CLEARY GOTTLIEB

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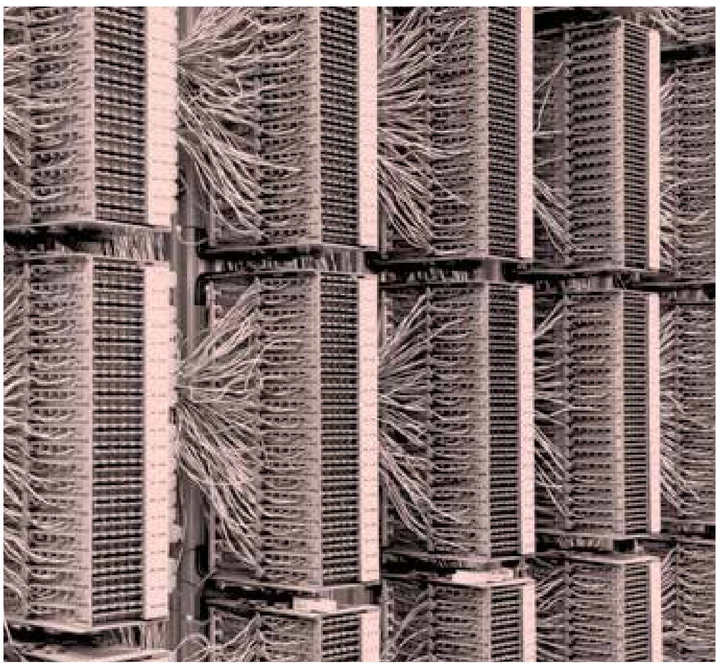

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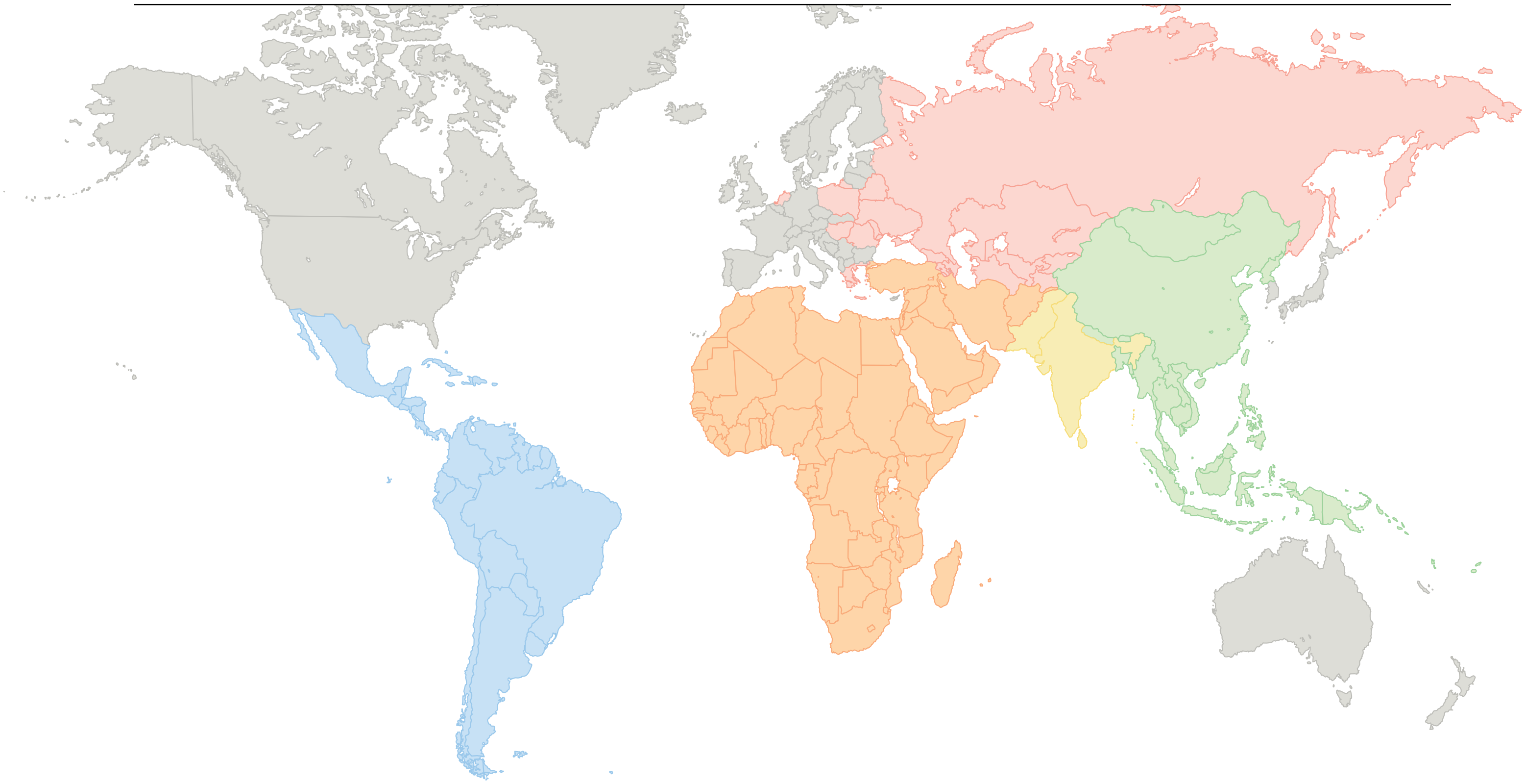

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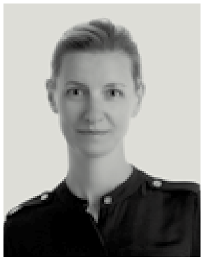
Letter from the Editors




Welcome to a special issue of the Emerging Markets Restructuring Journal being published in time for the International Bar Association's Latin American Regional Forum. As always, Latin America has proved to be a nuanced region—Brazil (perhaps paradoxically) continues to be the epicenter of financial restructuring in Latin America amidst a booming economy and strong markets. Mexico is looking to post-election maturities while it sorts out the in- and out-of-court restructurings of a number of companies in the construction and oil services sectors. The southern cone, buoyed by a new sense of political and economic stability and access to markets has put years of restructuring in the rear-view mirror, while countries in the Andean region wonder what lies ahead.

Our articles in this issue are reflective of this diversity. A piece on the Oi restructuring shows the continuing importance of bankruptcy law in Brazil—and the complexity and depth that cases like Oi have produced. Likewise, our article from Mexico demonstrates the growing importance of cross-border restructurings of multinationals, as well as the well-tested principle that bankruptcy consideration cannot be an afterthought—it is part and parcel of the negotiation of any financing. Articles from Peru and Colombia show increasing interest in insolvency topics in the Andean region amid continuing political uncertainty. An article on Costa Rica reflects a bankruptcy regime that may be soon be tested following downgrades of companies in Costa Rica, while an article on the Cayman Islands indicates that there are a number of different options for debtors and creditors that seek to avoid a home country proceeding.

We hope that everyone—including our fellow participants in the Regional Forum—finds these articles to be of interest and look forward to your contributions for future issues.

Polina Lyadnova, **Adam Brenneman**, **Sui-Jim Ho** and **Denise Filauro**

DEAL NEWS / BRAZIL

Oi S.A.: The Saga of Latin America's Largest Private Sector In-court Restructuring

By **JESSE W. MOSIER**

After a nearly 2-year long process, creditors of Oi S.A. ("Oi") and certain of its subsidiaries approved a plan of reorganization at a creditors meeting on December 19, 2017, held in a former Olympic boxing venue on the outskirts of Rio de Janeiro, to restructure nearly US$20 billion in claims, the largest corporate restructuring in the history of Latin America (and potentially any emerging market), and the first truly public Brazilian company to go through judicial restructuring since Brazil reformed its insolvency laws in 2005.

Oi is one of the most important companies in Brazil, and is one of the largest Brazilian integrated telecommunications providers, with over 60 million customers throughout Brazil and over 138,000 direct and indirect employees. Oi also has operations in a number of other Portuguese speaking countries around the world, including Angola, Cape Verde and Timor Leste.

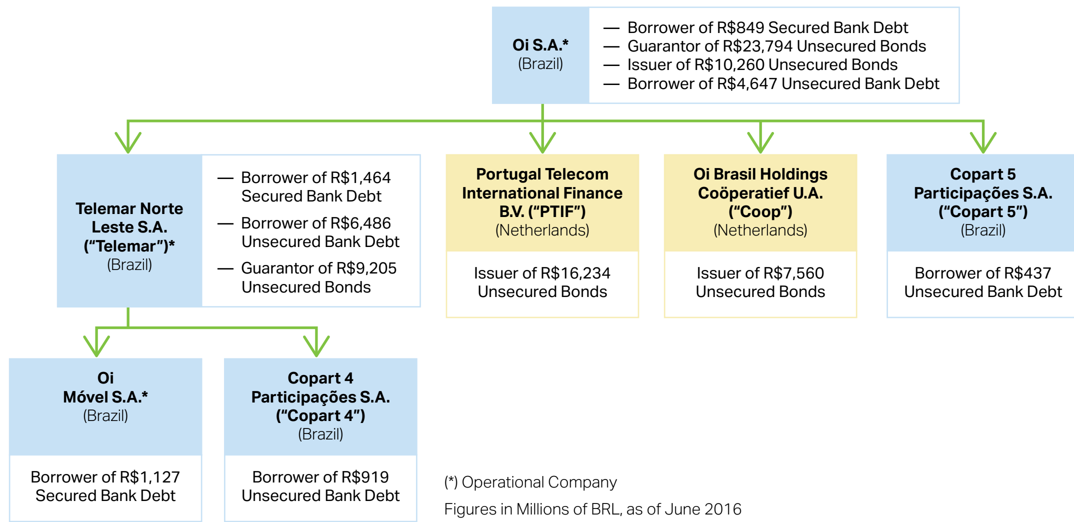
The size and complexity of Oi's restructuring resulted in a number of interesting and precedent setting aspects, and has been extensively litigated in Brazil, the Netherlands and New York. Among the more interesting aspects of the restructuring are: (i) potential limits to the ongoing trend in Brazil of substantively consolidated restructuring plans, (ii) the attempt (ultimately abandoned) by certain creditors to use the existence of intercompany claims by off-shore finance subsidiaries to improve their recoveries, (iii) potential limits on abusive behavior by Brazilian shareholders and their board representatives and (iv) the treatment of regulatory claims in Brazilian restructuring proceedings.

Background

In the wake of its unsuccessful acquisition of Portugal Telecom, structural problems resulting from its concessions, substantial underinvestment in its assets and a general downturn in the Brazilian economy, by early 2016 Oi was facing an unsustainable debt burden. Oi and its subsidiaries' debt consisted of nearly US$15 billion in financial debt, including approximately US$10 billion in New York and English law governed bond debt,[1] in addition to sizeable regulatory fines and tax and other contingencies.

After initially considering an attempted out-of-court exchange in the spring of 2016, Oi and certain of its subsidiaries filed for judicial reorganization

Oi Corporate Structure



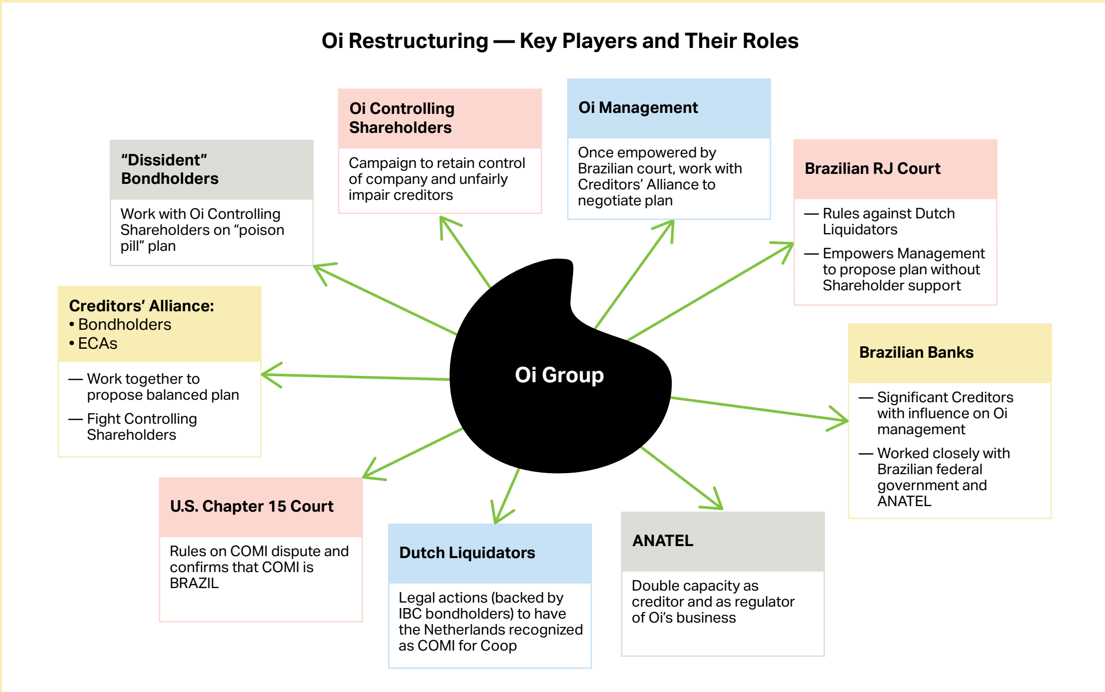
in Brazil in June 2016, and the Brazilian reorganization court accepted jurisdiction over each of the debtors, including Oi's two Dutch finance subsidiaries, Oi Brasil Holdings Coöperatief U.A. ("Coop") and Portugal Telecom International Finance B.V. ("PTIF"). Shortly thereafter, Oi and/or certain other of the debtors in Brazil filed for additional protection in ancillary proceedings in New York and the United Kingdom, as well as separate proceedings in the Netherlands.

Substantive Consolidation

In Brazil, as in most countries, the bankruptcy law respects the corporate separateness of debtors, and therefore it is the general rule that, within a corporate group restructuring, creditors' claims will not be treated *pari passu* with those of creditors of other members of the corporate group. However, particularly since the *Rede Energia S.A.* restructuring in 2014, Brazilian courts have increasingly confirmed restructuring plans for Brazilian corporate groups that substantively consolidate creditor claims, even over the objections of creditors. Oi's initial proposed restructuring plan, presented in September 2016, took a substantively consolidated approach. Various creditor groups opposed such substantive consolidation (albeit for different reasons), and filed motions against substantive consolidation with the restructuring court.

An appeals court in Rio de Janeiro ultimately decided that the question of substantive consolidation was one that should be determined by creditors by vote at a creditors meeting. Importantly, the judge ruled that this vote should occur on an entity-by-entity basis, thereby providing the creditors of Oi and its debtor-subsidiaries with an important protection by ultimately leaving the decision on whether to accept substantive consolidation in the hands of creditors – if creditors at any particular entity were to reject substantive consolidation, it would present significant difficulties for the rest of the Oi Group to restructure on a substantively consolidated basis. If this decision is adopted more widely as precedent in Brazil, it could represent an important step in the right direction towards protecting creditors' interest against unfettered substantive consolidation. In Oi's case, a consensual deal with creditors was eventually reached, and creditors of each debtor entity voted in favor of substantive consolidation.

It is, however, worth mentioning that in the course of deciding that the substantive consolidation vote



should be counted on an entity-by-entity basis, the court also determined that guarantees on the bonds (e.g., Oi's guarantee of bonds issued by Coop or PTIF, and Telemar Norte Leste S.A.'s ("Telemar") guarantee of bonds issued by Oi) should not be counted for voting purposes, despite being due and payable at the time, and therefore should not be entitled to vote on whether to accept substantive consolidation. We understand that this ruling is inconsistent with existing Brazilian law, and it is also troubling from a lender's perspective and could have implications on the Brazilian financing markets if it is followed by other judges in Brazil.

Attempt by Certain Creditors to Use the Existence of Intercompany Claims to Improve Their Recoveries

Like companies in many emerging markets, Brazilian companies routinely issue bonds in the international markets using off-shore finance subsidiaries for tax and other reasons. In Oi's case, it has two Dutch finance subsidiaries, Coop and PTIF, which were used to issue a majority of Oi's bond debt. Such offshore financing arrangements gave rise to intercompany loans between the finance subsidiaries and Oi (and guarantees of the bonds by Oi), so that the cash obtained from the sale of bonds could be on-shored to Brazil, used in operations, and, upon maturity of the bonds, off-shored back to the finance subsidiaries for payment to the bondholders in a tax efficient manner. Generally, and in the case of Coop and PTIF, the ability of finance subsidiaries to repay bonds depends fully on the credit worthiness of the operating companies that are counterparties to the intercompany loans and that guarantee the bonds. In Oi's case, as is market practice, this was made abundantly clear in the disclosure documents related to the bonds.

Brazilian restructuring law provides no specific treatment for intercompany claims (other than prohibiting debtors from voting such claims at any creditors meeting) and, as a matter of practice in Brazilian restructuring plans, intercompany claims are generally either ignored entirely or treated as subordinated to third-party debt.

Nevertheless, the existence of certain intercompany claims of Coop against Oi and Oi Móvel S.A., another Brazilian operating company (but not other intercompany loans or transactions among other Oi Group companies) became the focus of a group of bondholders known as the International Bondholder Committee ("IBC"), who sought to use the existence of these intercompany loans to improve the recoveries of creditors of the finance entities. The strategy manifested itself in a litigation strategy in the Netherlands, Brazil and the U.S.

In particular, in the U.S., the Coop judicial administrator, at the urging of the IBC, petitioned the U.S. Chapter 15 court to find that Coop's Dutch proceedings, rather than the Brazilian proceedings, should be considered Coop's foreign main proceeding, despite the Chapter 15 court having already recognized the Brazilian proceedings as Coop's foreign main proceeding nearly one year prior. If the Coop judicial administrator were successful, he could replace Coop's foreign representative (at that point, an Oi appointee) in the Chapter 15 proceedings, and generally control Coop's actions in the Chapter 15 proceedings going forward. He could also use his status as judicial administrator for Coop to seek to block the Chapter 15 court from enforcing any plan of reorganization for Coop confirmed in Oi's Brazilian proceedings.

Coop's judicial administrator (and the IBC in supporting filings) contended, *inter alia*, that the conversion from Dutch suspension of payments proceedings (a debtor-in-possession regime) to bankruptcy liquidation proceedings (where the administrator would have increased control) shifted Coop's "center of main interest" or "COMI" from Brazil to the Netherlands.[2] Oi, supported by the Steering Committee of an Ad Hoc Group of Bondholders (the "AHG Steering Committee"),[3] opposed the requested relief. After extensive discovery and depositions and an expedited four-day bench trial, Judge Sean H. Lane of the United States Bankruptcy Court for the Southern District of New York, in early December 2017, issued an opinion in favor of Oi and the AHG Steering Committee's position, and against Coop's judicial administrator, finding that Coop's COMI remained in Brazil, and therefore that the Brazilian proceedings remained the foreign main proceeding for Coop. The decision took issue with the attempt by creditors to "weaponize Chapter 15 to collaterally attack" legitimate ongoing foreign restructurings to serve their own purposes, undermining "the goals of maximizing the chapter 15 debtors' assets and assisting in the rescue of their financially troubled business."[4] As is further described in the table, the decision is likely to have an important precedential effect, as it may provide more certainty for creditors and debtors alike regarding Chapter 15 courts' COMI analysis with respect to finance subsidiaries in multi-jurisdiction restructurings, and in particular their willingness to revisit earlier COMI determinations. The

Other Key Takeaways from Oi Chapter 15 Decision

Creditor Behavior and COMI Manipulation

— Chapter 15 court found that creditors' behavior can be taken into account in the Chapter 15 COMI manipulation analysis

— Previous decisions had focused only on the behavior of debtors and their representatives

Standard For Modifying Existing Recognition Order

— Chapter 15 court found that the appropriate standard for modifying or terminating an existing recognition order is that the court may do so, in its discretion, upon a finding that the grounds for its entry were fully or partially lacking or have ceased to exist

Independent Obligation to Make COMI determination

— Even where foreign jurisdictions (such as the Netherlands) have comprehensive restructuring regimes, where such jurisdictions have ***not*** adopted the UNCITRAL Model Law (basis for Chapter 15), the findings of such foreign courts do ***not*** replace the Chapter 15 court's obligation to make an independent COMI determination decision is currently subject to a pending motion for reconsideration by the IBC and appeals by the IBC and the Dutch judicial administrator. Ultimately, the IBC and the AHG Steering Committee agreed that their respective claims would receive *pari passu* treatment, which agreement helped cement a coalition of creditors that managed to negotiate a consensual restructuring with Oi.

Limits on Abusive Behavior by Shareholders and their Board Representatives

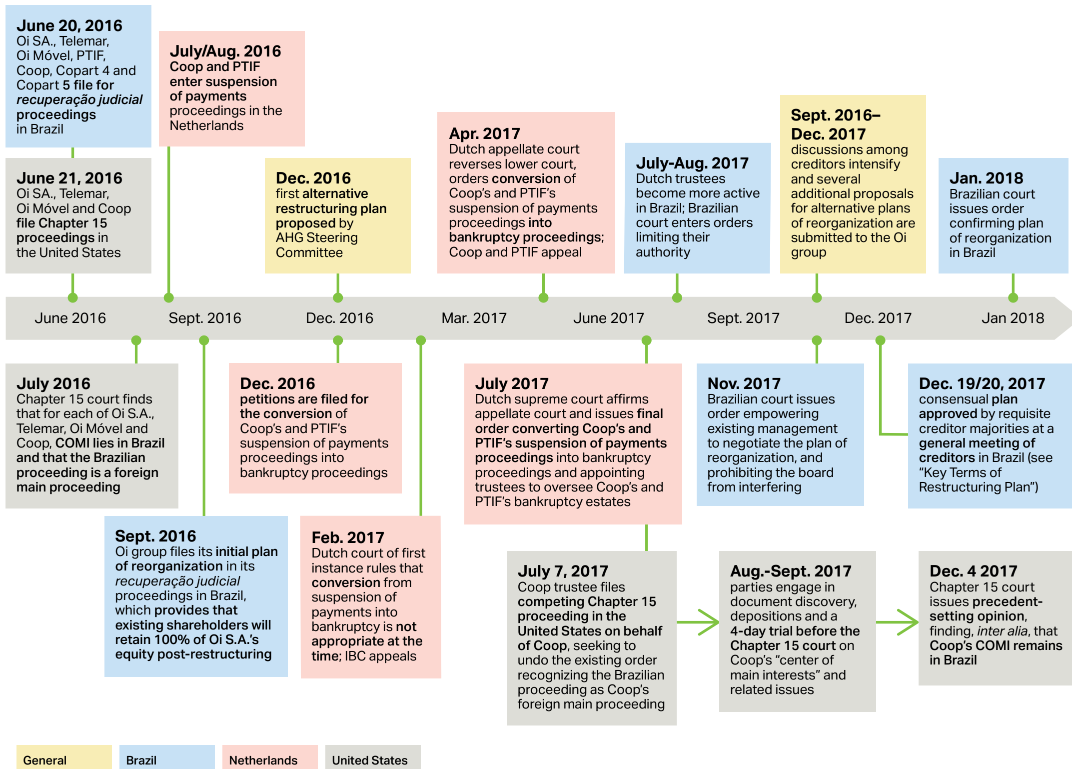
Brazil's restructuring law does not allow creditors to formally propose alternative restructuring plans, instead leaving that power in the hands of a company's board and its management.[6] That said, the basic premise of the law is that debtors and creditors will negotiate in good faith in order to approve a restructuring plan that is in the best interest of the debtors and creditors in an expeditious manner,[7] and that creditors have the right to reject any proposal put forward by the debtors. However, in general, Brazilian restructuring proceedings are considered more debtor-friendly than in many jurisdictions, and recent court decisions in Brazil, notably the *Grupo Schahin* case, have determined that creditors can have their right to vote on a restructuring plan disregarded if they are found to have acted "abusively" during the restructuring negotiations.[8] Shareholders also typically play a large role in Brazilian restructurings, particularly given that most Brazilian companies do not have independent boards.[9]

In Oi's case, it had two minority, but effectively controlling, shareholders that were actively involved throughout the restructuring process – the investment vehicles of Pharol, SGPS S.A., the legacy owner of Portugal Telecom, and Nelson Tanure, a well-known activist shareholder in Brazilian restructurings who acquired his interests in Oi on the eve of its judicial restructuring. Pharol and Tanure exerted pressure on Oi's board throughout the process and ensured that each restructuring plan proposed by Oi's board, over the course of nearly 18 months under judicial restructuring, would have effectively resulted in existing shareholders retaining 100% of Oi's shares immediately post restructuring, while forcing creditors to either take massive principal haircuts or significant maturity extensions and interest rate cuts.

While creditors are not able to formally propose alternative restructuring plans in Brazil, the AHG Steering Committee, and in the later stages of the restructuring, together with the IBC, developed and publicly presented multiple alternative proposals, which were supported by a group of international export credit agencies ("ECAs"), for restructuring Oi in a far more viable and equitable way. In each case they had their proposals either ignored or rejected by Oi's board. Nevertheless, the AHG Steering Committee, IBC and ECAs continued to attempt to engage the company's management in negotiations, and throughout the process were in regular communication with Oi's other key stakeholders, including Brazilian state and private banks and key government actors, in the hope of advancing a consensual and viable restructuring plan.

By November 2017, nearly 18 months after entering judicial restructuring proceedings, and immediately following some particularly egregious actions by the minority controlling shareholders and their board representatives, the AHG Steering Committee and the IBC filed a motion seeking to remove the voting rights of Pharol and Tanure and their board members in response to their abusive actions. The Brazilian court quickly ruled that the board could no longer have any role in formulating or negotiating a restructuring plan for Oi, and that instead that power was vested solely with Oi's existing management. This important and precedential decision held that shareholders (and their board representatives) could also be deemed to have acted abusively and therefore have their rights disregarded, essentially subordinating Brazilian corporate law to Brazilian restructuring law and creating a shareholder-side analogue to the *Grupo Schahin* creditor abusiveness case. The decision potentially goes a long way towards restoring some balance between creditors and debtors in judicial restructuring negotiations. Most immediately, in

Oi Restructuring — A Basic Timeline



Oi's case, the decision freed Oi's management to finally engage in *bona fide* negotiations with Oi's creditors, and significantly accelerated the process of agreeing on a consensual restructuring plan, using the various alternative creditor-proposed plans as a framework.

Treatment of Regulatory Fines in Brazilian Judicial Restructurings

Part of the Oi Group's financial and operational difficulties resulted from the fact that Brazil's existing concession-based telecommunications regime is significantly outdated. For example, the terms of Oi's concessions impose on Oi the obligation of maintaining public phones and land-lines in some of the most remote and poorest parts of Brazil, even when residents in those areas are already overwhelmingly served by wireless service, and imposed heavy fines whenever Oi was not in compliance with such requirements.

As a result, when Oi filed its initial creditors list it included approximately R$10 billion in fines levied by ANATEL, the Brazilian telecommunications regulator, resulting in part from non-compliance with its concession obligations.

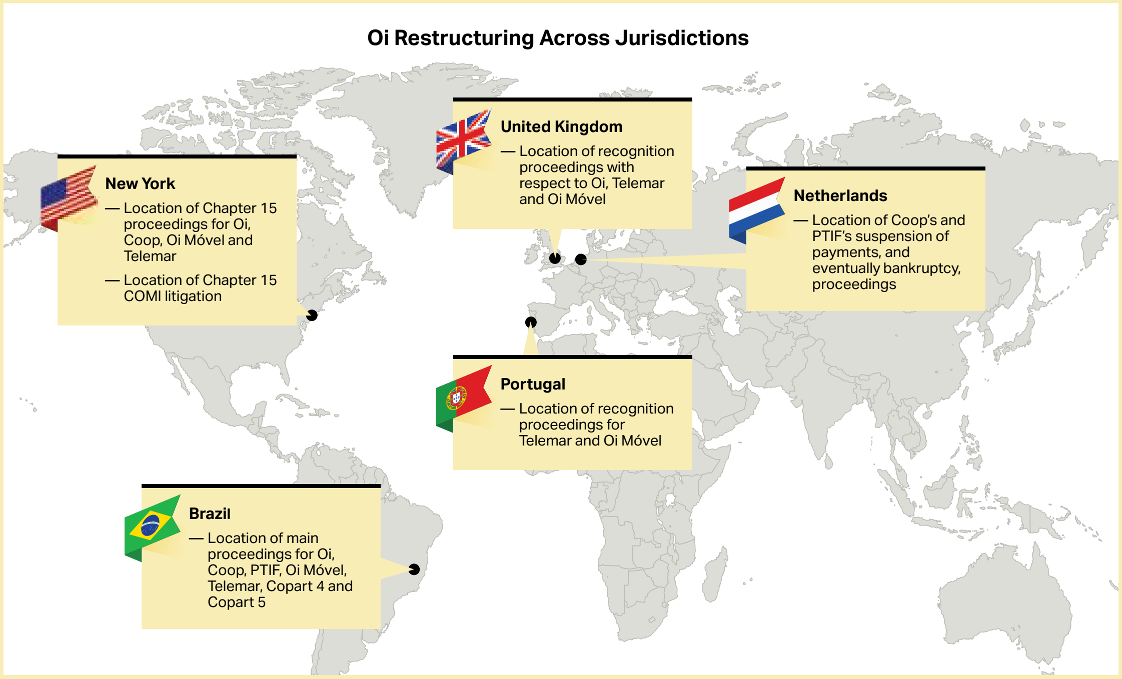
Brazil's restructuring law does not explicitly allow for regulatory fines to be restructured as financial debt, nor does it explicitly disallow it. Tax claims, on the other hand, are generally explicitly excluded from restructuring. ANATEL predictably took the position that its claims were not subject to restructuring, and were more properly characterized as tax-like claims. Throughout the restructuring process, then, ANATEL was wearing a dual hat as regulator and creditor, albeit resisting its characterization as a creditor whose claims could be impaired by judicial restructuring. The Brazilian presidential administration and other government actors faced massive political pressure not to provide Oi (or its international creditors) any sort of a bailout with respect to its ANATEL claims, particularly given the dire state of the Brazilian economy. Brazilian state-owned banks, such as Banco do Brasil, Caixa Economica and BNDES were also among Oi's largest creditors, and were also facing potential write-downs with respect to their Oi claims, further exacerbating the political issues and drawing extensive coverage in the Brazilian business and popular press.

Nevertheless, throughout the restructuring proceedings, ANATEL's claims remained on Oi's creditors list, and both the judicial restructuring court and an appeals court sitting in Rio de Janeiro have sided with Oi. The restructuring plan that was ultimately approved provides specific treatment for ANATEL's claims, with crystalized amounts to be restructured and paid over a 20-year period and gave Oi the ability to use cash sitting in judicial deposits for the initial installments. Non-crystalized amounts that are subsequently finally determined are to receive the far less generous general payment option, entailing an 85% haircut and no cash payments for the first 20 years. The plan also contains a provision whereby if a law change or regulation allows for an alternative means of settling the ANATEL claims, the debtors may do so.

ANATEL continues to dispute the characterization of its claims in the courts, and went so far as to describe (on the eve of the creditors meeting that approved the plan) its treatment as illegal. If the treatment of ANATEL's claims is not overturned, it would be a significant development as it would provide a framework for dealing with regulated entities with significant regulatory fines in Brazilian judicial restructurings, potentially providing more clarity for creditors and debtors alike.

Key Terms of Restructuring Plan

Existing Debt	Restructuring Consideration
US$10 billion NY and English law bonds	— Reinstated NY Bonds w/ 80% haircut: • Amortization: 7-year bullet; Non-callable • Interest: 8% cash + 4% PIK or 10% cash during the first 3 years; then 10% cash — Shares/warrants for up to 75% of Oi's equity
US$4.2 billion unsecured Brazilian bank and foreign ECA debt	— No haircut — 17 year tenor — Non-linear amortization starting in year 6 — Interest: 80% of CDI for Banks; 1.75% for ECAs
US$1 billion secured Brazilian bank debt	— No haircut — 15 year tenor — Non-linear amortization starting in year 7 — Interest: TJLP + 2.946%
General Payment Option	Creditors not affirmatively electing a specific payment option to receive take-back debt on the following terms: — 25 year tenor — Linear amortization starting in year 21 — Interest: TJ for R$ debt; 0% for US$ and € debt — Pre-payable at any time by Oi for 15% of principal
ANATEL Claims	— 20 year tenor — No principal haircut; 50% haircut on accrued interest; 25% haircut on accrued late charges — Non-linear amortization starting in year 1 — Initial payments to be made using judicial deposits — Adjusted monthly by SELIC — ANATEL claims still subject to appeal paid pursuant to General Payment Option
Other Key Features	
New Money Capital Increase	— R$4 billion new money capital increase pursuant to rights offering — Fully backstopped by large financial institutions
Governance Reforms	— Substantial changes to Oi's governance structure to improve transparency and increase independence of board



Conclusion

Oi's restructuring plan was approved, on a substantively consolidated basis, on December 19, 2017, after a nearly two-year process. The plan was confirmed by the Brazilian restructuring court in January 2018 and, while there are ongoing appeals pending, the plan is expected to be implemented over the course of 2018. ■

1. Oi's bond debt consisted of the Brazilian *reais* equivalent of approximately R$16.2 billion in notes issued by PTIF and guaranteed by Oi, R$7.6 billion in notes issued by Coop and guaranteed by Oi, R$9.2 billion in notes issued by Oi and guaranteed by Telemar, and R$1.0 billion in notes issued by Oi without a guarantee. Oi's other financial debt consisted mostly of debt owed to banks and export credit agencies, and its only secured creditor was the Brazilian Development Bank (BNDES).
2. A Chapter 15 debtor can only have one "foreign main proceeding," which must be located in the same jurisdiction as its COMI.
3. Cleary Gottlieb is international counsel to the AHG Steering Committee in connection with the Oi Group's restructuring. Pinheiro Neto Advogados and Moelis & Company served as Brazilian counsel and financial advisors, respectively, to the AHG Steering Committee.
4. *See In re Brasil Holdings Coöperatief U.A.*, 578 B.R. 169 (Bankr. S.D.N.Y. 2017).
5. The Oi Group will still need to comply with Dutch restructuring law in order to allow Coop and PTIF to exit Dutch bankruptcy liquidation proceedings.
6. For a more fulsome discussion of the debtor-creditor dynamics in Brazilian restructuring proceedings, *see* Richard J. Cooper, Francisco L. Cestero & Daniel J. Soltman, Insolvency Reform in Brazil: An Opportunity Too Important To Squander, Cleary Gottlieb Emerging Markets Restructuring Journal Issue No. 4 (Fall 2017), *republished* with certain updates and modifications in Pratt's Journal of Bankruptcy Law, Jan. 2018.
7. The Brazilian Bankruptcy Law provides for an automatic stay of 180 days, though such period is routinely extended at the request of debtors, which has had the effect of diminishing the pressure on debtors to negotiate with their creditors in a timely manner.
8. The *Grupo Schahin* decision determined that a secured creditor should have its votes disregarded at the creditors meeting, because it was behaving "abusively" – an unclear and judicially created concept in Brazil – because the proposed restructuring plan would have provided the creditor with a higher recovery than a liquidation.
9. Article 47 of the Brazilian Bankruptcy Law states the purposes of judicial restructuring, which explicitly does not include the interest of shareholders, but does specifically mention the interest of creditors: "The object of judicial reorganization is to make it possible for the debtor to overcome his economic and financial crisis in order to be able to maintain the production source, employment of workers and interests of the creditors, thus contributing to preserve the company and its social function and to foster economic activity."

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Corruption Investigations in the Peruvian Infrastructure Industrial Sector: Background, Effects and Considerations to Protect Foreign Creditors

By **RENZO AGURTO ISLA** *and* **PATRICIA CASAVERDE RODRIGUEZ**

Corruption has always been a sensitive issue when doing business in Latin America. Recently, the impact of the corruption scandal known as *Lava Jato* (Car Wash) has rippled across several countries in the region. Peru has not been an exception to this reality. In December 2016, Odebrecht S.A., the Brazilian engineering and infrastructure construction firm, admitted to the U.S. Department of Justice that it paid US$ 29 million in bribes to Peruvian officials between 2005 and 2014 in exchange for construction projects with the Government. Since then, the Peruvian Public Ministry has commenced several investigations against several foreign and local engineering and infrastructure construction companies, former managers and directors of such companies and former Peruvian officials. Those criminal investigations include Odebrecht, Camargo Corrêa S.A., OAS S.A. and UTC Engenharia S.A., among others.[1]

The Government's executive branch[2] responded to the *Lava Jato* scandal by issuing Legislative Decree Nos. 1341 and 1352 in January 2017, which introduced severe administrative sanctions towards companies convicted of corrupt practices and money laundering. Furthermore, in February 2017, the Government's executive branch issued Urgency Decree No. 003-2017 to prevent the sale of rights and assets of companies convicted of such crimes. Such Urgency Decree established restrictions for certain companies, including (i) the restriction on the transfer of their funds abroad; (ii) the required prior authorization from the Ministry of Justice in case of a transfer of rights and/or assets[3]; and (iii) the withholding of payments that public entities owe to the debtor.

The companies falling within the scope of Urgency Decree No. 003-2017

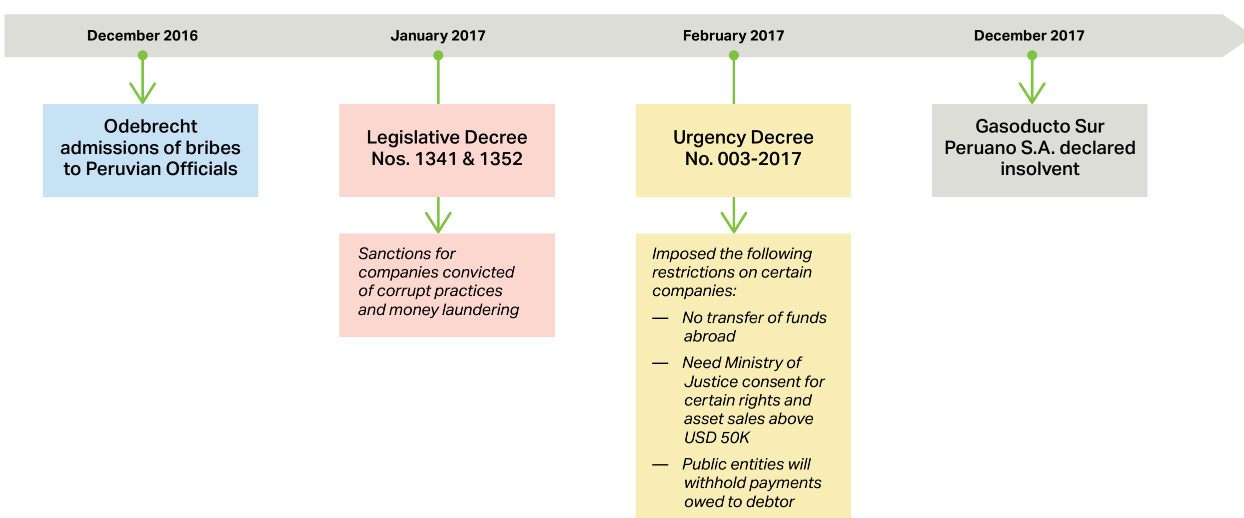
1. Entities convicted, or whose officials or representatives have been convicted, in Peru or abroad, by means of a consensual or enforceable judgment for crimes against the public administration or money laundering or equivalent crimes;
2. Entities that, directly or through their representatives, have admitted and/or acknowledged the commission of any of the crimes described above before any competent Peruvian or foreign authority; or
3. Entities that are "related" (such as this term is defined in Urgency Decree No. 003-2017) to those entities mentioned in (1) and (2) above.

All these measures have severely impacted the stakeholders of companies in the infrastructure industrial sector. For example, Legislative Decree No. 1341, which amended the Peruvian State Procurement Law (*Ley de Contrataciones con el Estado*), forbids foreign and domestic entities to contract with the Government if they have been convicted in Peru or any other jurisdiction of corruption-related crimes and/or money laundering. The same restriction applies if representatives of such entities disclose the commission of such crimes under a leniency program in any jurisdiction. At the moment, the implications of Legislative Decree Nos. 1341 and 1352 and Urgency Decree No. 003-2017 only reach Odebrecht[4]. However, an amendment to Urgency Decree No. 003-2017 is currently under review,[5] which may bring in other infrastructure companies within the decree's scope and/or modify other relevant aspects of such Urgency Decree.

The foregoing situation, including the fact that there is another ongoing criminal investigation against major local companies in the infrastructure sector accused of allegedly colluding to secure infrastructure local projects,[6] has created an imminent risk of a severe paralysis in this sector and, therefore, an interruption of the infrastructure supply payment chain.[7] In our experience, this may trigger the insolvency of some companies that have a direct or indirect relationship with the infrastructure industrial sector.

According to the Ministry of Economy and Finance of Peru (MEF for its acronym in Spanish), the *Lava Jato* scandal has already negatively affected the appetite for private investment and the generation of jobs and the domestic consumption. According to MEF statistics, such scandal, together with the

Corruption Developments in Peru: A Timeline



natural phenomenon "*El Niño Costero*" that also affected Peru last year, has generated a negative impact of 1.5 percent of Peru's GDP in 2017, as compared to Peru's GDP in 2016.[8] According to a recent statement made by the MEF, this is a systemic issue that could trigger a severe paralysis in different sectors of the Peruvian economy.[9]

In fact, in December 2017, the Insolvency Commission (the "**Commission**") of the National Institute for the Defense of Competition and the Protection of Intellectual Property ("**INDECOPI**"), which is Peru's insolvency authority and a public specialized agency under the executive branch, announced in the Peruvian official gazette that Gasoducto Sur Peruano S.A. ("**GSP**"), former concessionaire of a 1,100-kilometre pipeline project in the south of Peru overseen by a consortium group that included Odebrecht, Spain's Enagás S.A. and Peru's Graña y Montero S.A.A., has been declared insolvent. Unfortunately, this may not be the first nor the only insolvency case in the near future. As its well known, the insolvency of GSP is closely related with the *Lava Jato* scandal, since financing for the project dried up in the wake of its corruption revelations. The banks backing the project refused to provide further loans unless Odebrecht withdrew, but the Brazilian company was unable to find a buyer for its 55% stake in GSP. According to the latest information, 31 creditors have presented their proof of claims before the Commission.[10] Currently, such claims are under evaluation. Once this stage is completed, the Commission will call for a creditors' meeting.

The case of GSP is an example of what may happen in the following months to other companies in this sector and, in light of this situation, it is important for foreign investors to understand the main features of an insolvency proceeding in Peru as well as important rights of creditors party to such proceeding.

Peruvian Insolvency Proceeding Main Features

The general regime for insolvencies and reorganizations in Peru is set by Law No. 27809 (the "**Insolvency Law**") and has an administrative nature, as the insolvencies are carried out before INDECOPI, through its Commission in the first instance and then through its Tribunal in the second instance, deals with insolvency proceedings. Peruvian judicial courts play a complementary role (e.g., reviewing at a request of a party INDECOPI's decisions and analyzing the transactions that may be clawed back).

Scope:	Business entities and individuals that carry out business activities, in each case domiciled in Peru.
Types of insolvency proceedings:	Preventive insolvency proceeding and ordinary insolvency proceeding. The latter may be either voluntary or involuntary. Involuntary ordinary proceedings are confidential until the Bar Date (as defined below).
Who can commence a preventive insolvency proceeding:	Only the debtor.
Who can commence an involuntary ordinary proceeding:	One or more creditors that maintain a claim before the debtor that exceeds 50 tax units,[11] and such amount has been due for more than 30 calendar days.
Debtor's options:	The debtor may opt for: — paying the total amount of the claim; — making an offer to pay the total amount of the claim; — opposing the existence, ownership, enforceability or amount of the claim; or — accepting the filing to commence the insolvency proceeding.
Bar Date:	When the Commission announces in the Peruvian official gazette that the debtor has been declared insolvent. According to the Insolvency Law, the term for the Commission to determine the Bar Date is 90 business days. However, in our experience, depending on the complexity of the case, it might take longer.
Automatic stay:	Once the automatic stay is in effect, then from the Bar Date: — all the debtor's obligations comprised within the insolvency proceeding are stayed; and — all foreclosure proceedings for collection as well as injunctions against debtor's estate are stayed. This does not include assets of a debtor that are secured by the guarantee of obligations of third parties (originated before the Bar Date), which can be foreclosed at the expiration of the obligation [12].
Corporate Groups:	The Insolvency Law does not recognize corporate group insolvency. That is, the law regulates the insolvency proceedings on a company by company basis and does not include any regulation relating to proceedings covering more than one legal entity or entitling creditors of insolvent companies or the companies themselves to include others.

Transactions That May be Clawed Back

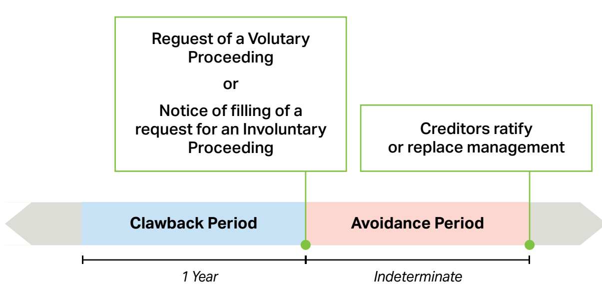
A very important aspect that creditors should bear in mind is that actions taken by some of the debtor companies may be placed under scrutiny.

In this respect, once the debtor is given notice of a creditor petition to commence an involuntary insolvency proceeding, all actions taken by management: (i) during the prior year ("**Clawback Period**") and, (ii) from that date on and until the date the creditors ratify or replace debtor´s management ("**Avoidance Period**"), could be questioned. If the transactions (i.e., any transfer or sale of assets) meet certain requirements as detailed below, they may be voided by a Peruvian judicial court.

— **Clawback Period.** The Clawback Period covers all actions or transactions, whether for consideration or not, that:

- Have been taken by an insolvent debtor during the previous year from the notification to commence the insolvency proceeding;
- Have a "negative effect" on the net worth of the insolvent debtor. (There is no consensus on the definition of what "negative effect" means. In our opinion, it occurs when there is an impairment, deterioration, loss or prejudice in the debtor's estate and a negative impact on the creditors' ability to obtain payment of their claims.); and
- Are not in the "ordinary course of business." There is no consensus on the definition of what "ordinary course of business" means. In our opinion, this concept shall be interpreted as widely as possible. Therefore, not every action or transactions taken by the insolvent debtor that goes beyond its corporate purpose (*objeto social*) shall be considered out of its ordinary course of business.

— **Avoidance Period**: Some actions taken by an insolvent debtor once the Clawback Period concludes and until the date when creditors ratify or replace the management may also fall under scrutiny. Analyses should be done on a case by case basis.



Any creditor who is planning to deal with the debtor companies should bear in mind the risk that the Clawback Period and Avoidance Period can implicate. As we discussed previously,[13] in such cases, the corresponding legal due diligence that creditors conduct should include within its scope the financial situation of the debtor.

Proof of Claims

Any claim originated before the Bar Date will be considered a pre-publication claim. Only pre-publication claims are subject to the rules under the Insolvency Law, INDECOPI's jurisdiction and the terms and conditions of the reorganization plan or liquidation agreement.

— **Allowed claims**: Creditors must file a proof of claim before INDECOPI within 30 business days from the Bar Date to be considered allowed creditors. Only those creditors can vote in the creditors' meeting. Allowed claims will be paid before non-allowed claims either in a reorganization or liquidation.

— **Support of claims**: For the recognition of such claims, the creditor must present every documentation that supports the creditor's claim, such as invoices, agreements, among others.

— **Foreign creditors**: In Peru foreign creditors have the same rights as national creditors regarding a request for the commencement of an insolvency proceeding and their participation therein. There are no special proceedings, impediments or protections applicable to foreign creditors.[14]

The Creditor's Meeting and The Rights of Creditors with "Allowed Claims"

The creditors' meeting plays a key role within an insolvency proceeding. Indeed, in a reorganization process, the creditors' meeting replaces the shareholders' authority so that they are allowed to designate the company's management, approve the debtor's restructuring plan and its amendments, modify by-laws and even to approve any merger of the debtor. Likewise, in a liquidation process, the creditors' meeting will have to designate a liquidator (who must be registered before INDECOPI), approve a liquidation agreement and decide if the debtor can carry out business during the liquidation as a going concern.[15] Every creditor with "allowed claims" can attend and participate in the creditors' meeting. The voting power of such creditors is determined by their percentage in relation to the total amount of allowed claims. However, it is important to consider that there are certain matters (e.g., the restructuring plan, the liquidation agreement) that require specific quorum and majority for its approval.

Key Indicators – Peru Insolvency Regime

Experience Level: Limited established precedents of successful in-court restructurings or significant cultural resistance to resolution of insolvency through court proceedings

KEY PROCEDURAL ISSUES	
Can bondholders/lenders participate directly (i.e., do they have standing to individually participate in a proceeding or must they act through a trustee/agent as recognized creditor?)	Yes[16]
Involuntary reorganization proceeding that can be initiated by creditors?	Yes
Can creditors propose a plan?	Yes
Can a creditor-proposed plan be approved without consent of shareholders?	Yes
Absolute Priority Rule?	Yes[17]
Are ex parte proceedings (where only one party participates and the other party is not given prior notice or an opportunity to be heard) permitted?	No
Are corruption/improper influence issues a common occurrence?	No
Viable prepackaged proceeding available that can be completed in 3-6 months	No
Secured creditors subject to automatic stay?	Yes
Creditors have ability to challenge fraudulent or suspect transactions (and there is precedent for doing so)	Yes
Bond required to be posted in case of involuntary filing or challenge to fraudulent/ suspect transactions?	No
Labor claims can be addressed through a restructuring proceeding	Yes
Grants super-priority status to DIP financing?	No
Restructuring plan may be implemented while appeals are pending?	Yes
Does the restructuring plan, once approved, bind non-consenting (or abstaining) creditors?	Yes
Does the debtor have the ability to choose which court in which to file the insolvency proceeding (or is it bound to file where its corporate domicile is)?	No
Other significant exclusions from automatic stay?	Yes[19]
Prevents voting by intercompany debt?	No
Strict time limits on completing procedure?	No
Management remains in place during proceeding?	Yes[20]

Protection Mechanisms for Investors

Once a creditor has identified that the debtor is in a difficult financial situation, the creditor may consider to protecting its exposure by implementing some of the following mechanisms.

In our experience, some of the most important mechanisms for creditor's protection are the insertion of adequate representations and warranties within the credit agreement (or any other similar or related agreement), and the sanction of any breaches of the debtor with high penalties. The representations and warranties could be complemented by, among others, the imposition of a debtor's obligation to periodically report its debts that may expire in the near future.

Another mechanism for creditor's protection in such contexts, but certainly much more expensive, is the constitution of a trust into which the debtor transfers the amount agreed as penalty in case of breach of the mentioned representations and warranties. The benefit of the latter mechanism of protection is that in case an insolvency is commenced against the debtor; the assets included in the trust will not be considered as part of the insolvency estate.

Finally, creditors may also consider the inclusion of third parties as guarantors. Pursuant to Insolvency Law, if eventually an insolvency is commenced against the debtor, the creditor will have the chance to directly collect its claims against such guarantors.

Protection Mechanisms

— Enhanced protections in Credit Agreements

— Bankruptcy remote trust for pre-agreed penalty awards

— Third party guarantors

Conclusions

The *Lava Jato* scandal has had an important impact on players, big and small, within the infrastructure industrial sector of Peru. Based on our experience, this may trigger the insolvency of some companies that have a direct or indirect relationship with the infrastructure industrial sector. In fact, the insolvency of GSP shows a situation that may be reflected in some other companies.

In this regard, it is important for any creditor (especially foreign creditors who may not be familiar with Peruvian Insolvency Law) to bear in mind its rights within an insolvency proceeding and several aspects that shall be considered in case they are willing to become creditors of one of those companies. As mentioned, transactions in such contexts should be assessed after evaluating the risks and implementing adequate mechanisms for protection in order to mitigate them. ■

1. Information obtained from the digital investigative journal "Ojo Público" (https://ojo-publico.com/).
2. The Peruvian Congress authorized the executive branch to legislate in the prevention and fight against corrupt practices, among other matters.
3. This restriction is applicable for anyone who intends to acquire, under any title, any asset or right of any of the companies falling under the scope of the Urgency Decree No. 003-2017, as well as the shares or other securities representing rights of participation issued by such companies, even when these assets, rights, actions or values have been transferred to a trust or under other similar mode.

   Furthermore, the Ministry of Justice excluded any transfer with a book value under USD 50K from the scope of this restriction.
4. The Ministry of Justice of Peru has issued a list that only includes Odebrecht related companies within the scope of Urgency Decree No. 003-2017. To access such information, enter the following link: https://www.minjus.gob.pe.
5. In February 2018, the Government's executive branch presented a draft of Law No. 2408-2017-PE before the Peruvian Congress. To date, such proposed law is under review.
6. This ongoing criminal investigation is known in the media as "*El Club de la Construcción*".
7. According to Odebrecht creditors' association (services and products providers), 169 out of 450 providers have gone out of business. See the following article from the Gestión: https://gestion.pe/economia/empresas/caso-odebrecht-deuda-constructora-proveedores-suma-s-80-millones-227084.
8. "*Informe de actualización de proyecciones macroeconómicas*", published by MEF on April 30, 2017.
9. Statement made by Claudia Cooper, Minister of MEF on January 30, 2018 to "*RPP noticias*": "*this is one of the priorities of the economy portfolio. It is very complicated because we are talking about a systemic issue and not just one or two infrastructure companies. Approximately S/ 30,000 millions in public investment projects that have not been awarded yet, could be paralyzed*".
10. Based on publicly available information, the Bank of Tokyo-Mitsubishi, Intesa Sanpaolo, Sumitomo Mitsui Banking Corporation, Banco Bilbao Viscaya, Natixis, Odebrecht related companies and the Peruvian Government (Tax Authority and the Ministry of Mining and Energy) are among the entities that have filed their proof of claims against GSP.
11. In 2018, 50 tax units are approximately USD 63,000.
12. The mentioned exception is applicable only in case of the granting of a guarantee related to a particular asset (rights in rem duly registered before the Peruvian Public Registry such as a pledge or mortgage).
13. For further detail and mechanisms for creditor´s protection, see Renzo Agurto Isla, "*Economic crisis, is it a good investment opportunity? The acquisition of assets or companies in pre-bankruptcy situations or subject to bankruptcy procedure*" included in Ius Et Veritas volume No. 54 (July 2017), pp. 116-118.
14. In accordance with the 1993 Peruvian Constitution, the Insolvency Law establishes no difference between national and foreign creditors. However, the 1984 Peruvian Civil Code maintains particular preferences for domiciled creditors and credits registered in Peru. In our opinion, such differences are incompatible with the later 1993 Peruvian Constitution, so legal actions can be taken in order to avoid those provisions, if necessary.
15. The maximum term for this type of liquidation is one (1) year, extendable for one (1) additional year.
16. This issue is not regulated under the insolvency law. In the case of the bondholders, their participation is subject to the provisions in their contract(s) with the issuer. In the case of the lenders, they can directly participate in the proceeding without a trustee/agent.
17. Mandatory only in a liquidation proceeding. In the event of a reorganization, creditor may opt for another payment structure.
18. At the request of a party, the INDECOPI may suspend the effect of the plan during an appeal.
19. Significant exclusions from automatic stay are: (i) debtor's obligations originating after the Bar Date, and (ii) debtor's assets that guarantee any third-party obligations originating before the Bar Date.
20. In a preventive insolvency proceeding, management remains in place. In an ordinary proceeding, management remains in place unless the creditors' meeting opts otherwise.

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How to Overcome Limitations to Lenders' Step-in Rights Under Mexican PPAs

By GABRIELA PÉREZ SIERRA

On September, 2017, Abengoa announced the agreement to sell the 907 MW combined cycle project called Norte III, in the state of Chihuahua (México), to be developed and operated pursuant to a power purchase agreement entered into with the Mexican Federal energy commission (*Comisión Federal de Electricidad*, "**CFE**").[1] This project had received financing through an Abengoa Mexican special purpose vehicle before Abengoa's pre-insolvency filing in Spain in November of 2015.[2] As a result of this filing, lenders' step-in rights under the power purchase agreement in an event of insolvency became very relevant and were extensively analyzed by Mexican legal advisors. The terms of those step-in rights are significantly similar to the ones in the current form long term power purchase agreements ("**LT-PPA**") for the first, second and third-round power bids organized by the Mexican National energy control center (*Centro Nacional de Control de Energía*, "**CENACE**") under the current Mexican law to regulate the electric energy industry (*Ley de la Industria Eléctrica*).[3] Considering the Norte III experience, the step-in rights for lenders under the LT-PPA might be limited when attempting to foreclose on the collateral created for a project finance in the event of the sponsor's insolvency.

Lenders' Step-in Rights under the LT-PPA

The purchaser under the LT-PPA may terminate the agreement upon occurrence of one of the events of default of the seller listed in the LT-PPA. Notwithstanding, before the purchaser terminates the LT-PPA, it should notify the seller and its lenders of its intention to do so.[4] After receiving the purchaser's notice, the project lenders may notify the purchaser of their intention to (i) remedy the event of default or (ii) enforce their control or step-in rights over the seller and foreclose on their collateral, or both.

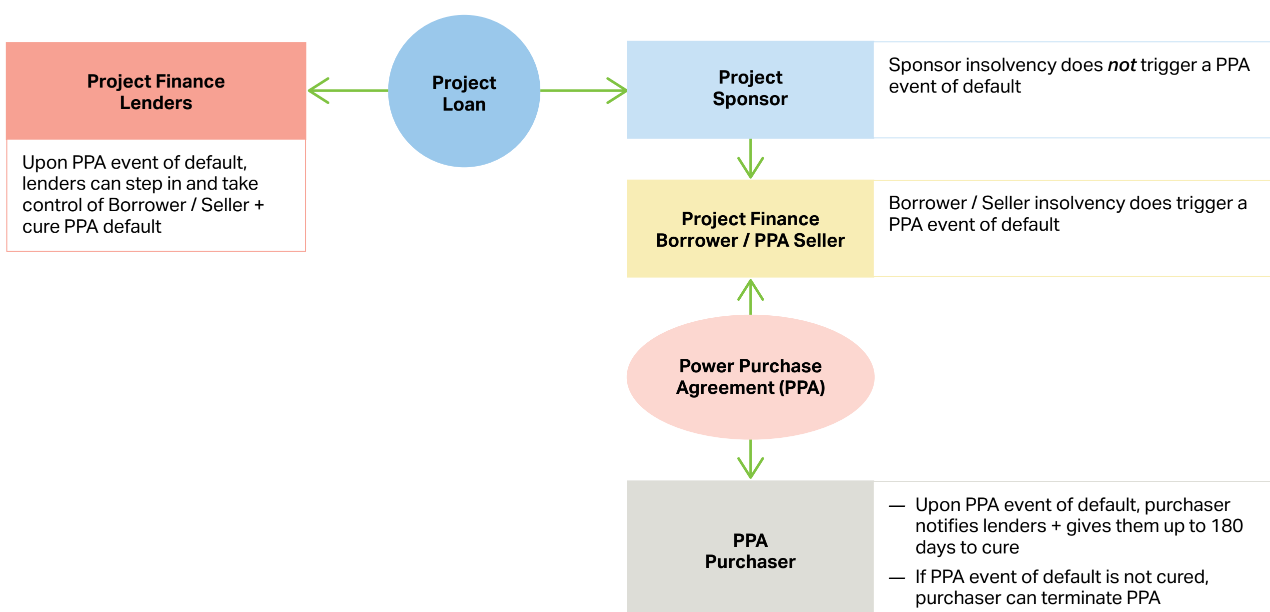
Following the notice by the project lenders to the purchaser, the purchaser shall refrain from terminating the PPA agreement for up to180 days. During such time, lenders can remedy the seller's event of default by enforcing their collateral to take control of the seller and consequently of the project.

Practical and Legal Limitations to Step-in Rights

Under the LT-PPA, the step-in rights of a lender are triggered if an event of default of the seller under the LT-PPA occurs. Note that the LT-PPA does not provide for a cross-default of such agreement if there is an event of default by the seller under the loan by which project is financed. Therefore, there could be a scenario where the project loan is in default but the LT-PPA is in full compliance.

However, under the LT-PPA, the seller's insolvency (*concurso mercantil*) or its bankruptcy (*quiebra*), or the seller's acceptance of a receiver constitute events of default. On the other hand, if the seller's sponsor becomes insolvent or bankrupt, or acknowledges its inability to pay debt such circumstances are not an event of default under the LT-PPA, although they may be an event of default under the project financing loan agreement.

Mexican PPAs – Project Lenders Step In Rights



Events of Default under Project Loan v. PPA		
Events of Default	**Project Finance Credit Agreement**	**Power Purchase Agreement**
Event of Default of Borrower under Credit Agreement	— Event of default → lenders can enforce remedies	— No cross-default → lenders do not have step in rights
Event of Default of Seller under PPA	— Cross-default → lenders can enforce remedies	— Event of default → lenders have step in rights
Event of Default of Seller under PPA	— Cross-default → lenders can enforce remedies	— Event of default → lenders have step in rights
Insolvency of Borrower / Seller	— Event of default → lenders can enforce remedies	— Event of default → lenders have step in rights
Insolvency of Sponsor	— Event of default → lenders can enforce remedies (but no PPA step in rights)	— No event of default → lenders do not have step in rights

Strictly speaking, if the loan is for a project finance there is a presumption that the project and the lender are bankruptcy remote vehicles and, therefore, the sponsor's financial condition should be less relevant. However, to the extent that the sponsor is required to contribute any equity during the term of the loan and the project is under construction, as is the case in many projects in Mexico, the sponsor's solvency becomes more relevant.

Should the sponsor become insolvent or if it acknowledges its inability to pay its debts, there is a risk that it will be unable to make its equity contributions, which could possibly delay the project. Furthermore, while any insolvency procedure is pending, the lenders' remedies against the sponsor could be limited. Consequently, in such case it would be reasonable for lenders to notify of the occurrence of an event of default under the project finance loan agreement and foreclose on the project by selling it to a reasonable third party that can guarantee the construction and operation of the project as scheduled.

Therein lies the problem, in the event of the sponsor's insolvency, there would be an event of default under a project finance loan agreement and the lenders could seek to foreclose on the collateral; however, they would not have step-in rights under the LT-PPA because the sponsor's insolvency does not trigger an event of default of the seller under the LT-PPA.

The above does not mean that the lenders cannot seek to foreclose, but there are a number of issues stemming from the fact that lenders do not have a direct relationship with the purchaser under the LT-PPA.

For any sale of the project to occur, the LT-PPA requires the seller to request that the purchaser authorize a change of control (and the purchaser to agree). Note that the seller is the only party authorized to make such a request under the LT-PPA (except when lenders enforce their step-in rights). If lenders cannot exercise their step-in rights under the LT-PPA, they could obtain corporate control over the seller/borrower and then proceed to request that the purchaser authorize the change of control.

The lenders could obtain such control over the seller/borrower by means of a Mexican guarantee trust (*fideicomiso de garantia*) created pursuant to a trust agreement. Under this construct, all but one of the shares representing the capital stock of the borrower are contributed to the trust, and, upon an event of default notified to the borrower, the trustee, through the instructions of the administrative agent as beneficiary under the guarantee trust, could enforce the voting rights under each share contributed to the trust and take control of the borrower on behalf of the lenders.

Once lenders have corporate control over the seller, they should be able to request the change of control to sell the project to a third party as part of their collateral enforcement rights. In practice, however, this extra hurdle can mean that the foreclosure process would take longer and become more cumbersome.

Strategies to Address Limitations to Lenders' Step-in Rights

The analysis in this article addresses the worst case scenario in which there is a LT-PPA entered into by a seller, and the seller, in turn, has a sponsor not party to the LT-PPA that could have liquidity constraints at some point during construction of the project, which could affect its ability to fulfill its equity contribution obligations in a project finance and in which there are no viable alternatives to fund such equity, like sufficient reserve accounts or a letter of credit and, furthermore, that those constraints lead to insolvency or the declaration of the inability to pay debt.

In these specific cases, lenders have alternatives to prevent limitations to their step-in rights under the LT-PPA; however, none of them are addressed as specific prerogatives under the LT-PPA and they should all be negotiated with the purchaser.

The most straight forward approach would be to amend the LT-PPA to include the sponsor's insolvency as an event of default under the LT-PPA. There might be a discussion however, as to how much the agreement can be amended given that it is a form and it is entered into as a consequence of a public bid.

Alternatively, lenders could seek to mitigate the limitation to their step-in rights discussed here through the direct agreement with the purchaser under the LT-PPA, to clarify that the sellers' insolvency should also include the insolvency of its sponsor.

In any case, based on the above, the LT-PPA does not fully address the risk of lenders associated with the solvency of the sponsor, particularly during the construction period of a project, and there could be limitations to step-in rights; Notwithstanding, as mentioned herein, it is possible to foreclose on the lenders' collateral with the current provision of the LT-PPA, it might just take a bit longer than it should. ■

1. http://www.abengoa.com/export/sites/abengoa_corp/resources/pdf/noticias_y_publicaciones/20170901_NP_NIII_Final_ING.pdf
2. http://www.abengoa.com/export/sites/abengoa_corp/resources/pdf/gobierno_corporativo/hr_y_otras_comunicaciones_cnmv/hechos_relevantes/2015/20151127_hr_en.pdf
3. The LT-PPA for each bid are available at http://www.cenace.gob.mx/Paginas/Publicas/MercadoOperacion/SubastasLP.aspx
4. Under the LT-PPA, a lender is any entity that grants financing to the seller under financing documents (including agents, trustees and representatives) provided that their name, contact information and financing amount are notified to the purchaser.

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Ms. Pérez Sierra has over eleven years of experience advising national and foreign clients in various transactions in Mexico and abroad. She has represented Mexican and foreign banks and multilaterals, including CAF, SMBC, Caixa Bank. She has also represented sponsors and borrowers in several types of transactions, including project finance, granting of partial credit guarantees and equity and bond issuances in the capital markets. Additionally, she has advised foreign and domestic investors in M&A transactions.

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The Fiduciary Duties of Directors In "Twilight Zone" of Insolvency Under Colombian Law

By **SERGIO MICHELSEN JARAMILLO** *and* **SUSANA HIDVEGI ARANGO**

Bankruptcy does not usually occur suddenly. As the business starts to deaccelerate—suppliers and creditors become anxious and the market becomes aware of the red flags—directors may act desperate to "keep the boat afloat." The big question they face is whether in such distress the beneficiaries of the fiduciary duties become the creditors, instead of the shareholders.

Colombian bankruptcy law, Law 1116 of 2016 ("Law 1116") does not have a straightforward answer, but does hint at the special consideration that directors must give to creditors in the twilight of insolvency.

General Liability Rules

Colombia's Code of Commerce provides that directors are jointly and severally liable for the losses they cause to the company, its shareholders or third parties. In this regard, director liability requires proof of (i) negligent or willful misconduct on the part of the director, (ii) a loss to the plaintiff, whether plaintiff is a creditor, shareholder or a third party and (iii) causation.[1] The burden of proof is on the plaintiff with respect to all the elements of the cause of action, unless the director or officer's conduct is in violation of the law, in which case negligence is presumed.[2]

If, however, the director—particularly as a board member—(i) has no knowledge of the decision that will result in the action or omission that causes the plaintiff's loss, or (ii) votes against such decision, and provided that, in either case, the relevant director does not take any action to implement the approved action or omission, such director will not be liable vis-à-vis the company, its shareholders or third parties.[3]

The above rules are generally construed as liability rules (i.e. tort rules), which means that, unless otherwise specifically set forth in the law, their application is subject to the general tort principles of loss and causation. This is relevant to the extent that, pursuant to such principles, it is the person causing the harm who will be liable. It is therefore the director who approved or implemented a damaging decision that caused the plaintiff's loss, and not necessarily the current director or group of directors in office at the time the action is brought before the Court, who will be liable vis-à-vis the company, its shareholders or third parties. The fact that a director resigns, for example, should have no bearing on such director's liability for the decisions he or she approved or implemented prior to resignation.

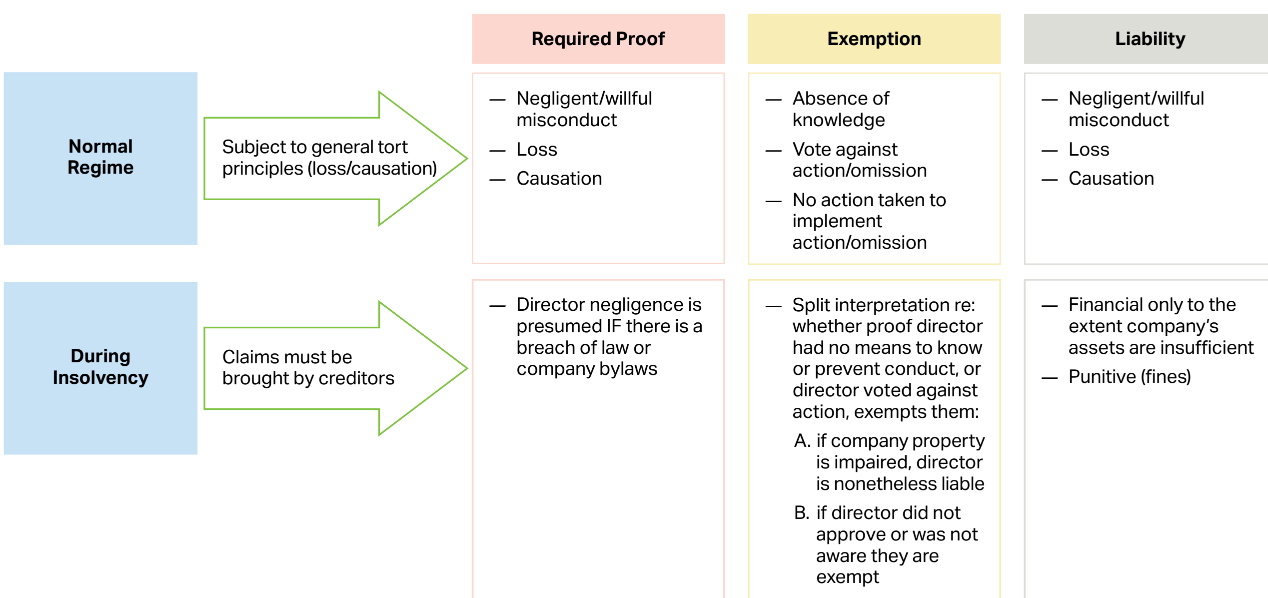
Director Liability Regime in Insolvency

Directors are also liable for the damages caused to the company's property when the company is subject to an insolvency proceeding.[4] Claims against directors within insolvency proceedings for damages caused to the company's property must be initiated by external creditors, and the competent authority to decide on these actions will be the bankruptcy judge.

Three points are particularly relevant in this regard: first, a director's financial liability to a plaintiff in this scenario is secondary and may only be brought to bear if, as a result of his or her actions, the company's assets are not sufficient to pay for its external liabilities; second, during bankruptcy proceedings, negligence on the part of the directors is presumed, **provided** that the conduct of the directors is found to be in breach of the law or the company's bylaws; and, finally, this is also a "liability" rule, which, as explained above, will govern the responsibility of a director for the decisions they approved or implemented while occupying the directorship, irrespective of the fact that they may not be a director of the company at the time the action is brought.

The next question, then, is whether or not in an insolvency context directors may also be released from liability if they

Director Liability



had no knowledge of, or voted against, a decision which, once implemented, caused a loss to the plaintiff. The answer to this question is unfortunately not straightforward, as there are two possible interpretations of the Colombian law on this point. Pursuant to the first interpretation, directors who had no knowledge of the relevant decision, or who voted against it, are nonetheless liable if, as a result of a board decision, the company's property is somehow impaired and, in consequence, the company's assets are not sufficient to pay for its liabilities. This interpretation stems from the fact that Article 82 of Law 1116, which governs directors' and shareholders' liability within insolvency proceedings, only mentions these grounds of exoneration when referring to the liability of shareholders, which could lead a judge to consider that directors, to the extent not expressly covered by the exception set forth in Article 82, should be liable notwithstanding their lack of knowledge of the decision or their having voted against it. Pursuant to the second interpretation, the absence of a clear rule in Article 82 regarding the liability of directors means that this hypothesis should be governed by the general liability rules applicable to directors (i.e. the liability rules that apply to the directors of a "going concern"), in which case directors would not be liable for decisions they did not approve or of which they were not aware.

However, of note is that the Superintendence of Companies, a government agency responsible for supervising commercial companies in Colombia, when mentioning the level of diligence that directors must employ when exercising their functions within companies undergoing insolvency proceedings, has referred to the following quote:[5]

> *It is not enough, in order to elude joint liability, for board members to prove that they did not participate in the corresponding board meeting; unexcused absence may be qualified as culpable negligence. Board members must prove that there were no means of knowing or preventing the negligent conduct. Honest and prudent directors that prevent lawful maneuvers, do not satisfy with merely voting against, but quit in order to avoid any association with the measure.*

Thus, even if it is accepted that general liability rules are applicable to directors' liability during insolvency proceedings, the bankruptcy court may not exonerate the questioned director, if the director merely proves the absence of knowledge of the decision that resulted in the action, or the omission that caused the plaintiff's loss, or if they voted against such decision. The bankruptcy court may demand more diligent conduct on the part of directors before it will relieve them of their liability, as it did in the MNV S.A. Judicial Liquidation Proceeding, for example.

In addition to the liability regime illustrated above, the bankruptcy court may also impose fines and sanctions consisting of the banning of the director from engaging in any business for up to ten years if it appears that, among others, (i) the company was used to defraud the creditors, (ii) the business was fraudulently driven into insolvency, (iii) the director unjustifiably breached the reorganization plan, (iv) the director speculated with respect to the creditors' claims to purchase them at a discount, (v) the director participated in simulated acts, or altered the financial records, and (vi) the director waived a right or action without reasonable cause.

Conclusion

As a conclusion, although Colombian law does not expressly answer the question on the fiduciary duties of directors before and during insolvency proceedings, the high standards applicable to directors that are embroiled in a bankruptcy proceeding, and the severe sanctions for the breach of such standards, seems to actually impose the observation of fiduciary duties not only to the shareholder, but also to the creditors in the twilight of insolvency proceedings and during the days of distress that make up the insolvency process.

Accordingly, creditors must be aware of the actions that may be brought against directors for the damages caused due to their negligence or misconducts, particularly during insolvency proceedings, where the acts of the directors may be the direct cause of the distress. ■

1. Corte Suprema de Justicia [*Supreme Court of Justice*], Cas.Civ. Exp. 9879 (2005) (Col.).
2. When negligence must be proved, evidence of ordinary negligence will suffice; there are no special or deferential standards requiring evidence of gross negligence or willful misconduct.
3. Corte Suprema de Justicia [*Supreme Court of Justice*], Cas.Civ. Exp. 9879 (2005) (Col.).
4. Law 1116, Article 82.
5. *Cf.* Superintendence of Companies, MNV S.A. Judicial Liquidation Proceeding, Writ from August 21st, 2012; Superintendence of Companies, Gas Kapital GR. S.A. Judicial Liquidation Proceeding, Writ from August 8th, 2012.
6. Law 1116, Article 83.

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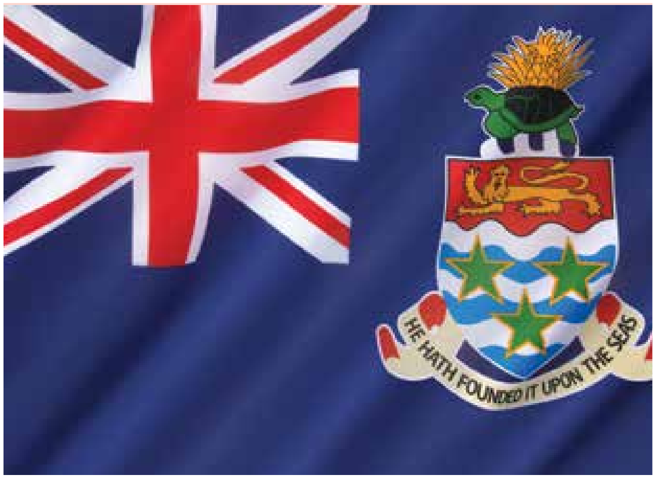
Cross-Border Restructuring: The Cayman Islands Option

By **SIMON DICKSON**, **ALEX LAST**, **CHRISTOPHER LEVERS** *and* **JENNIFER CROOKE**



Introduction

The global economy is increasingly cross-border in nature, and so are restructurings of companies with a presence in multiple jurisdictions. This manifestation of globalisation can raise some particularly challenging issues if the company finds itself in financial difficulty. The issues are even more acute if the company is incorporated in a jurisdiction without a sophisticated restructuring regime.

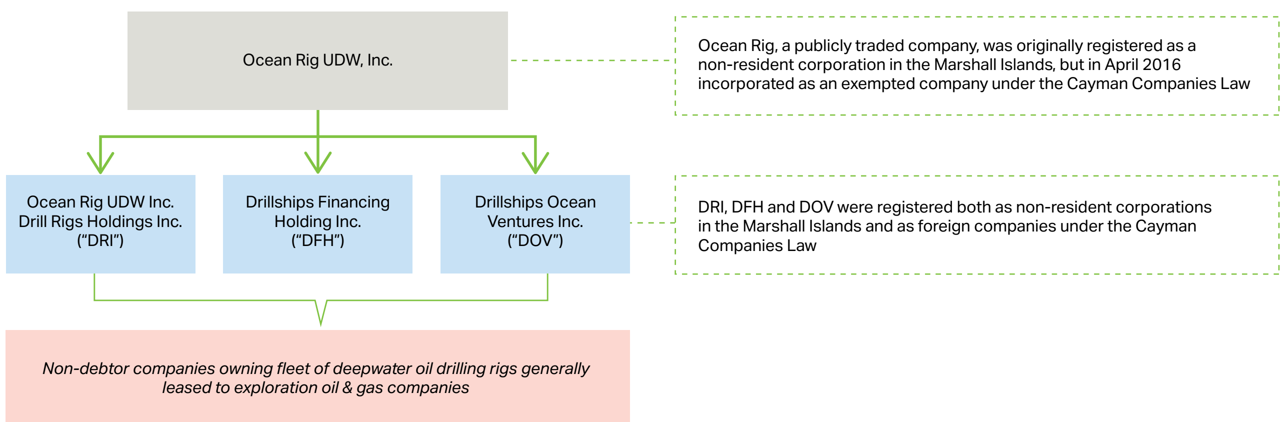
In such circumstances, the company in question will often look for solutions offered by other available jurisdictions. For example, it has become common for the Courts in England to approve a scheme of arrangement in respect of a foreign company. Alternatively, a company may look to Chapter 11 in the United States of America. However, in cases where Chapter 11 or an English scheme may not be appropriate (for example, due to cost, lack of jurisdictional nexus, timing or adverse tax consequences), the recent Ocean Rig restructuring demonstrates that the Cayman Islands provides another option for high profile, complex, cross-border restructurings.

Cayman Scheme

A scheme of arrangement is specifically provided for under the Companies Law in the Cayman Islands (the "**Cayman Companies Law**"). Generally, the provisions are the same as those set out in the Companies Act in England. Accordingly, the process involves the approval of the scheme by each class of the affected creditors/members (by a majority in number representing 75% in value of those voting at the relevant meeting) and the subsequent approval of the scheme by the Court. The Cayman Islands' Court will normally follow English case law where there is no local precedent available, meaning there is a very high degree of certainty as to how the Cayman Court will approach any restructuring.

As with an English scheme, once effective, a Cayman scheme binds all creditors/members, including any dissenters to the proposals, but it is worth noting, like in an English scheme, a Cayman scheme will only be effective where each class of creditor/member approves the scheme. Accordingly, unlike under Chapter 11 (where a plan may be confirmed even with respect to a non-accepting class, subject to certain circumstances), if any class of creditors/members that is affected by the scheme does not approve the scheme, the Cayman scheme will be defeated.

Ocean Rig Corporate Structure



Ocean Rig

Ocean Rig UDW Inc. ("**Ocean Rig**") is an international offshore deep-water drilling contractor which recently completed a complicated and high profile restructuring in the Cayman Islands comprising four schemes of arrangement. It involved an exchange of approximately U.S.$3.7 billion of debt for new equity in the company, U.S.$450 million of newly issued debt and U.S.$288 million in cash.

The four relevant companies in the Ocean Rig structure were all initially incorporated in the Marshall Islands (a parent and three subsidiaries). In order to take advantage of a Cayman scheme of arrangement, which in contrast to the Marshall Islands offered a legitimate opportunity for restructuring as opposed to liquidation, the parent company transferred its incorporation to the Cayman Islands prior to the restructuring proceeding and the three subsidiaries each registered in the Cayman Islands as foreign companies under the applicable provisions of the Cayman Companies Law.

With these registrations, the four foreign companies were provided the jurisdictional gateway to take advantage of the Cayman Companies Law. The resulting Cayman proceedings were subsequently recognised as foreign main proceedings under Chapter 15 of the U.S. Bankruptcy Code in August 2017 (which recognition necessarily included a finding that the "center of main interests" or "COMI" for all four debtors was in the Cayman Islands). One month later, in September 2017, the Chapter 15 court entered a separate order making the approved Cayman schemes binding and enforceable in the U.S.

An important and useful element of the Ocean Rig restructuring was that the companies were able to obtain a moratorium on claims both in the Cayman Islands and in the United States prior to the scheme being presented to the creditors. The reason for this is that the Cayman Companies Law allows a company to seek the appointment of a provisional liquidator where a company is or is likely to become unable to pay its debts *and* intends to present a scheme of arrangement. The

Chapter 15 COMI Considerations

- In making its COMI determination, the Chapter 15 court relied on, inter alia, the lack of any real connection to the Marshall Islands aside from initial incorporation / registration, and the actual activities of the debtors in the Cayman Islands (such as board meetings). Importantly, the court also addressed challenges to allegations that the pre-filing shift of COMI to the Cayman Islands was bad faith COMI manipulation.
- In determining that the COMI shift was done in good faith in order to gain access to a restructuring regime that provided for more options than just a liquidation, the court stated that "[t]he only provisions under [Marshall Islands] law that address financially distressed corporations…contemplate dissolution and, therefore, any insolvency in the [Marshall Islands] would invariably result in a value-destroying liquidation process. Accordingly, the [debtors'] COMI shift to the Cayman Islands was done for legitimate reasons, motivated by the intent to maximize value for their creditors and preserve their assets. The Court finds that the [debtors'] COMI was not manipulated in bad faith." *In re Ocean Rig UDW Inc., et al.*, 570 B.R. 687, 707 (Bankr. S.D.N.Y. 2017).

benefit of this provision, as was seen in Ocean Rig and several other restructurings in the Cayman Islands,[1] is that where a provisional liquidator is appointed, there is an automatic stay preventing any claims from being brought or continued against the company. Not only does this give a company valuable breathing space in the Cayman Islands, the provisional liquidator's appointment can also be recognised under Chapter 15, thereby enabling the provisional liquidator to obtain similar relief from the U.S. Bankruptcy Court (often by way of provisional relief while a motion for recognition of a foreign main proceeding remains pending, after which such relief is automatic). This, in turn, also gives a company invaluable breathing space in the U.S. while it formulates its restructuring proposals. Upon the successful conclusion of the restructuring, the provisional liquidator is discharged. Ultimately, once presented, 100% of Ocean Rig's participating creditors approved the scheme for each of the Marshall Islands entities and 98% approved the scheme for the parent company.

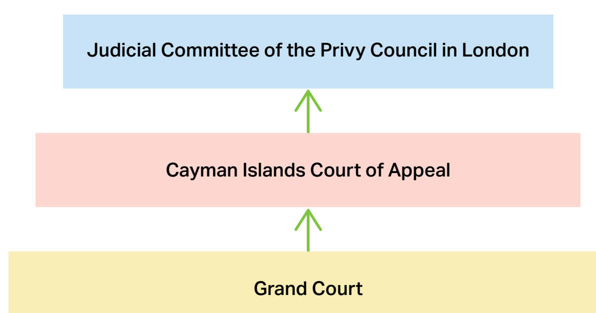
When to use the Cayman Scheme?

We do not expect the Cayman scheme to displace the use of English schemes of arrangement or Chapter 11. However, it may become an attractive option to entities that can demonstrate that their COMI is in the Cayman Islands, which at this point is a growing group, as nearly 100 Latin American companies (public and private) in Standard & Poor's Capital IQ database have direct subsidiaries in the Cayman Islands.[2] Additionally, the Cayman scheme may be attractive in restructurings where its benefits outweigh the use of Chapter 11 and in circumstances where an English scheme may not be appropriate, for example if shifting the COMI of the relevant company to England would cause adverse tax consequences.

By its nature, the Cayman Islands lends itself to transactions involving a cross-border fact pattern. One of its biggest advantages is that it provides neutrality for all parties to the transaction by eliminating any bias brought by home field advantage—neither creditors nor debtors will suffer any disadvantage by having the case decided in an opposing party's home jurisdiction. This is particularly acute in transactions involving multiple counterparties in multiple jurisdictions with often conflicting legal systems.

In addition, the Cayman Islands is a leading international finance centre, which is supported by a sophisticated and comprehensive infrastructure of professionals and advisers. Due to the nature of the jurisdiction and its extensive use in the financial services industry, the Cayman Islands Courts hear a very large number of cases relating to cross-border disputes and restructurings. In addition, the ultimate Court of Appeal is the Judicial Committee of the Privy Council in London. This provides a huge amount of legal certainty to all participants.

Cayman Islands Appeal Structure



The scale, complexity and successful execution of the Ocean Rig restructuring sets a precedent for the use of the Cayman Islands scheme in other cross-border restructurings. It has put the Cayman Islands firmly on the restructuring map. ■

Advantages to a Cayman Islands Scheme of Arrangement

- — Similarity to U.K. Scheme of Arrangement and reliance on English law where no local precedent exists → high level of predictability in outcomes
- — Allows for relief through Chapter 15 → preclude dissenting creditors from bringing competing insolvency proceedings and seeking to attach assets in the United States
- — Low country risk → political and economic stability for companies domiciled in Cayman Islands and proceedings located there

1. Examples include the CHC Group restructuring, involving U.S.$1.6 billion in outstanding debt obligations, the ATU Group restructuring, which is believed to be Cayman's first ever "pre-pack" restructuring, the LDK Solar restructuring, involving U.S.$700 million in debt obligations and the Mongolian Mining restructuring, involving U.S.$760 million in debt obligations.
2. S&P Global Market Intelligence, Capital IQ Database (2012) (last visited February 16, 2018). The potential for using the Cayman Islands to effectuate cross-border restructurings takes on particular significance when considering that foreign companies can meet the jurisdictional requirements of the Cayman courts by, *inter alia*, paying a de minimis fee (approximately U.S.$1,600 as of January 1, 2018) to register as a foreign company (although Cayman courts do retain discretion to reject jurisdiction depending on the determined level of contacts with the Cayman Islands). Moreover, past cases demonstrate that the courts have taken a pragmatic approach to jurisdiction, and will typically not find forum shopping objectionable where the Cayman scheme is being pursued for legitimate purposes, such as the benefit of creditors.

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Prior to joining Mourant Ozannes he was a barrister in chambers in London. Simon has extensive experience in insolvency and restructuring, fraud and asset tracing and regulatory matters.

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He specialises in private equity, investment funds and corporate and commercial work and has many years of experience advising leading private fund sponsors on the structuring and establishment of investment funds, secondary transactions and related deals. Before relocating to the Cayman Islands, Alex led the investment funds practice in Mourant Ozannes' Hong Kong office where he advised on some of the largest fund raisings in the Asia region. Alex has particular expertise advising on the establishment of funds for Japanese fund sponsors for both retail and institutional distribution in Japan. Alex frequently advises on general corporate and finance matters and has particular expertise in the context of fund financing. Prior to joining Mourant Ozannes, Alex worked for another Cayman Islands law firm and, before moving offshore, Freshfields Bruckhaus Deringer in London.

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He joined Mourant Ozannes in 2014 after spending several years practising in chambers in London and with another offshore law firm in the Cayman Islands. Christopher's practice covers all areas of international commercial, insolvency and contentious trust litigation. He has frequently appeared before both the Cayman Islands Grand Court and its Court of Appeal.

▼ **Jennifer Crooke** is a senior associate in Mourant Ozannes' Cayman Islands corporate and finance practice.

She specialises in both corporate and finance work, with a focus on private equity, investment funds, structured finance and capital markets. Prior to joining Mourant Ozannes, Jennifer worked in-house at Wells Fargo in London where she advised on a broad range of finance matters including securities, M&A, structured finance, bank lending, energy and financial regulatory work. Before Wells Fargo, Jennifer was at Cleary Gottlieb Steen and Hamilton LLP.

Costa Rican Bankruptcy Rules: What Every Investor Needs To Know

By ANDRÉS LÓPEZ

Introduction

Costa Rican law on insolvency and bankruptcy creates a fairly reliable system that offers stability and solutions for creditors in Costa Rica and abroad. However, there are certain issues and complexities that foreign investors and professionals need to bear in mind.

From a general stand point, Costa Rican law contains specific rules and procedures designed to (1) restructure or reorganize the outstanding obligations of the debtor when there are viable solutions to its difficult financial situation or (2) liquidate the debtor's assets and pay its creditors when there is no viable remedy available.

Under Costa Rican law, commercial debtors (i.e., corporations, commercial entities) are subject to bankruptcy rules while individuals and organizations not formed for a pecuniary profit or commercial purpose are subject to insolvency rules. The rules on bankruptcy are stringent and reserved for the liquidation of assets owned by commercial debtors that have ceased payments on their obligations and are in financial distress. Meanwhile, insolvency rules are designed to orderly liquidate the assets of individuals and non-commercial organizations through a relatively more simple process.

This article focuses on bankruptcy proceedings, the provisions governing such proceedings and the advantages and challenges they might present.

General Overview

The Costa Rican bankruptcy system may be described as more creditor-friendly due to its robust protections of creditors' rights. However, depending on the case, bankruptcy proceedings can be slow and difficult due to the existence of several codes and laws and also due to an overburdened court system. In addition, the satisfaction of creditors' interests depends on the availability of assets of the debtor. If the debtor does not have sufficient assets to satisfy each claim, then the creditors will be paid proportionally and up to the value of the assets available.

A bankruptcy proceeding is triggered by the inability of the debtor to pay its outstanding obligations. Bankruptcy cases are therefore related to a debtor's cessation of payments (and not to the debtor's possession of sufficient assets).

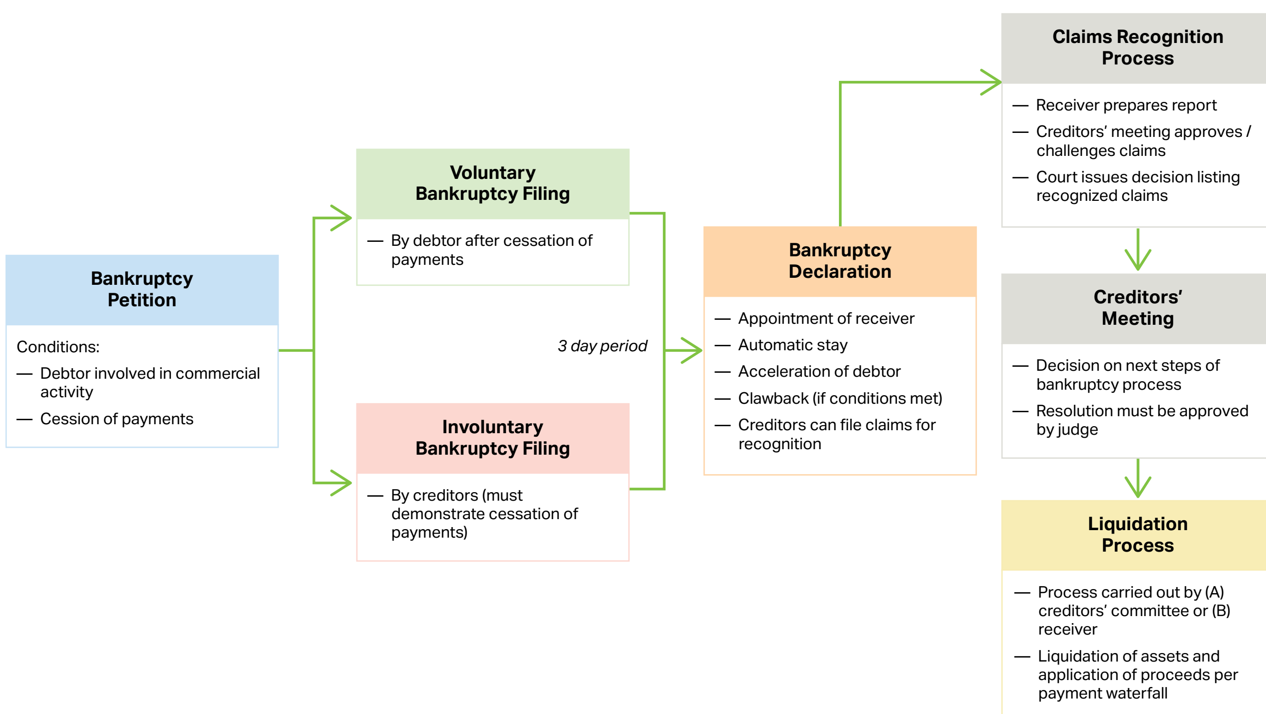
The Bankruptcy Proceeding

In order for a court to declare a debtor bankrupt, there are two requirements that must be met. First, the debtor must be involved in a commercial activity. Known as the subjective element (*elemento subjetivo*), this is the classic characteristic of bankruptcy proceedings. According to applicable law, all Costa Rican companies are deemed to be commercial entities by nature. In addition, individuals, local or foreign, and foreign companies that perform any type of commercial activity shall also be eligible under the bankruptcy rules.

Furthermore, the other relevant element that must be present in order for the court to declare the debtor bankrupt is the objective element (*elemento objetivo*), which is evidence of a cessation of payments. As mentioned before, sufficiency of assets is not relevant under Costa Rican bankruptcy law. The factor that triggers the bankruptcy is the inability of the company to pay its debts in a timely manner. Costa Rican case law has interpreted such cessation of payments as a condition of the debtor, meaning that it is a general situation of non-compliance with the entity's payments that is presumably not reversible.

The bankruptcy petition may be filed by the creditors but also by the debtor. Once the petition is filed by a creditor, the court in charge of the proceeding will issue a resolution and

Bankruptcy Process



give the debtor a three-day period to either pay the debt in full or to provide enough assets to secure its obligation with the creditor. If the debtor fails to pay or provide sufficient assets as requested, the court hearing the case will declare the debtor bankrupt and the proceeding will move forward regardless of the opposition of the debtor.

Upon the declaration of bankruptcy, all obligations of the debtor become due and payable. In the case of executory contracts, the receiver (appointed by the judge, as described below) may permit the debtor to continue with its obligations under such contracts. The receiver will then take over the rights and obligations the debtor under the contract. If the judge, after obtaining the receiver's and the creditors' input, does not permit the debtor to continue with its obligations under the executory contract, then the contract will be terminated and the counterparty of such contract will be able to file all available claims against the debtor.

In the resolution declaring the bankruptcy, the judge must appoint a receiver (the creditors do not participate in such appointment). The judge chooses the receiver from a list of pre-authorized attorneys that is prepared and managed by the court. Among the expenses related to the bankruptcy process, the fees of the receiver are easily the highest as they are based on a percentage (typically 5%)of the total liquidated value of the assets of the debtor.

The receiver is in charge of the management of the debtor company and its assets, and must produce a complete inventory of its assets and liabilities. The debtor company may dispose of assets through the receiver, but must have the previous authorization of the judge in charge of the bankruptcy.

Following the appointment of the receiver by the judge, there is the liquidation and appreciation of assets in accordance with the waterfall according to the priority rules described further below.

Out-of-court liquidation proceedings are possible and normally implemented through a trust or in a mediation proceeding. However, in order to implement an out-of-court proceeding of this kind, all parties must agree. Such alternative may not be imposed to any party because the access to an insolvency proceeding at court is a right that both creditors and debtors have. This is the reason why such out-of-court solution are not so common.

Although there are very detailed rules that deal with bankruptcy, they are not consolidated in one specific law or code. Instead, Costa Rica has both procedural and substantive rules spread across different laws, particularly in the Civil Code, the Commercial Code and the Civil Procedures Code. This is a situation that has added a level of complexity to bankruptcy cases over the years, because the court has had to issue resolutions that intend to harmonize and integrate the rules from various separate legal codes. There are several aspects of our bankruptcy legislation that need to be updated and modified, but a modern, comprehensive and exclusive bankruptcy law is certainly one the main issues we need to address.

Creditors' Rights

The effect of the declaration of bankruptcy on the debtor's assets is that the assets are from that point on seized for the benefit of creditors. This means that the assets are reserved to be liquidated and the proceeds of such liquidation will be used to repay the creditors' outstanding obligations. Therefore, the assets cannot be sold, transferred or encumbered unless the court determines that it is for the best interest of the creditors.

The procedures established by law are designed to treat all creditors equally within their specific classification (*par condicio creditorum principle*), including foreign creditors. This means that when two or more unsecured creditors benefit from the same level of protection, no one creditor may be paid a higher percentage of their claim than other creditors and if funds are not enough to pay them all, they should be paid proportionally to the amount of their pending debt.

For the purpose of approval and payment of the bankrupt obligations, creditors are classified as follows, in order of priority:

— Creditors having a rights over specific assets of the debtor:

- The federal government and the several municipal governments for certain taxes owed in connection with the relevant asset
- Creditors secured by a mortgage (real estate)
- Creditors secured by a pledge or movable asset guarantees
- Creditors that have the right to withhold the assets from the debtor
- The lessor of real estate for any lease payments due

— Employee creditors

— Creditors of the bankruptcy proceeding itself (this refers to any obligations acquired by the bankruptcy estate/receiver on behalf of the bankrupt debtor after the bankruptcy order issued

— Unsecured creditors

Creditors whose debt is secured by a real assets guarantee may continue collecting on such security. Depending on the security and the status of collection procedures, the creditor may initiate an independent claim against the debtor or may be called to initiate or continue collection procedures with the same bankruptcy judge.

Extension of Bankruptcy Protections to Companies in the Same Economic Interest Group

Although there is no specific provision in the bankruptcy laws, based on civil procedure rules governing reorganization proceedings, Costa Rican case law has recognized the extension of bankruptcy protection to all companies belonging to the same economic interest group (*grupo de interés económico*), which may include companies outside Costa Rica.

In order to obtain an extension from the court, companies consider the following factors (which are neither exclusive nor dispositive):

— be considered one business and economic unit

— have similar or common words shared in their names

— have common representatives and shareholders

— have the same domicile

— the direction of the companies is exercised by one person or group that is common to all of them

In this case, there is an element that case law has accepted as clear evidence of the existence of the same economic interest group, and that is the express acceptance of such existence by the companies of the group.

The extension of bankruptcy protection to companies of the same economic interest group has proven to be important for foreign investors, as it is customary for groups of companies to distribute funds or assets amongst their subsidiaries and affiliates, making it difficult for their creditor to pursue those assets or funds when collecting their debts as there is a separation of assets due to the individuality of each company.

Several court resolutions have dealt with the recognition of the economic interest group within bankruptcy proceedings, but there is one resolution issued in 2006 that presents the basics of the arguments that have supported this thesis. Resolution 985-F-2006 issued by the First Chamber of the Costa Rican Supreme Court established:

"These groups are usually formed by several independent legal entities. They arise in the context of economic models in which the expansion of markets, thanks to globalization, promotes unions, creation or integration of a complexity of subjects, usually corporations, to meet the needs of consumers, increasingly less simple. Thus, they can respond to the most diverse reasons, but all of them, usually operative, among which can be cited a wide variety, from the specialization by activities, to the exploitation of specific geographical areas. The intra-organic relationship can be of direction, with an entity at the head and several subordinates, or, of coordination, between legal persons with similar decision-making power. To create them, a variety of mechanisms are used, such as business agreements (contracts) or acquisition of shares. This form of organization, absolutely legitimate as it responds to the exercise of the autonomy of the will, freedom of commerce and freedom of association, however, should not be used in fraud of law. Therefore, ***the majority of doctrines states that the legal independence held by the members of the group cannot constitute a screen to cause harm to the principle of patrimonial responsibility****. Imagine, for example, a group of economic interest constituted, for instance, by a directing legal entity that also owns all the assets of the group and also owns the capital, which decides to constitute a series of subordinated companies with insufficient capital, with the purpose of acquiring obligations through them, in such a way that in case of non-compliance, only the assets of the latter are subject to liability, protecting their real operating assets from third parties. However,* ***this fraud of law is avoided through the declaration of existence of a group of economic interest, which is justified in the fact that it functions as a single economic entity and, therefore, must respond accordingly.****"*

Look Back Period

Among the variety of rules that deal with bankruptcy, there are provisions that establish a look back period mainly as a protection for creditors. The look back period protects creditors from any action by the debtor which adversely impacts its patrimony by diminishing its assets and/or increasing its liabilities before the declaration of bankruptcy. Therefore, during the lookback period, all extraordinary actions of the debtor are suspicious and therefore may be challenged by the receiver or the creditors and eventually be annulled by the judge.

The judge sets the date in which the look back period starts when the declaration of bankruptcy of the debtor is issued. In this resolution, the judge applies the effects of the bankruptcy declaration back in time until the date in which the debtor became insolvent. This date is set preliminarily, because the order is issued very early in the process, but may be changed later as the judge gets more information.

The judge may set that date of insolvency up to three months back from the time of the declaration of bankruptcy. Upon request of the receiver or any of the creditors, the date of insolvency may be changed going back up to a maximum of six months from the time of the bankruptcy.

Similar rules apply when there are fraudulent transfers or the creation of security interests by the debtor when the cessation of payments occurred or even when it was imminent. In such cases, the receiver and the creditors might challenge disposition of assets or payment of debt for longer periods than those described in the previous paragraph.

This is another issue that must be taken into consideration by foreign investors, especially when coming into the bankruptcy proceedings late in the game.

Foreign Bankruptcies Involving Costa Rican Assets

A foreign bankruptcy process may seek to adjudicate for assets located in Costa Rica, but a preliminary liquidation process in Costa Rica must take place first, as such assets are held by the law as a preferred guaranty for the local creditors. Creditors in Costa Rica are protected before bankruptcy proceedings pending in other countries.

The law specifically requires that before adjudicating for local assets, a foreign bankruptcy must establish a partial liquidation procedure in which local creditors are convened to officially recognize their claims under law and be paid against the debtor's assets, before the foreign liquidation proceeding may dispose of those assets. If there are no local creditors or when there are, after they are duly paid, the judge will allow access to the foreign receivership to dispose of the debtor's assets.

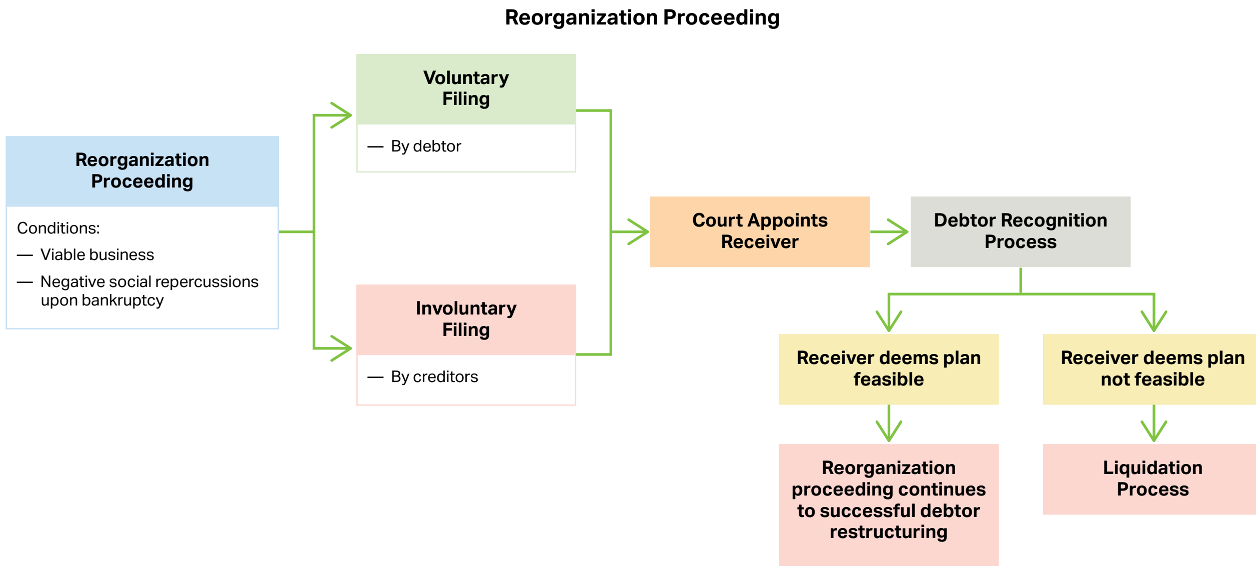
Alternatives to Bankruptcy: Rehabilitation Mechanisms

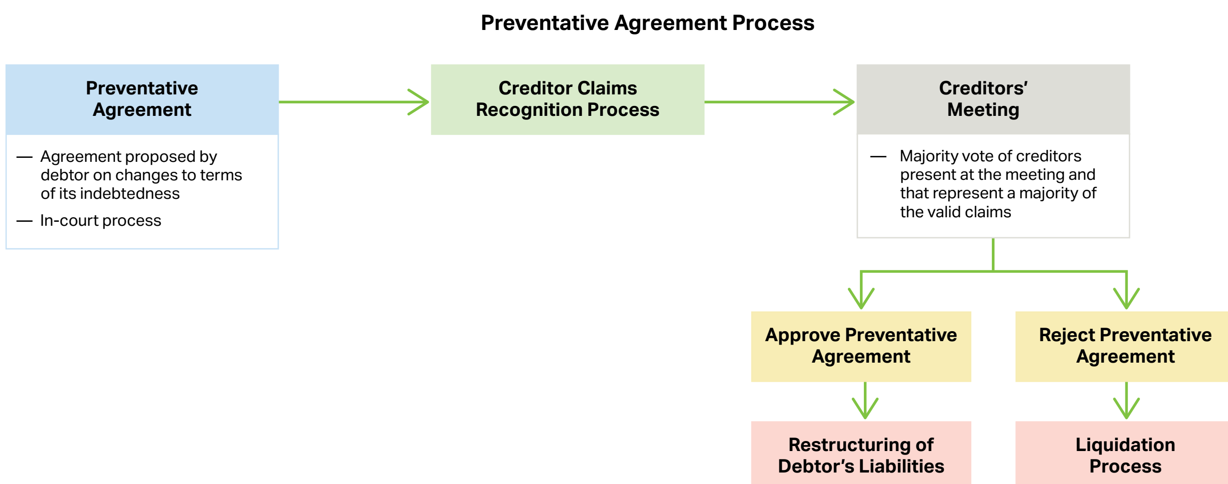
Under Costa Rica law, there are two alternative legal measures which are intended to avoid the liquidation for commercial debtors. However, they still need improvement in order to be viable remedies to rescue the financial situation of the debtor.

This first is an in-court reorganization proceeding, which may be initiated by either the debtor or a creditor. The rules governing this proceeding are reflected in the Civil Procedures Code of Costa Rica. In order to take advantage of this option, the court must determine that there exist the following two main requirements: (1) the debtor must still have a viable business and (2) in the event the debtor declares bankruptcy, there will be negative social repercussions (e.g., significant job losses, detrimental effects to creditors or providers of the company). Once the proceeding begins, the judge will appoint a receiver to take control of the debtor's business. However, before that occurs, the debtor must present a reorganization plan and the receiver must determine that the plan is feasible. The creditors may also opine on the plan but the judge will at the end decide, with all the elements of the case, if the plan is acceptable or not. If the plan is feasible, the proceeding will continue, otherwise, the reorganization will convert into liquidation. Among other advantages, the debtor can obtain a reduction in principal and interest payments on loans if the process is successful. This procedure is not attractive for debtors in general, because of the complexity of the requirements, especially the reorganization plan, and also because if the plan is not accepted, there is a possibility that the company will go into bankruptcy.

The second measure is an in-court proceeding whereby the debtor may propose before the court a "preventative agreement," providing specific changes to the terms and conditions of its outstanding indebtedness to obtain some relief from its payment obligations. Creditors will then present their claims before the court so that they and their claims are recognized before the law. If approved, such creditors will convene a creditors' meeting and the creditors' meeting may approve or deny by a majority vote the agreement presented by the debtor. If the agreement is rejected, then the debtor must pursue a liquidation proceeding under the bankruptcy rules. This measure is also not that popular, mainly because the continuity of the debtor lays in the hands of the creditors.

As discussed, the preventive measures described above are not that attractive to debtors in Costa Rica. That is clearly confirmed by the fact that between 2015 and 2017 only 3 of reorganization and 4 of preventive agreement have been filed, in contrast with 73 cases of bankruptcy filed within the same period of time.





Conclusion

There are certainly more issues worth analyzing in the Costa Rican bankruptcy system, but we believe those set out here are relevant for foreign companies, business executives and attorneys. Based on what has been laid out here, we can come to the following conclusions:

— Costa Rican law has structured a reliable system regarding bankruptcy of commercial debtors, covering relevant issues such as creditor rights, foreign bankruptcies, economic interest groups, etc.

— Nevertheless, the complex structure of codes and laws and judicial delay in attending the cases make procedures slow and cumbersome.

— In addition to the losses incurred in bankruptcy proceedings, creditors need to consider if there are other relevant expenses to bear such as the receiver's fee.

— Preventive measures intended to avoid the liquidation of a debtor whose difficult financial situation may be resolved exist, but present certain inconveniences that make them unattractive.

— There is definitively room for improvement in the Costa Rican insolvency and bankruptcy system, especially in regards to the simplification and modernization of the tools to restructure companies in financial difficulties, the efficiency of court offices dealing with these cases, the expenses that users must incur when involved in these kinds of proceedings and the availability of measures to assist debtors with financial difficulties but with a viable business.

Key Indicators – Costa Rica Bankruptcy and Insolvency Regime

Experience Level: Some established precedents of successful in-court restructurings involving international bond or bank debt or multiple established precedents but mostly occurring more than 10 years ago.

KEY PROCEDURAL ISSUES	
Can bondholders/lenders participate directly (i.e., do they have standing to individually participate in a proceeding or must they act through a trustee/agent as recognized creditor?)	Yes
Involuntary reorganization proceeding that can be initiated by creditors?	Yes
Can creditors propose a plan?	No
Can a creditor-proposed plan be approved without consent of shareholders?	No
Absolute Priority Rule?	No
Are ex parte proceedings (where only one party participates and the other party is not given prior notice or an opportunity to be heard) permitted?	No
Are corruption/improper influence issues a common occurrence?	No
Viable prepackaged proceeding available that can be completed in 3-6 months	No
Secured creditors subject to automatic stay?	Yes
Creditors have ability to challenge fraudulent or suspect transactions (and there is precedent for doing so)	Yes
Bond required to be posted in case of involuntary filing or challenge to fraudulent/suspect transactions?	No
Labor claims can be addressed through a restructuring proceeding	No
Grants super-priority status to DIP financing?	No
Restructuring plan may be implemented while appeals are pending?	Yes
Does the restructuring plan, once approved, bind non-consenting (or abstaining) creditors?	Yes
Does the debtor have the ability to choose which court in which to file the insolvency proceeding (or is it bound to file where its corporate domicile is)?	No
Other significant exclusions from automatic stay?	No
Prevents voting by intercompany debt?	No
Strict time limits on completing procedure?	No
Management remains in place during proceeding?	No

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Mr. López's practice focuses on banking and finance transactions. He has represented lenders and borrowers in a wide range of transactions for over 20 years. He also has broad experience in real estate and corporate transactions, civil and commercial litigation and arbitration. He has participated as legal advisor in many national and international transactions in which he has been responsible for coordinating with several participants, including parties from other countries such as United States of America, Panama, Grand Caiman, United Kingdom, Netherlands and Germany.

Mr. López became a member of the Costa Rican bar in 1996. He is an arbitrator at the International Center of Arbitration and Conciliation of the Costa Rican-American Chamber of Commerce. He is also Vice President of the Costa Rican Chamber of Commerce and Vice President of the Costa Rican chapter of the International Chamber of Commerce.

He received a law degree from the University of Costa Rica in 1996 and a post-graduate degree in commercial law from the University of Costa Rica in 2000.

Practice Highlights

Counsel to Steering Committee of Bondholder Creditors in Brazilian telecom **Oi**'s restructuring of **U.S. $20 billion** of liabilities (**largest ever Latin American bankruptcy**).

Restructuring Deal of the Year: OAS SA
International Financial Law Review, 2017

Counsel to **Automotores Gildemeister, one of the largest vehicle importers and distributors in Chile and Peru**, in an exchange offer to restructure its **$700 million** of debt.

Global Finance Deal of the Year: Insolvency and Restructuring (Latin America): Enel Américas corporate reorganization
The American Lawyer's Global Legal Awards, 2017

Counsel to an ad hoc bondholder committee in connection with the restructuring of **Grupo R**, a Mexican oil and gas conglomerate, including a drill ship and related companies.

Capital Markets Practice Group of the Year (for work for clients including Pemex and Petrobras)
Law360, 2015, 2016 and 2017

Counsel to a group of secured and unsecured bondholders of, and providers of new financing to, **Tonon Bioenergia** in a distressed LM transaction and subsequent judicial restructuring in Brazil.

No. 1 Law Firm in Latin America
Latinvex, 2016 and 2017

Counsel to **Empresas ICA** in the restructuring of over **U.S. $1 billion** of indebtedness, currently the largest debtor assignment in Mexico.

Counsel to **Grupo Inbursa**, a financial services company in Mexico and secured lender to multiple entities in the Mossi & Ghisolfi S.p.A. corporate group (M&G), in the restructuring of M&G debt in Brazil, Mexico and the United States.

Corporate High-Grade Bond of the Year (Sigma Alimentos' €600 million Eurobond)
LatinFinance, 2017

Counsel to an ad hoc group of bondholders in the debt restructuring of **Arendal, S. de R.L. de C.V.**

Sovereign Liability Management of the Year and Local Currency Deal of the Year (República Oriental del Uruguay, UYU35.3 billion)
LatinFinance, 2017

Counsel to **Petróleos Mexicanos**, the Mexican state oil company, in its **$4 billion** Rule 144A/Reg S debt offering with registration rights, and in two concurrent liability management transactions.

Counsel to **Petróleo Brasileiro S.A.** in its SEC-registered offering of **$2 billion** principal amount of its 5.750 percent global notes due 2029.

Counsel to an ad hoc committee of bondholders in connection with the restructuring of approximately **$1.2 billion** of bank and bond debt of **GVO**, **one of the largest sugar and ethanol companies in Brazil**.

Corporate Liability Management of the Year (Petrobras, $6.97 billion)
LatinFinance, 2017

Counsel to **CPPIB Credit Investments Inc.** as the initial lender in a refinancing of a **2.94 billion** Mexican peso-denominated senior secured loan to Grupo Gayosso S.A. de C.V.

Law Firm of the Year in Latin America
LatinFinance, 2012-2017

Counsel to **Telecom Argentina S.A.**, in connection with a **$1 billion** credit facility with a consortium of international banks.

Equity Follow-On of the Year (IEnova's September 2016 MXN27.1 billion F/O offering)
LatinFinance, 2017

Counsel to the **Republic of Argentina** in a registered USD bond offering of an aggregate **$9 billion**.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

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