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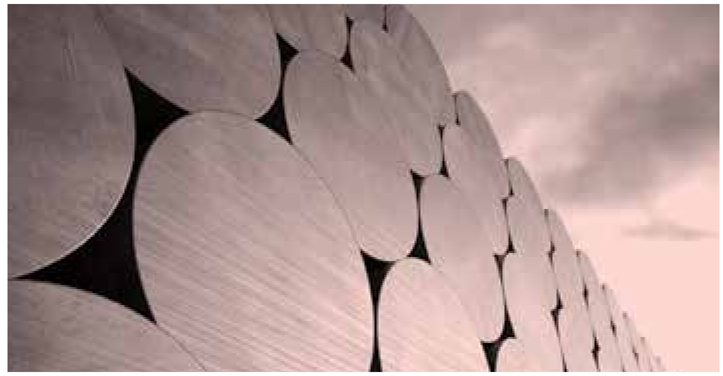
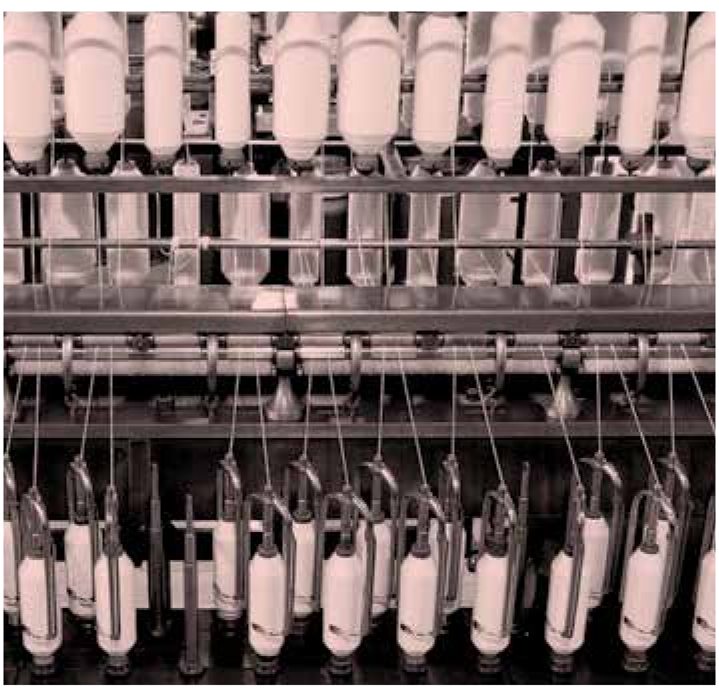
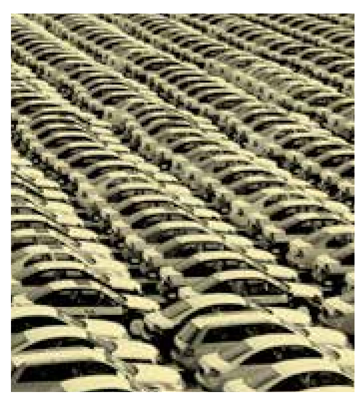
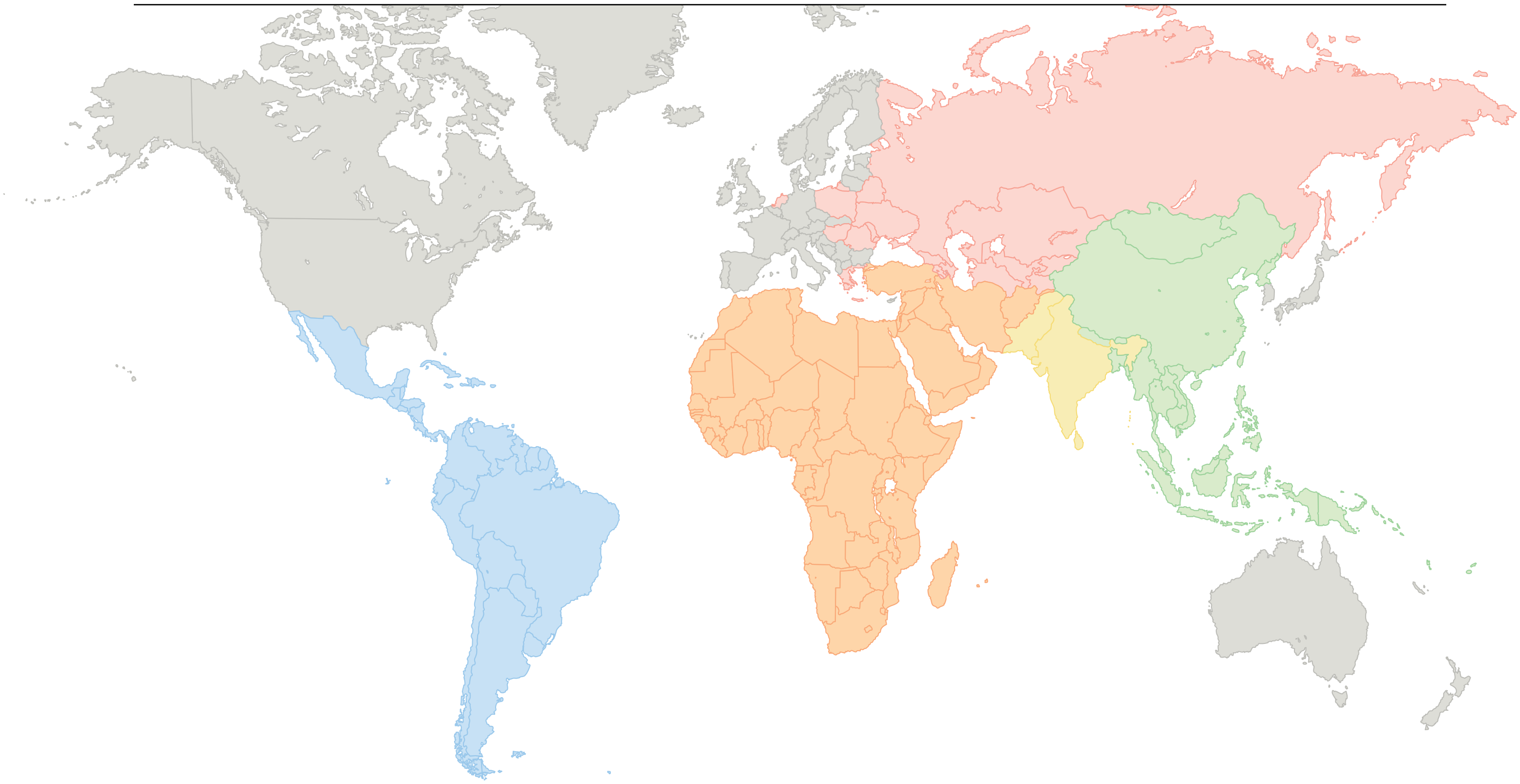








In This Issue



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Letter from the Editors

The turn of the year is traditionally a time for honest self-reflection; both for a focused assessment of one's journey through the previous year, and for planning the coming one with a suitable blend of optimism and realism. This issue does precisely that, ranging over coverage of recent insolvency and bankruptcy reform in India and its impact so far, to proposed changes to the U.S. Bankruptcy Code, to guides on developing investment opportunities for emerging market investors.

An assessment of the past year in emerging markets makes for fairly mixed reading. Global trade tensions as a result of the burgeoning trade war have spooked emerging markets investors, and a rallying dollar has proved bad news for many emerging markets. Recent figures from China indicate that trade concerns especially are having the expected effect. News of Turkey's troubles too kept coming throughout the year, and we have in this issue taken a close look at some of those.

India on the other hand seems still to be growing at comparatively fast rates, and is projected to overtake the U.K.'s GDP in 2019. With its importance on the world stage ever growing, this issue offers insight into its restructuring landscape in three different ways, with a particular focus on the recently enacted Insolvency and Bankruptcy Code. Firstly, we offer a guide for international investors hoping to take advantage of distressed debt situations, analyzing different routes into the market and providing advice on each. Secondly, we go through the developing role of insolvency professionals in India, who manage companies in insolvency on behalf of a committee of creditors. This is in sharp contrast to what was previously a debtor-in-possession system. Finally, we consider how the new system compares to U.S. Chapter 11 insolvencies and U.K. schemes of arrangement.

While the Indian-U.S.-U.K. comparative piece makes clear that restructuring policy can be modeled on the Anglo-Saxon systems, other articles relate to the critical interplay in practice between these systems and those in emerging markets. In this issue, we also explore the proposed changes in the U.S. procedure of determining a company's center of main interests (or "COMI"), which could have significant impact on where future restructurings play out across the globe. On a related note, we also consider whether there is a need for U.S. recognition of Argentinian restructurings, given the large amounts of debt securities deposited with a trustee in the United States clearing system.

There are also interesting legal developments in Mexican and Brazilian restructuring markets. The emerging markets investor seeking a safe way to invest in Mexico will do well to read our discussion of the treatment of security trusts in Mexican commercial reorganization proceedings. These trusts seem to be an effective way to trump the ranking of creditors which is otherwise constructed in such circumstances. Similarly, in our article on acquiring Brazilian judicial payment orders from financially distressed companies—until recent years, a relatively underused investment strategy—we carefully point out the potential pitfalls in doing so, and give tips on how to avoid them. These articles combine with others in the issue to offer detailed and practical guidance to emerging markets investors for a year in which, given deteriorating indices, the upside could be significant.

We hope you enjoy this issue.

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

A Guide to Special Situations and Distressed Investments in India for International Investors

By **NIKHIL NARAYANAN**

Introduction

The enactment of the Insolvency and Bankruptcy Code 2016 ("**IBC**") and pressure on Indian banks from the Reserve Bank of India ("**RBI**") to clean up their balance sheets has created a distressed investments market in India. This has resulted in a wave of interest in India from distressed debt and special situations funds. However, while the scale of the opportunity and its potential are evident to most international funds, tackling this opportunity requires an understanding of the Indian regulatory landscape and will usually require engagement with the large state controlled banks in India. This article demystifies the Indian distressed debt and special situations market for international debt funds seeking to enter it.

Baseline Restriction—Restrictions on 'External' Commercial Borrowings

The starting point for any debt fund seeking to invest in India is the fact that participation in the Indian debt market by international lenders is still restricted by Indian exchange control laws and restrictions on the capital account convertibility of the Indian rupee. Specifically, the '*external commercial borrowing*' ("**ECB**") regulations contain restrictions that investors have historically found problematic. Although there has been some easing of the ECB regime on January 16, 2019, as a result of which international funds now qualify as permitted lenders (which was not the case earlier), a number of difficult issues remain such as caps on the cost of debt (meaning that the proper price of risk is still an issue) and the end-use restrictions amongst others. Therefore, direct lending under the ECB regime may still be unattractive to international investors in many cases.

Participation in the Indian debt market by international lenders is still restricted by Indian exchange control laws and restrictions on the capital account convertibility of the Indian rupee.

However, there are certain workarounds which utilize the limited exceptions to the ECB regime and other routes that the RBI has permitted to facilitate debt trading and some limited forms of lending, i.e., these exceptions permit lending and debt trading outside the constraints of the ECB regime.

Therefore, the first issue that an international investor will need to consider is the structuring of the most optimal 'route in' to the Indian market. This determination will be driven by a number of factors including: (a) its objectives (e.g., does the investor want to lend, to invest in equity linked securities along with debt securities, or to simply acquire an existing debt portfolio); (b) its willingness to satisfy Indian legal set-up requirements (i.e., does the investor have the appetite to set up a long-term platform for investment into India); and (c) whether or not the investor has local partners to help source and execute transactions in India.

The larger and more organized international investors that are active in the Indian market have invested the time and effort in setting up platforms with multiple limbs as discussed later in this article.

Non-Indian Rupee-Denominated Exposure

Many international investors start by seeking opportunities in dollar (or non-rupee) denominated debt to avoid the need to price in the expected depreciation of the rupee. Non-rupee lending more readily facilitates the benchmarking of the expected returns in India against investment opportunities elsewhere in the world.

Restrictions on Non-Rupee Denominated Debt

Indian exchange controls make it difficult to achieve the benefits of non-rupee denominated lending because, if the borrower is an Indian company, the debt will be subject to the ECB rules.

Apart from lending to, or acquiring the debt of an Indian borrower, an international investor could also seek to lend to or acquire the debt of an offshore affiliate denominated in dollars (or any other international currency). However, exchange control requirements might still apply. For instance, a pledge of Indian shares to secure the offshore lending is permitted, but the dollar funds cannot then flow into India (and RBI approval will be needed to create the pledge if the lender is not a bank). Other forms of security can be considered but, depending on the relationship between the borrower and the Indian group, various restrictions apply. Broadly speaking, the provision of security or credit support by an Indian company to secure the borrowing of an offshore affiliate is problematic.

Hedging by the Borrowers

The ECB regime requires that borrowers of foreign currency denominated loans under the ECB regime hedge 70% of their exposure (where the average maturity of the debt is under five years), effectively increasing the cost of debt by the hedging costs.

Hedging by Lenders

In 2015, the RBI permitted the issuance by Indian companies of rupee-denominated but dollar hedged bonds known as '*masala bonds*'. Although there was initial market interest in these instruments, the RBI subsequently imposed a number of conditions which have made them more difficult to use. It remains to be seen if these become more popular following the changes to the ECB policy on January 16, 2019 announced by the RBI.

Rupee Exposure

There are certain exceptions to the ECB regime that can be used by international debt investors to participate in the Indian market free from the problematic restrictions of the ECB regime.

If the investor is seeking to simply gain access to distressed debt portfolios, the most common way of achieving this is by investing in securitized instruments known as security receipts ("**SRs**") issued against non-performing loans acquired by debt aggregation vehicles known as '*asset reconstruction companies*' ("**ARCs**"). Alternatively, investors can make equity investments in Indian shadow banks, known as non-banking finance companies ("**NBFCs**"), that aggregate loans. The former is more common and advantageous. Synthetic exposure may, in certain circumstances, also be possible, subject to certain restrictions.

If, on the other hand, the goal is to lend, then there are only a few routes to achieve this, which operate as exceptions to the debt restrictions discussed above. The main possibilities are subscription to straight bonds known as '*non-convertible debentures*' ("**NCDs**") (although the RBI's concentration rules have made this more difficult as discussed further below) or establishing an '*alternative investment fund*' vehicle ("**AIF**"), which is permitted to subscribe for debt instruments.

The various possibilities are discussed further below.

The 'FPI Route'/'ARC Route' to Acquire Rupee-Denominated Debt

If the strategy is simply to acquire an existing rupee-denominated distressed debt portfolio (rather than to lend), then a commonly used technique is to invest in SRs issued by an ARC against portfolios of distressed debt acquired by them. This route has continued relevance even after the easing of the ECB regime in January 2019.

FPI registration

This route requires the investor to register as a '*foreign portfolio investor*' ("**FPI**"), which is a type of investor registration regulated by the Securities and Exchange Board of India ("**SEBI**") (although the registration process is dealt with by local banks known as depositary participants).

Tax structuring considerations

The other factor relevant to FPI registration is tax structuring. A new investor will want to factor tax structuring into its timetable.

> **Historically, attempts at reorganizations led by banks have been disorganized, with investors being provided with insufficient information and stop-start processes with no clear timelines.**

Withholding on interest on the SRs can be expensive and range from 20–40%, but investments routed through treaty jurisdictions can benefit from preferential treaty rates. For interest withholding, jurisdictions such as Mauritius, Luxembourg, UAE, Ireland, and Hong Kong all offer favorable treatment (although for Hong Kong, at the date of publication, the treaty has not yet come into force). There is also still uncertainty as to the tax treatment of any redemption premium. In this regard, the taxability of capital gains may also be of relevance and other jurisdictions have more favorable capital gains treatment under their treaties, e.g., Netherlands and France.

The choice of jurisdiction is not normally based on the treaty treatment alone. The general anti-avoidance regime in India means that the fund will need to have genuine substance in the relevant jurisdiction. This factor, along with the need for there to be local registration (as discussed above), means that a better way to approach this would be to start with the jurisdictions in which the fund has a meaningful presence and then triangulate which of those jurisdictions is optimal.

Practical issues in dealing with ARCs

There are a small number of ARCs relative to the market size and an even smaller sub-set of them are well-capitalized. Therefore, most international funds must deal with a small sub-set of market participants who act as '*gatekeepers*'.

Apart from difficult conflict of interest related issues and the leakage of fees to the ARCs, other challenges may arise. For instance, the RBI rules require ARCs to hold at least 15% of the SRs that they issue. Therefore, an international investor cannot gain exposure to the entire distressed debt portfolio acquired by a third-party ARC.

Further, particularly in light of the tight funding conditions prevailing at the date of publication of this article, many ARCs do not have the funds to acquire the 15% holding interest. Market participants have evolved various funding models, but these are largely untested from a regulatory standpoint.

Use of NBFCs to Lend in Rupees or Acquire Rupee-Denominated Debt Portfolios

NBFCs, although regulated, are not treated as banks and are permitted to lend and to acquire distressed debt portfolios. Over the past few years, NBFCs have emerged as a key source of credit, particularly in relation to highly leveraged (although perhaps not distressed) borrowers in India. However, these NBFCs are now facing their own funding issues in the wake of recent defaults by IL&FS, one of the largest NBFCs in India, but the main considerations as far as international investors are concerned are set out below.

Historically, it was possible for FPIs to lend to NBFCs in the form of straight bonds known as NCDs. These proceeds were used to fund on-lending by the NBFCs. However, this route is now more difficult to use as recent investment limits on each tranche and concentration rules make it difficult for most funds to lend to NBFCs. The alternative is for an investor to fund an NBFC by investing in its equity. This has become easier as historic minimum capitalization requirements from a foreign direct investment perspective have been removed, as have the limitations on the activities that NBFCs with foreign investment can undertake. However, distributions from an NBFC to overseas investors by way of dividend is tax inefficient as they are subject to tax leakage of 20.56% at the Indian company level (and this cannot be mitigated through the use of tax treaties).

Additionally, NBFCs also have certain concentration norms which may, depending on the circumstances, apply. This may make their usage challenging in larger deals, so NBFC lending will then need to be combined with lending under other permitted routes.

Therefore, if an investor is willing to set up a more permanent structure to lend in rupees or to acquire debt before it is distressed, then an NBFC structure will be relevant. However, if the intention is to use NBFCs simply to aggregate distressed debt, they may not necessarily be the best vehicle to do so. Therefore, this is not a commonly used route for international funds other than a few funds who have a long-term strategic interest in India.

Rupee Lending Through Domestic High Yield Bonds
Until early in 2018, it was common for foreign investors with an FPI registration to subscribe to NCDs issued by Indian companies (as opposed to by NBFCs, as discussed above). The RBI had treated these as falling outside the ECB restrictions and a large market in these instruments emerged, subject to certain aggregate market capacity restrictions.

However, this market quickly reached the aggregate issuance capacity cap imposed by the RBI. The RBI addressed this, but then also imposed a more problematic set of restrictions in April and May 2018, restricting the exposure of any investor (and its group entities) to no more than 50% of any tranche of NCDs. This means that entirely 'captive' lending arrangements are not possible and that the FPI will need to syndicate out half its exposure. More significantly, any single international investor (or its group) cannot have exposure to any borrower exceeding 20% of its overall FPI exposure, which makes it difficult for the newer funds without large portfolios to use this route. Therefore, unless the ongoing RBI consultation (which proposes the replacement of these restrictions with 'voluntary' holding commitments by FPIs) leads to a change, the use of NCDs may not be viable for every fund.

Rupee Lending Through Convertible Instruments
Subject to foreign direct investment regulations, international investors can freely invest in instruments that compulsorily convert into equity because the RBI does not view these as debt. Any instruments that optionally convert into equity are treated by the RBI as debt and are subject to the ECB requirements.

The period of compulsory convertibility is lengthy (up to 30 years for infrastructure companies and up to 10 years for other companies), so if an investor intends to hold the instrument only for a short time period, this could be used to make a debt investment if no other routes are available. Also, compulsorily convertible instruments present a useful way for special situations investors to seek the upside of any revaluation of any distressed borrower if it emerges from its distressed situation and can also be useful to achieve '*loan to own*' structures.

Lending Through Alternative Investment Funds or a Foreign Venture Capital Investment Registration
The issues with the lending techniques set out above have resulted in some creative structures to facilitate lending outside of the regulatory constraints of the ECB Regime and the recent issues that apply to NCDs. Although not conceived as lending vehicles, pooled investment vehicles known as AIFs, that are registered with the SEBI, have been used to facilitate rupee lending by international investors free from the constraints of the ECB regime which remain. While there is no express restriction on these entities being captive vehicles, involving local partners or co-investors would help preempt any potential objection from the SEBI.

The permitted holdings by AIFs depend on the category of registration sought, but historically, a number of the more established distressed platforms in India have been registered as '*category 2*' AIFs, meaning that they can invest primarily in instruments issued by unlisted companies (including debt securities where the fund is set up as a debt fund) without leverage and cannot have any 'single name' exposure greater than 25% determined by reference to its investible funds.

A similar (but less common) technique involves the international investor procuring a '*foreign venture capital investor*' ("**FVCI**") registration. This registration, which takes approximately six to eight months to procure, allows the foreign investor to subscribe for optionally convertible debentures. However, there are some disadvantages as compared to AIFs. For instance, FVCIs are required to invest two-thirds of their funds in unlisted equity or equity-linked securities and the remaining one-third can be invested in debt. Since equity-linked securities includes optionally convertible instruments, this would allow for complete debt allocation if properly structured. However, this has not been commonly used to structure debt funds, as it is unclear whether a pure-play debt strategy would be viewed by the SEBI as being '*venture capital*' and also because FVCIs are only permitted to invest in certain permitted sectors of the economy (no such restriction applies to AIFs).

Use of Derivatives to Gain Exposure to Indian Distressed Debt Portfolios

Investors can also explore synthetic solutions to gain exposure to Indian debt. There are various regulatory issues involved (as discussed further below) and hence these structures are more likely to be a short-term solution for international investors that have not had the time to secure an FPI registration in the event of a fast-moving opportunity, or that wish to 'test' the Indian market before establishing a long-term structure.

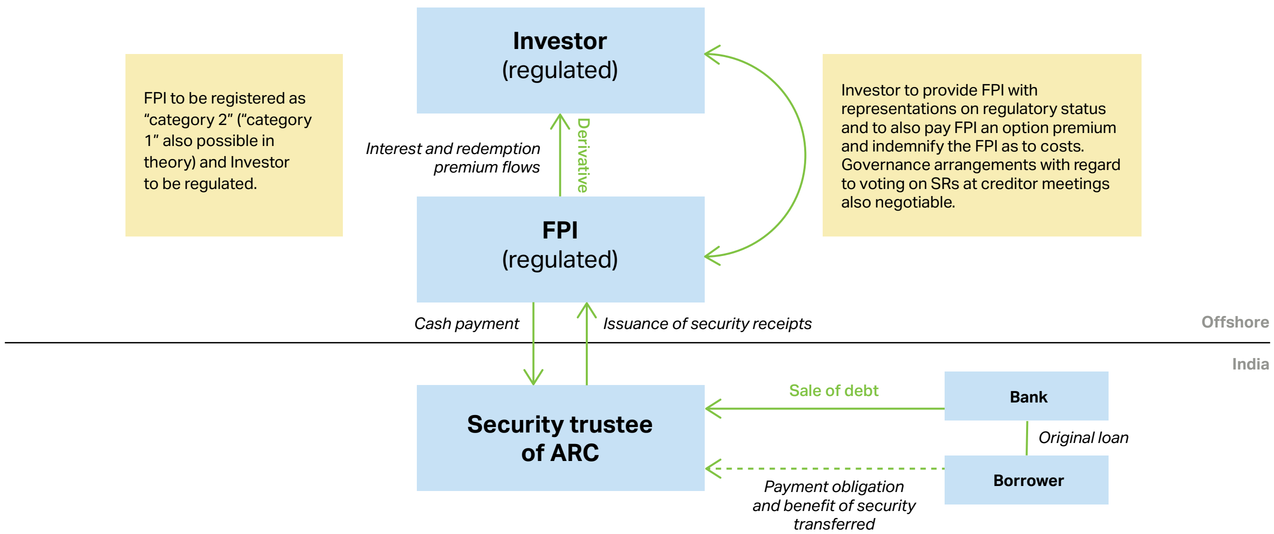
This route involves a category 2 FPI issuing '*offshore derivative instruments*' against acquired debt to an international investor. The international investor will need to be regulated and the issuing FPI will want representations confirming this. Negotiation of these representation letters can take time and that should be factored into any timing expectations. The FPI regulations refer to indirect interests as well, so funds participating through a multi-layered derivative structure will still need to consider this carefully. Various disclosure obligations also arise.

In the past, many promoters have extracted value from their companies at the expense of shareholders and creditors. In this regard, there is value in securing related party transaction restrictions, robust information rights and working with a trusted local partner who can carefully monitor investments.

The other issue that is topical in relation to these derivative structures relates to the withholding treatment on interest or any other returns on the investment received by the FPI. The focal point is whether the offloading of exposure by the FPI through derivatives will affect its ability to retain any favorable tax treaty treatment. For instance, certain treaties require that for the treaty provisions to apply, the recipient must be the beneficial owner of such interest. The structure also needs to be robust enough to withstand a challenge under the Indian general anti-avoidance rules.

Currently, there are no easy answers to these issues and much will come down to the specific details of what is proposed and various deal specific factors. FPIs sometimes seek tax indemnities, passing on the ultimate risk to the funds investing in the derivative instruments. Therefore, it is critical that such funds form an informed view on any tax risk and factor in any incremental tax leakage into their financial modeling.

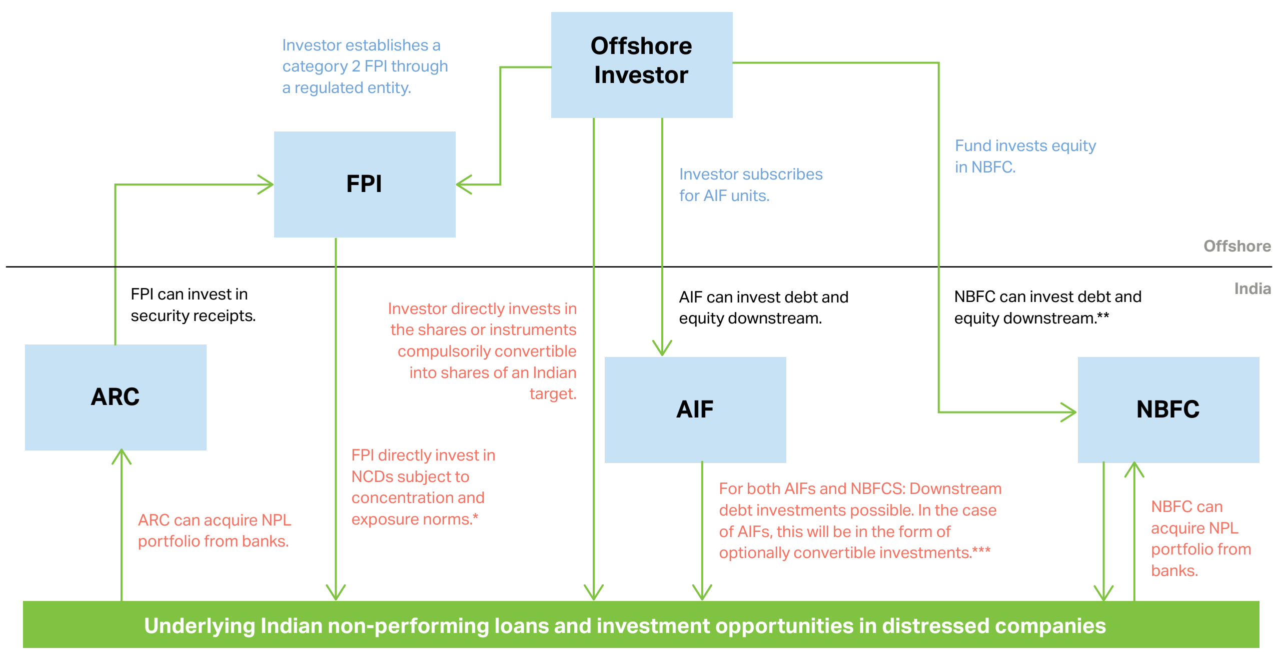
Illustration of the Derivative Structure



Diversified Approach

Although this may not be appropriate for international funds participating in the Indian market opportunistically, funds with a longer-term interest in the Indian market have set up diversified platforms that allow them to come at opportunities from multiple angles. An example of the various possibilities is set out in the diagram below.

Illustration of a Diversified Investment Strategy



* No more than 50% investment in any NCD issuance and 20% per corporate exposure limits, although the RBI has published a recent consultation paper suggesting that it might in the future be prepared to move away from this to a voluntary retention regime.

** NBFCs can invest equity downstream too, but having received foreign investment, that will be subject to certain rules on "downstream investments". There may also be debt and equity concentration limits depending on the circumstances.

*** Category 2 AIFs cannot invest more than 25% of the investible funds in any one company and category 3 AIFs cannot invest more than 10% of the investible funds in any one company.

Summary of Routes In

Getting the structuring right is the critical piece in any distressed or special situations investment involving India. To help simplify the menu of choices, the table below highlights the main routes in and the key considerations in respect of each route.

Consideration	Mezzanine/high yield lending (INR)	Acquiring security receipts	Direct lending (USD)	Direct lending (INR) via NBFC	Direct lending (INR) via platform (AIF - category 2)	Derivative exposure
Concept	Investor secures FPI registration and invests in NCDs.	Investor secures category 2 FPI registration and invests in security receipts issued by the security trustee to an ARC.	ECB lending that is compliant with the RBI's rules. International investors will now qualify as permitted lenders.	Listed NCD holders have enhanced enforcement rights, but upon bankruptcy, a moratorium will affect this.	Investor sets up and invests in AIF, along with partners, and AIF invests in debt instruments.	Exposure to underlying Indian debt acquired by a category 2 FPI.
What is it used for?	Can be used to provide INR funding to Indian borrowers.	Cannot be used to lend; can only be used to gain exposure to distressed debt portfolios.	Can be used to provide dollar/non-rupee funding.	Broad usage in providing rupee financing.	High yield lending to as part of a '*platform*' structure.	This is used as a short-term solution to gain economic exposure to an Indian debt portfolio; it does not provide Indian borrowers with funding.
Security?	Due to exchange control considerations, the security is customarily in favor of a local security trustee. Listed NCD holders have enhanced enforcement rights, but upon bankruptcy, a moratorium will affect this.	Security will be in favor of a domestic security trustee. ARCs have enhanced enforcement rights, but upon bankruptcy, a moratorium will affect this.	If the loan is ECB compliant, then the overseas lender can take direct security over Indian assets. There may still be practical advantages to appointing a local security agent.	The NBFC will hold the security and any benefit will flow up to the investor via dividends (assuming it makes an equity investment into the NBFC).	AIF trust/LLP can benefit from security (provided the manager and sponsor of the AIF are resident, the AIF will be treated as domestic, even if the majority of its capital is from non-Indian investors).	No direct security, but subject to any tax withholding, the derivative holder will normally benefit from all flows, including as a result of security enforcement.
Key issues	The recent RBI concentration norms have made this much harder to use. However, the RBI has initiated market consultations on a replacement "voluntary" regime. Investors will need to monitor developments here.	The fact that it cannot be used to lend means that this may not be useful in all cases. Investors will need to negotiate robust investor protection rights with the ARC. Investors will need to diligence the ability of ARCs to fund their 15% SR holding requirement.	ECB funding is unlikely to be used often; the various restrictions make it unattractive. Hedging requirement on domestic borrower adds to the costs.	Useful for INR lending, but the investor will need to make an equity investment into the NBFC first.	100% captive AIFs, although not restricted, may create regulatory issues. Modified pass through treatment on tax (withholding of 10% applies to foreign unit-holders, unless the relevant tax treaty provides otherwise, in which case the treaty rate will apply).	Investor will need to be regulated.
Pros	Commonly used. Simple way of lending. Flexibility as to terms and end use of funds.	Commonly used. SRs are liquid instruments.	Allows for direct security. Dollar lending protects against FX depreciation risk.	NBFCs can participate in a broad range of financing activities.	Increasingly being considered by international investors. Flexibility as to investments. Provided the manager and sponsor are resident, capital is treated as domestic.	Provides a short-term solution for investors who want to "test" the market without the time and expense of setting up investment platforms or seeking investment registrations.
Cons	Returns are in INR and therefore exposed to exchange rate volatility, which then needs to be priced in. Recent concentration and diversification requirements make this more challenging for new investors, although as indicated above, the position here may evolve.	Cannot be used for new lending. No direct "seat at the table" for investors in creditor committee meetings in bankruptcy. Value leakage because of fees passed on to the ARC. There are a limited number of ARCs serving the needs of multiple debt investors. This can cause practical issues. In the current market, not all ARCs are able to fund their 15% holding requirement.	Conditions are extremely onerous and make its usage unattractive, e.g., cap on the cost of debt and end-use restrictions.	Investors will need to invest equity into NBFCs to gain exposure and suffer dividend tax leakage on their returns.	Will take 3-4 months to set up and finding local managers and sponsors mean that this is more suited to investors with a long-term interest in India.	Position with regard to taxation is currently evolving. Investor will need to be regulated and certain disclosure requirements will apply. Negotiating the representation letters with the FPI counter-party may take time.

Undertaking Distressed Investments

In addition to entry routes, an international investor will also need to consider its investment strategy and which of its techniques can be replicated in the Indian market. The answer to those questions will depend, in part, upon the stage at which the investment is contemplated and what the overall investment objective is.

Pre-Insolvency Investment
The primary advantage of investing prior to the commencement of formal insolvency proceedings is that the process is often a privately negotiated arrangement (although it is also possible to restructure debts through a court approved scheme), with a lower probability of litigation as compared to the highly litigated bankruptcy environment.

Securing lender cooperation
The initial issue that any investor will face is securing lender cooperation. For instance, securing any changes to the security package or any variation of lender rights as part of a restructuring will need the consent of the other lenders. Historically, outside of project finance and a few other transactions, inter-creditor agreements have not been common in the Indian market. Further, legacy lender forums aimed at collective action, such as the '*joint lender forum*', have not proved to be effective. Recently, a number of banks agreed a standard inter-creditor agreement to deal with distressed and special situations. The effect of this remains to be seen, and two concerns remain.

First, the terms of the standard inter-creditor agreement have been criticized by ARCs. Although ARCs can accede to the agreement, the agreement restricts them from selling their exposure to other ARCs. Since ARCs are an active part of the Indian distressed eco-system, this remains a gap.

Second, the jury is still out as to whether this will change the behavior of the public sector (i.e., state owned) banks which dominate the Indian banking system. Historically, attempts at reorganizations led by banks have been disorganized, with investors being provided with insufficient information and stop-start processes with no clear timelines.

Cooperation with promoters/controlling shareholders
Pre-insolvency investments typically involve some degree of 'working together' with the promoters of the debtor company.

As the separation of ownership and management is often missing in India, diligence on the promoter (including from a reputational risk perspective) is as important as diligence on the underlying business or assets.

Second, in the past, many promoters have extracted value from their companies at the expense of shareholders and creditors. In this regard, there is value in securing related party transaction restrictions, robust information rights and working with a trusted local partner who can carefully monitor investments.

Third, it is important to ensure that the investment is structured so as not to rule the investor 'offside' in any future insolvency situation that may arise. For instance, under Section 29A of the IBC, being a 'promoter' of, or in the management or control of, an insolvent company may render the investor ineligible to participate either in the insolvency resolution process or in liquidation. The restriction also applies to concert parties and connected persons of the promoters. While there are certain carve outs to the ineligibility rules in relation to financial investors, an investor should still seek to mitigate the risk through careful structuring and by monitoring the health and affairs of the company in India (including through a local partner).

In this regard, a question that often arises is whether a minority shareholding combined with affirmative voting rights in relation to investor protection matters would put them in control of the corporate debtor. The Supreme Court in *Arcelor Mittal India Private Limited v Satish Kumar Gupta* (the "**Essar Judgment**") has clarified a number of principles. The Supreme Court indicated that it would be willing to pierce the corporate veil to ascertain the true identity of those in control, but held that control is to be determined on the basis of *de jure* and *de facto* control. The mere power to block special resolutions does not in itself amount to control but clearly a pattern of exercise of controls will be a concern. Also, even if an investor is itself not deemed to be in control of a borrower, it may still be treated as acting jointly or in concert with another party who is, so the concern is not entirely addressed.

Pre-insolvency transactions
The IBC has imported the concepts of preferential transactions, transactions at an undervalue and extortionate credit transactions from the United Kingdom, with provisions very similar to those in the Insolvency Act 1986 in England and Wales. Therefore, any restructuring (e.g., disposal of assets, restructuring any debt or alterations to the capital structure) in the shadow of insolvency will need to be considered from that perspective, with supporting independent valuation reports and expert advice, and other common-sense protections, being obtained.

With respect to restructuring through schemes of arrangement, as with England and Wales, the IBC states that undertaking a transaction pursuant to a court approved scheme does not in and of itself protect a transaction from being considered a preference (though the valuation requirements that apply to schemes in India offer some structural protection). There is no corresponding provision in respect of transactions at an undervalue, which suggests that such transactions may be relatively less prone to challenge if undertaken through a scheme.

Ability to enforce security and/or take control of a borrower

Under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act 2002 ("**SARFAESI Act**"), certain lenders including ARCs, qualifying NBFCs and debenture trustees of listed NCDs constitute '*qualifying lenders*', conferring on them enhanced debt recovery rights, such as the ability to enforce security without the involvement of a court and the ability to take control of the borrower (although the latter is rarely used). Lenders that are not qualifying lenders can, of course, enforce their security rights, but the process is likely to take longer.

Under the IBC, once an insolvency process commences, a moratorium is imposed upon creditor rights, including rights under the SARFAESI Act. Therefore, qualifying lenders will need to have initiated and completed their SARFAESI sales prior to the occurrence of an insolvency trigger (which may be difficult to achieve in practice if the investment is made when the borrower is already distressed).

Other techniques

Techniques used in other markets, such as debt-to-equity swaps and payments-in-kind, are possible in India but require the cooperation of the promoters, as preferential allotments of shares (i.e., non-pre-emptive issuances) need a special resolution (approved by 75%) of shareholders.

Investments as Part of the Insolvency Process

Participation in the process

The IBC introduces a cash flow test of corporate insolvency, i.e., a corporate debtor defaulting on a debt of at least INR 100,000 (approximately USD 1,393) which, once triggered, allows management, operational or financial creditors to trigger an insolvency process. During the pendency of the corporate insolvency process, there is a moratorium in relation to claims and litigation against the corporate debtor. An insolvency resolution professional manages the corporate debtor and seeks to resolve the debtor's position, usually by inviting bids for '*resolution plans*' that must be approved by 66% by value of the financial creditors and then approved by the National Company Law Tribunal within a period of 180 days (extendable by a further 90 days).

International investors can participate in this corporate insolvency process either as bidders (or by providing funding to bidders) or as creditors on the creditor committee. Given the exchange control restrictions set out above, many international investors have only indirect access to creditor committees through SRs or offshore derivative structures. The governance rights negotiated with the holder of the ARC or the holder of the debt may provide some comfort on recovery strategies that the ARC pursues in the committee meetings and information access.

Creditor recoveries

The law on creditor recoveries in India is still evolving. Although there have been various judgments dealing with certain aspects of this (for instance, the *Binani Industries* judgment), there still remain a number of areas of uncertainty. The market is currently awaiting the outcome of a current case being heard before the Supreme Court (the *Swiss Ribbons* case). This judgment, that is expected in early 2019, may provide the answers to certain open questions. In any event, investors will need to seek advice on the most current case law before making an investment.

Claims unaffected by the moratorium

Lenders will also want to consider the availability of personal guarantees issued by promoters or other persons. Following a recent ordinance and decision of the Supreme Court, third-party guarantees remain unaffected by the moratorium and lenders can, therefore, enforce their rights in this regard.

Liquidation Possibilities
The corporate debtor is subject to compulsory liquidation if the insolvency process fails. This presents an interesting investment opportunity. It is currently not possible to '*cherry pick*' assets in an insolvency process under the IBC. However, that possibility certainly exists in liquidation. Also, the liquidation valuation of assets may be considerably lower than in the resolution process. However, the practicalities of a liquidation process mean that this is still new and difficult territory. An investor may therefore benefit from the experience of a local partner.

Closing Thoughts

Although the macro picture in relation to distressed debt opportunities in India is undoubtedly compelling, translating that into an Indian investment portfolio requires time and effort.

That said, international funds considering the market should not be unduly concerned as to the issues discussed in this article. Other emerging markets have exchange controls and similar practical issues with state run lenders. India has imported an English style insolvency regime which has had decades to develop and is testing it in an accelerated manner in large and complex insolvencies. It is therefore unsurprising that there are some teething issues.

Partly as result of the high levels of interest in India by international debt funds and other market participants, solutions are emerging to some of the access issues as highlighted in this article and the market is growing in sophistication. The judiciary has also been broadly supportive of the new insolvency regime and the regulator, the Insolvency and Bankruptcy Board of India, is willing to engage with the market. Therefore, for international funds that are willing to invest the time and effort in understanding the market and that are able to find the right local partners and advisers, the Indian market remains an exciting one. ■

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Insolvency Professionals Under India's New Insolvency Regime

By **DHANANJAY KUMAR** *and* **GAUTAM SUNDARESH**

The profession and the regime for insolvency professionals in India came into existence following the enactment of the new Insolvency and Bankruptcy Code 2016 ("**IBC**") in late 2016.

The adoption of the IBC has resulted in a shift away from a debtor-in-possession rescue regime to one that is largely creditor-run, pursuant to which insolvency professionals take control of a financially distressed company as part of the resolution process and coordinate its management and operations in tandem with its financial creditors. Today, there are over 2000 insolvency professionals registered with the Insolvency and Bankruptcy Board of India ("**IBBI**"). In this article, we discuss the role of insolvency professionals in undertaking both the resolution and liquidation processes contemplated under the IBC, as well as the practical issues and hurdles affecting the insolvency professional regime during the nascent stages of its implementation (including from the point of view of distressed debt investors and potential acquirers).

The Regulatory Framework: The IBC

The IBC now constitutes the primary framework for the insolvency resolution of Indian companies (other than to the limited extent that the Companies Act framework still provides for winding-up of companies, as discussed in more detail below). Apart from providing for the resolution process itself, the IBC also provides for and regulates the liquidation (voluntary and involuntary) of companies and LLPs.

Under the IBC resolution process, a committee of creditors ("**CoC**") comprising all the unaffiliated 'financial' creditors of the corporate debtor is constituted to vote on significant decisions relating to the day-to-day operations, and on the resolution process, of the company. The meetings of the CoC are presided over by the insolvency professional appointed for the debtor. In addition, the items to be deliberated upon in such meetings are also proposed by the insolvency professional.

DUAL REGIMES: THE INDIAN COMPANIES ACT

— It is pertinent to note that the winding-up regime under the (Indian) Companies Act continues to exist and is available in respect of certain equity-based triggers. Thus, there theoretically continues to exist a dual insolvency regime for corporate debtors in India.

— However, the Companies Act regime does not infringe upon the sanctity of the process or the jurisdiction of the insolvency courts constituted under the IBC in respect of insolvency proceedings that are triggered based on the default test (default in repayment obligations of INR 100,000 or above), except in situations where a winding-up order has already been passed prior to the commencement of the proceedings under the IBC.

— It is also relevant to note that the Companies Act now also contemplates the appointment of insolvency professionals as the liquidator of the company in a winding-up.

Roles Played by Insolvency Professionals Under the IBC Framework

Insolvency professionals in India wear many hats. Their roles under the IBC can be divided on the basis of statutorily designated functions during the resolution and liquidation processes. For the purposes of a resolution process, insolvency professionals act as: (i) interim resolution professionals; and (ii) resolution professionals. In addition, during a liquidation process, insolvency professionals also play the role of liquidators of the corporate debtor.

Interim Resolution Professionals

Interim resolution professionals are usually appointed simultaneously with the admission of an application to initiate the corporate insolvency resolution process ("**CIRP**") in respect of a company under the IBC. The interim resolution professional undertakes the management of the company during the period between the commencement of the CIRP and the appointment of a full-time resolution professional by the CoC. The name of the interim resolution professional to be appointed is specified (mandatorily in the case of a financial creditor or company applicant, and optionally in the case of a trade creditor application—in which case, the IBBI recommends the interim resolution professional to be appointed) in the application for initiation of the CIRP. The interim resolution professional remains in office until the date of appointment of the resolution professional (which may be delayed, for example, by a challenge to the eligibility of the resolution professional sought to be appointed).

Resolution Professionals

The appointment of a resolution professional is approved by the CoC in its first meeting (by way of a majority vote of not less than 66% by value), approximately 30 days from the date of the commencement of the CIRP or soon thereafter.

The CoC has the option of reappointing the interim resolution professional as the resolution professional for the corporate debtor or to choose a different insolvency professional to be appointed as the resolution professional. If the CoC elects to appoint the interim resolution professional as the resolution professional, it is required to communicate its decision to the National Company Law Tribunal ("**NCLT**") (which is the court vested with jurisdiction under and relating to the IBC) along with the written consent of the interim resolution professional (in the prescribed form) demonstrating his/her willingness to be appointed as the resolution professional for the corporate debtor, pursuant to which the NCLT passes an order for the re-appointment of the interim resolution professional as the resolution professional for the company.

If it is decided to replace the interim resolution professional with another insolvency professional, any CoC member may propose the name of an insolvency professional to be considered for appointment. The CoC would then have to vote in favor of the appointment of such person by the requisite majority, and is required to communicate its decision to the NCLT, which in turn, is required to forward the name of such proposed resolution professional to the IBBI for its confirmation. The NCLT is authorized to appoint such person as the resolution professional of the debtor upon receiving the confirmation from the IBBI. However, if this confirmation is not received within a ten day period (from the date the name is forwarded by the NCLT to the IBBI), the NCLT is statutorily obligated to direct the previously appointed interim resolution professional to continue to function as the resolution professional of the debtor until such time as the IBBI confirms the appointment of the new resolution professional.

Further, the IBC also accords the CoC the right to replace the resolution professional appointed by it with another resolution professional at any time during the CIRP of the corporate debtor. This appointment is also required to be approved by the NCLT and is subject to the confirmation of the proposed resolution professional by the IBBI. All applications submitted to the NCLT for the approval of the appointment of the relevant interim resolution professional/resolution professional are liable to be dismissed in case there are any disciplinary proceedings pending against the relevant insolvency professional.

Similarly, a resolution professional may, with his/her consent, be re-appointed by the NCLT as the liquidator of the corporate debtor if the company enters liquidation, unless there are

circumstances (such as pending disciplinary proceedings in relation to the relevant resolution professional) which require the NCLT to appoint a different insolvency professional as the liquidator.

A company proposing its voluntary liquidation is also required to appoint a liquidator (who has to be qualified as an insolvency professional under the IBC).

ELIGIBILITY OF RESOLUTION PROFESSIONALS

— Prospective insolvency professionals are required to pass an examination conducted by and to be registered with the IBBI and are also to be enrolled with an insolvency professional agency that is recognized by the IBBI.

— Eligibility to apply for registration as an insolvency professional is restricted to individuals that are resident in India (a non-citizen is eligible for membership if he/she is a partner or director of an '*insolvency professional entity*' ("**IPE**")), and grounds for ineligibility include being a minor, an undischarged insolvent or of unsound mind; or having a conviction for an offense involving moral turpitude which results in imprisonment for a period exceeding six months (subject to certain mitigating factors which have been prescribed).

— Further, insolvency professionals are prohibited from engaging in any alternative employment while holding a valid certificate of registration.

Duties and Powers

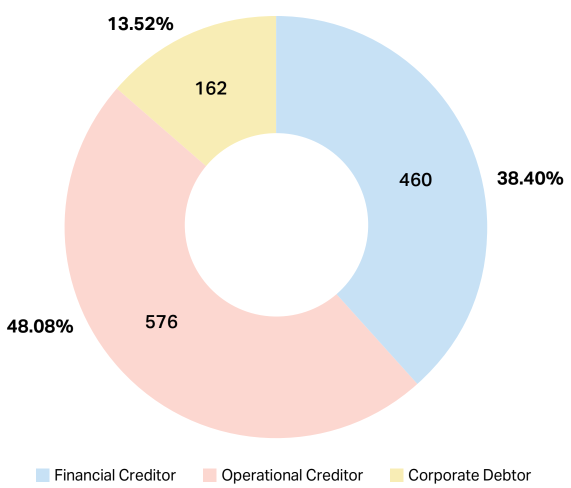
Interestingly, the IBC does not provide for specific duties to be owed by interim resolution professionals or resolution professionals to creditors of the company. However, as per a recent decision of the National Company Law Appellate Tribunal ("**NCLAT**"), it has been clarified that the objective of an insolvency resolution process under the IBC framework is the overall resolution of the corporate debtor and the maximization of value of assets of the company for the benefit of all of its stakeholders. In addition, in one case, a bench of the NCLT equated the resolution professional with a 'public servant' and clarified that the CoC is to perform the function of an 'instrumentality of the state', and that their duties/performance should be scrutinized by courts accordingly. Further, although the interim resolution professional/resolution professional is obligated to take over the management functions of the board of directors of the corporate debtor pursuant to the initiation of a CIRP against the company, the fiduciary obligations of directors have not been extended to insolvency professionals. While the powers of the board of directors of the corporate debtor stand suspended upon the commencement of the CIRP, the powers of the shareholders are also effectively suspended, as the approval of a resolution plan does not require the consent of the shareholders.

For ease of understanding, the duties of insolvency professionals under the IBC have been segregated into their duties in the capacity of: (i) interim resolution professionals; (ii) resolution professionals; and (iii) liquidators, as set out below:

Interim Resolution Professionals

The duties imposed on interim resolution professionals under the IBC are specific to the role they perform during the 'transitory' phase (as mentioned above), before the full-time resolution professional is appointed for the company. Most significantly, in line with the shift away from the debtor-in-possession regime, the management of the affairs/assets and the powers of the board of directors of the company immediately vest in the interim resolution professional upon his/her appointment by the NCLT. Consequently, the officers and managers of the corporate debtor, and financial institutions maintaining the accounts of the corporate debtor, are required to act on the instructions of the interim resolution professional and to provide him/her all the necessary details, information and access. The primary duty of an interim resolution professional is to take such actions as are necessary to keep the corporate debtor as a going concern. Interim resolution professionals are also empowered to act and execute any documents/deeds/receipts in the name of the company, and they also have the obligation to ensure that the company complies with requirements under applicable law during its operation.

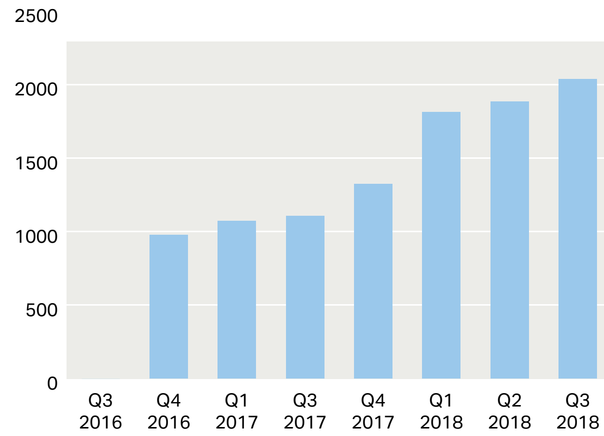
Who is Using the Code?
(as of September 2018)



Source: IBBI, Quarterly Newsletter July 2018 – September 2018

Interim resolution professionals are also required to constitute the CoC, to receive/collate claims submitted by various creditors and to collect information relating to the assets, finances and operations of the corporate debtor. Further, interim resolution professionals are required to take control of all assets over which the debtor has any ownership rights (including shares held by the corporate debtor in its subsidiary companies—but not including any of the assets of the subsidiary companies, as was clarified by the appellate court under the IBC). It is also important to note that the interim resolution professional is bound by the terms of the moratorium instituted against the corporate debtor, including the prohibition on transfer or disposal of any assets, legal right or beneficial interest by the corporate debtor during the CIRP period.

Number of Registered Insolvency Professionals



Source: IBBI, Quarterly Newsletter October 2016 – September 2018

Interim resolution professionals are also empowered to carry out specific functions, in order to protect and preserve the value of the corporate debtor and its assets, and to manage its operations as a going concern. For performing these duties, interim resolution professionals are permitted to appoint professionals, including accountants and lawyers, to enter into/modify existing contracts or transactions on behalf of the company and to raise super-priority finance for undertaking the CIRP.

Resolution Professionals

As the role/functions of resolution professionals come into play during the substantive part of a CIRP, they have a wider and more significant range of duties to perform (than do interim resolution professionals). Resolution professionals are required to conduct the entire CIRP and manage the operations of the company during the CIRP following their appointment. The IBC includes a specific deeming provision that provides that resolution professionals are to exercise all the powers and perform all the duties as are vested or conferred upon interim resolution professionals under the statute.

Similar to interim resolution professionals, resolution professionals also have the duty to carry out certain functions to preserve and protect the value of the corporate debtor, and to continue its business operations. Further, resolution professionals are required to maintain an updated list of claims of the company's various creditors, convene and attend all meetings of the CoC, file applications (before the NCLT) to reverse the effect of avoidable transactions and prepare an information memorandum to be issued to the prospective resolution applicants of the company. Resolution professionals are also required to appoint two '*registered valuers*' for the purpose of determining the fair value and liquidation value of the company. One of the most significant duties of the resolution

professional is the invitation and vetting of resolution plans submitted by resolution applicants. As mentioned below, the Supreme Court has recently clarified that the examination of resolution plans by resolution professionals is only to be done for purposes of the issuance of an opinion containing the *prima facie* views of the resolution professional, and that resolution professionals are not expected to make any binding determination in this regard.

There are also certain powers specified under the IBC which can be exercised by the resolution professional only with the prior approval of the CoC (these powers are not available to interim resolution professionals, however). These include, *inter alia*, the creation of any security interest over the assets of the corporate debtor, raising of interim finance in excess of CoC specified thresholds, effecting a change in the capital structure or ownership interest in the corporate debtor, undertaking related party transactions, amending constitutional documents of the corporate debtor, transferring rights or debts under material contracts outside of the ordinary course of business, delegation of one's authority and the disposal of shares of any shareholder of the corporate debtor to third parties. Further, resolution professionals are also permitted to enter into new contracts and modify existing contracts of the corporate debtor (for which the prior approval of the CoC is not required). Thus, from the above, it can be seen that while the role and duties of the resolution professional primarily pertain to managing the corporate debtor in a manner to keep it functioning as a going concern, resolution professionals are also permitted to undertake certain actions that were previously exercisable by the board of directors, to ensure the continuing operations of the company. On a separate note, while resolution professionals are constrained in their functioning by the restrictions created by the moratorium imposed under the IBC (as is the case with interim resolution professionals), certain actions are permitted to be undertaken in contravention of the moratorium, with the prior approval of the CoC (for example, the creation of security interests over the assets of the corporate debtor).

Inviting and Presenting Plans for the Insolvent Company
One of the most important duties performed by the resolution professional is in relation to effecting the resolution of the company. As per the IBC, the resolution professional is required to invite prospective resolution applicants, who meet the eligibility criteria prescribed by the CoC (usually pertaining to the financial and technical capability of the prospective resolution applicants), to submit resolution plans for the company. The resolution professional is also required to provide to the resolution applicants (who meet the eligibility criteria specified in the expression of interest issued by the resolution professional) all information in relation to the insolvent company that is relevant for the preparation of resolution plans by such persons. All such information is provided subject to the execution of a strict confidentiality undertaking and can be used by the resolution applicants only for the purpose of preparing resolution plans for the company. In practice, resolution professionals usually issue a '*process memorandum*' to the prospective resolution applicants, which sets out the entire process and timelines for submission of resolution plans. Typically, resolution applicants are provided a window to carry out legal and financial due diligence on the debtor. In order to protect against disclosure of sensitive information to non-credible bidders, it is usually required (under the terms of the process memorandum) that prospective applicants submit an earnest money deposit/bid bond prior to gaining access to the data room. It is relevant to mention that courts have been flexible when it comes to strict compliance with the process memorandum, so long as creditors are able to maximize their recoveries in a fair and just manner.

Once received, the resolution professional reviews the plans for compliance with the IBC and other applicable laws. One such aspect of compliance is eligibility of the resolution applicants under Section 29A of the IBC. Section 29A, introduced in November 2017, provides for wide-ranging disqualifications in relation to the types of persons/entities that are eligible to submit a resolution plan under the IBC. In brief, if the resolution applicant or any of its group companies has (anywhere in the world) been classified as a chronic/willful defaulter to banks or has been prohibited from the securities market or convicted of specified offenses, such resolution applicant may be disqualified from submitting a resolution plan. Practical difficulties of confirming 'worldwide' compliance with such requirements (many of which are not available in the public domain) aside, many resolution applicants have also been seen to challenge the determination by the resolution professional of their (or their competitors') eligibility under Section 29A, or the lack thereof. Quite a few high profile cases have been delayed on account of such challenges (for instance, the *Essar Steel* and *Ruchi Soya* cases). The scope of the resolution professional's duties in this regard have, however, recently been watered down by the decision of the Supreme Court in the landmark *Essar Steel* decision (passed on October 4, 2018). The judgment clarifies that the resolution professional is only required to provide his *prima facie* opinion regarding the compliance of resolution plans with applicable law (including with the Section 29A eligibility requirements). It has also been clarified that resolution professionals do not have the power to decide whether resolution plans contravene applicable law, but must only present their findings (preferably in the form of a due diligence report) to the CoC in this regard (the decision being required to be taken by the CoC instead). It will not be out of place to mention that in July 2018, the IBBI amended the relevant regulations to provide for a time-bound mechanism of testing the eligibility of resolution applicants, including by giving the other suitors for the company a chance to present to the resolution professional any material in relation to ineligibility of their competitors.

The *Essar Steel* judgment has also brought about clarity on certain other issues in relation to the submission and assessment of resolution plans under the IBC. This includes the fact that the Section 29A disqualification is to attach and is required to be assessed as on the date of submission of the resolution plan; and as a corollary, that the ineligibility of a resolution applicant (relating to the disqualification of having an account that has been classified as a non-performing asset) can be cured only by repaying all overdue amounts (along with interest and relevant charges) prior to the submission of a resolution plan.

After having conducted such an examination, the resolution professional is required to present eligible plans to the CoC for its approval, and subsequently to the NCLT after the receipt of CoC approval. Typically, the resolution professionals do not prepare or negotiate the plans and this is left to the resolution applicants and the CoC, respectively.

Liquidators

The IBC provides that if during a CIRP, a plan is not approved within 180 days (extendable by another 90 days, subject to judicially created exceptions relating to the period of litigation), or if no plan is received, the company is required to be liquidated. This determination is made by the NCLT on receiving an application from the resolution professional of the company. As mentioned above, subject to the receipt of their consent, resolution professionals continue to function as liquidators for the company. In order to carry out and manage the distribution of assets under the liquidation process, the liquidator is empowered to take custody or control of all the assets, property, effects and actionable claims of the corporate debtor, and to take any measures required for the protection and preservation of its assets and properties. The liquidation estate constituted by the liquidator (comprised of all the assets owned by the corporate debtor) is managed and held by the liquidator in a fiduciary capacity for the benefit of all the creditors.

In order to equip the liquidator with the necessary powers to create the liquidation estate and distribute the assets constituting the estate, the IBC entitles him/her to, *inter alia*, invite, verify and settle the claims of all creditors and claimants, to conduct an evaluation of the assets and property of the corporate debtor and to take all actions or to sign or execute any documents (including, *inter alia*, applications, petitions, affidavits and deeds) that are necessary for the liquidation or the distribution of the corporate debtor's assets. For the purposes of managing the affairs of the corporate debtor during the liquidation process and to carry on the business of the corporate debtor for its beneficial liquidation, the liquidator is empowered to institute or defend any suits, prosecutions or other legal proceedings (whether civil or criminal) and to investigate the financial affairs of the corporate debtor and the occurrence of avoidable transactions in the past. The liquidator is also required to prepare and submit progress reports to the NCLT on the status of the liquidation of the corporate debtor on a periodical basis.

The liquidator is empowered to sell the immovable and movable property constituting the liquidation estate, as well as the actionable claims of the corporate debtor, by public auction or private contract, and also has the power to sell such property in parts. Further, by way of an amendment earlier this year, liquidators have been empowered to sell the corporate debtor as a going concern. This provides a second chance for the company to be taken over as a going concern, even following the failure of the CIRP initiated against it, contingent on it being able to sustain its business operations up to this point. However, to prevent misuse of this provision, the ineligibility criteria that are applicable to the CIRP process have also been made applicable to such liquidation sales.

Implied Duties

Insolvency professionals are governed under specific regulations issued by the IBBI along with a comprehensive code of conduct, which mandates the highest standard of care and integrity and prohibits any conflict of interest/partiality. While there is a specific prohibition on insolvency professionals taking up assignments in matters where the insolvency professional or any of his/her relatives, or any of the partners or directors of the IPE in which he/she is a partner/director, are in any way connected to the insolvent company or any of its related parties, the regulations and the code of conduct are not always clear. In interpreting the scope of these requirements, the courts can also be said to be implying certain duties in respect of insolvency professionals.

Accordingly, as the jurisprudence under the IBC evolves, the contours of the role of insolvency professionals continue to be defined. In a recent order, the NCLT expressed its displeasure with the fact that the resolution professional had undervalued the assets (in terms of their liquidation value) of the company and had outsourced work to a firm that he was associated with. The court stated that the IBBI may need to revise the applicable framework in order to prohibit such conduct by insolvency professionals (the specific remarks made and the costs imposed by the NCLT against the resolution professional were directed to be expunged by the NCLAT, however).

At the same time, courts are also being careful to ensure that insolvency professionals do not exceed their legal remit. In a recent case, costs of INR 50,000 (approximately USD 700) were imposed on a resolution professional by the NCLT for having acted in contravention of the provisions of the IBC and the code of conduct, by having attempted to reverse the decision of the CoC to reject the resolutions plans voted upon by it, by approaching dissenting lenders directly and seeking consent letters from them for the approval of the plan presented. In this case, too, the remarks made against the resolution professional were directed to be expunged by the NCLAT on appeal. In another such instance of determination of the scope of duties of resolution professionals by the NCLT, the resolution professional in question was reprimanded for not having taken the necessary actions to service the company's contractual obligations towards one of its biggest customers, which resulted in the termination of the contract.

The IBBI has also been proactive in regulating the conduct of insolvency professionals by issuing various circulars from time to time. For example, the IBBI, by a circular, has prohibited insolvency professionals from outsourcing work in respect of duties that are specifically required to be carried out by them under the IBC. Similarly, circulars have been issued mandating insolvency professionals to disclose their relationship with all the stakeholders involved in the CIRP (including the corporate debtor, the financial creditors, interim finance providers, prospective resolution applicants and other professionals appointed by the insolvency professionals); mandating transparency by insolvency professionals in the charging of fees and raising of invoices for services rendered; and requiring IPEs to publish compliance certificates containing the details of compliance of all insolvency professionals registered with them (with the requirements of the IBC and the regulations thereunder) on an annual basis. Further, the IBBI has specifically prohibited IPEs from being directly engaged to carry out the duties of an insolvency professional, and has also specified that insolvency professionals will be personally liable for any penalty suffered by the corporate debtor on account of non-compliance with applicable law (while under the management of the insolvency professional). The law does not currently provide for a cap on the liability of an insolvency professional for any actions taken by him/her, and this becomes a problem when members of the CoC are unwilling to approve liability insurance packages for the insolvency professional.

DISCIPLINARY PROCEEDINGS AGAINST INSOLVENCY PROFESSIONALS

— The possibility of insolvency professionals abusing their powers or overstepping their mandate is mitigated by the power accorded to the IBBI to initiate disciplinary proceedings against insolvency professionals.

— The IBBI may initiate such proceedings, either on a complaint received from any person or *suo moto*.

— It is significant to note that an insolvency professional who has been issued a show cause notice by the IBBI (pursuant to which disciplinary proceedings are initiated), is not permitted to accept any fresh assignment (whether as interim resolution professional, resolution professional or liquidator) until the completion of the disciplinary proceedings against him/her. Another safeguard in this respect is the power given to the CoC to replace or remove the concerned interim resolution professional/resolution professional at will.

— This power is currently not exercisable by the operational creditors and other stakeholders that do not qualify for membership in the CoC, however.

— At the same time, it is relevant to note that the IBC accords protection to all insolvency professionals for any actions taken by them in good faith.

Some Practical Issues

Despite several protections built into the statutory framework to enable and facilitate the functions of insolvency professionals, such professionals have, in a few cases, faced hurdles in the day-to-day management of companies undergoing a CIRP. In some instances, the workers, the suppliers, the promoters and the erstwhile management have refused to cooperate with such third-party professionals. This is especially true of companies where wages and salaries of workers have remained due for a long period of time, even prior to the commencement of insolvency. In cases where an official complaint is filed by the resolution professional regarding the non-cooperation by an officer of the company during the CIRP, the IBC provides for a penalty of imprisonment of between three and five years, and/or a fine of between INR 100,000 and INR 10 million.

Another major issue is having to work with incomplete information and records, and having to conduct extensive and time-consuming compliance checks and corrections, with the employees and personnel of the corporate debtor not being easily forthcoming with information. It is relevant to note that the July amendment to the relevant IBC regulations provide for tight milestone-based timelines for the insolvency professionals to follow during the CIRP. This includes an upper limit of ten days (from the date of receipt of expressions of interest from prospective resolution applicants) for the issuance of a provisional list of eligible prospective resolution applicants; and a further ten-day period (post completion of the five-day window for receipt of objections regarding non-inclusion in the provisional list) for the issuance of the final list of prospective resolution applicants. Further, the resolution professional is now also obligated to issue the information memorandum, evaluation matrix and request for resolution plan document to every prospective resolution applicant (including prospective resolution applicants who challenged the decision of non-inclusion in the provisional list) within five days of issuance of the final list of prospective resolution applicants. Another stringent timeline that has been introduced is the requirement for the resolution professional to form his/her opinion regarding the occurrence of any antecedent/avoidance transactions prior to the commencement of the CIRP on or before the 75th day from the insolvency commencement date. A final determination in this regard is required to be made on or before the 115th day, and an application to the NCLT seeking the appropriate relief is to be filed on or before the hundred and 135th day from the insolvency commencement date.

Considerations for Stakeholders Involved

Potential Acquirers/Distressed Asset Investors

Owing to the restricted and highly regulated role of insolvency professionals, potential acquirers and distressed debt investors may have to keep certain things in mind while opting to participate in an insolvency resolution process under the IBC. Some of the significant concerns include the fact that resolution professionals are not in a position to offer representations and warranties on behalf of the corporate debtor. This becomes a cause for worry for bidders who are accustomed to greater protections under the traditional mergers and acquisitions route. Resolution professionals are also usually unwilling to facilitate the transfer of existing approvals and licenses in the name of the successful acquirer, and this exercise is required to be carried out by the successful bidder itself. At a more fundamental level, another cause for concern for potential acquirers/distressed debt investors is that the insolvency professional profession itself is still in its nascent stages, and that the level of experience in the market may currently be inadequate given the complexity of the structures and operations of some of the companies undergoing a CIRP under the IBC framework.

Existing Creditors

Similarly, certain concerns may arise for existing creditors of the corporate debtor. These include the fact that insolvency professionals owe no express duty (whether fiduciary or otherwise) to creditors. Further, as it is the obligation of the CoC to appoint the interim resolution professional/resolution professional, it also becomes incumbent on the CoC to ensure that any allegation of bias is allayed during the term of appointment of the insolvency professional. ■

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CHAPTER 15 WATCH

Turning Back the "COMI" Clock: Key Trade-Offs in Proposed Revisions to Chapter 15

By **AARON GAVIN**

On August 20, 2018, the National Bankruptcy Conference—"a voluntary organization composed of persons interested in the improvement of the bankruptcy code and its administration"—sent a letter ("**NBC Letter**") to the Subcommittee on Regulatory Reform and the Committee on the Judiciary proposing several amendments to chapter 15 of the U.S. Bankruptcy Code.[1] Most significant of these proposed amendments is a recommendation to revise sections 1502 and 1517 of the Code to specify the relevant timing for court determinations of a foreign debtor's center of main interests ("**COMI**").

Under a chapter 15 proceeding, courts often look to a number of non-exhaustive factors in making a COMI determination, including the location of the debtor's headquarters, controlling managers, primary assets and major creditors as well as the jurisdiction whose law would apply to most of its disputes.[2] Successful COMI determinations arrive with notable benefits for debtors, including recognition of a foreign insolvency proceeding as the "main" proceeding and the effectuation of an automatic stay throughout the United States.

Although numerous courts have previously held that COMI should be determined at the time of filing a chapter 15 petition,[3] the NBC Letter follows the guidance of the United Nations Commission on International Trade Law ("**UNCITRAL**"), who drafted the model law on cross-border restructurings upon which chapter 15 is based, proposing that COMI should be determined at the time that a foreign proceeding is commenced.

This proposed change is somewhat controversial.[4] The NBC Letter has defended its proposed change by focusing on how shifting the timing of COMI determinations could create more uniform and predictable insolvency laws across all national jurisdictions. However, if adopted, some individuals have expressed concern that the practice of "COMI shifting"—that is, the decision by a debtor to shift its center of main interests to another jurisdiction before filing a chapter 15 petition in order to take advantage of that jurisdiction's restructuring laws—would become more difficult to achieve, especially because debtors often require immediate

assistance and may have insufficient time to shift COMI before filing for such relief.

In order to be properly prepared, creditors and debtors should carefully consider the full-range of benefits and drawbacks that will arise from concerns like these, as well as others, if this proposal is adopted by Congress.

Certainty and Uncertainty in Cross-Border Restructurings

The NBC Letter follows UNCITRAL in noting that one of the main rationales for anchoring COMI determinations to the commencement date of a foreign proceeding is to provide certainty and predictability for cross-border insolvency laws. This allows creditors and debtors to better anticipate how such laws will be applied and enforced across various national jurisdictions.[5]

The NBC Letter highlights two scenarios where anchoring the timing of COMI determinations to the chapter 15 petition date, instead of the commencement date of a foreign proceeding, could prove problematic:

- if the business activity of the debtor ceases after the commencement date (in which case it is unclear how the loss of this factor will affect a court's COMI determination);[6] and

- if the debtor no longer has a COMI at the time of the chapter 15 petition because a "reorganizing entity" has taken its place (in which case it is unclear whether courts will seek to determine the COMI of the debtor or reorganizing entity).[7]

Even if a change to the timing rules could help debtors and creditors achieve greater certainty over how courts will act in these scenarios, it is important to note that the current timing rules, which tie COMI determinations to the chapter 15 petition date, afford a different kind of certainty for debtors and creditors in anticipating how a court might generally rule. As the Second Circuit has noted, any kind of COMI analysis that requires a court to look back at the debtor's past interests or operational history, whether in general or at a specific point in time, could only "make it more difficult to pinpoint [a] single COMI" and might cause "a meandering and never-ending inquiry into the debtor's past interests,"[8] which in turn would make it more difficult for creditors and debtors to figure out what evidence the court will rely on to determine COMI. By focusing on the chapter 15 petition date (which occurs close in time to when the court makes its COMI determination), however, debtors and creditors might have a better idea about the contours of the relevant evidence, and thus the likely result, ultimately leading the various parties to avoid costly litigation over this issue.

In any case, creditors and debtors should recognize that no matter which timing rule is adopted, some uncertainty is likely to remain. In particular, anchoring COMI determinations to the commencement date will not necessarily allow creditors and debtors to anticipate how U.S. courts will determine:

- the COMI of multinational corporations or debtors with a wide international reach who have a strong economic presence in multiple jurisdictions; or

- the COMI of debtors who have multiple foreign proceedings each competing for recognition as the foreign main proceeding.

The fact remains that creditors and debtors cannot always anticipate how courts will decide such issues, which only underscores that disputes over COMI determinations are likely to remain.

COMI Shifting and Forum-Shopping

The NBC Letter further notes that anchoring a COMI determination to the commencement date promotes UNCITRAL's goal of ensuring that foreign proceedings are recognized "in a country where the debtor ha[s] a tangible economic presence."[9] By tying recognition to economic presence, the NBC Letter highlights how this timing rule might decrease the ability of a debtor to shift its COMI and shop for a forum or jurisdiction that is more favorable to its restructuring before filing a chapter 15 petition.

Reducing the likelihood of COMI shifting could be beneficial. It could create a greater sense of security among creditors in knowing that debtors cannot shift their COMI to achieve greater benefits in another jurisdiction and then seek implementation of those benefits in U.S. courts. In turn, this could increase confidence in lending and ease capital flows with direct benefits to both creditors and debtors.

[A] number of individuals have expressed concern about the possible end of COMI shifting, which could have negative effects not only for debtors but for foreign restructurings more broadly.

However, a number of individuals have expressed concern about the possible end of COMI shifting,[10] which could have negative effects not only for debtors but for foreign restructurings more broadly. Forum-shopping can be a net-positive for both debtors and creditors when a debtor shifts its COMI to a jurisdiction that allows for a reorganization plan that maximizes value and better serves the interests of all parties involved. In addition, because the current rules already check some of the unsavory aspects of COMI shifting by allowing courts to reject a debtor's attempt to shift its COMI if it is proven that the debtor "manipulated its COMI in bad faith," the current rules also provide a check against some of the unsavory aspects that may result from COMI shifting.[11]

Even if the proposed change is adopted, it is still somewhat unclear whether COMI shifting would end completely. Some debtors may attempt to shift their COMI well before filing any kind of restructuring proceeding, which means that the proposed change may be inconsequential for them. For example, in the recently decided *In re Ocean Rig* (2017),[12] foreign debtors shifted their COMI to the Cayman Islands to support their reorganization. Because their main business was in the Marshall Islands, which had no reorganization laws and only provided for the equivalent of chapter 7 liquidation, the debtors sought relief under Cayman reorganization laws. However, the debtors accomplished this shift not only before filing the chapter 15 petition, but also before filing for reorganization in the Cayman Islands altogether. Therefore, this kind of COMI shift would remain possible even after any change to the timing rules and as long as debtors plan ahead.

Uniformity vs. Flexibility

In noting that the U.S. timing rules are "not consistent with how UNCITRAL itself deems timing to function under the Model Law," the NBC Letter finally stresses that "the Model Law was promulgated in the first instance to promote uniformity of application around the world, a principle to which Congress subscribed in enacting section 1508."[13] Arguably, uniform law across all national jurisdictions is a good in itself, and could also aid in creating greater legal predictability, as well as increase confidence in cross-border lending, as described above.

However, with greater uniformity will also arrive a trade-off against the current system, which is quite flexible. While COMI determinations are currently measured against the chapter 15 petition date, judges are also able to disqualify any manipulative COMI shifts that occur in "bad faith." Together, this two-faceted test provides U.S. judges with a larger degree of discretion than a one-size-fits-all rule that requires COMI to be determined at the commencement date of a foreign proceeding. Indeed, it is not clear that the new timing rules would even account for "bad faith" COMI shifts that occur prior to the commencement of a foreign restructuring because this rule is a judge-made standard and the NBC Letter has made no recommendations about this key issue.

It will remain the responsibility of Congress to weigh any such trade-offs before deciding whether to revise the timing aspects of COMI determinations. In the meantime, creditors and debtors should be prepared and ready to understand the implications of this potential revision if it comes to fruition. ■

1. NBC Letter at 1. (Caps omitted). The NBC Letter is available at https://drive.google.com/file/d/1DIfvi1wP9vQHFugAk1rcsPChmhw6VDX1/view.
2. See *In re Fairfield Sentry Ltd.*, 714 F.3d 127 (2d Cir. 2013).
3. A number of courts have followed the lead of the Second Circuit in *In re Fairfield Sentry Ltd.*, 714 F.3d 127 (2d Cir. 2013), which is referred to below.
4. See Kyle J. Oritz, Sarah Denis and Rafael X. Zahralddin-Aravena, "NBC Proposes Revisions to Chapter 15 of the Bankruptcy Code," ABI Journal (October 8, 2018).
5. NBC Letter at 13.
6. Id.
7. Id.
8. *In re Fairfield Sentry Ltd.*, 714 F.3d 127, 134 (2d Cir. 2013) (Internal quotations and citations omitted).
9. NBC Letter at 15.
10. *Supra*, Note 4.
11. *In re Fairfield Sentry Ltd.*, 714 F.3d 127, 137 (2d Cir. 2013).
12. *In re Ocean Rig UDW Inc.*, 570 B.R. 687 (Bankr.S.D.N.Y.2017)
13. NBC Letter at 15.

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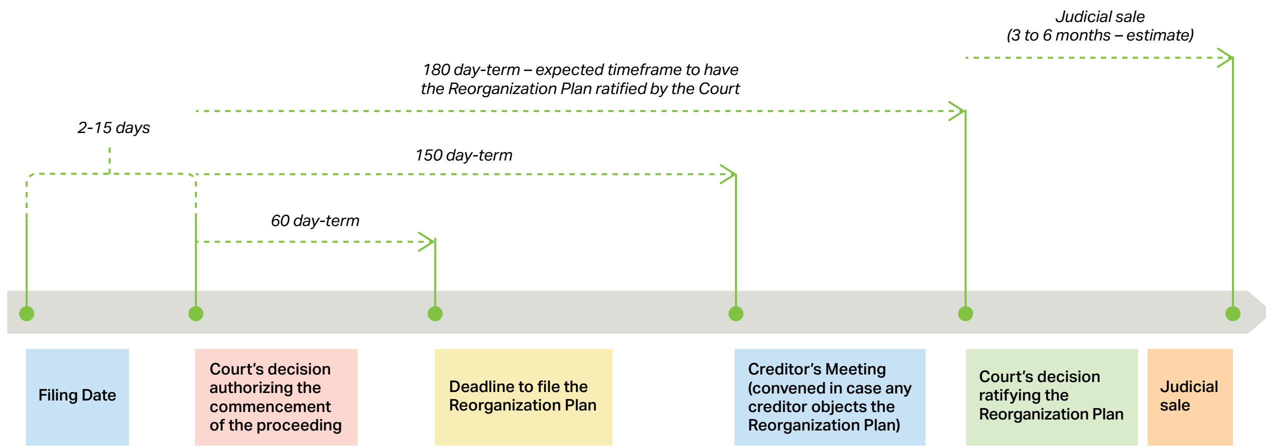
The Rise of *Precatórios*: Considerations and Recommendations for Investors in Brazilian Judicial Payment Orders

By RAPHAEL NEHIN CORRÊA *and* ANDRÉ MILESKI

Investments in what is known in Brazil as *precatórios*, judicial payment orders arising from debts owed by the states, municipalities, federal treasury and other governmental entities in Brazil, have seen a significant boost in recent years, sustained by the increased interest of financial institutions and local and foreign investors in those assets. The market for *precatórios* today has a potential value of more than 100 billion Brazilian Reais. The economic context in which this market has developed as well as the legal framework under which *precatórios* may be acquired are important for investors to understand when investing in those assets. This article highlights the main issues to consider when investing in *precatórios* and provides our general recommendations for mitigating the risks involved.

Timeframe – Sale of Assets Under Judicial Reorganization



Background

Due to the financial crisis and the corruption scandals that have affected, and continue to affect, the Brazilian economy, many companies in financial distress that hold *precatórios* and other legal claims against the Brazilian government, especially within the construction, infrastructure, energy, sugar and ethanol sectors, view the sale of those assets as a way to gain liquidity. From the investors' standpoint, such transactions require special caution and attention and must be carefully structured to avoid challenges from third parties and succession liabilities, as described below.

Out-of-Court Transactions

Generally, it is preferable for investors to acquire *precatórios* through out-of-court transactions, so as to permit them to occur in a non-regulated environment that is controlled by the investor and the seller, with terms and conditions determined by the investor and the seller, similar to any other ordinary commercial transactions. However, given the typically financially distressed situation of the seller, certain aspects should be carefully analyzed by investors prior to moving forward with such out-of-court transactions in order to avoid claims of fraudulent conveyance and/or claims of fraud upon pre-existing enforcement lawsuits filed by other creditors against the seller.

Claims of Fraudulent Conveyance

Under Brazilian law, the sale of assets by distressed companies may be challenged by the seller's creditors, especially if the seller is insolvent at the time of the transaction (the sale of the *precatório*) or becomes insolvent due to the transaction. Insolvency here means that the creditor lacks sufficient remaining assets to enable it to pay its outstanding debts. To challenge a sale transaction, an affected creditor must file a lawsuit before a competent court, evidencing that the sale was fraudulent and was detrimental to the seller to the benefit of the third party acquiring the asset. Such lawsuits may be filed within four years from the time the transaction became public.

A finding of fraudulent conveyance by the court will result in the annulment of the transaction in relation to the creditors who brought the claim. In the case of such finding, the disposed assets are returned to the debtor's property and may be used to satisfy the claims of the creditors who sought the annulment of the transaction. As a condition to the annulment, the purchaser must be reimbursed for the purchase price paid for the asset, as well as the cost of any damages arising out of the loss thereof (i.e., expenses, material damages and loss of profits). However, one should bear in mind that those indemnity claims will be advanced against a seller that is financially distressed and as such the chances of the claims effectively being satisfied tend to be very low.

Claims of Fraud Against Pre-Existing Enforcement Lawsuits

Another potential claim that could jeopardize a transaction is the risk of a determination of fraud against pre-existing enforcement lawsuits (*fraude à execução*) in cases where a transaction involving the assignment of *precatórios* may negatively affect ongoing enforcement lawsuits filed by the seller's creditors, especially tax enforcement lawsuits.

If a court finds that fraud against an existing enforcement lawsuit has occurred, it will render the transaction ineffective in relation to the plaintiff in that lawsuit in which the fraud was declared. Therefore, even though the disposed assets remain in the acquirer's property, they may be seized by the creditor in the relevant enforcement lawsuit to secure and satisfy its claim.

Naturally, due diligence on the seller's financials is important for the proper assessment of how deeply distressed the company is and, consequently, the risk of claims of fraudulent conveyance and/or fraud upon pre-existing enforcement lawsuits. In addition, as we discuss in our recommendations, to mitigate challenges based on fraud, it is essential to evidence that the transaction was entered into at arm's length and proper consideration (market value basis) was received.

Investments in *precatórios* have seen a significant boost in recent years. The market for *precatórios* today has a potential value of more than 100 billion Brazilian Reais.

In cases where the seller's financial situation is distressed to the point that it may impose significant risks of fraud allegations against the transaction, the appropriate alternative would be the acquisition of the assets under the seller's judicial reorganization, as analyzed below.

Precatórios and Companies Under Judicial Reorganization

Under the Brazilian Bankruptcy Law (No. 11,101, dated February 9, 2005, as amended), financially distressed companies have the option of initiating a judicial reorganization process (*processo de recuperação judicial*) aimed at renegotiating the company's debts with its creditors under a court supervised proceeding and rescuing the debtor from its financial difficulties while maintaining creditors' interests.

The assignment of *precatórios* by companies under judicial reorganization results in a more complex deal structure but at the same time provides more protection to investors, depending on the specifics of each transaction. This is the case because Brazilian Bankruptcy Law provides that the purchase of assets made under a debtor's judicial reorganization plan (as approved by the creditors and ultimately by the court and followed by a competitive bidding process conducted under court supervision) grants protection to purchasers against succession of liabilities of the debtor of any nature. Additionally, actions undertaken in the context of the reorganization plan will not be annulled nor unwound in the event of a subsequent liquidation/bankruptcy of the debtor.

Note that legal authorities and case law maintain that the protection against succession on past liabilities of the debtor is effective against all the debtor's creditors, including impaired and unimpaired claims. However, in limited instances that we will touch on, such investor protections are disregarded for the benefit of certain types of unimpaired claims. In the event that the relevant assets of the debtors are sold under a judicial reorganization proceeding and no sufficient valuable assets remain available to bear the outstanding debts owed to unimpaired creditors, the courts may render the sale transaction void in relation to the relevant creditors, allowing them to seize the assets and satisfy their claims.

As a general rule, judicial reorganization binds all pre-petition debts, even those not yet due, except for (i) tax and social security-related debts; (ii) debts related to forward foreign exchange agreements; (iii) debts arising from financial leases and fiduciary liens or transfers of property; and (iv) debts relating to real property sale agreements that have an irrevocability or irreversibility clause and purchase agreements with title retention provisions. Thus, creditors falling into any of the foregoing categories that hold unimpaired claims not subject to the judicial reorganization proceeding (*créditos extraconcursais*) may challenge any asset sale if the debtor is not left with sufficient relevant assets upon completion of such sale.

Considering that virtually all debtors that file for judicial reorganization proceedings in Brazil also have unimpaired creditors, investors should conduct due diligence on such claims for the proper verification and assessment of the risks of allegations of fraudulent conveyance or fraud against pre-existing enforcement lawsuits.

It is also worth noting that in the context of a judicial reorganization, except for any sale expressly set forth in the reorganization plan, the debtor is not permitted to sell or pledge assets or rights that comprise its fixed assets, unless the usefulness of such transaction is recognized by the bankruptcy court following consultation with the creditors' committee.

Although there is ongoing legal debate about the proper classification of *precatórios* and legal claims as "fixed assets" of a debtor, in our view, by having the assignment of such assets be governed by the reorganization plan and requiring creditor approval at a creditors' assembly, followed by ratification of the reorganization plan by the bankruptcy court, the purchaser of *precatórios* and other legal claims is protected against the succession liabilities of the debtor.

Conclusion and Recommendations

Investors interested in acquiring *precatórios* from companies in financial distress (pre-insolvency or under judicial reorganization proceedings) should take the following recommendations into consideration in order to manage the risks involved as well as to add additional layers of protection:

For Out-of-Court Transactions:

1. ***Due diligence:*** Aside from the legal and technical due diligence of the *precatórios* (legal nature and factual background, ownership, chain of assignments, inexistence of encumbrances, etc.), we also recommend that investors conduct extensive and detailed due diligence of the seller for a proper assessment of its financial situation, ongoing lawsuits and contingencies (tax, civil, labor, environmental, etc.), among other relevant matters.
2. ***Appraisal report:*** If possible, investors should carry out an independent appraisal report on the remaining assets of the seller as evidence that the seller would hold sufficient assets to pay its financial obligations even with the assignment of the *precatórios*.
3. ***Arm's length deal:*** Negotiations between the investor and the seller should be carried out on an arm's length basis.
4. ***Market value basis:*** The purchase price paid in consideration for the assignment of *precatórios* should be determined on a market value basis, which is not necessarily a simple matter considering the type of asset and its non-liquid nature. A review of the economics of prior, similar transactions and/or fairness opinions is useful for this purpose.
5. ***Contractual protections:*** Transaction agreements should include protections, such as representations and warranties to the effect that the transaction will not affect the capacity of the seller to fulfill its current obligations.
6. ***Attention to formalities:*** There are certain formalities that should be followed for the adequate perfection of assignment of *precatórios* and other legal claims, such as the execution of a public assignment instrument (*escritura pública*), registration of the applicable documents with the competent registries and communications with the competent court regarding the assignment of the *precatórios*.

For Transactions Completed in the Context of Judicial Reorganization Proceedings:

1. ***Due diligence:*** Due diligence is even more critical for companies under judicial reorganization, considering that certain creditors (e.g., those with tax claims, post-petition claims and creditors of fiduciary liens, among others) are not subject to the reorganization plan.
2. ***Competitive process:*** For companies under judicial reorganization, the organization of a competitive bidding process in which third parties are granted the opportunity to submit bids for the acquisition of the *precatórios* is material for providing proper protection to the purchaser against succession liabilities of the debtor entity.
3. ***Market value basis:*** The purchase price should be determined on a market value basis, and the competitive bidding process should evidence that the best price was achieved.
4. ***Creditors and court approval:*** For companies under judicial reorganization, investors must ensure that the assignment of *precatórios* is made based on the terms and conditions of the reorganization plan approved by the creditors at a creditors' general assembly and confirmed by the bankruptcy court.
5. ***Attention to formalities:*** The same recommendations regarding formalities for out-of-court transactions should also apply for assignments of *precatórios* made in judicial reorganization proceedings. ■

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Turkish Corporate Debt Restructurings: Navigating a Changing Landscape

By **SERA SOMAY** *and* **SONER DAĞLI**

This article aims to give a brief summary of recent developments in the Turkish financial markets relating to corporate restructurings and legal changes made as a result of such developments.

Overview of the Turkish Financial Markets

The second half of 2018 has been a difficult period for Turkey and its financial markets. Turkey has faced rating downgrades, the depreciation and volatility of the Turkish Lira, an increasing inflation rate and rising distress in the private sector.

In July 2018, Fitch lowered the sovereign rating of Turkey to BB from BB+. In August 2018, Moody's lowered the sovereign rating of Turkey to Ba3 from Ba2, three notches below investment grade, and Standard & Poor's decreased the rate to B from BB-. These downgrades took place shortly after the U.S. imposed sanctions against two Turkish government officials as a result of the detention of Pastor Andrew Brunson, who was held in prison by Turkey due to his alleged involvement in the failed coup of July 2016. After the release of Pastor Andrew Brunson on October 12, 2018, the U.S. lifted sanctions against two Turkish government officials in November 2018.

In September 2018, the Central Bank of Turkey raised its benchmark rate by 625 basis points to 24%. This steep rise in interest rates and an amelioration of the relations with the U.S. stabilized the Turkish Lira, which, as at August, had lost 36% of its value against the Dollar since the start of the year.

In October, Fitch downgraded the long-term foreign currency issuer default ratings of 20 banks and the viability rating of 12 banks. Although the Turkish banking sector has a strong track record and a moderate level of non-performing loans, these downgrades were based on the assumption that the sector could face challenging conditions in 2019 due to weaker economic growth, higher interest rates and an expected rise in non-performing loans. Furthermore, the Turkish banking sector is expected to roll over its loans at a higher cost.

Consumer prices were 24.52% higher in September 2018 and 21.6% higher in November 2018 compared to the same months in 2017, according to official statistics released by the Turkish statistics office (TUIK).[1]

Recent Legal Measures to Support Stability in the Turkish Financial Markets

Following the Turkish Lira's dramatic fall against the U.S. Dollar in recent months, the Turkish government has taken a number of measures to support the financial markets and stabilize the Turkish Lira, as discussed further below. One such measure is a new foreign exchange enabling Turkish residents to utilize foreign currency loans. The market appears to have welcomed the amendments.

Restrictions on FX Borrowings

On January 3, 2018, the Council of Ministries amended the Decree numbered 32 on the Protection of the Turkish Lira ("**Decree No. 32**") to restrict any foreign currency borrowings by Turkish corporates with no foreign currency revenues, except in limited cases, with effect from May 2, 2018. Turkish corporates are no longer authorized to borrow in foreign currency from Turkey or from abroad unless they have foreign currency revenues, an outstanding cash loan balance of at least USD 15 million or they benefit from other exemptions listed in Decree No. 32, namely:

— Foreign currency borrowings of public institutions, banks, financial leasing companies and financing companies;

— Foreign currency borrowings of legal entities with an investment incentive certificate allowing them to borrow in foreign currency;

— Foreign currency borrowings utilized by the legal entities for the financing of machinery or equipment with HS Codes as referred to under the relevant legislation;

— Foreign currency borrowings of legal entities that are the winners of national public tenders announced internationally, or foreign currency borrowings of the legal entities that will carry out defense industry related projects that are approved by the Undersecretariat of Defense;

— Foreign currency loans to be used by Turkish legal entities for the financing of renewable energy investments within the scope of a government purchase guarantee pursuant to the Law on Utilization of Renewable Energy Sources for the Purpose of Generating Electrical Energy numbered 5346 and dated May 10, 2005;

— Foreign currency loans to be used by Turkish legal entities who win tenders within the scope of the Law on Privatization Implementation numbered 4046 and dated November 24, 1994, or tenders in which the price is determined in foreign currencies;

— Foreign currency loans to be used by Turkish special purpose companies which are established for the sole purpose of acquiring the shares of a new company and which do not have any operations other than the realization of this purpose; or

— Foreign currency loans to be used by wholly owned (directly or indirectly) Turkish subsidiaries of foreign companies from such foreign companies and their wholly owned affiliates.

Furthermore, those Turkish corporates that do have foreign currency revenue or benefit from other exemptions listed above cannot borrow in foreign currency from abroad or from Turkish banks.

The banking sector could face challenging conditions in 2019 due to weaker economic growth, higher interest rates and an expected rise in non-performing loans.

Restrictions on FX Transactions

Pursuant to an amendment to Decree No. 32 that came into effect in September 2018, pricing and other payment obligations specified in certain types of agreements executed between persons residing in Turkey must be denominated in Turkish Lira. Accordingly, monetary obligations stipulated in sales and lease agreements for real estate property and vehicles, agreements to commission work that does not involve costs in foreign currency, service agreements (including consultancy, transportation and brokerage agreements) and employment agreements can no longer be determined in foreign currency or indexed to foreign currency but need to be set in Turkish Lira.

A number of exemptions were issued in October 2018 and updated in November 2018 with the Communiqué No. 2018-32/52, relaxing the restrictions and providing calculation methods for the conversion of existing foreign currency agreements into Turkish Lira. Amongst others, the exemptions are as follows:

REAL ESTATE SALE AND LEASE AGREEMENTS

The following real estate sale and lease agreements executed between Turkish residents are exempt from the Turkish Lira denomination requirement:

- Sale and lease agreements for real estate property located in free zones;[2]
- Real estate lease agreements executed for the purpose of operating accommodation facilities certified by the Ministry of Culture and Tourism;
- Lease agreements in relation to the lease of duty-free stores;
- Real estate property sale and lease agreements to which non-Turkish nationals residing in Turkey are party as *purchaser* or *tenant;* and
- Real estate property sale and lease agreements to which (x) the branches, representative offices or liaison offices of persons who are not residents in Turkey ("**non-residents**"), (y) Turkish companies in which non-residents directly or indirectly hold 50% or more of the share capital or which are under the control or joint control of non-residents or (z) companies based in free zones, are party as *purchaser* or *tenant*.

MOVABLE SALES AND LEASE AGREEMENTS

Agreements for the sale or lease of movable assets (commodities) other than vehicles (including heavy construction equipment) are exempt from the restriction. While the Turkish Lira denomination requirement applies to sale and lease agreements for vehicles, an exemption has been granted for the sale and lease of heavy construction equipment; these agreements can thus be denominated in foreign currency. Also, lease agreements executed before the restrictions entered into force for vehicles and sale agreements for passenger-carrying commercial vehicles can remain in foreign currency.

WORK COMMISSION AGREEMENTS

All agreements to commission a work that incorporate costs in foreign currency can be denominated in foreign currency.

EMPLOYMENT AGREEMENTS

The following employment agreements can be denominated in foreign currency:

- Agreements made as part of residents' activities to be performed abroad;
- Agreements to which non-Turkish nationals are party;
- Agreements to which seamen are party; and
- Agreements executed by (x) the branches, representative offices or liaison offices of non-residents, (y) Turkish companies in which non-residents directly or indirectly hold 50% or more of the share capital or which are under the control or joint control of non-residents or (z) companies located in free zones, where such entities are party to the employment agreement as *employer*.

SERVICE AGREEMENTS

The following service agreements can be denominated in foreign currency:

- Agreements to which non-Turkish nationals are party;
- Agreements that are made as part of export transit trade, sales and deliveries that may be deemed as export and exchange saving services and activities;
- Agreements made as part of Turkish residents' activities to be performed abroad;
- Service agreements that are initiated outside of Turkey and end within Turkey or vice versa, and service agreements that initiate and end outside of Turkey; and
- Service agreements executed by (x) the branches, representative offices or liaison offices of non-residents, (y) companies in which non-residents directly or indirectly hold 50% or more of the share capital or which are under the control or joint control of non-residents or (z) companies located in free zones, where such entities are party as *service recipient*.

Service agreements in relation to transportation activities can be indexed to oil prices.

SOFTWARE AGREEMENTS

IT agreements for the sale of software developed outside of Turkey, as well as license and service agreements for hardware and software, are exempt from the restriction.

Other Restrictions
The Banking Regulation and Supervision Agency ("**BRSA**") capped Turkish banks' cross currency swap, spot and forward transactions to 25% of a given bank's regulatory capital. New transactions will not be executed or renewed until the current excess has been reduced to 25%, calculated on a daily basis. Transactions conducted by banks between their foreign credit institutions or financial institutions and which are within the scope of the same consolidated group are exempt from this restriction. Separately, when calculating the transactions falling within the scope of the 25% threshold, local banks should consider transactions having a maturity of (i) 90 to 360 days as 75% and (ii) no less than 360 days as 50%.

Furthermore, as of September 2018, Turkish exporters are now required to bring at least 80% of their foreign currency export revenues into Turkey within 180 days following the date of exportation and sale of such foreign currency proceeds to Turkish banks.

Recent Key Restructurings

The current restructuring environment is shaped by contractual arrangements amending the existing loan facilities and extending their maturity.

In May 2018, Yıldız Holding, the holding company of Godiva and McVitie's, refinanced its short-term loan portfolio of approximately USD 6 billion. This refinancing is one of the largest such transactions undertaken by Turkish banks to date.

The closed restructuring of the USD 4.75 billion loan provided to Oger Telecom ("**OTAS**") by a syndicate of Turkish and international banks is one of Turkey's largest restructurings. OTAS is the special purpose vehicle holding the shares of Turkish Telecom—a listed company and a strategic asset for Turkey. As a result, the shares owned by OTAS in Turkish Telecom have been delivered to a special purpose company established by OTAS's lenders. The financing being restructured dates from May 2013; OTAS began to fail making repayments in September 2016.

Dogus Holding, a conglomerate active in the automotive, construction, media, food and entertainment industries, disclosed that it is in talks with banks for the restructuring of loans valuing up to EUR 2.3 billion. This restructuring was completed very recently, just eight months following Dogus Holdings' initial public announcement thereof.

We are also aware of a number of construction and energy companies currently working on restructurings. The energy sector, which has significant foreign currency exposure, has been affected particularly severely by the devaluation of the Turkish Lira along with rising natural gas and oil prices. The energy sector is also affected by the lack of realization of projected growth, which was projected by the IMF to be around 5% for both 2018 and 2019 but has been updated as 3.5% for 2018 and 0.4% for 2019. On the construction side, companies face pressure from decreasing real estate prices due to excessive supply and the rise in interest rates and construction costs.

As part of this ongoing restructuring, we expect to see various asset disposals by distressed companies.

Current Legal Framework on Restructuring on a Comparative Basis

There are three formal restructuring mechanisms provided for by Turkish legislation: (i) the concordat (*konkordato*), (ii) restructuring by way of framework agreement and (iii) restructuring upon settlement.

The concordat and restructuring upon settlement are formal restructuring options provided under the Enforcement and Bankruptcy Code No. 2004 ("**EBC**"). Restructuring by way of framework agreement is a form of restructuring based on (i) a restructuring regulation issued by the BRSA and (ii) a framework agreement issued by the Turkish Bankers' Association and accepted by most Turkish banks by the execution of such framework agreement. Foreign financial institutions can choose to join the restructuring and become a member of the consortium creditors of a borrower by signing the framework agreement, without requiring the approval of other consortium creditors.

We provide below a comparative table reflecting the major steps under the concordat and a restructuring by a framework agreement. The table does not include restructuring upon settlement since this is not commonly used in the Turkish market. ■

1. http://www.turkstat.gov.tr/PreTablo.do?alt_id=1014
2. Free zones have been established in Turkey with the entry into force of Free Zones Law No. 3218. Free zones are special sites deemed outside the customs area, although they are physically located within the political borders of the country. Legal and administrative regulations in the commercial, financial and economic domains that are applicable within the customs area are either not implemented or partially implemented in free zones.

RESTRUCTURING BY A FRAMEWORK AGREEMENT	CONCORDAT
WHO CAN APPLY?	
Debtors (i) with a minimum credit balance of TL 100 million and (ii) against whom no enforcement proceedings have been initiated.	Individual and corporate debtors who are unable to pay their debts or who are not likely to pay their debts when due. Financial status and initial concordat project approved by an independent auditor should be submitted to the court.
COURT APPROVAL	
No court approval is required.	The court grants an initial concordat term up to three months (which can be extended to five months) and appoints a trustee to prepare an initial report reviewing whether the restructuring can be achieved. With the initial concordat, the standstill period commences. At the end of the initial concordat term, the court may decide to reject the concordat claim or to grant a definitive concordat term for one year, which can be extended to one and a half years. If the court rejects the concordat application, it declares the debtor bankrupt. Upon creditor approval (explained below), the restructuring needs to be approved by the court to be binding on all creditors.
CREDITOR APPROVAL	
The restructuring plan proposed by the debtor is required to be accepted by the Consortium Creditors holding at least two-thirds of the total indebtedness. "**Consortium Creditors**" are financial creditors that signed the Framework Agreement. Other financial creditors that would like to be members of the consortium should sign the Framework Agreement and be approved by at least 30% in number of existing Consortium Creditors and by those Consortium Creditors holding at least 75% of the total indebtedness. Foreign financial institutions can choose to become members of the consortium without the approval of Consortium Creditors.	During the definitive concordat term, the restructuring plan proposed by the debtor is required to be accepted by: — the majority of the Creditors and the majority of the receivables; or — one-fourth of the Creditors and two-thirds of the receivables. For these purposes, the term "**Creditors**" includes all creditors of the debtor except (i) secured creditors, unless security is not sufficient to cover the secured debt, and (ii) employees, since payments to employees are not stopped as a result of the concordat.
STANDSTILL PERIOD	
The standstill period starts upon application by the debtor for the restructuring and continues until the expiration of the restructuring period. The standstill period is a minimum of 90 days and can be extended to 150 days unless agreed otherwise by the Consortium Creditors. During the standstill period, all enforcement actions by the Consortium Creditors are suspended and no new enforcement action can be initiated by the Consortium Creditors. During the standstill period, the debtor undertakes to treat all creditors equally, not to take new loans, not to make any asset disposals, including any disposals of tangible rights, not to make any settlement of debt and to share information and documents with creditors.	The standstill period starts with the court's approval of the initial concordat term and continues until (i) the court's rejection of the concordat or (ii) the court's approval of the definitive concordat period. The initial standstill period is 90 days and can be extended to 150 days with court approval. If the court accepts the concordat, the definitive concordat period lasts a minimum of one year and can be extended to one and a half years. During the standstill period, all enforcement actions by creditors (excluding the proceedings initiated for the debts secured with a pledge or mortgage and the proceedings initiated by the employees) are suspended and no new enforcement action (excluding proceedings initiated for the debts secured with a pledge or mortgage and proceedings initiated by the employees) can be initiated by the creditors. There are no specific restrictions on the debtor.
AMENDMENT, HAIRCUT, EXTENSION OF NEW LINES	
A new credit line should be extended by all Consortium Creditors if such extension is approved by more than one Consortium Creditor holding at least 90% of the total indebtedness. If this majority is not reached, Consortium Creditors can still extend a new credit line with the approval of 30% in number of Consortium Creditors and those holding at least 75% of the total indebtedness. Any haircut or payment in kind is possible if approved by 100% of Consortium Creditors. Any reduction or cancellation of debt will be distributed among Consortium Creditors on a pro rata basis. The restructuring agreement can be amended if approved by at least 30% in number of Consortium Creditors and those holding at least 75% of the total indebtedness.	No higher voting quorum applies to any haircut or extension of new lines. The restructuring agreement cannot be amended without court approval.
END RESULT FOR CREDITORS	
Following execution of the restructuring agreement and as long as the obligations under such agreement are performed, no further enforcement action can be initiated by the Consortium Creditors. This is not binding on creditors other than Consortium Creditors.	Once the restructuring is approved by the court, the restructuring agreement binds all creditors.

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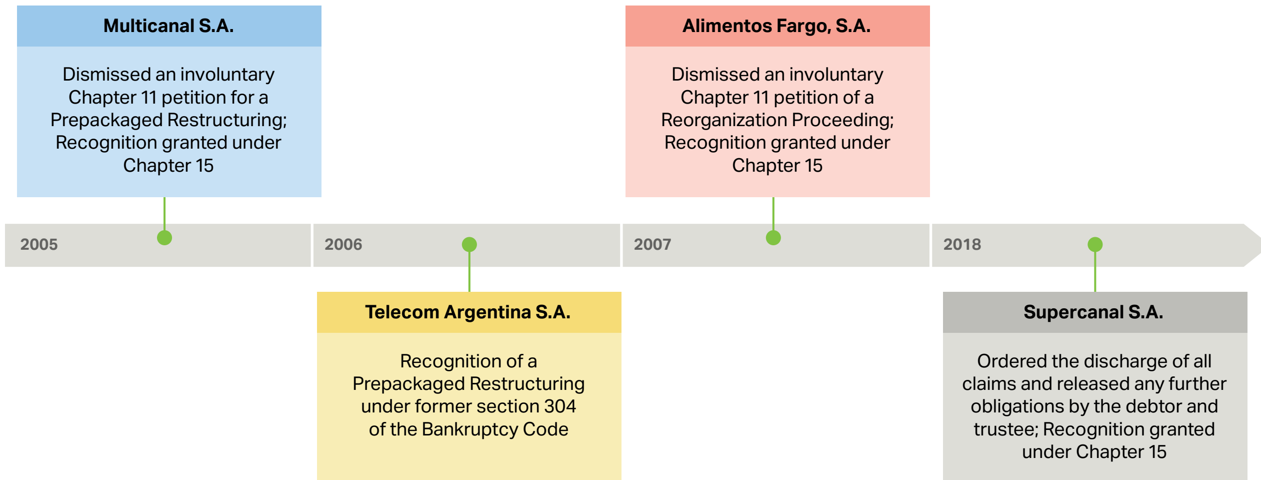
Soner Dağli is an associate at Paksoy. His practice areas include finance, restructuring and capital markets. He has advised a consortium of Turkish banks in their restructuring of loans provided to a Turkish steel company, and is currently advising international financial institutions on a restructuring. He received a law degree from Galatasaray University School of Law.

Cross-Border Restructurings in Argentina: Making Inroads in Recognition by United States Bankruptcy Courts

By FERNANDO DANIEL HERNÁNDEZ


In 2001, Argentina suffered one of its largest and deepest systemic economic crises. The sudden sharp depreciation of the Argentine Peso caused the failure of hundreds of companies and gave rise to some of the largest cross-border corporate restructurings in Argentine history. This article provides an overview of the corporate restructuring process in Argentina and its implementation mechanics. The article then touches on how bankruptcy courts in the United States have consistently recognized Argentine restructuring proceedings, helping consummate the corporate restructuring process contemplated under Argentine law. We conclude by discussing the notable case of *In re Supercanal*, one of the longest-running restructurings in Argentine history that has recently been granted Chapter 15 protection and introduces innovative features to the cross-border restructuring process.

Case Law Timeline



Background on Cross-Border Restructurings in Argentina

After the Latin American debt crisis in the early 1980s, Argentina adopted a "convertibility plan" that pegged the Argentine Peso one-to-one to the U.S. dollar in 1991. The convertibility plan, along with other measures such as the privatization of public services, utilities companies and other government-owned enterprises, was initially successful, leading to considerable expansion of the Argentine economy. During this time, many of the largest companies in Argentina raised funds in the international capital markets through the issuance of U.S. dollar-denominated debt securities that were governed by New York law.

After a decade of the convertibility plan, however, the growth of the federal fiscal deficit provoked inflation and a sharp appreciation of the Argentine Peso that resulted in loss of industry competitiveness, a drop of exports, a higher trade balance deficit and loss of federal reserves, among other things, and the Argentine economy ultimately collapsed. By 2002, Argentina was forced to end the ten-year convertibility plan and the Argentine Peso suddenly depreciated more than three times. All companies that were highly indebted in U.S. dollar-denominated debt and had income in Argentine Pesos immediately increased their liabilities more than three times with no correlative increase of income and were then forced to enter into restructuring proceedings under the Argentine Bankruptcy Law (the "**ABL**").

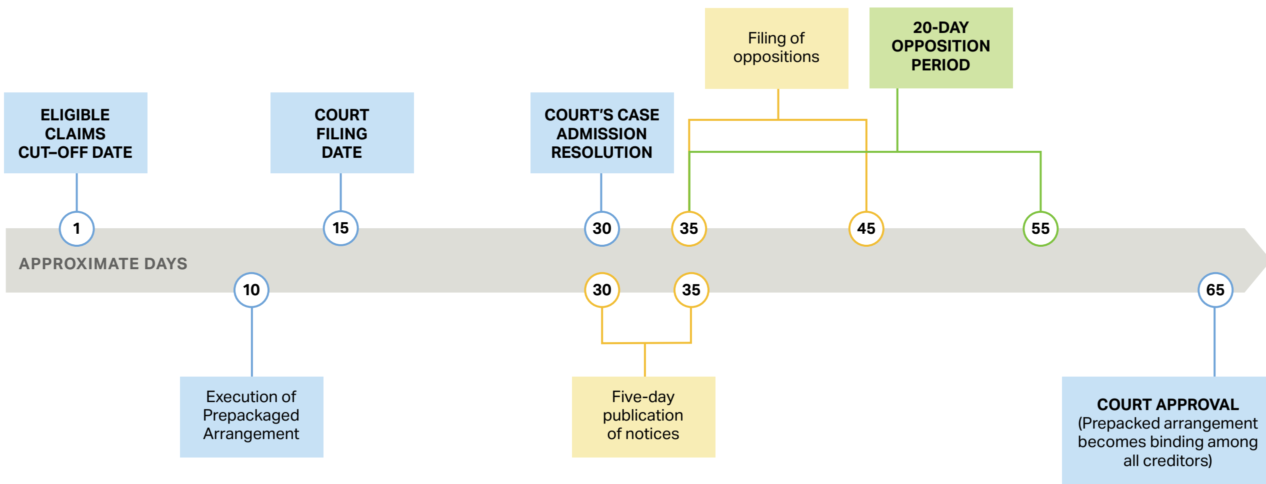
Argentine Restructuring Proceedings

The ABL provides for two restructuring schemes: (i) the out-of-court restructuring agreement (*acuerdo preventivo extrajudicial*) (the "**Prepackaged Restructuring**"); and (ii) the in-court reorganization proceeding (*concurso preventivo*) (the "**Reorganization Proceeding**").

Prepackaged Restructuring
A Prepackaged Restructuring is similar to a prepackaged arrangement in the United States. It consists of an agreement entered into between the debtor and some or all of its unsecured creditors grouped into one or more categories determined by the debtor, with a single or different restructuring proposal for each category.

Prepackaged Restructurings may be filed before the court for endorsement if approved by the unsecured creditors representing both (a) more than 50% of the total number of unsecured creditors, regardless of the principal amount held by each creditor; and (b) more than 66⅔% of the total principal amount of unsecured claims (together, the "**Required Majority**"). The filing may be made by a debtor that is insolvent (i.e., generally unable to regularly satisfy its current liabilities) or by a debtor that is facing general economic or financial difficulties. Upon endorsement by the court, the Prepackaged Restructuring becomes binding against the unsecured creditors of all categories, whether they have consented to the restructuring or not.

Prepackaged Restructuring Timeline
(in court business days)



A Prepackaged Restructuring may also include secured claims. However, the restructuring of secured claims requires the consent of all secured creditors.

Upon filing of the petition for endorsement of a Prepackaged Restructuring and verification of the admission requirements (i.e., filing of an assets and liabilities statement, a list of the creditors, a description of pending actions and proceedings and of a description of the consents to the Prepackaged Restructuring), the court will order the publication of notices for five days. Publication of such notices triggers a stay of all pre-petition claims against the debtor (other than claims of secured creditors seeking foreclosure on collateral).

Other than for the general principles of law (e.g., abusive proposal), the debtor is free to formulate the proposed terms of the restructuring agreement with its creditors. With certain limited exceptions, the ABL does not provide for a substantive review of the terms of the restructuring.

Reorganization Proceeding

Reorganization Proceedings are full plenary proceedings similar to the reorganization procedure regulated under Chapter 11 of Title 11 of the United States Code (the "**U.S. Bankruptcy Code**"). Unlike Prepackaged Restructurings, a petition for a Reorganization Proceeding may only be filed voluntarily by a debtor that is insolvent. If the debtor has undergone a prior reorganization, a petition for a new Reorganization Proceeding may only be filed after one year from the date of the court's declaration of the performance of the prior Reorganization Proceeding.

Pursuant to the ABL, any creditor holding claims due and payable may file a petition for bankruptcy of a debtor that is insolvent (involuntary bankruptcy petition). If the debtor is adjudicated bankrupt, they may avoid liquidation through filing a motion for the conversion of the bankruptcy proceeding into a Reorganization Proceeding, provided that bankruptcy was not adjudicated as a consequence of the breach or failure of a Reorganization Proceeding.

Commencement of a Reorganization Proceeding has the following main effects, among others:

a. the court appoints a receiver to supervise the proceeding;

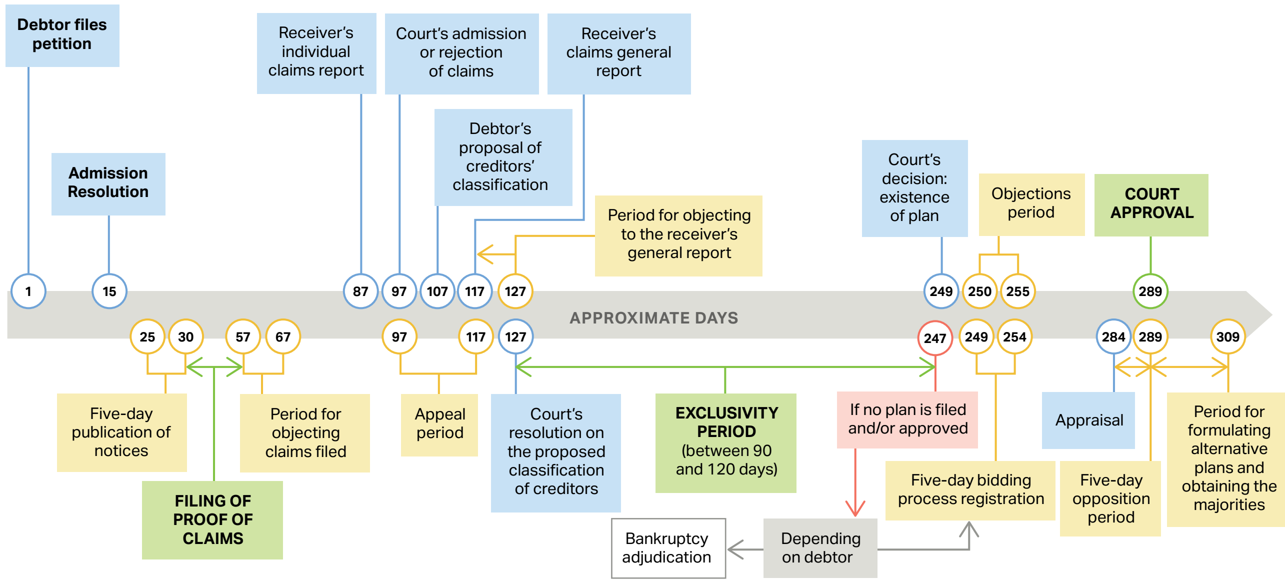
b. the debtor keeps possession of its assets, but management is subject to the supervision of the receiver;

c. all creditors must file proof of claims to the receiver;

d. in case of need (e.g., enforcement actions on collateral indispensable for the development of the debtor's business activities) or emergency, the court may order the temporary suspension of enforcement actions over secured claims and precautionary measures on collateral secured with mortgages or pledges for a period of up to ninety days. Interest accrued during the suspension period will benefit from the same priority of payment as administrative expenses;

e. the debtor is banned from entering into any transactions without consideration (*a título gratuito*) or other transactions that may affect the status of pre-petition claims;

Reorganization Proceedings Timeline
(in court business days)



f. within ten days following the filing by the receiver of a report on labor claims, the court authorizes the "prompt payment" of such labor claims without need for filing proof of claims;

g. any of the following transactions require the prior authorization of the court, following a hearing with the receiver and the creditors' committee: (i) transactions concerning registered property; (ii) disposition or lease of goodwill; (iii) issuance of secured debentures or bonds; (iv) granting of pledges; and (v) any other transaction not within the ordinary course of the debtor's business; and

h. accrual of interest is suspended on pre-petition unsecured claims. Interest accrued after the Reorganization Proceeding petition on claims secured with a mortgage or pledge is payable only with the proceeds from the enforcement of the collateral.

The debtor must classify the creditors into at least three classes: unsecured creditors, labor creditors and secured creditors, provided that the debtor may create additional subcategories within each class based on objective criteria set by the debtor. The debtor could formulate a reorganization plan including different restructuring proposals for each class and/or subcategory. The debtor enjoys a ninety-day exclusivity period (extendable up to thirty additional days from the date of the court's resolution admitting the debtor's proposed creditor classification) during which it must formulate a reorganization plan and obtain the creditors' consent (the "**Exclusivity Period**").

As with a Prepackaged Restructuring, the reorganization plan must be approved by unsecured creditors (excluding those who are also controlling shareholders) representing the Required Majority of unsecured creditors within each class and/or subcategory. Any proposal to secured creditors must be approved by unanimous consent of all creditors within the class and/or subcategory of secured creditors.

If at expiration of the Exclusivity Period the debtor did not file a reorganization plan, or such plan is not approved, then prior to resolving the bankruptcy adjudication (if applicable), the court must open a bidding process in which the debtor, the creditors, the debtor's workers organized in a cooperative and/or other third parties may file biddings for the purchase of the debtor's shares, quotas or participations and offer alternative reorganization plans. If the bidding process fails, then the court must declare the debtor bankrupt.

Only the workers who are organized in a cooperative may offset their labor claims against the bidding price for the purchase of the debtor's equity.

Despite the foregoing, Argentine courts have been eager to extend the Exclusivity Period for a longer period, and also to grant the debtors a second chance to improve their reorganization plans and obtain the Required Majority on such improved plan before launching the bidding process. This extension of the Exclusivity Period has been called the "third way".

Once the reorganization plan is endorsed by the court, and the debtor has adopted the measures for its implementation and granted guarantees for the performance of its obligations under the reorganization plan to the satisfaction of the court, the court will issue, at the debtor's request, a resolution declaring the Reorganization Proceeding concluded (the "**Conclusion Resolution**"). Once the Conclusion Resolution is granted, the Reorganization Proceeding is finalized, the receiver's performance and duties are terminated and the management limitations on the debtor are lifted.

Upon tender and delivery of all consideration under the reorganization plan, and fulfillment of all other obligations of the debtor under the plan, the court will issue a resolution confirming the performance and discharge of the debtor's obligations under the plan (the "**Performance Resolution**").

Implementing Prepackaged Restructurings and Reorganization Plans

A major portion of the unsecured debt in the largest corporate restructurings in Argentina involve large amounts of debt securities deposited with a trustee in the United States clearing system administered by The Depositary Trust Company ("**DTC**"), and governed by New York law (the "**Debt Securities**").

> Since the earliest cases were brought in 2001, the SDNY Bankruptcy Court has consistently granted recognition, relief and assistance with respect to both the Prepackaged Restructuring and the Reorganization Proceeding under Chapter 15 of the U.S. Bankruptcy Code and its predecessor section 304 of the U.S. Bankruptcy Code.

The Debt Securities are eligible for trading in the DTC system, and beneficial ownership is held by the beneficiaries through custodians that are, or hold their positions in the Debt Securities through, direct participants in the DTC system (the "**DTC Participants**"). Therefore, the only holders of the Debt Securities known to the issuer are the DTC Participants, who hold the positions in their own name or account or in the name or account of their clients (including custodians holding the positions in the names of their respective clients).

In order to take any action with respect to the DTC Participant's third-party positions, the DTC Participants need to receive adequate instructions from the beneficial owners. Due to the characteristics of the custody system, in all restructurings there is always a certain portion of beneficial owners that will never give instructions on their positions and cannot be identified by the issuer, the trustee or the DTC Participants (the "**Non-consenting Creditors**").

The Implementation Process

The implementation mechanics of the Prepackaged Restructurings and reorganization plans depend on the nature of the unsecured claims and the consideration to be delivered under the restructuring agreement or plan.

Under Argentine law, Prepackaged Restructurings and reorganization plans may include a variety of consideration, such as cash, DTC eligible securities or non-DTC eligible securities.

DTC Eligible Debt Securities
To the extent the unsecured claims relate to Debt Securities that are DTC eligible and the consideration under the Prepackaged Restructuring or reorganization plan consists of cash or other DTC eligible securities, the exchange of the securities for the cash or new securities can be performed through the DTC settlement system. This involves the debit of the positions in the debt securities and the credit of the cash or new securities at the DTC accounts and each beneficial owner's custody account.

Consent to the Prepackaged Restructuring or reorganization plan by the holders of Debt Securities is generally implemented through a tender process whereby the consenting creditors tender their Debt Securities to an exchange agent. The exchange agent's endorsement of the Prepackaged Restructuring or reorganization plan implements the exchange of the Debt Securities and delivers the consideration under the Prepackaged Restructuring or reorganization plan.

Where consent to the restructuring is not sought through a tender process, then upon endorsement of the Prepackaged Restructuring or reorganization plan each of the beneficial owners will have to instruct their DTC Participant to tender their Debt Securities to receive the consideration under the exchange.

In this instance, an issue arises with respect to the Non-consenting Creditors, where trustees generally refuse to exchange and cancel their Debt Securities without an order of a U.S. court.[1] Debtors thus petition U.S. courts for recognition under the former section 304 and new Chapter 15 of the U.S. Bankruptcy Code in order to instruct the trustee to exchange and cancel the Debt Securities of the Non-consenting Creditors.

In re Supercanal **marks the first instance where an Argentine company sought discharge of pre-petition claims and release of delivery obligations under a reorganization plan upon elapse of the statute of limitations by a U.S. bankruptcy court and the U.S. bankruptcy court granted such relief.**

Non-DTC Eligible Securities

Where the consideration under the Prepackaged Restructuring or reorganization plan includes securities that are not DTC eligible (e.g., stock registered on the issuer's or other registrar's records) (the "**Non-DTC Eligible Securities**"), the exchange process cannot be implemented through the DTC settlement system. Beneficial owners must deliver, or cause to be delivered, their Debt Securities with the instructions of the beneficiary in whose name the Non-DTC Eligible Securities are registered.

Discharging the Debtor's Obligations

Pursuant to the ABL, the endorsement of the Prepackaged Restructuring or reorganization plan causes the discharge of all pre-petition unsecured claims such that the original rights of the unsecured creditors to receive payment under those claims is automatically replaced by the right to receive consideration under the restructuring. In addition, the debtor's performance obligations under the Prepackaged Restructuring or reorganization plan are discharged (and the Performance Resolution is granted by the court) following the tender of the consideration for the exchange of debt securities.

The ABL does not stipulate a statute of limitations for the delivery of the consideration under a Prepackaged Restructuring or reorganization plan. Therefore, such statute of limitations is governed by the general provisions of the Argentine Civil and Commercial Code. The generic statute of limitations term is five years,[2] and is computed from the date when the consideration is first made available to all unsecured creditors. Upon expiration of this term, all claims of the unsecured creditors that did not tender their Debt Securities in exchange for the consideration under the Prepackaged Restructuring or reorganization plan to claim the delivery of the consideration are barred and those creditors' outstanding Debt Securities must be cancelled. Trustees are typically reluctant to cancel the Debt Securities of those holders absent an order from a U.S. court.

However, in the recent case of *In re Supercanal*,[3] the United States Bankruptcy Court for the Southern District of New York ("**SDNY Bankruptcy Court**") took a new, more affirmative approach to granting recognition and relief under Chapter 15 of the U.S. Bankruptcy Code. Consideration under the reorganization plan is tendered and made available to the creditors with receipt conditioned upon the performance of certain affirmative actions by the creditors that are never taken.

The following is a survey of some of the leading recognition cases brought to U.S. courts and discusses the monumental decision in the aforementioned *Supercanal* case.

Recognition of Argentine Restructuring Proceedings in the United States

Since the earliest Argentine cases were brought in 2001, the SDNY Bankruptcy Court has consistently granted recognition, relief and assistance with respect to both the Prepackaged Restructuring and the Reorganization Proceeding under Chapter 15 of the U.S. Bankruptcy Code and its predecessor section 304 of the U.S. Bankruptcy Code.[4]

For example, *In re Compañía de Alimentos Fargo, S.A., 376 B.R. 427 (Bankr. S.D.N.Y. 2007)*, dismissing an involuntary Chapter 11 petition in connection with a Reorganization Proceeding pending in Argentina, the SDNY Bankruptcy Court noted that "*the Argentine insolvency system is procedurally and substantively fair, and provides a suitable forum to adjust the rights of the parties... Given this structure, it is not surprising that other courts in this district have granted comity to Argentine bankruptcies even though Argentine bankruptcy law is not identical to our own...[t]he Petitioners... have failed to show that these differences are at odds with our own fundamental notions of fairness or treat them unfairly...*"

Similarly, *In re Argentinian Recovery Co. v. Bd. of Dirs. of Multicanal S.A., 331 B.R. 537, 540 (S.D.N.Y. 2005)*, dismissing an involuntary Chapter 11 petition in connection with a Prepackaged Restructuring, the court noted that the U.S. Bankruptcy Code gives the court discretion to dismiss a bankruptcy case when "*the interests of creditors and the debtor would be better served by such dismissal ...*", for which purpose the court has to consider "*whether another forum is available and whether another proceeding has proceeded to the point that it would be costly and time-consuming to start afresh under the Bankruptcy Code.*"

In another example, *In re Bd. of Dirs. of Telecom Argentina S.A., 2006 WL 686867 at *2 (Bankr. S.D.N.Y. Feb. 24, 2006)*, leading telecommunications group Telecom Argentina had a Prepackaged Restructuring already approved by an Argentine court, but the trustee of the company's notes

that were subject to the restructuring refused to exchange and cancel those notes absent an order from a U.S. court, and Telecom filed a petition for recognition under former section 304 of the U.S. Bankruptcy Code. The court found the recognition "*especially appropriate where, as here, the Argentine Court has issued a final judgment that the APE (Argentina's out-of-court restructuring process) meets the requirements of Argentine Insolvency Law, and that judgment is final and binding on all affected creditors as a matter of Argentine law.*"

In re Supercanal S.A.

By the end of the 1990s, Supercanal S.A. and certain of its subsidiaries were highly indebted in U.S. Dollars. Severely affected by the Argentine economic crisis, the company filed for a Reorganization Proceeding in 2000. The company's proposed reorganization plan included the exchange of pre-petition Debt Securities for Non-DTC Eligible Securities. After the reorganization plan was approved and endorsed by a final resolution of the Argentine court, and the company fulfilled its obligations and tendered the Non-DTC Eligible Securities, the Argentine court declared the Reorganization Proceeding concluded and the reorganization plan satisfied through the issuance of a Conclusion Resolution and Performance Resolution. The company, under the reorganization plan, agreed to tender and make the Non-DTC Eligible Securities available to creditors for the term of the statute of limitations. In order to have the Debt Securities cancelled by the trustee upon expiration of the statute of limitations, the company filed a petition for recognition of the Reorganization Proceeding by the SDNY Bankruptcy Court.

Innovative Chapter 15 Relief

On July 19, 2018, the court granted the Chapter 15 motion and all relief requested. In granting such order, the court found that

> "*[absent] a permanent injunctive relief, the Foreign Proceeding and the Debtor's efforts to consummate its reorganization plan may be delayed or impaired by the actions of certain creditors, or by the failure of certain parties to take actions necessary to consummate the reorganization plan. Such results are at odds with the purpose of Chapter 15 of the Bankruptcy Code.... and could threaten, frustrate, delay, and ultimately jeopardize the reorganization plan and the Debtor's ability to have a fresh start following its Foreign Proceeding.*"

Upon those findings, the court granted the Chapter 15 petition and, among other things, ordered that

> "*the [Debt Securities] have no further force, effect and the holders have no right to receive any further cash payments on the [Debt Securities]. The sole right of the holders thereof is to exchange the [Debt Securities] for the Class A Shares... The Debtor and U.S. Intermediaries (including the Trustee) are hereby authorized and directed to take any ministerial actions that may be necessary to consummate the transactions contemplated by the reorganization plan.*"

In a positive response to the express petition by Supercanal, after over two decades of recognition proceedings granted by U.S. courts, the Supercanal decision finally directly ordered the discharge of all claims and release of any further obligations by the debtor, securities' trustees and other securities intermediaries, where the exchange of Debt Securities could not have otherwise been achieved without action by the beneficial owners. This decision has introduced new features to Chapter 15 recognitions and scope of relief that will facilitate consummating Prepackaged Restructurings and reorganization plans in the years to come.

Conclusion

The court's grant of Supercanal's petition constitutes a milestone in the scope of relief granted under Chapter 15 recognitions. This case marks the first instance where an Argentine company sought discharge of pre-petition claims and release of delivery obligations under a reorganization plan upon elapse of the statute of limitations by a U.S. bankruptcy court and the U.S. bankruptcy court granted such relief. This decision thus provides certainty on the discharge of all parties' obligations in reorganizations where the consideration cannot be delivered to the creditors without the performance of an affirmative action by them and will have a significant positive impact on future Argentine-US cross-border cases, Chapter 15 petitions and the formulation of debtors' reorganization proposals. ■

1. See *In re Bd. of Dirs. of Telecom Argentina S.A.*, 2006 WL 686867 at *2 (Bankr. S.D.N.Y. Feb. 24, 2006) below.
2. §2560 of the Argentine Civil and Commercial Code.
3. *In re Supercanal S.A.*, Debtor in a Foreign Proceeding.
4. See e.g., *In re Bd. of Dirs. of Compañía General de Combustibles S.A.*, 269 B.R. 104, 107 (Bankr. S.D.N.Y. 2001); *In re Bd. of Dirs. of Multicanal S.A.*, 314 B.R. 486 (Bankr. S.D.N.Y. 2004); aff'd and remanded, 331 B.R. 537 (S.D.N.Y. 2005); *The Argo Fund Ltd. v. Bd. of Dirs. of Telecom Argentina, S.A.* (*In re Bd. of Dirs. of Telecom Argentina S.A.*), No. 06 Civ. 2352 (NRB), 2006 WL 3378687 (S.D.N.Y. Nov. 20, 2006); *In re Compañía de Alimentos Fargo, S.A.*, 376 B.R. 427 (Bankr. S.D.N.Y. 2007); *In re Bd. of Dirs. of Telecom Arg.*, 2006 WL 686867, aff'd, Telecom Arg., 528 F.3d 162 (2d Cir. 2008); *In re Cablevisión S.A.*, Case No. 04-15697 (SMB) (Bankr. S.D.N.Y. October 23, 2009); *In re Rede Energia S.A.*, 515 B.R. at 93 (citing Telecom Arg., 528 F.3d at 174-76); *In re Sino-Forest Corp.*, 501 B.R. 665 (Bankr. S.D.N.Y. 2013); *In re Metcalfe & Mansfield*, 421 B.R. 685 (Bankr. S.D.N.Y. 2010); and *In re Inversora Eléctrica de Buenos Aires S.A.*, 560 B.R. 650 (Bankr. S.D.N.Y. 2016).

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During the last several decades, Fernando has been involved in advising either the debtor or creditors in some of the major international financial restructurings, out-of-court restructuring agreements and reorganizations, including the Supecanal S.A.'s reorganization Chapter 15 petition; the USD 135 million Inversora Eléctrica de Buenos Aires S.A. out-of-court restructuring; the KLP Emprendimientos S.A. reorganization; the Sociedad del Plata reorganization; the Supercanal S.A. USD 104 million reorganization and USD 305 million principal amount secured notes cancellation; the USD 800 million Cablevisión S.A. out-of-court restructuring and the USD 150 million Compañía de Alimentos Fargo S.A. reorganization.

Fernando has advised both debtors and creditors, has a large experience in cross-border reorganizations and is skilled in advising on complex restructuring cases. With a high level of experience in corporate finance and capital markets, Fernando's knowledge of insolvency proceedings is complemented by his demonstrated knowledge and experience in financial matters. His extensive experience in both procedural and finance matters gives him an integral view of restructurings and allows Fernando to add great value to the planning of process strategies and the formulation of reorganization proposals.

Fernando wrote many articles in the matters of his specialization, both domestic and international, and is a member of the Buenos Aires Bar Association, the American Bar Association, INSOL International, the International Insolvency Institute and the American Bankruptcy Institute. He received his law degree from the Buenos Aires University School of Law in 1994 and obtained an LL.M. at Columbia University School of Law in 2001.

To Trust or Not to Trust: Security Trusts in Mexican Commercial Reorganization Proceedings

By EVERARDO J. ESPINO

This article discusses the use of security trusts (*fideicomisos de garantía*) as a means for securing the payment of commercial obligations in Mexico, as well as the rights and risks associated with such trusts in the event of a commercial reorganization (*concurso mercantil*) of the debtor. We start with a brief overview of the types of instruments that creditors may use to create a security interest in a debtor's assets under Mexican commercial law and highlight how security trusts are distinct from other types of security interests. We then consider the impact of commercial reorganization proceedings on the property held by security trusts. We conclude the piece by examining the contradictory treatment of security trusts in recent court decisions in Mexico and summarize the practical implications for creditors who accept the use of security trusts as a form of security in commercial transactions.

Types of Instruments for Securing the Payment of Credits

Mexican law regulates several means for securing the payment of credits. The most common of these are mortgages, pledges and security trusts.

Mortgages: A mortgage grants a security interest to a creditor in the mortgaged property owned by the debtor. In the event of the debtor's bankruptcy, a mortgage gives the creditor the right to receive payment up to the value of the mortgaged property, in accordance with the priority ranking established by law.

Pledges: Similar to a mortgage, a pledge is a security interest created in disposable personal property of a debtor to secure compliance with an obligation to a creditor. In the event of the debtor's bankruptcy, the pledge permits the creditor to receive payment up to the value of the pledged property in accordance with the priority ranking established by law.

Security Trusts: In a security trust, a debtor (known as the "settlor"), which can be either a company or a natural person, transfers to a trustee (which may or may not be an affiliate of the settlor) the ownership of certain rights and/or assets for the purpose of securing compliance with any obligation to a beneficiary.

Classes of Creditors and Payment Priority

The Commercial Reorganization Law (*Ley de Concursos Mercantiles*) of Mexico aims to preserve the viability of financially distressed companies that have defaulted on their payment obligations and protect their business relationships with their partners. To achieve this, the Commercial Reorganization Law determines the character of the credits of the debtor and puts in place a priority scheme for the debtor's repayment of its debts. The law classifies credits into the following classes, each with a different priority ranking:

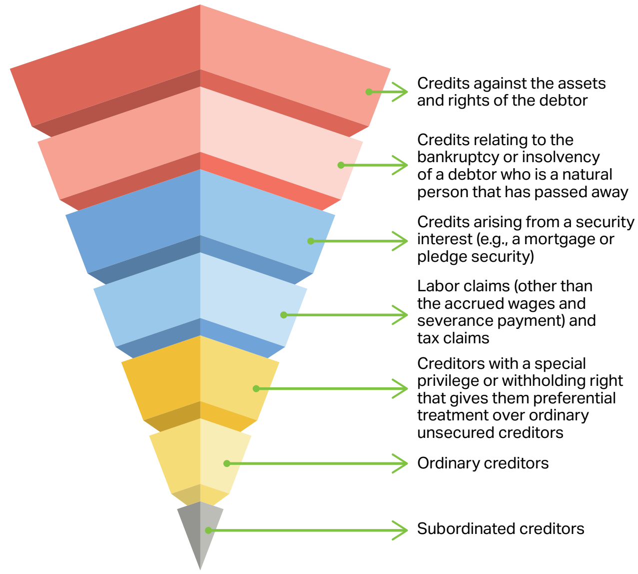
First, creditors with credits against the commercial reorganization property. These include:

a. Credits related to accrued salaries or wages and for severance payments, considering the wages for the past year;

b. Credits incurred during the commercial reorganization proceeding to manage the commercial reorganization property with authorization from the conciliator or receiver, as case may be;

c. Credits incurred to maintain the ordinary operation of the debtor and to provide the liquidity required during the commercial reorganization process;

Priority of Payments



d. Credits incurred to pay for ordinary expenses for securing the commercial reorganization property and for its repair, conservation and management; and

e. Credits incurred in court proceedings or out-of-court for the benefit of the commercial reorganization property.

Second, certain creditors who incur credits relating to the bankruptcy or insolvency of a debtor who is a natural person that has passed away (e.g., the funeral expenses of such debtor or the medical expenses caused by the death of such debtor).

Third, creditors that hold a security interest. This category only includes creditors holding a mortgage or pledge security. Creditors who are beneficiaries of a security trust are not contemplated in this category and, as we will further discuss below, must file a separation action if their property or rights form part of the commercial reorganization property.

Fourth, creditors with labor claims other than the accrued wages and severance payments described above.

Fifth, tax claims by the federal or local treasury. Note that tax creditors holding a security interest will be deemed secured creditors (ranking *third* above) for up to the amount of their security, and the remainder of their claim will constitute a tax credit.

Sixth, creditors with special privilege. Those are creditors that, according to the Commercial Code (*Código de Comercio*) and other applicable laws, have a special privilege or withholding right that gives them a preferential treatment over ordinary unsecured creditors. There is no jurisprudence that defines

To facilitate enforcement against security trusts, the Commercial Reorganization Law expressly provides that property that is in the possession of the debtor but that is beneficially owned by third parties may be separated from the commercial reorganization property.

who those creditors are, but they have commonly included commission agents, personal property vendors, carriers and building contractors, to name a few. As we will discuss later on, beneficiaries of security trusts may also potentially constitute creditors with special privilege.

Seventh, ordinary creditors, consisting of creditors that do not fall within any of the aforementioned classifications.

Eighth, subordinated creditors. Those include:

a. Creditors that agreed to the subordination of their rights with respect to ordinary credits; or

b. Creditors that have unsecured credits and that constitute a "controlled person," such as the manager, members of the board of directors or relevant employees of the debtor.

The priority between creditors of the same ranking shall be subject to the date of the credit, the registration date of the security or the relevant contractual provisions.

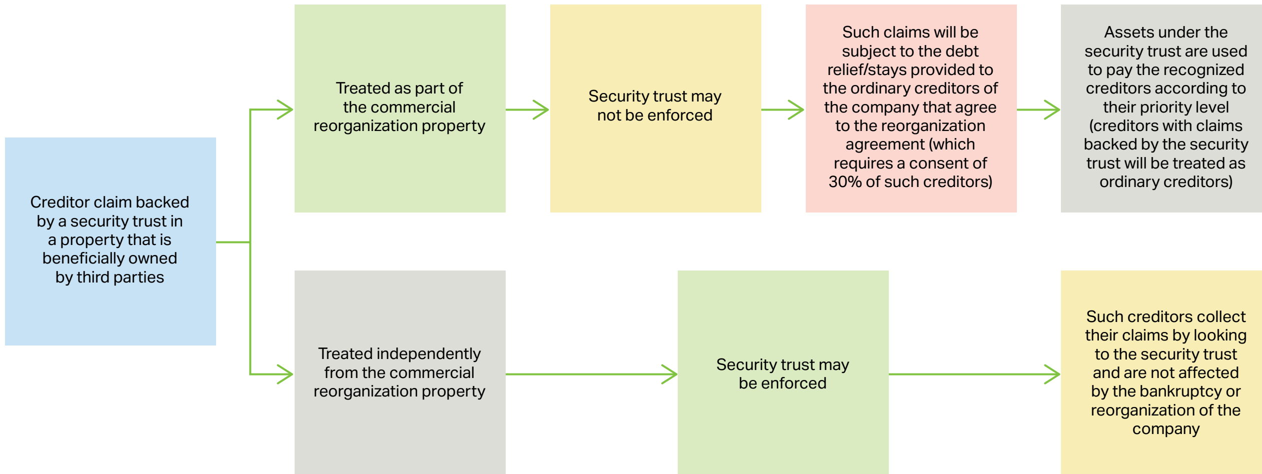
As mentioned above, the only secured credits of the debtor under the payment priority scheme are those that have a mortgage or pledge securing payment. The Commercial Reorganization Law does not recognize beneficiaries of a security trust as secured creditors of the debtor. Therefore, security trust beneficiaries with outstanding credits are treated as ordinary creditors.

Impact of Commercial Reorganization on Security Trust Property That is Owned by a Third Party Trustee

As a general matter, from the moment when a decision is issued in a commercial reorganization proceeding until the conciliation stage ends, if the commercial reorganization agreement is approved or the bankruptcy of the debtor is declared by the court, no seizure or foreclosure order may be enforced against the property and rights of the debtor (other than labor-related seizures and foreclosures). As an exception to that general rule, a commonly held view is that commercial reorganization proceedings do not affect the validity of a security trust arrangement. Pursuant to the laws applicable to disposals of real and personal property, a commercial reorganization of the debtor does not affect the validity of prior disposals of property. Under this view, it would be possible to seize the security trust property and collect the proceeds to satisfy the related credits, in spite of the debtor having been declared in commercial reorganization. The bankruptcy of the debtor will not affect the creditor backed by a security trust, since the debtor will not be the party disposing of the trust property to pay the creditors. Some court decisions support this view and hold that the assets of a security trust cease to be part of the property of the debtor and therefore do not form part of the commercial reorganization property.

To facilitate enforcement against security trusts, the Commercial Reorganization Law expressly provides that property that is in the possession of the debtor but that is beneficially owned by third parties may be separated from the commercial reorganization property. The request for separation by the trust beneficiaries, and any opposition by the debtor, must be adjudicated through an ancillary proceeding in the commercial reorganization proceeding.

Potential Treatment of Security Trust Claims Over Commercial Reorganization Property



Contradictory Treatment of Security Trusts by Commercial Reorganization Judges

In contrast to the foregoing, some commercial reorganization judges have held that assets allocated by the debtor to security trusts continue to form part of the commercial reorganization property. This view is typically taken when the debtor continues to hold the title to the trust property and continues to enjoy rights to such property or when the trustee is not a third-party entity and is, instead, affiliated with the debtor (e.g., when the court found that the real property was allocated to a security trust while the debtor continued to hold possession of the property as a custodian, when the accounts receivable of the trust property were invoiced by the debtor or when the debtor received consideration for services provided by it in relation to the trust property).

If the court comes to a finding that the trust property in fact forms part of the commercial reorganization property, the beneficiaries' claims that are secured by the security trust will be subject to the payment ranking and priority that applies more generally to the commercial reorganization property and the security trust may not be enforced, despite the enforceability of the underlying secured obligation. Additionally, such claims—which will now be treated as part of the unsecured claims of the ordinary creditors—will be subject to the debt relief and/or stays assumed by the ordinary creditors of the debtor that execute the commercial reorganization agreement. Such reorganization agreement under the Commercial Reorganization Law only requires the consent of the holders of 30% of the amount of recognized claims of the ordinary creditors. Furthermore, the assets allocated to the security trust will be used to pay the creditors of the debtor in accordance with their class and priority ranking, which means the creditor holding claims that were backed by the security trust will now get paid with the ordinary creditors and rank next-to-last in its priority of payment, coming ahead only of subordinated creditors.

Recent Court Cases Impacting the Treatment of Security Trusts in Reorganization Proceedings

On August 3, 2018, a court opinion issued on the treatment of security trusts was upheld by the Mexican Collegiate Circuit Courts.[1] The opinions issued by the lower court as well as the circuit court analyzed the nature of security trusts in commercial reorganization proceedings and the treatment to be accorded to them. Those opinions support the view that the property of the security trust is independent from the assets of the debtor that are subject to the commercial reorganization proceeding, despite any links that the trust property may have to the debtor. The main conclusions from both court opinions are as follows:

— Generally, security interests give creditors (i) priority on the sale price of the property that comprises the collateral, so the creditor may be paid with the price of the property before other creditors; and (ii) a right to pursue the property regardless of who its holder is, even if the property has changed ownership. The foregoing does not occur in security trusts. In a security trust, there are (i) no priority concerns, since there are no preferential rights of other creditors and no possibility of other creditors asserting a competing security interest (in other words, due to the effect of the trust itself, the property is removed from the debtor's property); and (ii) no need to pursue the property, since the property that comprises the trust cannot change ownership—it is allocated to the trust and it is the property of the trustee with no right to dispose of it.

— Therefore, property that is subject to a security trust may not be considered a security interest, since it is not the debtor's property. The fact that the trust is called a security trust does not mean that it is a security interest; it only means to denote that the property is subject to the payment of a debt and, in case of default in payment, the debt is satisfied with the enforcement of the security, without the risk of overlapping or competing claims by other creditors.

Further, the court held in those cases that if the trust property is in the possession of the debtor at the time of the commercial reorganization, the trustee may request its reversion, so the trust may hold it for the true legal owners. In addition, in the event of a precautionary measure (*providencia precautoria*) that suspends the enforcement of the security trust, the affected party (be it the beneficiary or the trustee) may challenge the suspension.

Although those two recent court decisions do not constitute binding precedents, they provide guidance for judges in commercial reorganizations and form part of the body of jurisprudence those judges must consider when adjudicating reorganization proceedings.

Inconsistencies in Treatment of Security Trusts to be Addressed by Mexican Federal Courts

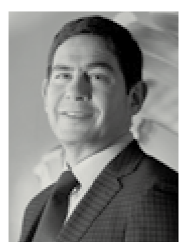
Although the two court decisions discussed above address the independence of the security trust property from the commercial reorganization property, they do not address the class and priority ranking that the creditors backed by the security trust should be attributed when classifying their credits.

Acknowledging the independence of the security trust property does not sufficiently protect the beneficiaries of security trusts if the underlying credits held by them are classified as ordinary credits. If that is the case, the satisfaction of the credits secured by the trust property will be subject to the debt relief and/or stays agreed with the class of ordinary creditors under the commercial reorganization agreement, regardless of the amount that was originally secured by the trust property. In other words, the creditor/beneficiary would only be able to enforce against the trust property up to the amount that results from the debt relief and/or stays agreed with the other ordinary creditors.

On the basis of the foregoing, liabilities secured by a security trust could be recognized as credits with special privilege by having a special collection or withholding right against the trust property that comes ahead of ordinary unsecured creditors. Under the Commercial Reorganization Law, the commercial reorganization agreement must give priority to the payment of credits to creditors with special privilege that have not executed the reorganization agreement. In bankruptcy, only the wages of the workers, the expenses of the litigation for the defense or recovery of the property subject to the security or on which the privilege lies, the necessary expenses for the conservation, maintenance and sale thereof and the guaranteed credits are paid before paying creditors with a special privilege.

The other possible negative effect on credits secured with trusts in the event of a commercial reorganization is the risk that the trust could be considered unenforceable. In an isolated court decision issued in 2015[2] (that is nonbinding on future court judgments), the court held that the predispositions of future income in favor of creditors for the purpose of paying their credits pursuant to a trust agreement or assignment of future rights agreement was ineffective. This precedent is questionable as it dismisses the intent of the parties to the trust agreement in favor of what it refers to as "the rules of public order that come into play" during a commercial reorganization—which is contrary to other jurisprudence on enforceability of contracts for the disposal of property. It is thus very likely that this precedent will come into direct conflict with future court decisions that will hold to the contrary. If so, the federal courts of Mexico will be required to issue mandatory jurisprudence on the subject matter and help remove the ambiguity currently surrounding the treatment of security trusts in reorganization proceedings. ■

1. *Amparo* under review 70/2018. Misiones de Casa Real, S.A. de C.V. May 30, 2018. Unanimous Vote. Reporting Judge: Abraham S. Marcos Valdés. Clerk: Patricia Villa Rodríguez.
2. *Amparo* under review 96/2015. Banco Invex S.A., Institución de Banca Múltiple, Invex Grupo Financiero. May 28, 2015. Unanimous Vote. Reporting Judge: Neófito López Ramos. Clerk: Samuel René Cruz Torres.



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Indian Bankruptcy Code—How Does It Compare?

By **SUI-JIM HO** *and* **SURYA KIRAN BANERJEE**

Corporate Insolvency in India

The Insolvency and Bankruptcy Code 2016, implemented in phases since August 5, 2016, was enacted to overhaul the outdated and complex corporate insolvency laws in India to address an economy-wide problem of bad loans, with its resulting impact on the banking sector and access to credit. Even so, the speed and resoluteness with which India's central bank, the Reserve Bank of India, has moved to list delinquent borrowers (and to direct banks to initiate insolvency proceedings against them) is unprecedented and has surprised many. The

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most prominent example is that of Essar Steel, which has defaulted on approximately $6.9 billion of loans and is now being sold in a distressed sale under the Code. Given the aggressive application of the Code by Indian banks (on the direction of the Reserve Bank) and the quality of assets on offer, it is essential for overseas debt and equity investors to understand the Code and the resulting challenges and opportunities.

The Code has also materially impacted the rates of default on loan repayments. The Insolvency and Bankruptcy Board of India estimates that the threat of use of the Code has prompted repayment in the last two years of USD 14.2 billion in loans that were otherwise outstanding. In other words, repayment rates have materially improved owing to a fear among controlling shareholders of Indian debtors that they may lose control of their (largely) family owned businesses if placed in insolvency. It is therefore equally important for existing creditors and shareholders to take note of the change in debtor-creditor dynamics introduced by the Code, given that it is now possible for creditors to credibly enforce their rights, including in ways that result in a change in ownership of debtors.

In this article, we explore some of the salient features of the Code, judicial and market practice to date and what can be expected going forward. We also draw a comparison against Chapter 11 of the U.S. Bankruptcy Code and various restructuring processes in the U.K. (in particular, administration and schemes of arrangement) where relevant.

Considerations for Overseas Investors

The Code presents a number of considerations that overseas debt and equity investors should bear in mind.

Goals of the Code

In the U.K., various insolvency proceedings such as company voluntary arrangements, administration and schemes of arrangement can be used to rescue a financially distressed debtor. Several options also exist under Chapter 11 in the U.S. Similarly, the primary objective of the Code is to resolve the insolvency of the corporate debtor (as a going concern, in contrast to liquidation). While the courts have held that a resolution process does not necessarily involve a sale, resolutions to date have almost exclusively done so—often by way of auctions. The emphasis on avoiding liquidation is also demonstrated in the ability of a liquidator to sell the debtor as a going concern in liquidation proceedings that follow a failed resolution attempt.

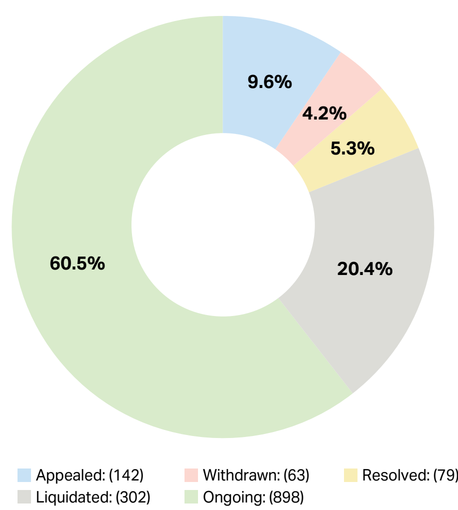
A rescue is generally more likely if the relevant process is available at an early stage. As in U.S. Chapter 11 and U.K. company voluntary arrangements and schemes, there is no insolvency requirement under the Code—the Code process is available once a debtor is in default. Further, the threshold for filing is

RESOLVING INSOLVENCY IN INDIA — BEFORE AND NOW

- According to 2018 World Bank data, India ranks 108th of 189 countries in insolvency resolution (from 136th in 2016).
- Historically, creditors recovered 26.4 cents on the dollar on average. This has reportedly gone up to 49.6 cents on the dollar following the implementation of the Code (partly as a result of the introduction of criminal penalties in respect of a related law on the enforcement of security). The rates of recovery in the U.S. and the U.K. are 81.8 and 85.3 cents on the dollar, respectively.
- Indian insolvency proceedings take 4.3 years on average. The time taken under the Code is yet to be empirically tested, but a drastic reduction is expected.
- Businesses have historically been sold piecemeal and not as going concerns. The focus, and experience to date, of the Code is to attempt a going concern sale of defaulting debtors.

low (arguably too low, *see inset below*). However, the focus on rescuing the debtor entity (instead of on the continuity of the debtor's businesses) is counterproductive—allowing sales of attractive assets or business verticals in a resolution process (currently only permitted in liquidation) would help preserve value, and possibly contractual and employment relationships.

Is the Code Working?
(as of December 31, 2018)



As with English administration, a secondary objective under the Code is the maximization of the value of assets for the benefit of the creditors. A conflict with the primary objective may arise if the committee of creditors votes to liquidate the

KEY CHANGES INTRODUCED BY THE CODE

- Replaces a patchwork of disparate federal and state laws, and overlaps in the court system, with a single law and forum—the National Company Law Tribunal. Appeals from decisions of the tribunal are heard by the National Company Law Appellate Tribunal. A further appeal to the Supreme Court is available in respect of questions of law.
- Move from '*debtor-in-possession*' to '*creditor-in-possession*' model—suspension of the board of directors of the debtor on filing of petition.
- Insolvency resolution professional appointed by committee of creditors (comprising all 'financial' creditors) to manage the debtor and formulate resolution plan.
- Increased expertise expected to lead to quicker and better outcomes, and reduced scope for appeal.
- Reduced 180-day (plus single 90-day extension) timeline for resolution process.
- Resolution plan requires 66% (value of claims; down from initial 75% threshold) creditor approval, and tribunal sanction.
- Debtor liquidated if resolution process not completed within timeframe, or if plan rejected by tribunal.

corporate debtor (instead of approving a resolution plan)—for example, if the debtor is in economic as opposed to financial distress (i.e., the liquidation value of the debtor is higher than its value as a going concern). The interaction of the two objectives is still to be tested.

Control of the Debtor During Insolvency Proceedings
The powers of the board of directors of the debtor are suspended once an insolvency petition is admitted under the Code, with the debtor being managed by a resolution professional for the duration of the resolution process. While the resolution professional has statutorily defined duties, the Code provides for ultimate control over the resolution process to be exercised by a committee of creditors, comprising all the financial creditors of the debtor. The committee may approve a resolution plan, or alternatively decide to liquidate the debtor, if 66% (contrasted with 75% in the previous version of the Code) by value vote in favor of such action. The committee may also elect to withdraw the debtor from the insolvency process if 90% by value consent to do so. Administrative decisions are made by a 51% majority.

'Financial creditors' are holders of 'financial debt', which includes not only bank debt and bonds, but also certain derivatives and guarantee transactions. Before triggering a resolution procedure, a friendly creditor may want to carefully conduct diligence on the size of the debtor's 'financial debt' within the meaning of the Code. As some of these forms of 'financial debt' may not be evident from the balance sheet of the debtor, there is a risk that any given financial creditor may constitute a smaller than expected part of the complete pool of financial creditors and, consequently, not have the expected level of control in the resolution process. It should be noted that any taxes owed to governmental authorities will not constitute financial debt and, therefore, that the Indian tax authorities will not form part of the committee of creditors or the voting pool of financial creditors.

The Code provides that certain actions may not be undertaken without the prior approval of the creditor committee. The range of matters covers not only material changes that should rightly require the consent of the creditor committee, such as the raising of interim finance and changes to the capital structure, but also certain administrative matters, such as changes to the contract with the auditors and the undertaking of any related party transaction. The requirement for creditor committee consent in such a wide range of matters may be cumbersome in practice and could risk slowing down the restructuring process, especially if the debtor has a disparate group of creditors, making it more challenging to meet the 180/270-day timeline.

> **The aggressive timeline poses a serious concern as the Code calls for liquidation if a resolution plan is not agreed on time.**

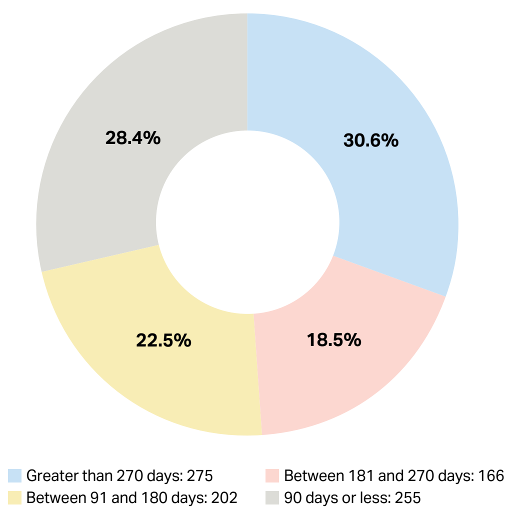
The creditor-led model under the Code can be contrasted with administration in the U.K. (where an administrator is appointed to manage the debtor but without the same level of creditor control), and with the debtor-in-possession model under Chapter 11 in the U.S. The creditor-led approach is not ill-suited to India given the concentrated composition of creditors (largely banks, as opposed to holders of capital markets instruments), which allows for a negotiated resolution plan to be agreed while continuing trading. However, the suitability of the approach may need to be revisited as the ownership of debt becomes more broad-based—interestingly, the Code itself is leading to a broadening of the creditor base beyond banks by creating a rapidly growing market in distressed debt instruments. Arguments in favor of retaining a role for existing directors absent mismanagement or fraud may also receive further attention once the initial set of high profile defaults is resolved, governance standards strengthen further and the performance of insolvency professionals receives scrutiny.

Aggressive Timelines

The 180-day (extendible once to 270 days) deadline set out in the Code may prove to be a double-edged sword. On the one hand, this deadline could encourage a resolution plan to be agreed in a timely manner. On the other hand, it may be unrealistic—it is not uncommon for restructuring talks to stretch beyond a year. This is especially true for larger global businesses with complicated capital structures and is likely to be more so in India given the outsized role of creditor committees in the management of the debtor during the resolution process. By comparison, according to World Bank data, insolvency proceedings in the U.K. and U.S. take approximately a year on average (taking into account the reduced timelines in respect of pre-packaged insolvency resolutions or '*pre-packs*', which are not yet available in India).

The deadline, if adhered to strictly, is likely to pose a serious concern as the Code calls for the tribunal to order the liquidation of the debtor if a resolution plan is not agreed within the deadline. A recent Supreme Court decision has held that the deadline is mandatory, but the scope of any exceptions or '*clock stops*' is still evolving.

Status Check – Pending CIRPs



Intervention by Opportunistic Creditors

The Code prescribes a relatively low threshold for the initiation of a resolution process by a broad range of creditors (*see inset*). Notably, a financial creditor can initiate the process even in relation to a payment default on debt owed to another financial creditor. This allows a go-around for creditors who do not have cross-default clauses in their debt instruments or whose debt is current, who can now use the Code to create an event of default (e.g., an event of default resulting from the commencement of an insolvency proceeding) under their own instruments. The fear of an opportunistic creditor calling a default in such circumstances may reduce the willingness of a sympathetic financial creditor to allow the debtor breathing space or to seek to restructure the debt outside of formal proceedings or at a forum of its choosing.

A practical solution may be for a sympathetic financial creditor to waive a payment default as soon as practicable to limit the scope for an opportunistic creditor that is not part of the same syndicate as the waiving creditor capitalizing on such default by initiating a resolution process.

Scope of Moratorium

Keeping in mind the overarching objective to restructure financial obligations while continuing to trade, a moratorium allows the debtor breathing room and facilitates trading while the debtor undergoes a negotiated process involving participants with often-competing incentives.

The Code envisages an automatic stay or moratorium against the institution or continuation of claims against the debtor, the execution of judgments against the debtor, the alienation by the debtor of its assets and the creation/invocation of security interests pertaining to the debtor (including, importantly, under the Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002, on which creditors typically rely) while the resolution process is ongoing.

FILINGS: STANDING AND THRESHOLDS

— The resolution process can be initiated under the Code by any financial or operational creditor, as well as by the debtor itself. An application by the debtor itself must be supported by a special resolution of shareholders (i.e., cannot be initiated by the board of directors without shareholder consent).

— No difference in rights under the Code between domestic and overseas creditors.

— *De minimis* threshold of INR 100,000 (~USD 1,500) for entitlement to initiate resolution process. A proposal to increase the threshold tenfold (~USD 15,000) was under consideration.

As in the U.S., the moratorium under the Code is automatic and applies to all legal proceedings against the debtor. While the U.K. government is consulting on a narrower, time-limited (28 days, extendable by another 28 days, and beyond this with majority secured and unsecured creditor consent) moratorium, there is currently no moratorium except in cases of administration (and for small companies, though this is rarely used). This is typically addressed by entering into lock-up or standstill arrangements or, in the case of schemes, a *de facto* moratorium can be put in place by courts using their extensive powers of case management. Practitioners also

sometimes use schemes in tandem with administration to avail of a moratorium.

Unlike in U.K. administration, the U.S. Chapter 11 moratorium precludes counterparties from terminating contracts on the basis of insolvency alone (limited exceptions apply). The U.K. government is considering prohibiting such *ipso facto* clauses—albeit in a restricted form allowing debtor companies to designate certain contracts as essential, and allowing creditors to challenge the designation in court. While the Code expressly sets out a provision preserving the supply of essential goods or services to the debtor, the enforceability of *ipso facto* clauses remains uncertain.

The scope of what is permitted or prohibited by the Code moratorium is in general not entirely clear. For instance, the Code is silent on whether the moratorium restricts set-off rights. Further, it is not clear whether the moratorium will be recognized overseas if the debtor has material assets outside India. This uncertainty can be a cause for concern as (in addition to the commercial implications) the Code prescribes a fine and/or imprisonment of up to five years for a contravention of the moratorium (e.g., by enforcing security furnished by a debtor outside India). However, the contours of the moratorium are gradually becoming clearer as courts pronounce on specific issues and corresponding amendments are made to the Code—for example, it is now clear that the moratorium under the Code does not extend to guarantees given in relation to the debt of the debtor undergoing resolution.

Foreign Proceedings

Importantly for creditors, the moratorium under the Code may not restrict foreign proceedings in relation to foreign law-governed debt depending on the governing law of such debt. For example, in December 2018, the Court of Appeal in the U.K. dismissed a petition by the International Bank of Azerbaijan seeking, in effect, a permanent moratorium against claims by creditors under English law-governed documents. The Court reiterated that the Gibbs rule remains good law and that a foreign process, even where it is the main proceeding, cannot compromise English law-governed debt.

The scope of what is permitted or prohibited by the Code moratorium is in general not entirely clear.

Conversely, under Chapter 15 of the U.S. Bankruptcy Code, U.S. courts will typically recognize the compromise of U.S. law-governed debt in a foreign proceeding, provided that such foreign proceeding functions in accordance with established principles of procedural fairness such as notice and due process, and the substance of the restructuring is not drastically different from what could be achieved under a Chapter 11 plan in the U.S. Interestingly, a U.S. court has recently granted recognition to a Croatian proceeding compromising English-law

governed debt, even though such proceeding would not be recognized under English law.

More broadly, the absence of a robust regime governing cross-border insolvencies is a notable lacuna in the Code. The Code contemplates that the Indian government will agree to bilateral arrangements with other countries (no such arrangements have been agreed) and that the tribunal will issue requests for information and action accordingly. There is no requirement for Indian courts to cooperate with foreign courts as regards concurrent proceedings (e.g., by granting a stay on Indian proceedings). The enforcement of final and conclusive judgments of a limited number of foreign courts can be sought in Indian courts, but additional requirements apply to judgments of most jurisdictions (e.g., the U.S., but not the U.K.), to orders of tribunals/executive bodies, as well as certain types of orders such as administrative and interim orders.

Both the U.S. and the U.K. have adopted the UNCITRAL Model Law on Cross-Border Insolvency (see Chapter 15 of the U.S. Bankruptcy Code and the Cross-Border Insolvency Regulations 2006, respectively), which sets out a model for procedural cooperation between states in cross-border insolvencies. The Insolvency Law Committee on Cross-Border Insolvency in India recommended in October 2018 that India adopt provisions based on the Model Law.

As in the U.S. and the U.K., the Indian model is also likely to broadly provide for the recognition of foreign proceedings as either main or non-main proceedings, and for certain reliefs (e.g., moratoria) to be available depending on the nature of the foreign proceeding. Typically, this would involve an automatic moratorium (though the scope of the relief is narrower in the U.K. than in the U.S., particularly with respect to secured creditors) in the case of foreign main proceedings, and a discretionary remedy in the case of foreign non-main proceedings. Similarly, the Indian model is also likely to allow for the establishment of concurrent proceedings limited in scope to domestically situated assets. An important drawback of the Indian proposal is that it does not propose to tackle issues relating to the enforcement of insolvency judgments/orders at this stage, pending the development of judicial practice on the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments.

Group Insolvencies

In addition to the cross-border issues identified above with respect to a single debtor having assets and liabilities across multiple jurisdictions, a group insolvency scenario (i.e., insolvency proceedings relating to different members of a group of companies, typically in more than one jurisdiction) should also be considered. The Code is silent on the manner in which group insolvency proceedings are to be administered. This is in contrast to the E.U.'s Recast Insolvency Regulation, which goes beyond the usual main/non-main tiering of proceedings to allow a consolidated group insolvency proceeding to be commenced, involving active cooperation between insolvency professionals and courts across the E.U.. Little progress is expected on this front in the coming months as the Indian Insolvency Law Committee on Cross-Border Insolvency specifically excluded group insolvencies from the purview of its report, noting that it would revisit the subject once there was further international consensus on the subject.

Minority Creditor Protection

In contrast to pure contractual processes such as workouts, a common feature of insolvency processes across jurisdictions is the ability to bind a minority of dissenting creditors and/or equity holders to a plan. This helps prevent a hold-up situation in which one or more creditors threaten to defeat a plan by withholding their consent to such plan in order to negotiate a better deal than they would otherwise obtain. The ability to cram down must be tempered by the ability of creditors to block unsound or discriminatory plans—the generally accepted yardstick for evaluating whether a plan is discriminatory is a comparison against other similarly situated creditors, grouped together as members of a 'class'.

In the U.K., a 'cram down' of secured and preferential creditors is not possible in company voluntary arrangements and in administration. Creditors, including secured creditors, within the same class can be crammed down using a scheme of arrangement. In practice, senior lenders have combined schemes with administrations to cram down entire classes of junior creditors where the value breaks in the senior debt. This is achieved by transferring the business of the company to another entity in which only the senior creditors hold shares. As the rights of the junior creditors are not affected, courts have upheld these schemes. The U.K. government is also considering the introduction of a new insolvency procedure called a restructuring plan, which would allow a cross-class cram down of creditors provided at least one class of impaired creditors votes in favor of the scheme and the absolute priority rule is followed (i.e., a senior class of creditors is paid in full before any junior class receives anything, unless the senior class consents to such arrangement)—however, unlike in the U.S., the court will have the discretion to approve a plan that does not respect the absolute priority rule if the deviation is necessary to achieve the aims of the plan and the plan is just and equitable in the circumstances. A cram down of entire classes of creditors is possible in the U.S. if the bankruptcy court finds that the plan is fair and equitable and does not discriminate unfairly with respect to the dissenting class.

The Code does not require the resolution professional, the committee of creditors or the National Company Law Tribunal to consider the interests of dissenting creditors in proposing and approving a resolution plan. In other words, a cram down not only of dissenting financial creditors but also of entire classes of creditors (e.g., operational creditors) is permitted.

That having been said, a tribunal has recently held that amounts owed to operational creditors should receive similar treatment as amounts owed to financial creditors—that is, the strict priority of payment in liquidation does not apply in a resolution process. A rule permitting the payment of only the liquidation value (possibly nil if the debtor is insolvent) to operational and dissenting financial creditors, generally accepted in the U.S. as a metric of a fair plan, was contemporaneously held to be *ultra vires* under the Code and subsequently deleted by amendment. The tribunal has also held that similarly situated creditors (whether operational or financial) should not be treated dissimilarly. The Supreme Court has also made nonbinding observations that operational creditors be given a more involved role in the formulation and approval of resolution plans. While these observations do not negate the ability to cram down entire classes of creditors, they introduce substantive requirements in relation to the content of the plan itself. A procedural safeguard under the Code is that it disenfranchises financial creditors that are related parties from voting on a resolution plan.

The Code also contains further safeguards in the form of the involvement of the resolution professional who must comply with statutorily prescribed duties in respect of the conduct of the process. As with schemes of arrangement in the U.K. (and in India in a non-insolvency context), an important minority creditor protection safeguard is the exercise of judicial oversight over the process and discretion in the approval of any plan. For example, in the U.K., the court may refuse to sanction a scheme in which the majority shareholders have a special interest that is separate from that of the minority—for example, if they provided irrevocable undertakings to vote in favor of a scheme in exchange for consideration not available to the minority. The U.S. courts also exercise oversight over proposed plans to ensure that they are feasible, and that they do not discriminate unfairly and are fair and equitable to impaired classes of creditors.

While there is no statutory provision on the point, the tribunals in India are likely to consider, among other factors, whether the statutory majority is acting in good faith and whether the arrangement is one that a creditor would reasonably approve. However, judicial practice on the standard of review by the tribunal, and on the practical implications of such review, is still developing and the position remains unclear. In the limited case law to date, tribunals have required the committee of creditors to consider the interests of all stakeholders (stating that the process is not a recovery proceeding); and for the plan to maximize the assets of the corporate debtor, to be equitable, to not discriminate unfairly and to promote entrepreneurship and the availability of credit.

Pre-Code Procedures

Given the systemic nature of the bad loans problem in India, the specialist tribunals set up to hear insolvency cases are quickly becoming overextended—the Reserve Bank of India has already called for better infrastructure to be put in place. In this context, Indian banks have proposed an alternative called Project Sashakt, which entails medium-sized loans being resolved contractually within a period of 180 days, with negotiations being led by a lead bank appointed by the lenders collectively. The establishment of a bank-funded asset management company, supported by institutional funding, is being contemplated for larger loans.

The voluntary process for medium-sized loans is essentially a contractual workout as it is underpinned by an inter-creditor template clause adopted by the relevant banks (and therefore does not apply to other creditors). The process does not require the involvement of an insolvency practitioner or nominee, and the agreed plan binds dissenting secured and preferential creditors (who have agreed to the template clause). The account is referred to the bankruptcy courts under the

Code as a fallback. However, the success of this program is contingent upon adoption by Indian banks of the template inter-creditor agreement, which has not received a favorable response to date. Further, the scheme arguably runs contrary to the policy objectives of the Reserve Bank of India, which in February 2018 abolished similar schemes allowing lenders to attempt to resolve bad debts outside of the Code process. The scheme has also been criticized as impeding the clean-up of banks' balance sheets attempted by the Code by allowing banks to delay recognizing loans as being in default, and to throw good money after bad. Therefore, there is uncertainty regarding its legal tenability given the broad powers of the Reserve Bank of India in this sphere.

Pre-packs

Another option to reduce the case load of the insolvency tribunals, and to allow for faster, cheaper and less disruptive resolution, is the use of pre-packaged resolution plans or pre-packs. Common in the U.S. and the U.K. (in administration), pre-packs were contemplated by a pre-Code amendment to the Companies Act, 2013, but were never enacted. They did not expressly make their way into the Code, and the consensus is that pre-packs cannot currently be undertaken given the highly prescriptive resolution process that must be followed under the Code.

The proposal in India contemplates the borrower agreeing to a resolution plan with its creditors before initiating insolvency proceedings to obtain formal court approval to cram down dissenting creditors and to override objections from other stakeholders. Unlike in the U.S., it is not clear whether the Indian proposal involves the solicitation of acceptances from creditors before filing, and may depend on the enforceability of lock-up agreements. The Indian proposal also does not contemplate a sale by the insolvency professional without the sanction of the court, as is permitted in U.K. administration. Court scrutiny minimizes the scope for conflicts of interest (an issue which in the U.K. saw the High Court remove administrators in *Vegas Investors v. Shinners* in 2018), and addresses an important criticism of pre-packs—that they lack transparency and often discriminate against unsecured creditors. Given the substantial litigation under the Code alleging discrimination against unsecured and operational creditors, a pre-pack that does not involve court scrutiny is unlikely to be adopted in India—the impact of this process requirement on the efficacy of pre-packs remains to be seen.

In addition to the usual benefits of pre-packs, there is a strong policy objective in favor of allowing pre-packs in the Indian context. The Reserve Bank's reluctance to allow banks to increase exposure to distressed borrowers means that it may be difficult for borrowers to obtain interim finance during the resolution process, possibly forcing a cessation of trading. The speed afforded by pre-packs may materially alleviate this issue.

Interim Finance

The provisions of the Code on interim finance are broadly similar to those in the U.S., with some important differences. On the other hand, the provision of interim finance in the U.K. operates largely as a result of market forces, and a recent consultation by the U.K. government to introduce U.S.-style provisions relating to the granting of super-security or 'priming' were not pursued as a result of negative market feedback.

The Code provides for two regimes governing the raising of interim finance. An interim resolution professional, who is tasked with managing the debtor until a full-time resolution professional is appointed, is permitted to raise interim finance, including the provision of security over unencumbered assets. The charging of encumbered assets requires the consent of the relevant secured lender. A full-time resolution professional is permitted to raise interim finance with the consent of the committee of creditors—this is in contrast to the U.S., where the court can effectively impose interim finance arrangements on existing creditors (subject to certain safeguards), but is consistent with the creditor-driven approach of the Code.

The Code grants super-priority to interim finance providers—along with the potential for 'priming' existing secured lenders, the high rates of interest on offer and the relatively short duration of exposure, this is a growing area of interest for lenders. An interesting point of note is that this market is likely to be supplied by alternate, non-bank providers of finance (including overseas lenders, who would however be constrained by the Reserve Bank's restrictions on external commercial borrowings by Indian borrowers) given the reluctance of Indian banks to lend further to distressed accounts (and the Reserve Bank's preference that they not do so).

Concluding Thoughts

The Code significantly improves India's ability to resolve insolvency efficiently and in a time-bound manner. Despite legal bottlenecks that have considerably delayed the first few cases as nuances in the law are ironed out, the Code is putting an end to the dysfunctional relationship between corporate debtors and lenders who, with no credible insolvency regime in place, were compelled to continue to fund errant debtors indefinitely in the hopes of ultimately recovering their dues. Given the creditor-led approach contained in the Code, lenders are now able to apply substantial pressure on borrowers to restructure their debts in a time-bound manner to increase recoveries. As mentioned earlier, a fear of being placed into a Code proceeding has also prompted debtors and their controlling shareholders to ensure timely compliance with repayment obligations. Viewed in the broader context of the enactment of a nationwide goods and services tax (creating a single Indian market), relaxation of foreign investment norms, governance reforms and the strengthening of anti-corruption law, the Code is an important milestone in making it easier to do business in India.

> **The Code seeks to put an end to the dysfunctional relationship between borrowers and lenders who, in the absence of a credible insolvency regime, funded errant debtors in the hopes of recovering their dues.**

A related consequence is the growth of the market for corporate debt. Reports indicate a vibrant market in pre-Code rescue finance, largely funded by non-bank finance providers. Further, given the slow progress of the initial few cases, banks are wary of participating in a Code process, and are increasingly looking to sell their exposure to specialist asset reconstruction companies (into which overseas investors can more freely invest).

There are also opportunities for equity investors given the high quality of assets on offer and the historically low recoveries expected by lenders. This is helped by the disqualification of existing controlling shareholders (and other persons who have defaulted on payments to lenders), rendering the process not fully competitive. Financial and strategic investors are also able to submit joint bids, allowing financial investors to participate in large processes and to tap management expertise, and allowing strategic investors to acquire assets that offer synergies at a compelling valuation without overextending their own balance sheets.

However, in addition to teething issues, such as the provision of relevant information to investors in a Code process, that remain to be resolved, some broader concerns remain. In addition to the issues highlighted above, these include the inability of the insolvency professional to sell profitable assets or verticals of the corporate debtor in a resolution process (permitted in a liquidation process). There is also uncertainty around the treatment of past and contingent liabilities, including as a result of a lack of coordination between regulators. For example, a recent decision of the Indian securities market regulator, the Securities and Exchange Board of India, imposed a fine on a debtor for non-compliance with securities laws in the period preceding the Code. This was imposed following the sale of a debtor in a court-approved process under the Code in which the acquirer expressly disclaimed liability for past non-compliance, bringing into question whether the 'whitewash' envisaged under the Code is operationally effective. There is also concern on the scope of the exclusion from participation in a Code process of persons connected to the existing controlling shareholders of the corporate debtor. This is widely believed to be too broad, and difficult to police—which the Indian government accepts and is re-examining. ■

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Notably, he is a trusted advisor of many sovereigns and state-owned entities in Europe, Russia/CIS, Africa, Asia and the Americas. He has advised states and SOEs on capital raising, debt management and disputes/investigations, including in relation to bribery, corruption and fraud matters.

Jim received an L.P.C., with distinction, from BPP Law School – Lincoln's Inn Fields, and an LL.B., First Class Honors, from the London School of Economics and Political Science.

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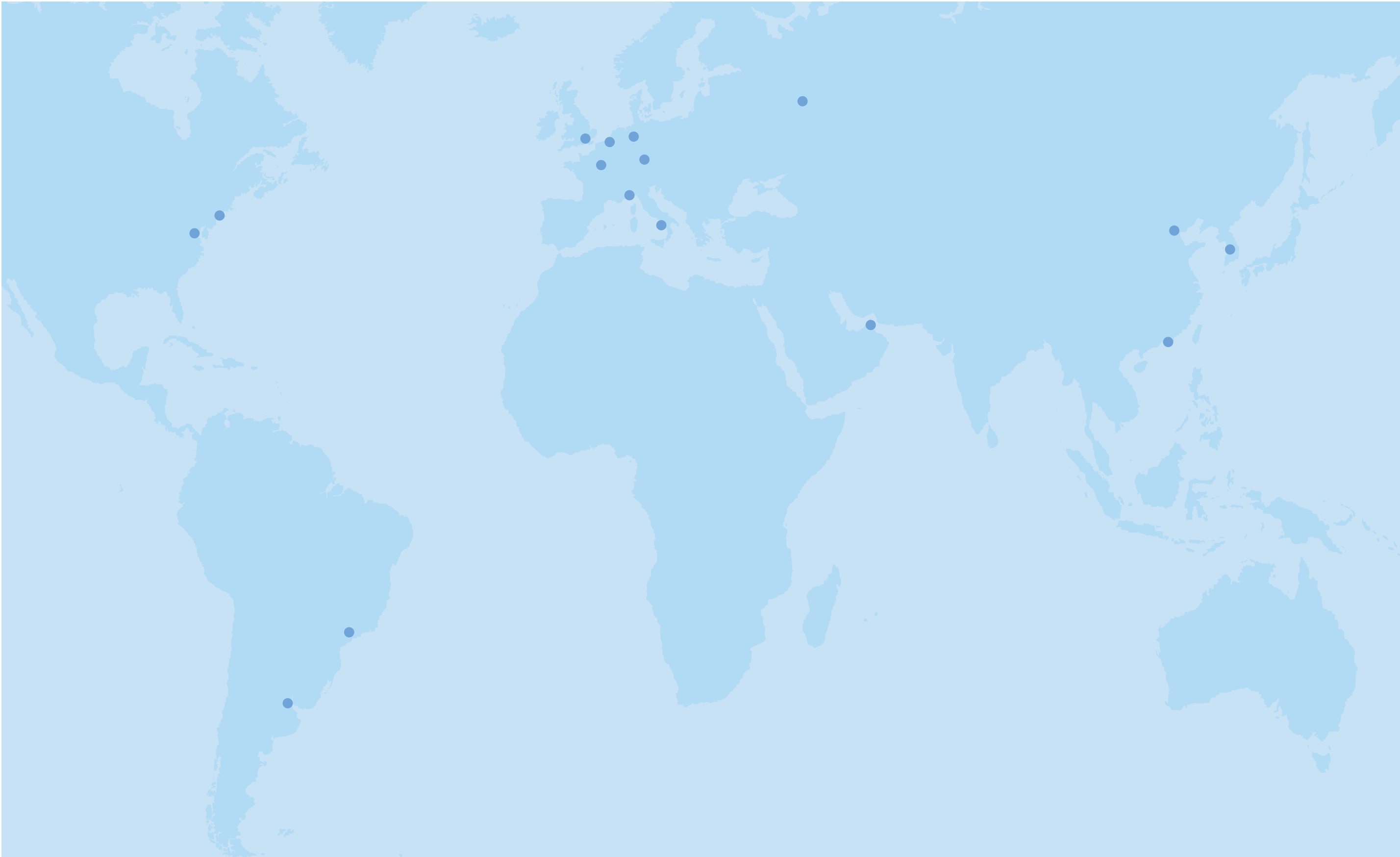
Surya joined Cleary Gottlieb in 2017, having previously worked at a leading law firm in India. He received a Master in Law and Finance degree from the University of Oxford, and a law degree from the National Law School of India University.



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Best Law Firm in Latin America
Seven Years in a Row
LatinFinance, 2012–2018

Counsel to **Eurasian Resources Group (ERG)**, the largest iron ore producer in Kazakhstan and one of the world's largest iron ore exporters, in its **$6.85 billion** complex debt restructuring.


London

Counsel to the **Government of Mongolia** in a Rule 144A/Reg. S offering of **$800 million** 5.625 percent notes due 2023 and its concurrent tender offer for its **$500 million** 4.125 percent notes due 2018 and its **CNY1 billion** 7.50 percent notes due 2018.


Milan

Top 15 Firm
Global Restructuring Review's GRR 30, 2018


Beijing

Practice Highlights

Counsel to **Industrias Metalúrgicas Pescarmona S.A.** (IMPSA S.A.) in connection with the implementation of the restructuring of approximately **$412 million** of U.S. dollar-denominated bonds issued by IMPSA and its affiliate WPE International Coöperatief U.A. (the old bonds).

Counsel to **Grupo Inbursa**, a secured lender to multiple entities in the Mossi & Ghisolfi S.p.A. group, in the restructuring of debt in Brazil, Mexico, and in the Chapter 11 cases commenced by certain U.S. affiliates, and representation of Inbursa's affiliate in the provision of debtor-in-possession lending by Inbursa to M&G.

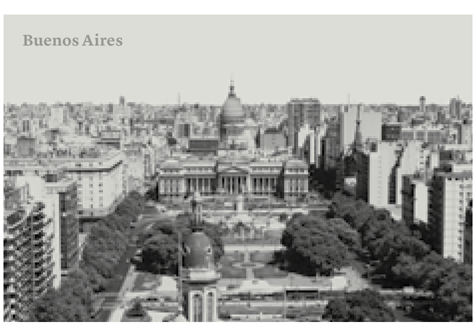

Abu Dhabi

Leading Firm for Restructuring/ Insolvency
Chambers Global, 2018

Restructuring Deal of the Year
(Odebrecht Óleo e Gás' debt reorganization)
Latin Lawyer and IFLR, 2018


New York

Counsel to an ad hoc group of over 70 bondholder institutions in connection with the restructuring of **Oi**, the largest bankruptcy filing in the history of Brazil and the largest cross-border restructuring in the history of Latin America, including successful resolution of contentious U.S. litigation regarding Chapter 15 recognition.


Buenos Aires

Leading Firm for Restructuring & Insolvency
IFLR1000, 2019


Paris

Counsel to the **Republic of Chile** in its concurrent offering of **Ps.37.330 billion** aggregate principal amount of 4.00 percent bonds due 2023 and **Ps.66.620 billion** aggregate principal amount of 4.70 percent bonds due 2030 in the international capital markets.

Capital Markets Deal of the Year

(Mexico City Airport Group Fibra E placement)

International Tax Review's Americas Tax Awards, 2018

Global Finance Deal of the Year

(Oi S.A.'s $20 billion restructuring)

The American Lawyer, 2018

Counsel to the **Republic of Indonesia** in a **$3 billion** three-tranche U.S. SEC-registered offering, with maturities of five, 10, and 30 years.

Counsel to an ad hoc group of secured project finance lenders in connection with the restructuring, recapitalization, and reorganization of over **$1.67 billion** in total indebtedness of **Constellation Oil Services Holding S.A.** and its subsidiaries, a market-leading provider of oil and gas drilling and FPSO services in Brazil.

Top 12 Key Player for India-related Deals

India Business Law Journal, 2018

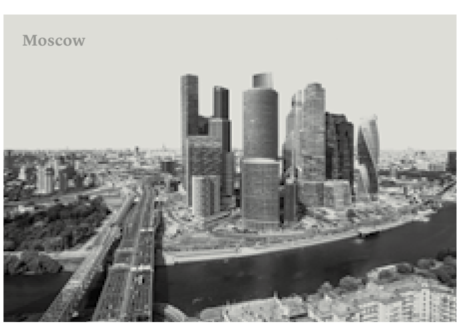
No. 1 Law Firm in Latin America

Latinvex, 2016–2018

Top Global Firm

Law360's "Global 20" List of Preeminent Global Law Firms, 2011–2018 (Every year since the list's inception)

Counsel to **Punjab National Bank**, the victim of a $2 billion fraud by international fugitive Nirav Modi, in the U.S. bankruptcy proceeding of Modi's subsidiaries in blocking sale of assets because of tainted sales process and obtaining of Chapter 11 trustee.



Counsel to **Empresas ICA** in the restructuring of over U.S. **$3.9 billion** of indebtedness.

Top-Tier Ranked for Bankruptcy

Benchmark Litigation, 2017–2019

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