had much impact because of its requirement for judgment and execution levied as a condition for proof of bankruptcy. Also, the ineffective discharge provisions render bankruptcy an unattractive option for debtors.

There is no specific legislation in Nigeria for the recognition of foreign insolvency proceedings, orders, or judgments as well as for co-operation between domestic and foreign courts, coordination of concurrent proceedings or communication of information. Nigeria only has a limited framework for recognition and enforcement of an international monetary judgment which must be final and conclusive, unchallenged on appeal and conditioned on reciprocity. The legislative framework creates a dual regime for Commonwealth countries and other countries. Foreign insolvency orders would scarcely fulfil such requirements while foreign judgments are recognised and enforced through a process of obtaining leave of court and registration of the decision.

Evaluating the process
The Nigerian insolvency system is unduly creditor friendly, and liquidation focused. There is no general business rescue law save for the scheme of arrangement provisions under CAMA, which provides a window for encouraging business recovery. However, the jurisprudence has not taken up the challenge primarily due
to the conflicting requirements on approval majority of 75% under CAMA and 90% under the Investment and Securities Act [ISA] for a buyout of dissenting minority and the approach of the Securities and Exchange Commission (SEC) to the interpretation of those provisions.

CAMA precludes the appointment of a provisional liquidator before the advertisement of a winding-up petition. Also, the catastrophic decision of the Supreme Court of Nigeria in FMBN v NDIC [1999] 2 NWLR pt 591, 333, that only actions or proceedings pending or instituted in the Federal High Court (the court that has jurisdiction in bankruptcy cases) is prohibited by the stay provisions of s.417 of CAMA brought uncertainty to the law around the availability of moratorium.

The decision has effectively circumscribed the automatic stay regime by the limitation on the bankruptcy court’s inherent power to bind everyone by a stay order on the threat of contempt. The absence of automatic stay encourages a race to the bottom as both creditors and debtors’ resort to various antics to either gain priority or moratorium. There is no effective moratorium even when the company is in liquidation. Creditors have also found a haven in filing for winding-up and obtaining a Mareva injunction (freezing order) when the company has not been found insolvent, and the petitioner is not a security holder but ends up exercising security rights over assets of the company even before judgment or winding up order.

Notwithstanding the above, there is the existence of limited rescue framework in the context of regulated industries such as banking and telecommunications through the Government’s enactment of AMCON Act, NDIC Act and NCC Act, establishing the Asset Management Corporation of Nigeria (AMCON), Nigerian Deposit Insurance Commission (NDIC) and the Nigerian Communications Commission (NCC) respectively.

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

Also, whilst AMCON was meant to be a temporary solution designed to last for only seven years for the purchase of eligible bank asset – toxic assets which the regulator – Central Bank of Nigeria (CBN) or the bank itself wants out of their books, it has now become a draconian albatross that has refused to phase out. The NDIC Act, on the other hand, was amended to enable the appointment of a liquidator for a failed or failing bank or financial institution without the need to go through the filing and advertisement of a winding-up petition.

In this regard, the mere withdrawal of the banking institution’s operational licence by the CBN Governor suffices to enable NDIC to be appointed liquidator. However, banking regulators have since abandoned the use of the appointment of the liquidator as a tool for liquidation or restructuring of banks. They now prefer the creation of bridge banks as it enables the bank to continue business the next business day after a weekend as a new bank.

In the end, the popular view is that the AMCON Act is not an insolvency regime but legislation aimed at protecting banks from collapse. It cannot, therefore, be a permanent solution in that it only purports to give respite to the banks but leaves the debtors entirely at the mercy of AMCON with its draconian powers. The need for a general insolvency and business rescue law that would render AMCON’s intervention unnecessary is thus imperative.

**Government’s response to Covid-19**

After a case of Covid-19 was recorded in Lagos State, Nigeria (the economic and commercial centre of the Federation) on 27 February 2020, the Federal Government of Nigeria through the Central Bank of Nigeria (CBN) announced key economic and fiscal policies/ measures calculated at minimising insolvency consequences caused by the pandemic and government lockdown. These include a one-year moratorium on all principal repayments; interest rate reduction on intervention facilities from 9% to 5%; grant of a three-month
repayment moratorium for all government-funded loans including government funded-loans issued by the Bank of Industry, Bank of Agriculture and the Nigeria Export Import Bank; and regulatory forbearance to Deposit Money Banks for the restructuring of loans for affected businesses and households among other additional incentives to encourage the extension of longer-tenured credit facilities.

The House of Representatives also passed an Emergency Economic Stimulus Bill 2020 (the Bill) on March 24, 2020 to provide a broader framework for the management of Covid-19-induced financial distress. The Bill which has neither been passed by the Senate nor assented to by the President, seeks to introduce a new 180-day moratorium on mortgage obligations of Nigerians under the National Housing Fund amongst other provisions. The passage of the Bill as well as the measures mentioned above are urgently welcome when considered in the light of existing legislative insolvency framework, the continued lockdown of the federal high court (being the insolvency court) and the increased clamour for urgent legislative reform into a more reorganisation friendly framework.

**Legislative reform efforts**

The past decade has seen the Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN) champion the growth of insolvency and business rescue practice in Nigeria through training, advocacy and law reform. This commitment resulted in the drafting of a new, business rescue and cross-border insolvency friendly Insolvency Bill for resolution of both personal and corporate insolvency following stakeholders’ consultation sponsored by UK Department for International Development (DFID).

Under the current political dispensation, the 9th session of the National Assembly saw a private member’s Bill to reform only the Bankruptcy Act, 1979, but the Bankruptcy and Insolvency Bill (“BIB”) is yet to pass into law. The BIB was proposed to repeal the Bankruptcy Act of 1979 (“BA”). It seeks to make provision for individual insolvency, some aspects of corporate insolvency, rehabilitation of the insolvent debtor, creation of the office of supervisor of insolvency, cross-border insolvency recognition and enforcement as well as other connected matters.

It is thus arguable that the Nigerian terminology relating to bankruptcy refers to personal or individual insolvency status while insolvency refers to corporate insolvency. The name of the Bill is somewhat misleading as the scope is restricted since virtually all its provisions deal with individual and not corporate insolvency. It is, therefore, neither general corporate insolvency nor business recovery law. It merely introduces a few personal bankruptcy law provisions. There is no indication that it has received presidential assent till date.

**The CAC initiative**

About 30 years down the line, CAMA has recently been the subject of an arguably detailed review at the instance of the Corporate Affairs Commission (CAC) set up to administer the Act. The CAC proposed a Bill for amendment of CAMA, with new provisions incorporating some aspects of insolvency such as Company Voluntary Arrangements, Administration and registration of insolvency practitioners including the recognition of the Business Recovery & Insolvency Practitioners Association of Nigeria (BRIPAN) as a certifying professional body, amongst others.

Apparently, the above rides on some aspects of the original recommendations made by BRIPAN in 2011, however, they fail to take on board some other recommendations made by PEBEC in 2017-18 based on more recent work geared towards achieving ease of doing business in Nigeria. This includes for instance the conspicuous omission of a framework of rules for cross-border insolvency.

The Bill has had a bit of back and forth history from the Executive such that by November 2019, the President refused to give assent and returned the same to the Nigerian Parliament to address concerns it raised particularly surrounding certain approval powers of the Supervising Minister of Trade and Industry in relation to companies matters.

The Bill was resent in April 2020 to the Senate and awaits a vote on the revisions made before it returns for Presidential assent. However, it is uncertain how quickly this would be done owing to the disruptive effect of the pandemic on the effective discharge of the functions of the Nigerian Legislature. Pressure is, however, being mounted by industry players,
based on a recent assessment of the Nigerian Government’s economic and legislative response to the effect of the pandemic on distressed businesses.\footnote{5}

The Bill has arguably earned the partial support of the Presidential Ease of Business Committee (PEBEC) as a bridge measure in the area of insolvency and business restructuring as PEBEC is still considering an agenda of reform through commercial omnibus laws because of the difficulty of passing or revising several business related laws through the National Assembly. Consequently, the new Bill was updated by CAC with some assistance from the World Bank on some of the identified business indicators for ease of doing business agreed.

Thus, in addition to existing provisions on Receivership (Chapter 19), Schemes of Arrangements and Winding Up (Chapters 20 to 25, and 27), some efforts are made to nuance the insolvency framework by adopting a chapter 17 (Company Voluntary Arrangement), 18 (Administration), 26 (Regulation of Insolvency Professionals) and 28 (Basic provisions on Netting). However, all the reforms remained local and territorial in the absence of adoption of any cross-border insolvency framework.

Though there is no standalone insolvency or business rescue law under consideration at this time at the National Assembly, the CAC sponsored Bill, to some extent, addresses some of the current shortcomings of the insolvency framework by transitioning the same from a creditor and involuntary liquidation led approach to a voluntary, more debtor and business rescue friendly regime.

However, it seems that the strong bias for an involuntary and creditor friendly regime remains entrenched as the opportunity to essentially abolish receivership as was done in the UK with the advent of the UK Insolvency Act has not been taken. It remains to be seen whether Chapter 19 on Receivership would not result in turf litigation between Receivers and Insolvency Office Holders. This is because, on the one hand, the Receiver appointed by the holder of fixed charge security has the right to challenge the hearing of an application for administration to be commenced by the court, and the court may dismiss such application for administration. By the provisions of the Bill, a company can voluntarily enter into a voluntary arrangement either out of court – where it makes a proposal to its creditors which would be implemented by a Nominee but without the advantage of a moratorium protection – or in the context of an Administration, or Winding Up proceedings, where it can for all intent and purpose propose or agree on a scheme of arrangement with its creditors or the Insolvency Office Holder.

In the current CAMA Bill, whilst there is a requirement of 28 days within which a Nominee, Administrator or liquidator would submit a report as to whether a creditors meeting should be summoned to approve a voluntary arrangement, an Administrator, on the other hand, has 30 days to make a proposal to creditors but 60 days to submit a comprehensive statement of the schedule of assets of the company to the person who appointed him.

Also, under the new CAMA Bill, the effect of administration is the dismissal of any winding-up petition and vacation of any receiver-manager appointed by secured creditors or holders of floating charge. There is also an automatic moratorium on enforcement of any security or repossess of goods and premises.

The netting provisions of the new CAMA Bill also seek to create a framework which would allow an Insolvency Holder to deal with claims arising from financial claims on a net basis after commencement of a winding up. Incidentally, the Investments and Securities Bill being championed by the Nigerian SEC is also making robust provisions to give super priority to regulated financial contracts in the event of insolvency of the counterparty and to modify general insolvency rules that would be enacted under the CAMA. The ISB specifically envisages that the netting provisions and special insolvency rules to be created under the securities statute would take precedence over ordinary insolvency rules based on a need for special protection of the Nigerian capital market.

Overall, this law, when it becomes effective, will bring some sanity to the current practice of appointment of multiple receiver-managers and provisional liquidators. It will be apparent that the administrator would have priority and failing administration the procedure will be converted to liquidation with the administrator as the liquidator or a separate liquidator is appointed to take over from the administrator. The CAMA
Bill therefore definitely provides a slightly more comprehensive framework for business recovery and a framework for the regulation of the insolvency profession by requiring licensing of practitioners by CAC and recognising BRIPAN and other professional bodies whose certification is a condition for licensing.

Leading the process currently through creativity and best practices
Overall, managing insolvency and business restructuring in Nigeria in the face of the inadequate legal framework requires creativity and innovation. A combination of understanding of the legal process and the application of the principles of informal workout can be of great assistance in achieving restructuring in a creditor-friendly and liquidation-focused system. The creditors usually respond positively, if the debtor voluntarily appoints a reputable firm to do an independent business review (IBR). Creditor perception of commitment to reform and openness by the debtor through IBR can kickstart and sustain the informal workout process.

Also, following the amendment of the AMCON Act, the use of the receiver managers by AMCON has improved the environment for insolvency practice and development of some culture of business rescue.

Current reform agenda
As mentioned earlier, agitation by BRIPAN and other stakeholders (such as PEBEC working with the Nigerian Bar Association Section on Business Law) have had an impact on the reform of some aspects of Nigeria personal and corporate insolvency laws. The National Assembly and existing institutions like the CAC have been sensitised and seem to be working on some relevance in the reform process.

PEBEC is considering the possibility of an omnibus Insolvency Bill to facilitate the ease of doing business and tackle challenges associated with existing legal impediments to various business indicators, including sound business recovery and insolvency framework. It means that the CAMA Bill is a stop-gap measure.

Further, following constant engagement through training and attendance at INSOL/World Bank African Roundtable, practitioners and Judges are now more commercially minded. The judges are more willing to use their authority under their enabling Act and rules to direct litigants to settle disputes amicably, encourage business rescue through negotiations and settlement, thereby creating the environment for multi-creditors workouts. The expectation is that given the realities exposed by the Covid-19 pandemic and with the support of the practitioners, Judges and the National Assembly, a holistic solution that addresses the management and resolution insolvency and restructuring issues in Nigeria is achievable in the not-to-distant future.

Notes:
1 The AMCON Act was amended in 2019 to strengthen some other provisions in the Act.
The Covid-19 pandemic kickstarts new reconstruction legislation

The previous debt negotiation rules have commonly been perceived by practitioners in the field to be impractical and non-functioning, and in need of reform. We have therefore seen very few judicial debt negotiation proceedings in Norway, and such matters have either been handled out-of-court, or even through judicial proceedings in other countries, if applicable, such as under Chapter 11 of the US Bankruptcy Code.

The new reconstruction legislation is based on a report which was subject to public inquiry in 2016, and which suggested several amendments to the existing legislation on judicial debt negotiation proceedings. Attorney Stine D. Snertingdalen in Kvale Advokatfirma was part of the advising committee during this work. After close to four years of being idle, the proposition was urgently handled by the Ministry of Justice and Public Security and presented to the Norwegian Parliament due to the extraordinary situation caused by the Covid-19 pandemic.

Even though financial relief measures have been offered by the government to businesses suffering financial losses because of the pandemic and the various restrictions in force, these are not enough to save all companies in distress. It is expected that we will see a large number of bankruptcies in the wake of the pandemic, many of which could potentially be avoided with a better restructuring toolset.

The changes in the interim law are hence a long time coming, and will hopefully help to save enterprises over the almost two-year period the legislation will be in force. The new interim legislation will be in effect only until January 1, 2022. However, the aim of the legislative authorities is to replace it with permanent, improved legislation, which will also take into account the 2019 EU restructuring directive.

Although the new legislation has been drawn up hastily and does not include all the elements that were highlighted and suggested in the 2016 report, it is thought to be a much better option than the old-established legislation on judicial debt negotiation proceedings. New key elements are super-priority financing, a full automatic stay against bankruptcy petitions, enforcement proceedings and attachments lasting throughout the reconstruction proceedings, the possibility to include debt-to-equity swap and to reduce or extend payment of priority tax and VAT claims, as well as no minimum dividend requirement, to mention a few.

A reconstruction composition under the new law can be voluntary with full flexibility in composing the reconstruction proposal, and where all creditors must be in agreement. Alternatively, the composition can be compulsory, where a majority of unsecured creditors bind the minority.

Creditors with security for their full claim, claims with priority which will have to be paid in full (mainly employees’ claims for wages) and creditors with close relation to the debtor, have no voting rights. Elements in a compulsory
composition can only include one or more of the following items: a payment moratorium, debt reduction, deb-to-equity swap and/or transferring whole or part of the debtor’s operations to a new owner and subsequently either continuing or winding up the company.

When a plan is presented, the court-appointed administrator and the reconstruction committee (consisting of the administrator and representative[s] for the creditors), shall show the presumed financial situation of the debtor company in case of bankruptcy/winding-up proceedings, and the preparatory works for the new legislation emphasise that one important assessment for the court will be to apply a “better than bankruptcy”-test before confirming a plan.

The new legislation is given retroactive effect, and all judicial debt negotiation proceedings opened after March 1, 2020 may be subject to the new rules.

There are several weaknesses in the proposal that should or could be addressed in the continued work towards a permanent new reconstruction legislation, such as:

• rules/options to enable the company a swifter downsizing of employees;
• rules/options to reduce the company’s burden of having to pay wages in full;
• specific regulation for company groups;
• a system of classes, in order to present different proposals to different creditor groups;
• rules on pre-pack reconstruction processes for medium sized and large businesses.

A business perspective: the Norwegian retail and airline industries

The retail industry
Two of the sectors which are likely to be highly represented amongst companies filing for reconstruction proceedings, are retail and travel/tourism. Similar to market developments in other countries, the Norwegian retail industry has suffered severely over the past few years. One factor playing a part is online market participants, e.g. larger chains which import goods in bulk or stand-alone businesses that only sell merchandise over the internet with considerably less expenses than store owners, both with the ability to offer lower sales prices. The benefits which could come from offering customers personal, face-to-face service and access to products, cannot justify the expenses of operating live stores with rental costs, employees, transportation, etc. With already low margins, shop owners are left with very challenging conditions for upholding a healthy business with positive operating results.

Several larger retail chains have ended in bankruptcy over the last few years, and Kvale Advokatfirma has administered a fair part of these. In some cases, the bankruptcy estates have sold the business operations to new owners who have managed to save parts of the operations with a reduced number of physical stores. In other cases, shops have been acquired by what used to be competitors, and rebranded. Such turnarounds are possible due to Norwegian bankruptcy rules, allowing for the bankruptcy estate to sell the debtor’s assets and whole or parts of the business operations as on-going, free from any debt and encumbrances and only taking on the desired number of employees.

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A bankruptcy estate is more or less free to enter into or discard the debtor’s business contracts, such as rental agreements and employment and supplier contracts, giving it wide authority to cherry-pick those contracts most beneficial to the continuing operations.

Further, and especially important in retail bankruptcies, any agreements and/or assertions of a vendors’ fixed charge in goods intended to be (re-)sold in the debtor’s business operations (e.g. typical retail goods) are not valid under Norwegian law. Hence, any suppliers who have sold the debtor goods on credit, cannot (with a few exceptions) rightfully reclaim the unpaid goods to cover their loss, but have to accept that the bankruptcy estate seizes and sells the goods while the suppliers are left with a dividend claim in the estate.

The already exposed retail industry, as well as many others, met a new and unforeseen challenge in 2020 in the Covid-19 virus. Schools, universities, kindergartens and many businesses were ordered by the government to shut down their operations, and the population was either quarantined, isolated or urged to stay at home and practice “social distancing”. Many stores decided to close completely for a
period of time, and others did not receive goods due to factory shutdowns both domestically and abroad. Although the government has issued relief measures towards many businesses, a wave of bankruptcies in the wake of the pandemic and the implemented measures is likely. Presumably, some of the first to go are those businesses which were already in bad shape before the virus measures were initiated, e.g. retailers.

With the new reconstruction legislation in force, it is more likely that several businesses will survive through reconstruction proceedings, rather than ending up in winding-up proceedings and seize to exist. Companies having been forced to postpone payment of mature debt, and possibly also having applied for and received emergency financing due to the Covid-19 crisis, can seek debt reduction under the new reconstruction legislation.

The reconstruction proceedings will however not solve operating issues such as high running costs and low margins, and if such factors are making the business not viable, the company should rather file for winding-up proceedings.

The airline industry

Another pressed industry, and especially now in the light of Covid-19, is the travel and tourism industry. Due to the pandemic, the government requested that people stay at home and do not travel outside of their municipality unless necessary, and the Norwegian borders have been under strict control. Foreigners have generally not been allowed to enter the country, and anyone allowed to enter has been instructed to stay in quarantine for 14 days. The main airport in Oslo, Gardermoen, reported that their traffic decreased by approximately 95% the first month after Covid-19 measurements were implemented.

Many hotels, cabins, visitors centres, campgrounds, etc. closed completely in order to save costs, and have envisioned that it will take time before people get back into their previous travel routines and that the usually busy Summer season will be very different this year. Governmental aid will probably help a large part of the industry to stay on their feet through these difficult times but, undoubtedly, a number of businesses will end up in bankruptcy.

Norway is a small country, but nevertheless has a relatively active air traffic industry. Oslo airport Gardermoen is Norway’s major international hub, and approximately 26.6 million passengers travelled through the airport in 2019. Scandinavian Airline Systems (SAS) and Norwegian Air Shuttle (Norwegian Air) are the most sizeable airlines operating out of Norway. The Norwegian airline Widerøe has a more domestic focus, with flights to 41 different domestic destinations as well as a few short-haul international flights.

Due to the rapid decline in revenues in connection to the Covid-19 outbreak, the airline industry is facing severe illiquidity and bankruptcy risk. State loan guarantees have been offered to the airlines SAS, Norwegian Air, Widerøe and other airlines that have a Norwegian Air Operators Certificate (“AOC”). The aid packages might be sufficient to avoid near term bankruptcies, however a full recovery seems unlikely. For example, in April 2020, four of Norwegian Air’s foreign subsidiaries filed for bankruptcy, leaving 4,705 pilots and cabin crew members unemployed. Norwegian Air just managed to avoid bankruptcy in early May 2020 after intense negotiations with their creditors, and further, SAS announced plans to lay off 5,000 employees in Scandinavia.

As mentioned above, judicial debt negotiation proceedings have been avoided as ineffective in Norway. This will hopefully improve with the proposed new reconstruction law. However, if winding-up proceedings turn out to be unavoidable for one or more airline operators, we expect that pre-packed sales of core assets would be a preferred solution. Such a sale could take place prior to or shortly after winding-up proceedings are opened. In either case, the transaction would be assessed by the bankruptcy trustee, who in order to safeguard the interests of the creditors will have to look into whether the sale was made on fair terms.

Should an aircraft operator file for winding-up proceedings without having a pre-packed solution in place, the administrator and the secured lenders would have to determine whether the debtor’s (secured) assets could be sold in a going concern transaction, and whether the operations of the debtor should and could be continued until such a sale can take place, with
financial guarantees and indemnifications from the secured creditors. Norway is a party to the Convention on International Interests in Mobile Equipment (the Cape Town Convention), which is meant to standardise the handling of aviation assets without a fixed location, including transfer agreements, establishing mortgages/liens and enforcement. Aircraft mortgages registered in either the International Registry of Mobile Assets or the Norwegian aircraft registry (NLR) are valid and enforceable. In case of an airline reconstruction or bankruptcy, the Cape Town Convention requires that possession of any seized aircrafts is given to the mortgage creditor within 60 days from when proceedings were opened.

Reconstruction proceedings under the new legislation might be preferable in order not to interfere with the debtor’s necessary permits from relevant authorities, and make it easier for the debtor to save their business operations – either to be carried on by the debtor or sold to new owners.

Going forward
The new reconstruction legislation will give Norwegian companies new and better possibilities of surviving the Covid-19 crisis, especially with respect to reducing unsecured debt and tax/VAT claims. Although the law will only be in effect temporarily, we understand that permanent legislation to be effectuated when the interim legislation ceases, is being prepared.

Notes:
1 Such as Enklere Liv, Notabene, Vita, Loco, Toys R’Us, SuperDry.
2 Cf. the Mortgage Act § 3-15.

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Debt restructurings involving corporate groups pose unique challenges. There is often a need for debt restructuring solutions that address the financial problems across an entire corporate group. The law in Singapore has developed in an incremental and principled way that, while not immediately apparent, lays strong groundwork for effective restructuring of corporate groups. In this article, we illustrate the potential of the Singapore regime in the context of corporate group restructurings.

In this article, we will examine the Empire Capital decision and related legislative developments in this area, and conclude with thoughts on how the law may develop further.

Empire Capital

Empire Capital involved the restructuring of the Berau Group, one of the world’s largest coal producers based in Indonesia. The restructuring involved two sets of notes issued by the Berau Group – these were referred to in the judgment as the “2015 Notes” and “2017 Notes” (collectively, the “Notes”). The 2015 Notes were issued by Berau Capital Resources Pte Ltd (“BCR”), a Singapore-incorporated special purpose entity established for raising debt-financing. The 2017 Notes were issued by PT Berau Coal Energy Tbk (“BCE”), the Indonesia-incorporated holding company helming the Berau Group.

The Berau Group sought to restructure the 2015 Notes and 2017 Notes through schemes of arrangement in Singapore. A scheme of arrangement (a “scheme” in abbreviated form) is a compromise or arrangement between a debtor company and its creditors to modify their respective rights. Debtors and creditors have flexibility in formulating the terms of a scheme. For example, a scheme can incorporate features such as payment deferrals, principal haircuts, and debt to equity conversions. A scheme is a potent debt restructuring mechanism as it binds all creditors (including dissenting creditors), provided that the scheme receives the approval of Singapore’s restructuring regime in the context of corporate group restructurings.

In this article, we will examine the Empire Capital decision and related legislative developments in this area, and conclude with thoughts on how the law may develop further.
of a majority in number of creditors representing 75% in value of the debt and is approved by the court.4

Initially, the Berau Group proposed two separate schemes of arrangement to restructure the Notes – one by BCR for the 2015 Notes and one by BCE for the 2017 Notes. However, two creditors collectively holding more than 25% in value of the 2015 Notes opposed BCR’s scheme (the “opposing creditors”).5 Since a scheme requires the approval of at least 75% in value of the creditors, the opposing creditors were able to veto BCR’s scheme.

This posed a significant problem as both schemes had to succeed in order for the Berau Group to emerge from insolvency. Various entities in the group provided guarantees and security in favour of the Notes. The security providers and guarantors for both sets of Notes largely overlapped,6 meaning that the Group could not simply excise the limbs that were at risk of enforcement if either the 2015 Notes or 2017 Notes were not successfully restructured.

The Berau Group ended up withdrawing the proposed schemes as a result of the opposition from the opposing creditors.

Several months later, the Berau Group initiated a new scheme proposal. This time, a single scheme of arrangement was proposed for both Notes. The scheme was proposed not by BCR or BCE, but by Empire Capital Resources Pte Ltd (“Empire Capital”), a Singapore-incorporated subsidiary of the Berau Group which had guaranteed both the 2015 Notes and the 2017 Notes. The scheme sought to compromise Empire Capital’s liabilities as guarantor of the Notes, and ancillary to that, the scheme sought the compromise of BCR, BCE and the other co-guarantors’ liabilities in relation to the Notes (we will refer to this as the “third party releases”).

Strategically, this was a deft move, as restructuring the Notes liabilities at a guarantor level [with corresponding releases at the borrower levels] opened the possibility of having the holders of both sets of Notes vote together in a single scheme of arrangement. The opposing creditors who initially blocked BCR’s scheme for the 2015 Notes would no longer have a blocking vote if the value of the 2015 Notes and 2017 Notes were taken together, as they only held about 14% of the aggregate value of the Notes.7

For this approach to work, Empire Capital had to cross two fundamental hurdles. First, it had to satisfy the court that it was within the court’s jurisdiction to allow a scheme to be proposed which sought to give the third party release of BCR, BCE and the other co-guarantors’ liabilities. Second, it had to persuade the court that the holders of the 2015 Notes and 2017 Notes should vote together as a single class of creditors. If the Noteholders were split into two classes (one for each set of Notes), the scheme approval threshold of a majority in number representing 75% in value of the creditors would have to have been met within each class, meaning that the opposing creditors would retain its veto within the class of 2015 Noteholders and thereby block the scheme from passing.

The Court of Appeal ruled in favour of Empire Capital on both issues, although ultimately, Empire Capital’s application failed for its failure to disclose adequate financial information.

On the issue of the third party releases, the court held that such releases are permissible under a scheme if there is sufficient nexus or connection between the release of the third party liability and the relationship between the company and the scheme creditors.8 The court found that the third party releases of the debts owed by BCR, BCE and the co-guarantors were evidently closely related to the creditor-debtor relationship between Empire Capital and the Noteholders, as the debts all arose out of the same note issuances.9

In some ways, the court’s decision on this issue was not surprising as third party releases have historically been endorsed by the Court of Appeal.10 However, what was unique in this case was that, unlike the typical scenario where it is the primary debtor proposing a scheme and seeking third party releases of its guarantors’ liabilities, here it was the reverse. The court nevertheless considered the distinction irrelevant.11 This opens the door to exploring creative ways for a corporate group to restructure in a single scheme without much disruption to operations or existing financial obligations – an entity within the group can undertake, as an additional obligor, to guarantee the various buckets of debt to be restructured across the entire group.

In Empire Capital, the court emphasised...
that the jurisdictional test had to be applied in a commercially sensible manner, particularly where a group restructuring is concerned. The court recognised that, even if it was the guarantor (and not the primary obligor) who was the scheme applicant, a release of the primary obligor’s debt would still be necessary, since the group would remain exposed to liability and enforcement risks and the overall restructuring objective would not be met.12

On the second issue of classification, the court reaffirmed the test established in prior cases.13 If the scheme favours or prejudices a group of creditors (against other creditors) differently from how they would be favoured or prejudiced in the most likely scenario if the scheme is not approved (usually liquidation), then that group of creditors should be classed separately.

The court reached a provisional view14 that the two sets of Noteholders could be grouped as a single class as the 2015 Noteholders and 2017 Noteholders’ relative positions in a scheme compared to a liquidation were not materially different. Under a scheme, both sets of Noteholders would receive the same treatment, while in a liquidation their respective rates of recovery only differed by around 3% which was not considered to be a material difference.15

Considering the case in its totality, the implications of the court’s ruling are quite remarkable. Through the application of tried and tested principles, a Singapore-incorporated subsidiary with only a nominal share capital and no apparent commercial significance to the Berau Group was in principle able to propose a comprehensive scheme of arrangement to restructure the major financial liabilities of its entire corporate group. At the conclusion of this article, we will consider whether the boundaries of such group restructuring schemes can extend even further.

**Related legislative developments**

Prior to Empire Capital, in 2017, the debt restructuring regime in Singapore was enhanced in a manner that would promote Singapore as an international debt restructuring centre. Some of the legislative amendments improved the ability for corporate groups to restructure their debts in a coherent and orderly manner.

Chief among these amendments was the introduction of moratorium protections for related companies of a company seeking to implement a scheme. Prior to the introduction of the related company moratorium, only the scheme company could seek moratorium protection. There was a disconnect in the regime providing moratorium protection to the scheme company and the commercial reality that other entities within the group, though not needing to propose a scheme, required protection from enforcement by the intended scheme creditors. This was starkly prevalent in the shipping companies with their typical group structure of many single vessel owning subsidiaries. Now, a related company, such as a subsidiary or parent company, can apply for a moratorium preventing legal proceedings and enforcement action from being commenced or continued against it, if it plays a necessary and integral role in the proposed scheme and if the scheme will be frustrated without such protections.16

Another important addition to the toolkit for corporate group restructurings was the introduction of a “cross-class cram down” mechanism. This enables the court to approve a scheme even where there are dissenting classes of creditors, provided that in aggregate at least a majority in number and 75% in value of creditors approve the scheme and other safeguards are met.17 Using Empire Capital as an example, if the Noteholders had been split into two classes, the “cross-class cram down” provision could have enabled the scheme to be approved by the court even if one set of Noteholders opposed the scheme. This in effect prevents holdout creditors from frustrating a scheme that benefits the group’s creditors as a whole. In a similar vein, the amendments also empower the court to adjust the “majority in number” voting threshold for the passing of the scheme.18

Other new provisions also facilitate restructurings of multi-national groups, including provisions which enable foreign companies with a “substantial connection” to Singapore to rely on its scheme of arrangement regime,19 and provisions which enable the court to impose a moratorium on creditor actions overseas by persons in Singapore or within the court’s jurisdiction.20

**Concluding remarks**

*Empire Capital* establishes a firm foundation for carrying out group restructurings in Singapore.
It affirms that a guarantor can propose a scheme of arrangement to restructure its liabilities and the liabilities of the primary debtor and other co-guarantors. The question now becomes how far the boundaries can be pushed for this type of scheme. Could a group seeking to restructure its debts establish a special purpose entity to unilaterally guarantee all the liabilities of the group, and then use that entity as a platform for implementing a global scheme of arrangement for the whole group?

For the doubting Thomases amongst us, this is not as outlandish as it may sound. A similar approach was adopted in the restructuring of the Codere Group. The Codere Group acquired an English incorporated company and caused it to assume a joint and several obligation under notes issued by another Codere entity, with the ultimate objective of having the English company invoking the scheme jurisdiction under English law.21 There, the court recognised the strategy as a clear case of forum shopping, but considered it good forum shopping as it was done with the aim of achieving the best possible outcome for the creditors.22

If such an approach is used to effect a group restructuring, it might be seen as artificial or open to abuse. However, it should be kept in mind that any scheme ultimately requires the approval of a supermajority of the creditors and the court, meaning that it will likely not pass muster unless it is a commercially sensible, fair and bona fide scheme. There are legitimate reasons for allowing a group restructuring to be conducted via a single global scheme of arrangement. It would swiften and streamline the restructuring and enable the restructuring plan to be formulated in a coordinated and coherent manner. It would not only prevent the mushrooming of holdout creditor groups that could result if there were multiple schemes, but prevent creditors with relatively modest voices from having a disproportionate say in the fate of the group’s restructuring.

The emergence of a group restructuring regime in Singapore has occurred slowly but surely. In the years to come, we can expect inventive and ambitious developments as Singapore’s law makers, specialist insolvency bench, academics and practitioners work in tandem to realise Singapore’s potential as a centre for international debt restructuring.

Notes:
1 Empire Capital at [4].
2 Empire Capital at [5] and [10].
4 Section 210 of the Companies Act (Cap. 50, 2006 Rev ed) (“Companies Act”).
5 These two opposing creditors also held about 5% of the 2017 Notes, but this is not relevant for present purposes.
7 Empire Capital at [13].
8 Empire Capital at [77].
9 Empire Capital at [80].
10 Daewoo Singapore Pte Ltd v CEL Tractors Pte Ltd [2001] 2 SLR(IR) 791.
11 Empire Capital at [80].
12 Empire Capital at [81].
13 Empire Capital at [87], citing The Royal Bank of Scotland NV v TT International Ltd [2012] 2 SLR 213.
14 The court only reached a provisional view as the financial disclosure provided by Empire Capital was considered inadequate (Empire Capital at [90] to [91]).
15 Empire Capital at [90].
16 Section 211C of the Companies Act.
17 Section 211H of the Companies Act.
18 Section 210(3AB)[a] of the Companies Act.
19 Section 210(11) of the Companies Act, read with Sections 351(1)(d) and 351(2A) of the Companies Act.
20 Sections 211B(5)(b) and 211C(4)(b) of the Companies Act.
22 Re Codere Finance (UK) Limited [2015] EWHC 3778 at [18].

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Directors’ duties of a company in financial distress

According to the Swiss Code of Obligation, the board of directors has specific duties if its company encounters financial difficulties.\(^3\) The two main tasks are based on a balance-sheet test:

**Capital loss**
If the last annual balance sheet of a company shows that half of the share capital and the legal reserves are no longer covered by the company’s net asset value (at going-concern value), the board of directors shall without delay call a general meeting of shareholders and propose adequate measures for restructuring. Concrete options for restructuring need to be considered based on the specific financial situation of the individual Swiss company concerned.

**Over-indebtedness**
In case of substantiated concern of over-indebtedness an interim balance sheet must be prepared and submitted to the company’s auditors for examination. If the interim balance sheet shows that the claims of the creditors are neither covered if the assets are appraised at going-concern value, a sound cash-flow plan securing operations for a reasonable period (typically 12 months) is requested.

There are two exceptions to this:
- a) no notification is required if creditors subdivide their claims to the claims of all other creditors in the amount of the over-indebtedness;
- b) the board of directors can refrain from notifying the bankruptcy or composition court for a short period of time if it has sufficient reasons to believe that the company can successfully be restructured. However, mere hope or a vague expectation of a restructuring does not justify the postponement of the filing for bankruptcy.

**COVID-19 reliefs**
Given the extraordinary circumstances and the drastic measures limiting economic activities, the Swiss Federal Council acting on the basis of constitutional emergency law decided to order an additional set of exceptions:
- a) Any loan of up to CHF500,000 guaranteed by the Swiss Confederation in accordance with the Credit Programme (see below) shall not be considered a liability in the company’s balance sheet. Therefore, such a loan is not taken into account in the over-indebtedness test [this relief is valid until March 31, 2022 only].
- b) In case of substantiated concern of over-indebtedness an interim balance sheet must still be prepared. However, the board of directors is released from the duty to submit this interim balance sheet for examination by the auditors [this relief came into effect on April 20, 2020 and will remain in force for the duration of six months].
- c) In case of over-indebtedness the board of directors does not have to notify the...
bankruptcy or composition court, provided the company was not over-indebted as per December 31, 2019 and there are sufficient reasons to believe that the company will overcome over-indebtedness by December 31, 2020 (this relief came into effect on April 20, 2020 and will remain in force for the duration of six months). The board of directors must justify and document the decision in writing.

In addition, the board of directors can file for composition proceedings (instead of bankruptcy). The Swiss Federal Council also simplified some requirements in order to allow companies suffering from the financial impact of the COVID-19 measures to file for composition proceedings.

Therefore, under the current and modified regimes, companies in financial distress are not out of options; however, their strategy should be planned carefully.

COVID-19 bridge loans
On March 25, 2020, the Swiss Federal Council adopted an unprecedented, massive liquidity support programme funded with CHF40bn for SMEs (hereinafter the Credit Programme): COVID-19 affected companies can apply for loans from their respective “house” banks up to a maximum of 10% of their annual turnover achieved in 2019 and up to a maximum of CHF20m. Certain minimum criteria must be met; in particular, the company must declare that it will suffer a significant loss of sales as a result of the Corona pandemic.

Classes of loans
Loans of up to CHF500,000 (so-called COVID-19 Credits) are non-interest bearing and fully guaranteed by the Swiss Confederation to the granting banks. Due to the use of an existing banking relationship they are paid out on the basis of the borrower’s commitments only without closer examination and within a short period of time, usually within less than a day.

Bridge loans exceeding the amount of CHF 500,000 (so-called COVID-19 Credits Plus) will be guaranteed to the granting bank in the amount of 85% by the Swiss Confederation. Such loans can amount up to CHF20m per company and therefore require a more comprehensive bank examination. For these loans, the interest rate is currently 0.5%. Companies with a turnover of more than CHF500m are not covered by the Credit Programme.

The loans guaranteed by the Swiss Confederation shall be used to meet liquidity shortages resulting during the pandemic phase; they may not be used to invest in new fixed assets, to pay dividends to shareholders or repurchase a company’s own shares, to repay existing loans, or to grant a private loan or a loan to a shareholder (including the use of cash pools). The restrictions and covenants shall incentivise borrowers to repay the loans, which are granted for five years, in exceptional cases for seven years. The board of directors must ensure that the company strictly complies with these restrictions and covenants.

In the event the loan is used for prohibited purposes, the members of the board of directors will be held jointly and severally liable for the repayment of the loan guaranteed by the Swiss Confederation. In addition, they could become subject to criminal sanctions.

Qualification on the balance sheet
Loans under the Credit Programme must be booked by the borrower as normal liabilities (debt). They are not subordinated to other claims. However, COVID-19 Credits are not considered debt when applying the balance-sheet test [see above; Article 725 Swiss Code of Obligations]. This rule is intended to prevent companies from getting into a capital loss or over-indebtedness situation as a result of financing under the Credit Programme. However, this relief is valid until March 31, 2022 only. After that date such loans will be considered debt again when applying the balance-sheet test. In contrast, COVID-19 Credits Plus are considered normal debt with respect to Article 725 Swiss Code of Obligations and can, therefore, result in a capital loss or even over-indebtedness situation for the company.

Credit programme in practice
At the beginning of June 2020, roughly 125,000 COVID-19 Credits with a total volume of CHF13.5bn had been granted and requests for 582 Covid-19 Credits Plus for a total of CHF1.6bn had been filed. The Credit Programme put in place in short time was much acclaimed by the local and international financial community for its quick and unbureaucratic handling. Interestingly enough, while such
loan applications had been submitted and
granted, the actual drawdown of these loans is
much smaller. According to Swiss newspaper
reports, by mid-May 2020, the vast majority of
enterprises had not yet used their approved
Covid-19 Credits. This means that a vast
majority of entrepreneurs have arranged for a
fall-back credit under the Credit Programme
but keep this option for liquidity in reserve.

COVID-19 Moratorium
The COVID-19 Insolvency Law Ordinance
introduces a new moratorium for small and
medium-sized enterprises that run into liquidity
problems due to the Corona crisis (COVID-19
Moratorium). With this measure, SMEs can be
granted a temporary moratorium of up to three
months by the composition court in a fast and
pragmatic manner without the need to submit
a restructuring plan. The moratorium can be
extended for an additional three months.

Prerequisites
The conditions to have a COVID-19 Moratorium
approved by the court are deliberately low in
order to grant access to this moratorium for
as many affected companies as possible. Any
company may file for a COVID-19 Moratorium,
provided that the company was not over-
debt as per December 31, 2019 or had
subordinated its debt according to Article
725(2) Swiss Code of Obligations in the amount
covering the over-indebtedness. Excluded
from the scope of the COVID-19 Moratorium
are larger undertakings, that is, (i) public
listed companies; (ii) and companies that
exceeded two of the following thresholds in
2019: (a) a balance-sheet total of CHF20m; (b)
sales revenue of CHF40m; or (c) 250 full-time
positions on annual average.

Application to composition court
The board of directors of the company must
submit a written request to the composition
court at the place of its registered office
accompanied by evidence of its financial
situation as per December 31, 2019.

Effects
During a period of three months starting from
the decision of the composition court, the debts
covered by the COVID-19 Moratorium (i.e. the
debts existing prior to the COVID-19 Moratorium
decision only) are under moratorium and
creditors may not enforce these claims (with
some exceptions such as claims of employees).
Moreover, the company must not settle the
debts that are under moratorium but is only
allowed to pay the debts that arose after the
court granted the COVID-19 Moratorium. This
allows companies to focus on the running
business. In addition, creditors may not request
a court to issue freezing orders.

Amendments to composition
proceedings
The Swiss Federal Council ordered specific
amendments to provisions regarding “ordinary”
composition proceedings. These amendments
came into effect on April 20, 2020 and remain in
force for the duration of six months:

a) During the crisis, the prerequisites for filing
for composition proceedings are lower
and the company does not have to file a
draft restructuring plan with its request for
composition proceedings. Moreover, the
court will not declare the company bankrupt
if the company fails to establish that there are
sufficient reasons to believe that the company
may be restructured (as would be the case
under normal circumstances).

b) The temporary composition moratorium (the
phase that allows the company to consider
whether it is able to take measures such as
restructuring or whether there is a chance
that the creditors agree on the principle of a
composition agreement) may last up to six
months (as opposed to four months under
normal circumstances).

Notes:
1 SR 281.242; Accessible at: https://www.admin.
.ch/opc/de/classified-compilation/20201083/
index.html.
2 Parallel to the COVID-19 Insolvency Law
Ordinance, the Swiss Federal Council
expanded the pre-existing state sponsored
system of short-time work compensation
and adopted numerous formal facilitations to
further mitigate the economic consequences
of the COVID-19 pandemic. The Swiss Federal
Council currently expects costs of around
CHF20bn for short-time work compensation.
For details see: https://www.walderwyss.com/
The terms “directors” and “company” refer to the legal form of a corporation (Aktiengesellschaft) whereby the same duties and conditions apply mutatis mutandis to the limited liability company (Gesellschaft mit beschränkter Haftung).


Introduction
2020 will be a worldwide socioeconomic case study for generations to come. Businesses large and small are experiencing unprecedented financial distress. The sweeping impact of COVID-19, coupled with the management (or perhaps mismanagement) of the pandemic has been, at a minimum, extraordinary. Recent civil unrest across the globe has further compounded the volatility of already fragile economies. Legislatures have enacted funding and economic relief packages at record pace in an effort to stabilise and stimulate their financial sectors and broaden economies.

However, for some industries, these efforts may prove “too little, too late,” and the economic challenges will likely lead to the reshaping of the business landscape and a realignment of the industry participants. The energy sector (particularly, the Oil & Gas Industry (“OGI”)) is a prime example of the extraordinary structural impairment to a vital sector of the global economy. In the US, insolvency and restructuring proceedings will likely be the catalyst in repositioning this industry, relying upon effective legislation, experienced practitioners, and judicial expertise to optimise the success of restructurings in the following years.

The ever-changing “current” state of affairs
The current state of affairs, though volatile, can be summarised as follows:
- The energy markets have suffered from plummeting oil prices due to excess supply and reduced demand. Earlier in 2020, global oil output levels far exceeded demand due in part to disputes by and among OPEC nations and Russia regarding compliance with output curtailment agreements. However, an underlying factor associated with Russia’s non-compliance is its concern involving the US shale industry and the purported belief that OPEC-driven production curbs effectively hand over market share to US shale producers.
- The COVID-19 pandemic has exacerbated the crisis. Countries across the globe adopted and enforced various restrictions that forced temporary closures of non-essential businesses, prohibited and/or restricted domestic and international travel, and implemented “social distancing” mandates that curtailed consumer demand.
- A glut of supply and a lack of sufficient storage capacity has further impaired pricing as storage costs consume margin.
- Publicly-traded US producers and the lenders in the energy sector have recently experienced large swings in stock prices as both prepare for economies to reopen despite the looming risk of a COVID-19 resurgence.
- Exploration and production (“E&P”) companies endured financial struggles before the pandemic, but the precipitous drop in oil prices and the almost non-existent demand for oil and gas due to COVID-19 restrictions have left them with few options. Their efforts to survive are particularly strained considering capital markets remain reluctant to underwrite those producers.
• Producers with stronger financials have greater optionality with respect to managing production while bearing asset preservation expenses. Senior debtholders end up in the precarious position of determining how much pressure to apply to maximise returns without triggering possible regulatory or lender liability. It has been reported that major industry lenders are forming holding companies and may partner with industry experts or specialty firms to own and operate assets upon seizing control.

• Producers with diminishing financials struggle to afford ongoing maintenance costs associated with production, even when largely non-operational. These operators must explore strategies that preserve assets, minimise costs and avoid defaults. Similarly, their lenders focus on minimising carrying and maintenance costs while developing paths towards value-maximising transactions.

• Industry players are reevaluating potential value opportunities that exist or may arise because supply curtailment may have been more significant than expected and cost-cutting measures associated with value preservation may have been deeper than reported.

• 2020 is a general election year in the US, where victories in states such as Pennsylvania (20 electoral votes), Ohio (18 electoral votes), New York (29 electoral votes), West Virginia (5 electoral votes), and Texas (38 electoral votes) often pave the road to the White House. The challenged oil market has impacted each of these states and may lead to favourable legislation to help reestablish the industry.

• Liquidity is king and access to working and other capital will play a critical role in the determination of which companies will survive during this unprecedented period of financial distress. Stakeholders often expect over-leveraged companies to pursue restructuring processes and, with any light at the end of the tunnel, will likely be subject to acquisition and/or consolidation at steeply discounted valuations.

Restructurings and the resurgence of the oil and gas industry

The macro and micro issues permeating the OGI presage a surge of bankruptcy filings for E&P companies and smaller oilfield servicers. Unlike debtors in other energy sectors – i.e. thermal coal – these cases show promise and opportunity if the producers engage experienced practitioners, with expertise both in the OGI and with complex restructuring transactions, to play a critical role in the survival of their companies.

So, what should one expect from the OGI resurgence via chapter 11 emergence? Industry participants should focus on the following “tells”:

Publicly active senior lenders

While often a leverage tactic, financial institutions exploring ownership options (especially involving physical commodities) is a notable and relatively novel development. Junior lenders typically serve as the fulcrum for a debt for equity swap that produces a change in control. While more traditional lenders have reluctantly taken control of an entity through legal recourse as a prophylactic measure in the past, there may be more opportunistic conduct going forward. This is particularly notable in light of the recent invitation by various governing US agencies for public comment to a proposal that would amend the regulations implementing section 13 of the Bank Holding Company Act ("BHC Act"), commonly referred to as the Volcker Rule, as added by Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 13 contains certain restrictions on the ability of a banking entity or nonbank financial company supervised by the Board to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund.

While perhaps coincidental, amendments to the Volcker Rule could smooth the path for banks to directly or indirectly acquire equity interests in oil and gas producers. Nevertheless, the formation of holding companies, reports of potential joint-venturing, and news about more aggressive enforcement of default rights and remedies by lenders strongly suggests forthcoming voluntary insolvency proceedings and corresponding deleveraging, leaving a “leaner and meaner” operator (albeit under new management or ownership via change in control).
Significantly discounted bond trading
While banks may be recalibrating their appetite for risk in distressed oil and gas settings, bondholders have often eaten this meal and, with a shift of headwinds towards the tail, stakeholders should carefully monitor bond trading activity. Discounted trading, together with a distressed company’s retention of “advisors,” “investment bankers,” or “restructuring” professionals (such as law firms experienced in chapter 11), is an indicator of a potential filing that contemplates deleveraging and ownership change through a debt for equity swap.

Also, amendments to inter-creditor agreements, negotiations about “restructuring support agreements,” and financial accommodations that yield short-term liquidity all suggest chapter 11 planning where creditors junior to bondholders (and in some instances non-participating bondholders) may be left out of the money.

Political action/intervention
While the phrase “never let a good crisis go to waste” has surfaced from time to troubled time, its usage is more than apropos now. With an election year upon the United States, one is compelled to conclude that the White House will attempt to advance policies or take actions to capture the 100 plus electoral votes of the oil and gas rich states mentioned above.

Modifications to energy-specific regulations or policies that preserve jobs in these states, regardless of the costs on the state and federal levels, should further whet the appetite of energy funds with the stomach for transactions in this industry. These policies may actually provide tailwinds to the sails of a restructuring company. Stakeholders must understand recent developments in law and policy when analysing rights and remedies associated with a forthcoming insolvency proceeding.

Separation of the winners from the losers
While certain energy companies are rebounding despite marginal improvement to market conditions, others are floundering. The markets are thinning the herd and the attractive assets of those companies that lenders conclude will create greater value through liquidation will become the targets of those that remain. Subject to the expectations of those at the senior level of the capital structure (and perhaps some anti-trust considerations), it is foreseeable that the assets of the market losers will become available for acquisition by their competitors via bankruptcy sales. In short, market consolidation is coming, which will unquestionably impact business relationships and contract rights.

Communications with large trade creditors or statutory lienholders
In most complex chapter 11 cases, the debtors file first day motions in order to pay certain statutory lienholders and “critical” vendors. These discussions, especially with the largest general unsecured creditors, often occur prior to the filing in order to minimise operational disruptions and gather support of key constituencies. While creditors of this type (with the exception of perhaps creditors providing oil storage) often accept considerable discounts on their claims notwithstanding protections otherwise available to them under applicable law, these concessions ensure a continuation of cost-efficient services to a distressed oil and gas company during the restructuring.

Statutory lienholders, such as the holders of various maritime liens should pay particular attention to proposed treatment of their claims at the outset of the case, as the first day relief may not only irreparably impair their rights and claims, but also impact their relationship with the debtor and a potential asset purchaser.

Reports/discussions of debtor-in-possession financing
Anyone involved in a complex restructuring case knows the process itself is almost cost prohibitive. But for large companies with asset-rich balance sheets and stockpiles of cash, almost every oil and gas company pursuing a restructuring transaction will require some form of debtor-in-possession (“DIP”) financing. DIP financing is a loan that facilitates the restructuring of an over-leveraged company. The lenders providing post-petition DIP financing are often pre-petition lenders advancing additional funds to protect their preexisting loans and maximise their recovery.

DIP financing is typically subject to strict restrictions – i.e., compliance with an approved budget, attaining case milestones, etc. – and often provides DIP lenders with...
enhanced protections and influence compared to existing debt, such as priming liens on existing collateral, superpriority claims for diminution in value, and termination rights upon an event of default. DIP financing is also a tool often used to drive a case to a particular conclusion, as milestones and other DIP financing conditions will establish the theme and direct the outcome of a chapter 11 bankruptcy case (most commonly a sale or similar transaction). Any reference to DIP financing is possibly the clearest indicator that an insolvency proceeding is on the horizon and junior/non-participating creditors should be cognisant that this heavily-negotiated document may advance interests inconsistent with their own.

Conclusion
The inevitable consolidation of industry participants and partial deleveraging of balance sheets should right size the US OGI. While it is unfortunate that some companies will likely disappear as a result of the financial crisis the industry faced earlier in 2020, those entities that survive and/or emerge will be healthier and stronger. Stakeholders should find that they have a more reliable trade partner that is not only more financially stable but is hopefully more astute, being armed with the education that comes from going through a formal restructuring proceeding. Moreover, this restructuring cycle should arm the survivors with the tools to withstand potential pitfalls that may arise and are beyond their control, yielding a more resilient and efficient marketplace.

But the keys to surviving these unprecedented times are: (i) understanding the current economic and financial climates; (ii) identifying the indicators of a forthcoming restructuring transaction; (iii) identifying mispriced assets relative to future valuation increases as the industry consolidates; and (iv) engaging practitioners with expertise in these areas to guide clients through the process.

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