CLEARY GOTTLIEB

Emerging Markets Restructuring Journal

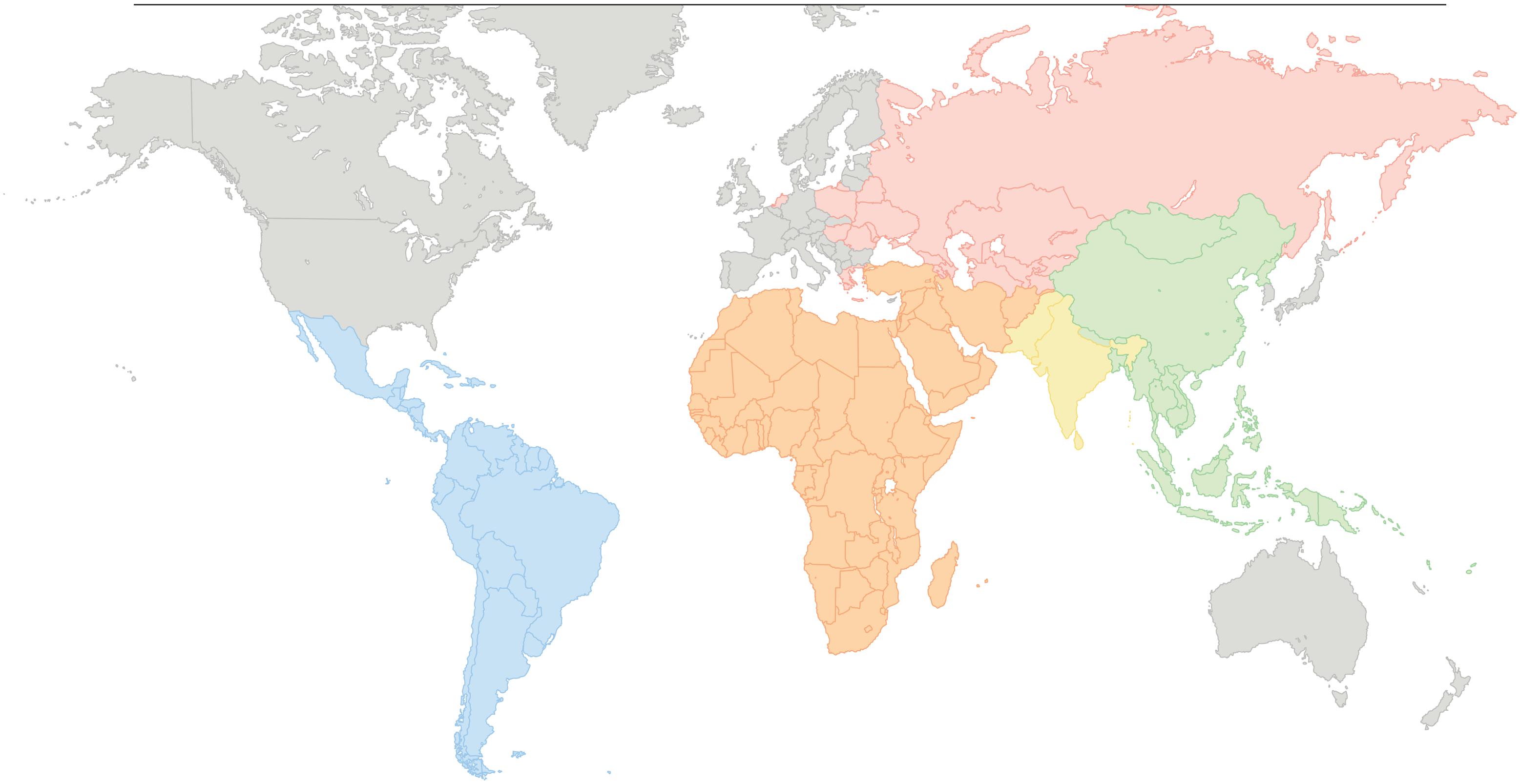
Issue No. 9 — Summer 2019



BANK




In This Issue



Contributors

GUGGENHEIM SECURITIES – VENEZUELA
Mark A. Walker

BAHRAIN ECONOMIC DEVELOPMENT BOARD – BAHRAIN
Buthaina Amin

WERKSMANS – SOUTH AFRICA
Eric Levenstein
Nastascha Harduth
Mahatma Khwidzhili

RESOR – THE NETHERLANDS
Sebastiaan van den Berg

AKOL NAMLI & PARTNERS LAW FIRM – THE NETHERLANDS
Meltem Akol

CLEARY GOTTLIEB
Richard J. Cooper, New York
Andrew Shutter, London
Sui-Jim Ho, London
Barthélemy Faye, Paris
David Billington, London
Naomi Tarawali, London
Polina Lyadnova, London
Maha Alali, London
Lucinda Smart, London
Fatema Al-Arayedh, London
Mohamed Taha, London
Julia Brownstein, *Summer Associate*

Letter from the Editors

This time last year, we presented an article that considered the outlook for Venezuela in the midst of an economic, political and humanitarian crisis. Twelve months on, the country is still in desperate need of reform, recovery and reconstruction, although many hope that the Guaidó administration and the National Assembly will be able to turn things around. In "Venezuela's Restructuring: A Path Forward", the authors assess the key objectives and a roadmap for a realistic and comprehensive restructuring for Venezuela's to be external financial obligations.

The theme of good governance remains prominent generally and a number of the articles in this issue consider various aspects of governance that are coming to the fore. The writers of "Sovereign Debt – Coming into the light" consider the various options available for achieving greater transparency in matters of sovereign debt ranging from voiding undisclosed debt to refining securities laws and money-laundering legislation to achieve the desired purpose.

We feature three articles relating to Africa: from key trends in sub-Saharan African sovereign debt, to the "delinquent director" provisions in South African company law, to the future of investment treaty arbitration in African jurisdictions.

Taking a geographical turn towards the Middle East, we note a number of recent reforms to bankruptcy laws across the GCC. These form part of a conscious push by the relevant governments to create investor-friendly regimes, acknowledging the need for robust and business oriented restructuring laws. In this issue you will find a snapshot of newly introduced changes across Bahrain, Saudi Arabia and the United Arab Emirates as well as a more detailed analysis of the regime in Bahrain as the most recently reformed of these.

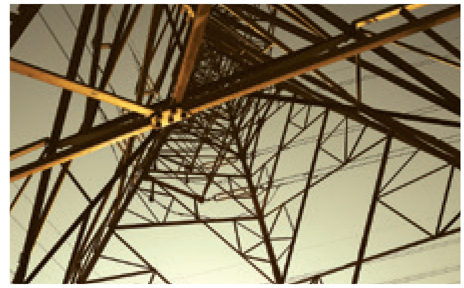
Also on the theme of strengthening restructuring regimes, we look into the recently reintroduced 'Concordato Scheme' in Turkey, as well as into the new EU Restructuring Directive and how it relates to upcoming legislation in the Netherlands, a jurisdiction always relevant to emerging markets given the many Dutch financing subsidiaries in large corporate groups.

To all our readers, we hope you enjoy this issue and find the collection of articles to be of interest. As always, we welcome your comments, questions and contributions.

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

Venezuela's Restructuring: A Path Forward

By **MARK A. WALKER** *and* **RICHARD J. COOPER**[1]



As we witness what we (and many in the international community)[2] hope are the final throes of the Maduro regime, Interim President Guaidó and the National Assembly have begun the process of preparing Venezuela for the transition from a failed state to a functioning state, where a broken economy, corruption and despair are replaced by recovery, reconstruction and hope. A broad swath of Venezuelan economists and other experts have reached consensus on a plan to restore civil society and rebuild the economy (the so-called Plan País), starting with steps to be taken immediately following the departure of the Maduro government. The Guaidó administration, in coordination with the National Assembly, is also preparing a series of draft laws that will begin the process of restoring democracy, restarting the economy and reestablishing the independence and credibility of the institutional pillars of Venezuelan life. Among the most urgent tasks facing a new Venezuelan government will be, of course, measures to address the humanitarian crisis—the provision of food and medicine and an end to lawlessness—and securing the needed funding for these efforts without delay.

A second order of concern, but one that must be addressed early on if only to ensure that its neglect does not derail or delay measures to address Venezuela's most urgent needs, is the treatment of Venezuela's more than USD 155 billion of external financial obligations, virtually all of which are in default.

IDEALLY, A FRAMEWORK TO DEAL WITH THESE OBLIGATIONS WILL INCLUDE THE FOLLOWING OBJECTIVES:

1. inclusion of all significant classes of claims against the public sector such as bonds and other debt of Petróleos de Venezuela, S.A. ("**PDVSA**"), the Republic of Venezuela (the "**Republic**") and Electricidad de Caracas ("**Elecar**"), bilateral and multilateral credits (including China and Russia), arbitration (expropriation) claims and trade creditors (goods and services);
2. establishment of a process for Venezuela and its creditors to reach decisions by negotiation and consensus;
3. elimination, where possible (or de-risking where it is not), of the threat posed by holdout creditors;
4. recapitalization of PDVSA so that it will be able fund itself in the market on reasonable terms;
5. inclusion of tools to address burdensome or illegitimate contractual undertakings entered into by the Maduro regime, and the recovery of billions of dollars that have been stolen from the State through fraudulent and criminal acts; and
6. reorganization of the public finances of Venezuela such that its external debt (including any newly issued contingent obligations) is sustainable and not only reflects the country's capacity to pay but also is sized and shaped to encourage direct investment and renewed market access.

Building on the framework that the authors developed in 2017,[3] we set out below a refined and expanded path forward that seeks to satisfy these objectives by setting forth a roadmap for a realistic and comprehensive debt restructuring process.[4] To be clear, this framework is intended to be neutral as between Venezuela and its creditors and not to enhance or diminish either side's bargaining power. We have no doubt that the negotiation of the nature and extent of the relief granted to Venezuela by its creditors and the treatment of different classes of creditors will prove highly contentious. What is not in dispute are the complexity and challenges of the exercise. The efforts of all stakeholders will be significantly advanced, and unnecessary and fractious disputes avoided, if at the outset there is agreement on a common restructuring framework built on principles of collective action and consensus. It is in this spirit that we put forward our proposal.

PDVSA – Looking Beyond the Traditional Sovereign Tool Kit

Venezuela's public external debt is comprised primarily of obligations of the Republic and PDVSA, the state-owned oil company. Some USD 62 billion is in the form of unsecured bonds issued by the Republic and PDVSA, and the balance includes substantial bilateral and multilateral debt, claims of vendors and contractual counterparties and claims resulting from litigation and arbitration.[5] The most critical and time-sensitive task is to normalize the status of PDVSA and protect its assets and operations, notwithstanding the fact that total claims against the Republic exceed those against PDVSA. Venezuela's future recovery and its ability to generate hard currency are and will remain for a long time heavily dependent on the country's ability to exploit its abundant oil and gas reserves. And although the role of PDVSA going forward may change dramatically as substantial private capital is committed to the oil and gas industry and Venezuela relies more on royalties and income taxes than on proceeds from exports by PDVSA itself, PDVSA is nonetheless likely to continue to play an important role in this critical sector of the economy. Thus, safeguarding the assets of PDVSA outside Venezuela—both tangible assets like Citgo as well as accounts receivable—and its ability to conduct business around the world are of paramount importance and will be essential to its ability to attract new capital and strategic partners.[6] Similarly, PDVSA's balance sheet must be restructured so that it is once again viewed as an independent, creditworthy enterprise on a stand-alone basis that can finance its operations in the ordinary course without the assistance of the sovereign.

Fortuitously, at its core, PDVSA is essentially a commercial enterprise, which allows an approach to a resolution of its financial problems that offers significant advantages over the traditional techniques used to arrive at an agreed restructuring of sovereign debt. Although the ultimate restructuring terms agreed to with respect to debt of the Republic and PDVSA may be comparable, and although we believe that the restructuring of the Republic's debt should be pursued in tandem with the restructuring of PDVSA's debt, the approach we propose embraces their differences and offers a path forward that will create significant value to all stakeholders. Thus, we would employ different restructuring techniques in each case to achieve common goals. And equally importantly, we believe that the approach we suggest for restructuring PDVSA's debt can be tailored to create powerful incentives for creditors of the Republic to join in a restructuring at the same time.

To date, the debate over how to restructure PDVSA's debt has focused on two very different techniques: the use of a local, Venezuelan and Chapter 9-like reorganization statute supported by a U.S. Chapter 15 ancillary proceeding (the "**Local Reorganization Law Solution**") or the issuance of an Executive Order by the U.S. Government (the "**Executive Order Solution**")[7] followed by a traditional sovereign bond exchange and consent solicitation. Although both approaches share a common feature—a stay of creditor remedies—they differ in most, if not all other respects.[8]

Fundamentally, the Local Reorganization Law Solution recognizes that PDVSA is a commercial enterprise—although owned by the state—dependent each and every day on transacting business with counterparties across the globe. The Local Reorganization Law Solution would provide a framework to achieve a consensual restructuring of all claims against PDVSA and would include not just a temporary stay on creditor actions but also the necessary tools to advance PDVSA's reorganization and recapitalization while enabling it to emerge from the process with a full and complete discharge of its debts. The process would provide the customary guard rails associated with the restructuring of state-owned municipal enterprises, but would leave PDVSA well positioned to attract new investment. It would also reinforce the separateness of PDVSA as an independent state-owned public enterprise, which will support future market access as well as the defense of claims by Republic creditors that PDVSA is the alter ego of the Republic.

The Executive Order Solution provides a means to immunize PDVSA's assets from the risk of creditor litigation and enforcement efforts in the U.S.,[9] but lacks essential elements to achieve a permanent or even stable solution. Under the Executive Order Solution, claims of holdouts would not be discharged, and therefore their ability to litigate and pursue assets of PDVSA outside the U.S. (and within the U.S. after the Executive Order ceases to remain in effect) would remain unimpaired, permitting them to prevent or disrupt PDVSA's ability to operate in global markets. In addition, the Executive Order Solution provides no process to reconcile claims, to deal with creditors by class or for a supermajority of creditors (collective action) to have the right or ability to bargain effectively with the debtor, which is at the heart of a consensual solution. In essence, the Executive Order Solution, imposing a stay of undetermined or arbitrary duration, is designed to tilt the negotiating scale so decidedly in favor of PDVSA that creditors would have no choice but to accept whatever offer PDVSA makes. On the other hand, the claims of PDVSA's holdout creditors, and we suspect there would be many, would continue to accrue interest at contractual rates prior to any judgment being entered, and could easily jeopardize PDVSA's access to new investment and new financing. The Executive Order Solution would also ensure that PDVSA remains mired in litigation for decades to come—both from holdouts as well as those challenging the validity of the Executive Order.[10] Finally, an Executive Order that not only precludes recovery of a judgment against U.S. assets but also (unlike the Local Reorganization Law Solution) precludes judicial determination of what in fact is owed to its creditors would leave PDVSA with uncertainty as to its outstanding obligations, a fact that will negatively affect its ability to transact business or seek investment from its counterparties.

The Local Reorganization Law Solution for PDVSA

Because PDVSA is not a sovereign state but an instrumentality of a sovereign, the architects of PDVSA's restructuring need not confine themselves to the traditional tools employed by sovereigns to restructure their debts.[11] As we have previously written, as an instrumentality, if Venezuela were to adopt a local reorganization law for PDVSA and other instrumentalities of the State modeled on Chapter 9 of the U.S. Bankruptcy Code, this law could be used to protect PDVSA's assets in Venezuela and, if supported by a U.S. Chapter 15 proceeding[12] and similar proceedings in other jurisdictions, its assets in the U.S. and elsewhere pending the resolution of a restructuring.[13]

Even before the new Guaidó Government assumes power in Venezuela, the National Assembly should begin the process of drafting and enacting a new public corporation reorganization law modeled on Chapter 9. This law would allow PDVSA (and potentially other public sector entities) to address their debt and operational challenges in a collective, centralized proceeding that offers not only protection from its creditors but also an opportunity to obtain a full discharge of its debts. Additionally, this law would facilitate new investment and provide protections for those vendors, counterparties and other stakeholders that continue to do business with PDVSA while it sorts through its financial and operational issues, which could take considerable time. Ideally, a draft of this law would be published prior to enactment and stakeholders would be given an opportunity to comment on the law. We refer to this law as the "**Venezuelan Public Sector Revitalization Law**."

The Venezuelan Public Sector Revitalization Law should be constructed to provide PDVSA and other public sector entities[14] the ability to restructure their debts fairly and effectively and to minimize the risk that a U.S. Bankruptcy Court would refuse to recognize and enforce the law and any resulting restructuring plan.[15]

TO ACCOMPLISH THESE GOALS, THE VENEZUELAN PUBLIC SECTOR REVITALIZATION LAW SHOULD:

— provide for a stay of creditor remedies;

— include a robust process to identify, reconcile and validate creditor claims and to classify creditor claims in a rational manner (potentially allowing separate treatment for claims of bondholders, vendors, bilateral creditors and counterparties whose executory contracts have been rejected by PDVSA because it declined to assume the obligations thereunder);

— provide the Venezuelan court with the authority to adjudicate disputed claims and resolve issues such as the treatment of original issue discount, claims of invalidity due to the absence of required legislative or other approvals, fraud or equitable defenses;

— permit the debtor to reject executory contracts such as long-term contracts for the sale of oil that have been entered into by the Maduro regime on terms unfavorable to PDVSA;

— provide certainty to vendors and suppliers that provide goods and services on credit during the pendency of the proceeding to ensure the continued operation of the debtor;

— permit and provide incentives for debtor-in-possession financing;

— allow the debtor to reorganize its operations, including by transferring assets or creating new entities, to encourage new investment and possibly the sale of assets free and clear of claims and encumbrances;

— permit the debtor to address and extinguish contingent claims, including claims by Republic creditors asserting that PDVSA is the alter ego of the Republic or otherwise seeking recourse against PDVSA's assets;

— permit the debtor to implement a reorganization plan as long as it obtains the requisite level of creditor support and meets certain minimum procedural and substantive requirements. Typically, in a judicial reorganization proceeding voting threshold requirements would only "count" those who participate in a creditor meeting or vote (which effectively means that the percentage of creditors required to support the transaction is less than would be the case in a typical exchange offer and consent solicitation) and would allow for a "cram down" or "cram up" of various creditor classes preventing a single class (or even multiple classes) of creditors from blocking the approval of a plan as long as certain minimum conditions are met;

— allow the plan to include incentives – in the form of priority or improved treatment or other means—to compensate creditors that commit new money as part of the consummation of any debt restructuring;

— establish a dedicated and independent Venezuelan court to administer the Venezuelan Public Sector Revitalization Law, possibly with the power and authority to appoint mediators and other experts (including international insolvency experts) to assist the court in its duties and foster settlements among parties;

— provide judicial and legislative tools to enable the debtor to seek recoveries from third parties, including corrupt government officials and others actors who defrauded PDVSA; and

— recognize cross-border restructurings under the laws of other jurisdictions as a matter of reciprocity so that the new Venezuelan law and any resulting plan of reorganization will be recognized in multiple jurisdictions outside Venezuela.

The Venezuelan Public Sector Revitalization Law should also include provisions designed to prevent affiliated parties of the debtor from voting their claims and ensure that creditors receive substantive and procedural due process (and that property interests are adequately protected). Venezuela also may decide to include sunset or other provisions in the law that would limit its use by public sector entities once they emerge from the process (or allow restructured entities to opt out of the insolvency regime post-reorganization) so their future access to the capital markets is not negatively affected by the law.

We believe that the mere announcement of this law, which could be enacted by the National Assembly even as the Maduro regime clings to power, will be viewed as a positive signal to the investment community and could ignite a process of cooperation, and possibly even interim funding by the private sector, while Venezuela addresses the very real humanitarian, economic and social challenges it faces.

The protection of assets and PDVSA's ability to conduct business on a world-wide scale would be of immense benefit to PDVSA and contrasts starkly with the U.S. Executive Order Solution that would only protect assets physically located in the U.S. and only as long as the U.S. Executive Order remains in effect.

The Benefits of the Local Reorganization Law Solution

The Local Reorganization Law Solution provides a Venezuelan-centered, as opposed to U.S.-centered, approach to resolving PDVSA's debt issues. Although the law itself and the jurists that would administer and oversee it would no doubt need to conform to international standards in order for the law to be recognized and enforced outside Venezuela, the process and plan would be dictated by PDVSA and its creditors and not by policy makers in the U.S. To be recognized outside Venezuela, the law would necessarily have to provide creditors a meaningful role in approving, if not helping to shape, a reorganization plan for PDVSA, and in so doing it would lay a durable foundation for PDVSA's revitalization.

Adopting such a law and making it the basis for PDVSA's restructuring would carry with it a number of advantages, most of which would not be possible if Venezuela were to rely on the Executive Order Solution.

Upsides to the Local Reorganization Law Solution

At the culmination of the proceeding under the Venezuelan Public Sector Revitalization Law, once a plan is approved, if enforced in the U.S. and elsewhere through Chapter 15 and other similar processes, it would provide a full discharge of all claims against PDVSA within and outside Venezuela (including claims against PDVSA brought by Republic creditors based on alter ego or other similar claims) and would allow PDVSA to raise new capital free from the risk of interference by any holdout creditors, wherever located. The permanent discharge of claims and ongoing protection of assets from legacy claims is critical, as it is difficult to imagine strategic partners or new money investors being willing to make long-term investments in PDVSA without a high degree of certainty that unresolved claims—even if stayed and neutralized during the pendency of a U.S. Executive Order—will not come back to undermine and adversely affect PDVSA's operations and balance sheet. By their nature, debt and capital investments in oil and gas entities are long-term, and if the lessons of Argentina reveal anything, they demonstrate that holdouts can have a substantial impact on a debtor's activities and operations many years after their claims first matured. In contrast, the Executive Order option would neither bind holdouts nor provide a discharge of claims and liabilities (many of which will continue to accrue interest at high rates). And unlike the Venezuelan Public Sector Revitalization Order, the Executive Order Solution would do nothing to deter and prevent attempts by creditors to disrupt or interfere with payments made on restructured debt as did vulture investors in Argentina.

The protection of assets and PDVSA's ability to conduct business on a world-wide scale would be of immense benefit to PDVSA and contrasts starkly with the U.S. Executive Order Solution that would only protect assets physically located in the U.S. and only as long as the U.S. Executive Order remains in effect (whether expiration or withdrawal of the Order is due to changes in the willingness of the U.S. Government to maintain the Executive Order or to legal challenges brought against it by aggrieved investors).

We would expect the Venezuelan Public Sector Revitalization Law to protect critical suppliers and counterparties of PDVSA that continue to provide goods and services to PDVSA during the pendency of the proceedings by granting their new claims priority or other special status that would ensure they come ahead of antecedent claims by unsecured creditors. This sort of protection is the lifeblood of commercial enterprises subject to financial stress, whether inside or outside a formal insolvency proceeding, and could ease PDVSA's short-term cash needs, allowing Venezuela to redirect such funds for other purposes.

We would also expect the Venezuelan Public Sector Revitalization Law to contain customary provisions to provide similar incentives and benefits to parties that are willing to provide working capital or capital funding to address PDVSA's immense capital needs, possibly even during the pendency of the proceeding. Given the urgent need for such financing and the tremendous benefits that would flow to all stakeholders from restoring PDVSA's productive capacity, such incentives—which could come in the form of DIP financing—could be game changers in the ability of PDVSA to resume and restore its operations and generate much needed foreign currency. Indeed, it would not be surprising were such a mechanism to be incorporated if existing PDVSA creditors welcome the opportunity to participate in such financing, particularly if offered improved treatment over other claimants who choose to sit on the sidelines.

An Executive Order, of course, would not provide a framework or means to do any of the above.

ALTHOUGH IT IS PREMATURE TO SPECULATE AS TO WHAT A PLAN OF ADJUSTMENT BASED ON THE VENEZUELAN PUBLIC SECTOR REVITALIZATION LAW MIGHT LOOK LIKE, WE IMAGINE THAT IT MIGHT CONTAIN SOME OR ALL OF THE FOLLOWING FEATURES:

— the provision of new money "exit" financing, perhaps through some type of co-financing facility under which existing private sector creditors would be given a financial incentive to participate in a new money financing alongside multilateral institutions or where existing creditors would be offered an incentive to "roll up" some portion of their existing claims on favorable terms for each dollar of new money advanced;

— different recoveries for different categories of creditors. The ability of a debtor to classify creditors in different classes and provide differentiated treatment of their claims typically provides a powerful tool to bring otherwise recalcitrant creditors to the negotiation table. In the case of PDVSA, there may be creditors who either view themselves as exempt from any obligation to negotiate because of their status (state-owned enterprises) or the nature of their claims (secured claims). For example, one can imagine creating a separate class of claims and differentiated treatment for contractual counterparties that have had their oil sales agreements rejected because their contracts imposed non-market terms on PDVSA. Similarly, one could expect that the claims of secured parties—such as PDVSA's 2020 bonds and its secured debt to Rosneft—would receive differentiated treatment while at the same time being subject to "cram up" provisions that could enable PDVSA to reinstate such debt with new and longer maturities at different market interest rates;

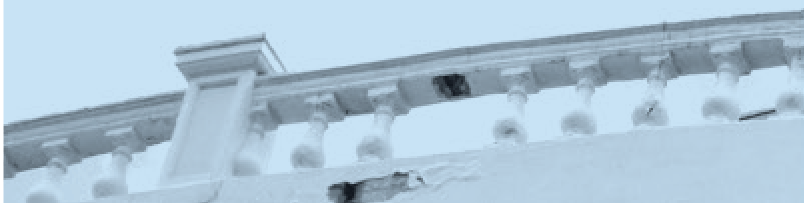
— court-approved settlements with counterparties, including possibly creditors of the Republic whose assets were expropriated, that could be given effect even prior to the consummation of PDVSA's adjustment plan. Many of the strategic investors that have asserted valid expropriation or arbitration claims against Venezuela or PDVSA might be willing to settle their disputes in consideration for an opportunity to participate in PDVSA's or the private sector's revival. Such court-approved settlements could provide incentives for strategic investors to reinvest in Venezuela and rely on enforcement mechanisms and direct undertakings from the State (including non-impairment protections) that could fast track disputes and have binding effect within and outside Venezuela in specialized courts or arbitral tribunals created as a result of the new Law; and

— mechanisms for creditors to obtain, on a contingent basis, additional recoveries over and above their restructured debt due to increases in oil prices beyond some agreed levels or outperformance as measured by some other parameter or macroeconomic variable.

The Executive Order Approach

The Executive Order Solution relies on the strength of the U.S. Government to deprive bondholders of their ability to enforce their contractual and legal rights. As a temporary measure to allow a new Venezuelan government time to enact a new Venezuelan Public Sector Revitalization Law or to avoid costly litigation while the Republic formulates and conducts an offer to its own creditors, one can imagine the utility of a measure essentially operating as an automatic stay on suing the Republic or PDVSA or seeking to enforce claims against its assets. Indeed, in many respects it could be viewed as a continuation of the policies underlying current OFAC sanctions. However, we do not believe the unrestricted, ambiguous and indeterminate use of such a measure is in either Venezuela's interest or the interests of its stakeholders.[16]

The success of Venezuela's efforts to rebound from the disastrous policies will require not only massive amounts of private capital but also a renewed commitment by the new Government to the rule of law and respect of creditors' rights.



First and foremost, an Executive Order puts the U.S. Government in the role of deciding what is best for Venezuela and what is fair and appropriate for creditors. Having the restructuring of Venezuela and its most important public sector borrower essentially determined by public officials in Washington, D.C. will not be helpful to any Government in Venezuela nor will it lend legitimacy or stability to a process that could easily extend beyond any one administration in Washington, D.C. or Caracas.

Second, it offers Venezuela none of the benefits of the Venezuelan Public Sector Revitalization Law: no mechanism to promote the provision of trade or other credit during the pendency of the restructuring process or upon PDVSA's exit from the proceeding; no means to adjudicate spurious claims; no enforceable legal process for rejecting burdensome long-term commitments; no mechanisms to deal with recalcitrant creditors whose status or claims might insulate them from negotiations; and no specific judicial tools to trigger the enforcement powers of courts within and outside Venezuela to recover the billions of dollars that have been stolen from PDVSA or gained through criminal enterprise to the detriment of all stakeholders.

Third, because it lacks any legal means to eliminate holdouts, but rather employs *in terrorem* means to avoid holdouts, it will jeopardize PDVSA's future access to the capital markets and new investment. Indeed, it may even expand the number of holdouts as creditors may be reluctant to participate in any exchange offer and consent solicitation if there is a risk that by doing so they will forego possible recoveries against the U.S. Government based on alleged violations of the U.S. Constitution for takings and other claims.[17]

The success of Venezuela's efforts to rebound from the disastrous policies of the Maduro regime will require not only massive amounts of private capital but also a renewed commitment by the new Government of Venezuela to the rule of law, transparency and respect of the rights of creditors and investors. Promoting or relying on the Executive Order Solution with an indefinite stay intended to tip the negotiating scales in one direction is incompatible with those principles.

Restructuring Claims Against the Republic

As we have stated above, we believe that restructuring negotiations between the PDVSA bondholders and Venezuela should be conducted in tandem with the negotiations between Republic bondholders and Venezuela.[18] We further believe that the conclusion of any agreement with either set of bondholders should naturally be conditioned on agreement with the other group. This is so not only because many large bondholders hold both Republic and PDVSA bonds but also because as a practical matter neither restructuring could be implemented in isolation. Moreover, following its past practice and policies, the IMF will not commit to grant Venezuela exceptional access to its resources unless it is able to conclude "with a high degree of certainty" that Venezuela's debt is sustainable—a conclusion that can only be reached if both PDVSA and Republic debt are restructured on terms consistent with debt sustainability. In the case of Venezuela, where bond debt is one-third or less than the country's estimated foreign liabilities, it will also be

necessary to strike arrangements with other large creditor classes. In the case of PDVSA, this should happen naturally within the scope of the Venezuelan Public Sector Revitalization Law. In the case of the Republic, bilateral debt will be dealt with in part through the Paris Club and in part through direct negotiation. Expropriation claims will be litigated through arbitral tribunals and the courts, though strategic investors asserting these claims are likely to be more inclined to settle their claims as a result of the enactment of the Venezuelan Public Sector Revitalization Law, which will cut off their ability to recover judgments based on the assets of PDVSA outside Venezuela (based on some alter ego or other legal theory) while at the same time offering them protections and incentives to reinvest in a healthy oil and gas sector and a legal regime that respects property rights.

The simultaneity of negotiations is not incompatible with the fact that PDVSA will act within the framework of the Venezuelan Public Sector Revitalization Law, whereas there is no judicial reorganization process that would apply to the Republic's debt. In each case, a predicate to a successful conclusion of the process is agreement between PDVSA and a very large majority of its creditors, on the one hand, and between the Republic and a very large majority of its creditors on the other hand. With revenues from hydrocarbon resources, be they export sales, royalties or taxes constituting more than 95% of the country's foreign exchange earnings, it is inescapable that absent both sets of agreements there can be no satisfactory resolution of the country's external indebtedness. There is no getting around this fundamental conclusion, but that should not be a source of despair. It is clearly in the interests of all parties to reach agreement. And bondholders will be well advised to negotiate as a unified group (even if they conclude that PDVSA and Republic bondholders should be treated differently). It is important to bear in mind that the true holdout problem is not that Venezuela will not be able to reach agreement with the vast majority of its creditors, but that, having done, so an important minority will seek to remain outside the deal and secure better terms for themselves through litigation and disruptive behavior.

For PDVSA, this risk should be neutralized by virtue of the facts that dissenting creditors are bound by the restructuring plan and any remaining legacy claims will be discharged on confirmation and implementation of the plan.

For the Republic, however, it will be necessary to resort to more traditional incentives and disincentives to corral would-be holdouts into agreement and neutralize the impact of those that stay out.

As challenging a task as it will be, historically, sovereigns faced with a similar mix of debt (unsecured bonds, bilateral debt, arbitration and litigation clams and awards) have been able to restructure the vast majority of their debt using traditional techniques and have managed to protect their critical assets located outside their borders. The fact that PDVSA's assets will be protected by the Venezuelan Public Sector Revitalization Law and Chapter 15 will be of critical importance in this regard, adding considerable armor to conventional techniques of exit consents, exchange offers and other structuring tools.

Prerequisites to a Successful Transaction

Let us assume that Venezuela and its bondholders act responsibly and in good faith and that through a transparent process they agree on a fair and inclusive restructuring plan that is consistent with the country's IMF program and will support recovery of the economy. How can the Republic deal with creditors that would rather seek preferential treatment than join the restructuring?

In our view, a successful restructuring of the Republic's bond debt will require an innovative approach that links the Republic and PDVSA restructurings as well as the inclusion of features that seek to drive participation rates higher while making holding out costlier and less attractive for dissenting creditors. We outline below a series of measures that we believe should together provide powerful incentives that will help to minimize holdouts.

Linkage to PDVSA Restructuring

As a first step, the terms of the PDVSA restructuring plan might require that PDVSA creditors who wish to consent to the plan must also agree to tender their Republic debt in the exchange offer launched to effect the restructuring of that debt. Given substantial cross-holdings, this feature of the PDVSA restructuring could prove quite helpful.

Similarly, we would propose that the PDVSA restructuring plan include a condition to its effectiveness that a specified percentage of Republic bondholders agree to the parallel restructuring of that debt. Indeed, it might even be possible for Republic creditors to participate in the PDVSA restructuring plan by exchanging their bonds for new PDVSA securities issued by PDVSA itself or by an entity created by it for this purpose. The tendered Republic debt would remain outstanding, perhaps held by PDVSA or placed in a creditor trust so that other features (e.g. voting and distributions in respect of the trust's assets) described below can be utilized to deter holdouts and benefit Republic creditors that participate in the exchange.

Finally, we envisage that the terms of the Republic and PDVSA restructurings might include distributing to participating bondholders a combination of Republic and PDVSA obligations together with an instrument providing for additional contingent payments based on Venezuela's capacity to pay as measured by oil prices or volumes or some other proxy for outperformance. The package offered to creditors who sign on before the closing of the exchange might by design differ from, and be superior to, that offered to creditors who join at a later date.

Exchange Offers, Exit Consents and Collective Action Clauses

The mechanism used to carry out a restructuring of sovereign bonds is an exchange offer, whereby holders of outstanding debt to be restructured are invited to exchange that debt for new bonds whose terms reflect the agreed restructuring terms. To encourage holders to tender, the sovereign debtor may ask tendering holders not only to participate in the bond exchange but also to amend the terms of the existing bonds, which are not tendered in the exchange and will remain outstanding so as to delete a number of protective provisions. If the exit consent (which is an agreement to amend the terms of the existing bonds that will remain outstanding after the exchange) is successful, non-tendering holdout creditors will be left holding an inferior and less valuable instrument post exchange. In the case of the Republic, we advocate being as aggressive as possible without jeopardizing the ability to sustain the exit consents against the inevitable legal challenges that will be brought. Thus, we would propose, among other things, that, to the extent permitted by the terms of the underlying documents and subject to obtaining sufficient consents, events of default and remedies (such as acceleration) be limited or qualified, the negative pledge clause be eliminated or cut back and waivers of sovereign immunity and other protective provisions be narrowed or eliminated. The reality is, however, that the voting requirements for many of the exit consents that are most likely to deter holdouts will require a substantial supermajority vote.[19] This obviously could make it challenging to effect exit consents in certain series.

We also propose introducing a "sharing clause" into the old bonds that would require all non-tendering holders of a series of bonds to "share" with all other holders of the same series of bonds (including any affiliate of the issuer) any recoveries they receive from litigation, settlement or otherwise that are not paid equally to the other holders. To add to the power of the sharing clause, we would organize the exchange offer so that the tendered debt remains outstanding and held by a creditor trust for the benefit of those Republic bondholders who participated in the restructuring (or, as noted above, by PDVSA itself or an entity created by it). The trust would thus be entitled to share in any recoveries received by a holdout creditor and could distribute any amounts received in this capacity as a prepayment of principal of restructured Republic bonds. Leaving tendered Republic bonds outstanding would have the further benefit of diluting the voting power of the holdouts and, if less than 25%, their ability to accelerate.[20]

The effect of these exit consents and the introduction of a sharing clause would be to create incentives for Republic bondholders to participate in the exchange both because their ability to enforce their rights would be diminished and because they would be required to share any recoveries they might succeed in obtaining through litigation or otherwise with all other original bonds.

Most sovereign bonds issued today include collective action clauses ("**CACs**") that allow a super majority of holders across multiple series of bonds to agree to the terms of a restructuring that would be binding on all creditors. Unfortunately, the outstanding bonds of the Republic do not include these modern CACs which permit aggregated voting across series. Two issues of Venezuela's bonds do not contain CACs at all and the balance include CACs that allow holders of 75% (85% in the case of two issues) of the outstanding amount on a series-by-series basis to modify the basic payment and other terms to accommodate the restructuring that Venezuela will require. These are high thresholds and recalcitrant creditors may already have blocking positions in a number of series, or at today's prices (assuming U.S. sanctions permit trading to resume normally) might easily acquire such positions. Moreover, the use of CACs to restructure bond debt will have no impact on those holders that have already obtained money judgments by the time the CAC is activated. So, although it is possible that the existing CACs may be sufficient to lock in a restructuring for certain series, it is unlikely that they will prove effective on their own to restructure the Republic's bond debt.

Other Incentives and Disincentives

In light of the high thresholds and series-by-series voting for exit consents and CACs (where they do exist), the Republic will need to consider what other targeted measures it could take to discourage holdouts. Some ideas worth considering are included below:

— **Subordination of Restructured Bonds – The Republic's Unusual Pari Passu Provisions.** If as part of the restructuring of Venezuela's debt the Republic could subordinate (or threaten credibly to subordinate) holdout debt, holders that otherwise might be inclined take their chances and not participate in the restructuring may elect to participate for fear of being left behind in a worse position as a future holdout. This, of course, is not a novel idea.

Certain sovereigns have sought to do this (or threatened to do this) in different ways, and some of the more aggressive exit consent strategies implicitly include this threat. But ever since the *NML* decision in Argentina, sovereigns that have had debt with *pari passu* provisions have been reluctant to do this for fear of finding themselves, like Argentina, unable to service their restructured debt. In the case of Argentina, a group of holdout creditors successfully argued that Argentina had violated the *pari passu* clause by paying creditors who had exchanged their defaulted debt for new debt, while at the same time refusing to pay holdouts on the legacy debt and acting legislatively to subordinate that debt. The court issued injunctions requiring Argentina to make "ratable payments" to holdouts each time payments were made to holders that had participated in an exchange offer.[21]

But the *pari passu* provisions in most of the Venezuela's bond documentation contain very unusual language not contained in Argentina's, nor in most other, sovereign bond documentation. The relevant language explicitly states that the Republic's unsecured debt cannot be subordinated "save for such exceptions as may be provided by applicable legislation."[22] Rather than protecting holders of such debt against subordination, the language explicitly contemplates the possibility that the bonds can be subordinated if Venezuelan law provides for such subordination.[23]

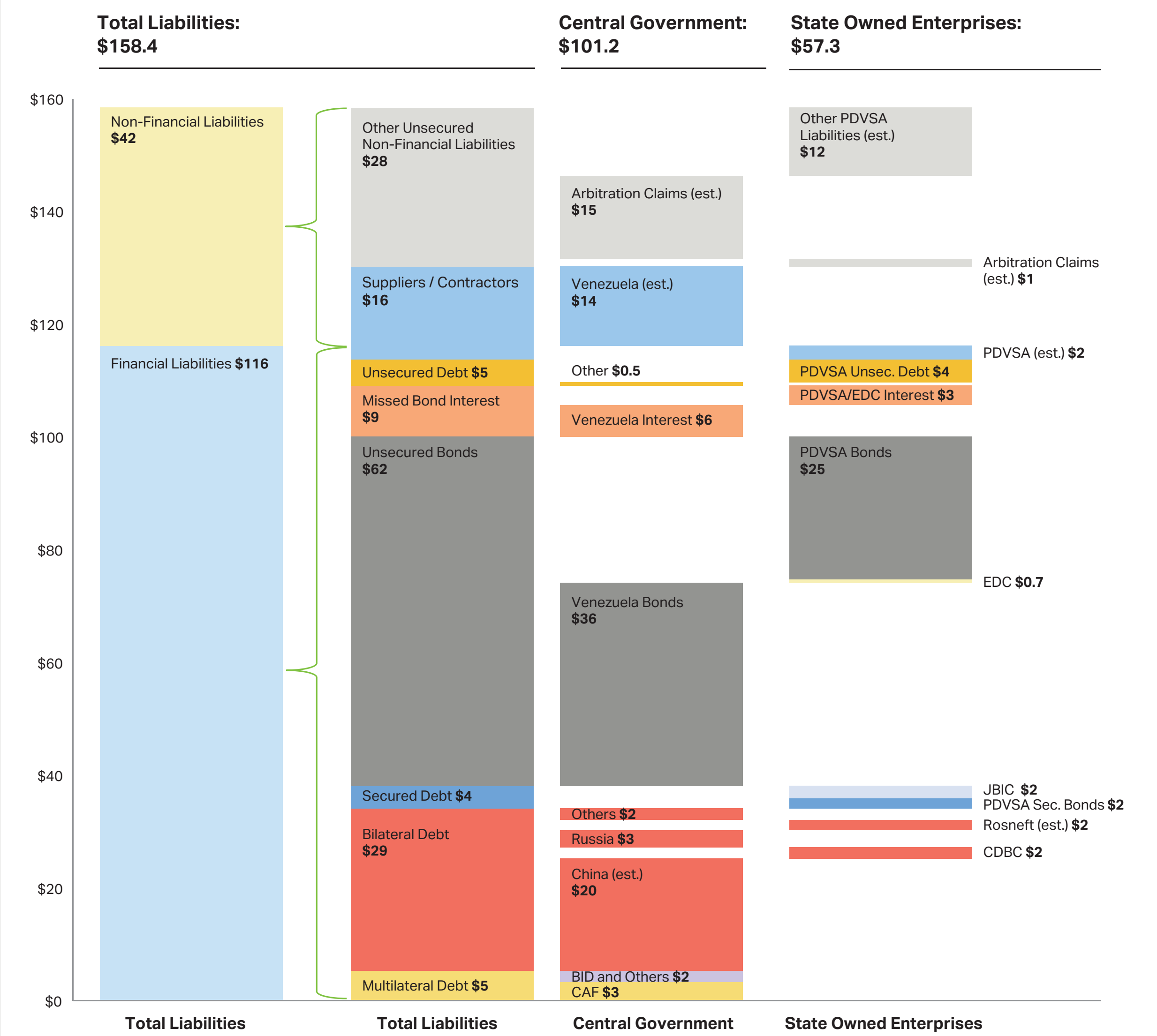
Consistent with the terms of such bond documentation, the Republic could adopt legislation prior to the launch of an exchange offer to provide a powerful incentive for potential holdouts to participate in the restructuring. This legislation could be expressly limited to subordinating any Republic bonds that remain outstanding after the closing of an exchange offer that exceeded some specified participation level and whose subordination is permitted by the terms of the underlying documentation. As a result, any new debt issued by the Republic as part of an exchange would be senior to holdout debt (the nature and extent of the subordination will no doubt be an issue to be determined at the time a transaction is agreed). Although there may be some legal risk to this approach, unlike in the case of Argentina's bond documentation, the plain language of the Republic bond documentation would seem to permit it.

— **Debt-to-equity swaps.** A limited and targeted debt-to-equity swap program, available only to creditors who participate in the Republic and PDVSA restructurings at the outset could be beneficial to both creditors and Venezuela, and provide an additional incentive for holders of Republic bonds to join a restructuring. The program would permit restructured debt to be tendered at market value (based on trailing average prices over, say a 90-day period), which could be used to purchase selected assets from the government. These assets could include rights to explore for and produce oil and gas as well as productive assets in other sectors in the hands of the government. Any participant in the program would be required to make a binding commitment to invest (in hard currency) not less than a minimum specified amount on or before specified dates in order to make the asset productive. Failure to invest would result in forfeiture of the investment. From the government's perspective, the program would enable it to retire debt at prices that would not be increased by virtue of its buying an equivalent amount of debt in the market and, from the investor's perspective, it would not risk lower prices by efforts to sell the debt for cash. Only restructured debt itself, and not value recovery instruments, would be eligible for the program.

Conclusion

We believe the enactment by Venezuela's National Assembly of a Venezuelan Public Sector Revitalization Law, complemented by proceedings in the United States and elsewhere under Chapter 15 of the U.S. Bankruptcy Code and equivalent legislation, provides an elegant and valuable framework for resolution of PDVSA's external liabilities. Resolution of the external liabilities of the Republic presents a more difficult challenge, but one that has been successfully met by other sovereign debtors in the past whose situation does not differ that greatly from that of Venezuela. And the fact that PDVSA's assets and revenues can be protected will be a critical factor in discouraging Republic creditors from seeking to hold out and obtain preferential treatment for themselves, as their ability to recover on their claims outside a restructuring will be severely limited. To ensure the maximum level of participation in a restructuring of the Republic's debt, we recommend that Venezuela deploy a combination of techniques—exit consents, structuring options and positive and negative incentives—whose design will require a great deal of thought. It is important to note that this exercise is not one that Venezuela will be required to undertake on its own. The contours of a restructuring of the Republic's and PDVSA's external obligations will in the first instance be negotiated and agreed with a substantial majority of the country's creditors, ideally with the support of a highly motivated and influential creditor committee, as well as the United States and other interested nations, the IMF and other international financial institutions and the international community generally. ■

Annex A:
Summary of Venezuela's External Liabilities



Source: PDVSA's audited financial statements, National Office of Public Credit ("ONCP") Reports, Ecoanalitica, court filings, other financials and news sources. Excludes all internal liabilities denominated in Bolivares. Government guaranteed loans are excluded due to lack of available data.

[1] Excludes Cadivi claims which may be asserted under applicable bilateral investment treaties (e.g., Air Canada, etc.).

[2] Believed to represent aggregate commercial debt claims against both the Venezuelan Central Government and State Owned Enterprises, for which a breakdown is not available.

Mark A. Walker is a Senior Managing Director & Head of Sovereign Advisory at Guggenheim Securities. He has 40 years of experience advising more than 20 countries around the world on complex financial matters.

Prior to joining Guggenheim Securities, Mark was head of sovereign advisory at Millstein & Co. and Rothschild London and a Senior Advisor at Lazard Paris. Mark led the Rothschild team that advised Cyprus during its financial crisis in 2013 and co-led the Lazard team that advised Greece in 2011 and 2012 on the first sovereign debt restructuring of a Eurozone country and the largest sovereign debt restructuring ever. Mark also advised the governmental authorities of Greece and Cyprus in their negotiations with the IMF, the European Commission and the European Central Bank and is currently advising the Venezuelan bondholders committee. Mark has worked with the IMF and other official bodies in seeking to improve the practices followed by debtors and creditors in dealing with liquidity and solvency problems of heavily indebted states. Mark has lived and worked in Paris, Brussels and London and has spent substantial time working in Latin American and Asia.

Mark was a partner at Cleary Gottlieb Steen and Hamilton LLP from 1975 to 2011 and the firm's Global Managing Partner from 2005 to 2011. He led and co-founded that firm's premier sovereign practice and developed much of the documentation that set the standard for sovereign debt restructurings during the 1980s and 1990s. Mark received a law degree from Yale Law School and a B.A. in English literature from Stanford University.

Richard J. Cooper is a senior partner based in Cleary Gottlieb's New York office. Rich's practice focuses, among other things, on domestic and international restructuring. Rich joined the firm in 1986 and became a partner in 1995. He has represented Governments, corporate debtors, creditor committees, buyers of distress assets and financial institutions in corporate, municipal and sovereign restructurings.

Rich has been recognized by *Chambers Global*, *Chambers USA*, *Chambers Latin America*, *Legal 500 U.S.*, *The Legal 500 Latin America*, *Latin Lawyer 250: Latin America's Leading Business Law Firms*, *IFLR 1000: The Guide to the World's Leading Law Firms*, and *Financial Times' 5th Annual North America Innovative Lawyers* Report. Additionally, he was recognized by *Law360* as a "Bankruptcy MVP", by *Global M&A Network* as one of the "Top 100 Restructuring & Turnaround Professionals", by *Turnaround and Workouts* in 2016 and 2017 as one of 12 "Outstanding Restructuring Lawyers in the United States", and by *Latinvex 100* as one of "Latin America's Top 100 Lawyers."

1. Richard J. Cooper is a Senior Restructuring Partner at Cleary Gottlieb Steen & Hamilton LLP and Mark A. Walker is a Senior Managing Director – Sovereign Advisory at Guggenheim Securities, LLC. The views expressed herein are those of the authors and not necessarily those of Cleary Gottlieb Steen & Hamilton LLP and Guggenheim Securities, LLC. The authors would like to thank Francesca L. Odell, Carmine D. Boccuzzi, Jr., Boaz Morag, Emily Michael, Gabriella Fortun, Alice Chong and Adam Preiss for their assistance with this article. This article is for general information purposes and is not intended to be, and should not be taken as, legal advice.
2. More than 60 countries have recognized the new Guaidó government as of March 2019.
3. Mark A. Walker and Richard J. Cooper, *Venezuela's Restructuring; A Realistic Framework* (Sept. 19, 2017).
4. We have assumed for purposes of this article that the bonds issued by the Republic and PDVSA will be restructured on similar economic terms. The framework proposed would work equally well should the stakeholders reach agreement on different terms.
5. See "Annex A: Summary of Venezuela's External Liabilities."
6. Although some commentators have proposed that a new Venezuelan government create a new PDVSA which would be granted the exclusive right to exploit the country's hydrocarbon resources in the future and would have no liability for the obligations of existing PDVSA (or undertake transactions such as sales or liens on assets that would have similar effect), the authors do not consider this a credible solution. (At best, it would lead to protracted litigation, subject the new government to charges of acting in bad faith and disrupt efforts to arrive at a fair and consensual restructuring.)
7. Buchheit and Gulati in fact propose three variants of an Executive Order: the first or base case would deny access to U.S. courts to creditors making claims against the Republic, PDVSA or their U.S. assets and is the Executive Order to which we refer throughout this article. Other, more far reaching (indeed extreme) variants would either couple this denial of access with a collective action mechanism imposed by the same Executive Order and applicable only to U.S. creditors in an unspecified way or go even farther and dictate the terms of a restructuring binding on U.S. (but not foreign creditors). Lee C. Buchheit and G. Mitu Gulati, *Sovereign Debt Restructuring and U.S. Executive Power* (Oct. 29, 2018) (hereafter, "Buchheit & Gulati"). For additional analysis of these proposals, see Mark A. Walker, *Restructuring Venezuela's Debt: An Update* (Dec. 11, 2018).
8. As a threshold matter, whereas the Local Reorganization Law Solution is capable of being implemented by Venezuela without U.S. Government support (though it would clearly benefit from such support including the filing of a possible amicus brief in support of PDVSA's Chapter 15 process), the United States would first have to embrace the Executive Order Solution. The Executive Order Solution would require the United States to take positions on debt restructuring issues contrary to its historical positions; assume the risk of liability from closing off court access, impairing the contractual rights of creditors and/or taking the property interests of creditors; and pick winners and losers between and among Republic and PDVSA creditors. That the United States would (or should) do so is not a given, notwithstanding the support of the Executive branch and Congress for the Guaidó administration and the imposition of sanctions that serve in part to preserve Venezuelan assets in the United States.
9. A broader protective mandate could be obtained if the United Nations Security Council were to adopt a resolution to that effect, as it did in the case of Iraq, but we are skeptical that such a resolution would receive the support of all veto-wielding members.
10. U.S. courts have largely rejected creditors' claims based on the exercise of Presidential authority to freeze foreign assets under U.S. jurisdiction, *e.g., 767 Third Avenue Associates v United States*, 48 F.3d 1575 (Fed. Cir. 1995) (rejecting takings claim by landlord of Yugoslav Consulate in NY seeking reimbursement for leases breached by Yugoslavia after OFAC closed the Consulate and froze Yugoslav assets); *Chang v. United States*, 859 F. 2d 893 (Fed. Cir. 1988) (rejecting takings claim of U.S. persons who were forced to abandon their employment contracts in Libya in order to comply with the U.S. sanctions against Libya); *Paradissiotis v. United States*, 304 F. 3d 1271 (Fed. Cir. 2002) (rejecting the takings claim of a Libyan national who was prevented from exercising stock options on frozen Libyan assets, which expired while sanctions were in place). The Executive Order Solution, however, goes considerably further than freezing assets for some limited time and purports to deprive U.S. and non-U.S. creditors not only of access to U.S. courts but also of any ability to adjudicate their claims. Some variants of the proposal go even further and purport to limit amounts otherwise due under New York-law governed contracts to amounts "[]consistent with the restructuring terms accepted by the supermajority of creditors." Buchheit & Gulati at 18. We believe that a deprivation of the rights of holdout creditors to enforce their contracts in court or to bind them in some fashion to the recovery agreed to by a supermajority would expose the Executive Order Solution to even greater legal vulnerability. In addition, such an Executive Order would be contrary to the U.S. Government's longstanding policy taken first in 1984 in *Allied Bank Int'l v.*

Banco Credito Agricola del Cartago of opposing a sovereign debtor's attempt to unilaterally alter through litigation in the United States the terms of a debt instrument that is valid under New York law.

11. PDVSA's disclosure documentation includes a risk factor stating that the ability of holders to recover their investment may be adversely affected if PDVSA is subjected to a Venezuelan bankruptcy or insolvency law.
12. PDV Insurance Company Ltd., a Bermudian entity and PDVSA wholly owned subsidiary, obtained recognition of its Bermudian liquidation proceeding under Chapter 15 of the Bankruptcy Code. *See* Order Recognizing Bermuda Proceeding of PDV Insurance Company Ltd. As a Foreign Main Proceeding and Granting Related Relief, *In re PDV Ins. Co., Ltd.*, Case No. 18-12216 (MEW) (Bankr. S.D.N.Y. Aug. 20, 2018) (ECF. No. 11). Note, however, that this was obtained on an uncontested basis and does not raise the same issues that could potentially be relevant to recognition of a Venezuelan proceeding for PDVSA.
13. We believe that PDVSA would be recognized as a Chapter 15 debtor and the Venezuelan proceeding as a "foreign proceeding" under Chapter 15. Chapter 11 relief, however, is unavailable to the Republic and could only be available to PDVSA if it could prove that it is not an instrumentality of Venezuela. For more information on the arguments that support Chapter 15 recognition, see Mark Walker and Richard Cooper, *Venezuela's Restructuring: A Realistic Framework* (Sep. 19, 2017).
14. Although PDVSA is by far the most important Venezuelan entity that will need to address its liabilities, other Venezuelan public sector entities, such as Elecar, may also find it beneficial to take advantage of this new law, whether to clean up their balance sheet, to attract new investment or to optimize their operations for better service to their customers or rate payers. In Puerto Rico, the Government is transforming its electric sector through a process that will be facilitated by the use of a reorganization statute that shares many of the characteristics of the law described in this article. See Richard Cooper, Luke Barefoot, Adam Brenneman and Antonio Pietrantoni, *Turning Bust To Boom: P3 Initiatives Under PROMESA* (July 19, 2017).
15. See Mark Walker and Richard Cooper, *Venezuela's Restructuring: A Realistic Framework* (Sept. 19, 2017) for more information on potential objections to Chapter 15 recognition.
16. Nor is it self-evident that it would be in the interests of the U.S. from a public policy perspective. The legal risk to the U.S. of an Executive Order, coupled with some of the other features mentioned by Buchheit and Gulati, is materially different from the cases they cite as precedent. And the facts and circumstances differ as well. With respect to Iraq, the effect of the world-wide freeze of Iraqi assets was to permit Iraq to offer take-it-or-leave-it restructuring terms to some 600 financial and commercial creditors with approximately USD21 billion in aggregate claims. Although holders of 96% of claims against Iraq accepted Iraq's offer, Iraq was shut out of the international debt markets for over 10 years from the time the freeze was implemented. Venezuela cannot afford a solution of that sort. In the case of Iran, the situation bears little resemblance to the situation in Venezuela. The executive order in the case of Iran ensured that all would-be U.S. litigants still received their "day in court", albeit before an arbitral tribunal perhaps with a less U.S. creditor-friendly disposition. The affected U.S. creditors were also significantly benefited by the fact that formerly blocked Iranian assets were earmarked and secured in an escrow account in Algeria for the purpose of satisfying claims, which proved sufficient to pay in full the more than USD 2 billion in awards obtained by U.S. creditors. Thus, the Iran example involved no debt restructuring at all, but merely the adjudication of claims in an alternative legal forum and the provision of substitute security.
17. The Supreme Court has recognized that secured creditors, such as the PDVSA 2020 bondholders, have a property right for which they are constitutionally entitled to protection to the extent of the value of their property. *Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 278 (1940). Moreover, where the President issues a stay with no alternative forum for creditors to bring claims of adequate protection or to generally be heard, there are arguments to be made that such actions are unconstitutional because they could lead to the destruction of the claim. *See Dames & Moore v. Regan*, 453 U.S. 654, 686-87 (1981) (the President's suspension of claims under an Executive Agreement with Iran was constitutional in part because the President provided an alternative forum "which [was] capable of providing meaningful relief").; *E-Systems, Inc. v. United States*, 2 Cl. Ct. 271, 272 (Fed. Cl. 1983) (holding takings claim was not ripe to be heard because the underlying claim had to be exhausted before the Iran-United States Claim Tribunal); *Ambac Assur. Corp. v. Comm. of P.R.*, 297 F. Supp. 3d 269, 277 (D.P.R. 2018) (holding takings claims asserted against fiscal plan proposed by Puerto Rico was not ripe because Puerto Rico had not made a final decision with regards to how it was going to disburse funds).
18. This suggestion is not dependent on our working assumption that Republic and PDVSA bonds will restructured on the same terms.
19. For most of its bond debt, the Republic would need the consent of at least 66 2/3% of the aggregate principal amount of each series of its outstanding bonds to modify its terms but many of the more impactful changes referred to above require the consent of 75% or 85% of each series. Included in these higher vote "reserved matters", in addition to core payment and financial terms, are terms such as governing law, waiver of sovereign immunity, ranking and, in connection with certain exchange and tender transactions, events of default. For two series of bonds that do not have collective action clauses, the general voting/consent requirement is the lesser of (i) a simple majority of aggregate principal amount of outstanding bonds and (ii) 66 2/3% of aggregate principal amount of each series of its outstanding bonds represented at a meeting, but any amendment of "core payment and financial terms" would require unanimous consent of the holders of such series.
20. The voting requirements for the addition of such a sharing clause would likely be an issue that would be litigated as it isn't specifically addressed in the documentation.
21. *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230, 238, 241 (2d Cir. 2013). Ultimately, the court vacated the injunctions noting that "the injunctions were a discretionary remedy, not a legal entitlement" under the pari passu clause, but so held only after Argentina settled with the majority of its holdout creditors. *NML Capital, Ltd. v. Republic of Argentina*, No. 08-CV-6978 (TPG), 2016 WL 836773 at *11 (S.D.N.Y. Mar. 2, 2016).
22. This language is not included in the documentation for the two series of Republic bonds that require unanimous consent to amend core payment and financial terms.
23. Although PDVSA's bond documentation includes similar language, the Local Reorganization Law Solution addresses the risk of holdout creditors of PDVSA.

Other Cleary-Authored Articles on Venezuela

Hitting the Brakes: How a Potential PDV Holding Bankruptcy Might Affect Venezuela and PDVSA Creditors
SSRN.com, August 6, 2018

The State of Creditor Recovery Efforts in Venezuela (Parts 1 and 2)
Law360, June 4-5, 2018

Recent Venezuela Executive Order Calls Into Question Enforceability of Security Interests
Cleary International Trade and Sanctions Watch, May 29, 2018

The Many Challenges Facing Venezuela Bribery Suit (Parts 1 and 2)
Law360, April 13 and 16, 2018

New Bribery Suit's Implications for Venezuela Restructuring
Law360, March 19, 2018

Crystallex's Implications for Holders of Venezuelan Debt
Law360, January 9, 2018

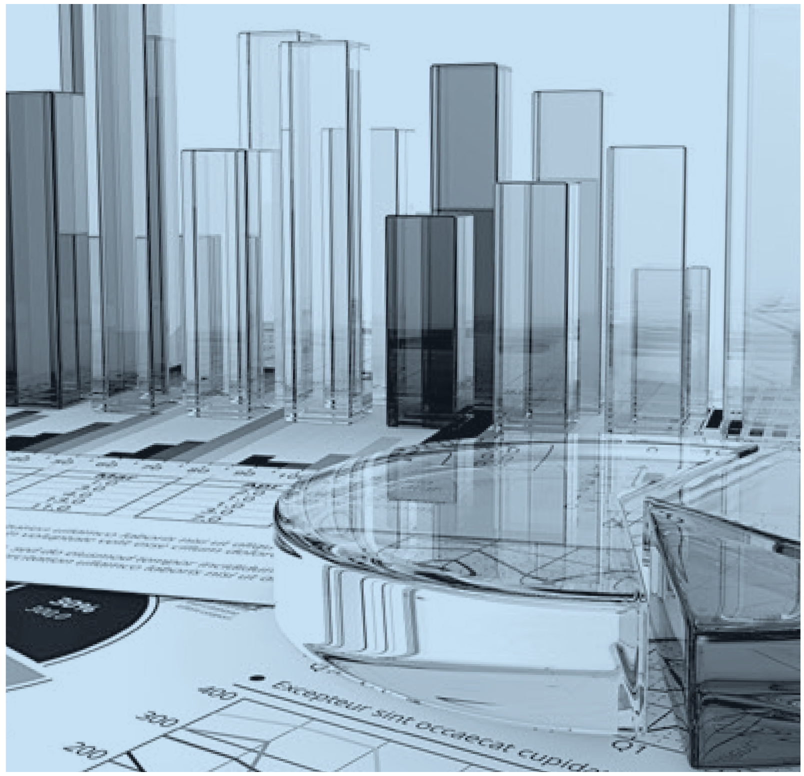
Why Venezuela's Bondholders Must Litigate, Not Arbitrate
Law360, December 15, 2017

Venezuela's Imminent Restructuring and the Role Alter Ego Claims May Play in This Chavismo Saga
SSRN.com, November 9, 2017

Venezuela's Restructuring: A Realistic Framework
Harvard Law School Bankruptcy Roundtable and SSRN.com, September 21, 2017

Sovereign Debt: Coming into the Light?

By **ANDREW SHUTTER, SUI-JIM HO** *and* **BARTHÉLEMY FAYE**



On May 20, 2019, ex-banker Detelina Subeva entered a guilty plea in New York admitting her part in a money laundering scheme relating to the proceeds of a bribe paid in connection with the secret loans made to Mozambique in 2013. The indictment of the former banker is one of the latest developments in the long-running USD 2 billion tuna bond scandal. The case was first made public in 2016 by international journalists who uncovered the hidden guarantees made by the then- Finance Minister of Mozambique. This guilty plea is likely to be the loosening of the thread that will unravel a ball of corruption linked to one of the most notorious examples of the lack of transparency in the world of sovereign debt.

If corruption festers in darkness, then transparency can provide the purifying light. Calls for the introduction of tools to keep sovereign loans out of the shadows have become steadily more emphatic in recent times, picking up converts from, quite predictably, civil society groups to, perhaps more unexpectedly, financial institutions. Still not all devotees are singing from the same hymn book. Here are some of the most recent offerings on the subject matter:

These papers trumpet the various virtues of greater debt transparency: greater accountability, more efficient markets, better debt sustainability, and swifter debt restructuring if we ever come to that. How can greater transparency be achieved?

Recent Calls to Tackle Hidden Debts

June 2018

G20 Note: "Strengthening Public Debt Transparency – The Role of the IMF and the World Bank"

— The World Bank and IMF are obviously interested parties in this debate as they have to pick up the pieces when a sovereign needs restructuring.

— In order to agree the terms of a restructuring, they - and other creditors – need to who know who is owed what.

— This is the case even if the hidden loans were not the trigger or main cause of financial distress for that sovereign.

August 2018

IMF Working Paper: "Fiscal Transparency, Borrowing Costs, and Foreign Holdings of Sovereign Debt"

— The working paper (which does not necessarily represent the views of the IMF) explores the effects of fiscal transparency on the borrowing costs of 33 emerging and developing economies and on foreign demand for their sovereign debt.

— The results suggest that higher fiscal transparency reduces spreads and increases foreign holdings of sovereign debt.

— In other words, debt transparency can contribute to lower borrowing costs and higher borrowing levels.

March 2019

The International Monetary Fund's Fiscal Transparency Code

— The IMF's Fiscal Transparency Code was first published in 1998 and most recently revised and updated in 2019.

— The Code covers various elements of fiscal transparency including fiscal reporting, which should offer relevant, comprehensive, timely, and reliable information on the government's financial position and performance.

April 2019

The Jubilee Debt Campaign's "Transparency of loans to governments"

— The Jubilee Debt Campaign is a UK-registered charity that helped bring about US$130 billion of debt relief for developing countries between 2000 and 2015 as part of the global Jubilee campaign, but saw their work undermined in several countries by hidden loans.

— In this briefing, they made the case for the citizens' right to know about the public debts.

May 2019

The International Institute of Finance (IIF) Draft "Principles for Debt Transparency"

— The IIF is the trade body representing the world's largest financial institutions.

— These Principles are designed to enhance transparency in private sector lending.

— The Principles are intended to be voluntary and will complement efforts to improve transparency on the part of public sector lenders and borrowers.

— The Principles are being submitted ahead of the 2019 G20 Ministerial in Japan for potential endorsement in June 2019.

Voiding undisclosed debts

The most radical solution proposed so far is that legislation should be passed so that by operation of the law of the relevant jurisdiction a lender cannot enforce sovereign debt that has not been disclosed by inclusion in a public register of debt. This solution put forward by the Jubilee Debt Campaign could be highly effective, but its implementation would be difficult. Overwhelmingly, debts of sovereigns owed to external creditors or denominated in a currency other than the currency of the sovereign are governed by English law or New York law. It is highly unlikely that the governments with the power to introduce legislation to effect this change would disadvantage their legal export industries by doing so unilaterally. Even if English and New York law were changed, other legal systems could be used as the governing law of the undisclosed debt. Borrowers and creditors intent on keeping their dealings secret are not likely to be too interested in a comparative analysis of the relative benefits of a third country's law versus English law or New York law if that third country's law does not require public disclosure.

Withholding access to rescue funds

Quite rightly the IMF and other international financial institutions whose role it is to provide funding of last resort take a very dim view of hidden debt. Countries hoping to be bailed out will find access to rescue funds much harder if they have hidden debt. In the case of Mozambique, the uncovering of the secret loans in 2016 resulted in international donors unceremoniously cutting off funding to the country. Still an argument can be made that these rescue funds should be made available when a country facing an economic crisis is in need of a rescue package regardless of whether all relevant debt of the country is fully disclosed. After all, the goal of rescue funding is to benefit the population of the distressed sovereign. That population will not have been responsible for the debt being concealed, other than indirectly by their poor choice of politician, if they had that choice. As long as the government promises not to repeat the sins of the fathers, perhaps all should be forgiven.

Making it voluntary

This may not be as ineffectual as it sounds. It is much easier to keep debts concealed for nefarious purposes if the failure to disclose those debt is not considered unusual or contrary to a standard of behaviour, whether voluntary or not. However, the standard should be comprehensive, not limited to a sub-set of debt. For example, the draft "Principles for Debt Transparency" prepared by the Institute of International Finance is drafted with many narrow definitions that look like they are lifted from a loan agreement. It would not take long for a banker or lawyer to come up with a debt structure that falls outside the definition of "Financial Transactions" used to set the scope of the voluntary disclosure regime proposed. For example, local currency loans are excluded as are derivatives for hedging purposes. So a state-owned oil company with dollar revenues could borrow in its domestic currency with cross-currency swap to hedge the loan into dollars to match its own revenues. As drafted a sovereign guarantee of the swap and the loan would not be within the scope of disclosable "Financial Transactions."

Encouraging increased disclosure through securities law

Currently, sovereigns with internationally listed debt securities are required in many jurisdictions to include disclosure on public sector debt. If the key jurisdictions were to introduce rules requiring more comprehensive disclosure of public sector debt, this would compel sovereigns looking to raise money in the international capital markets to have better debt transparency systems in place so that they can comply with the increased disclosure standards. The disclosure requirements would need to be calibrated carefully so that issuers can realistically comply with them. For example, one-third of low-income countries do not report on guarantees extended by the public sector, while fewer than one in 10 report debt of public enterprises. Greater transparency regarding public debt liabilities needs to be achieved over time. The increased disclosure requirements should not make it so onerous that it would be impossible for issuers to comply with them and we have actually seen more efforts toward transparency on guarantees and other contingent liabilities in recent Eurobond prospectuses.

Expand the scope of money laundering legislation to include hidden debts

Existing money laundering legislation already imposes a burden on those handling money to ensure that the funds being passed along are not proceeds of crime. If account banks are required to check the provenance of funds credited to a sovereign's account to ensure that such funds do not originate from an undisclosed source of debt (which may not necessarily be proceeds of crime), it is arguable that the burden on such account banks would only be incremental to the money laundering checks that they need to comply with currently. More importantly, given that only a few currencies represent a very high percentage of all monetary transactions, the impact could be huge even if only a few key jurisdictions made this change to their money laundering legislation. Unlike the governing law of a loan agreement, money laundering rules are much more difficult to side step. The challenge would be to define what undisclosed debt means in this context. Cynics may argue that there's no legislating for fraud if the actors are intent on wrongdoing, but adding a criminal sanction may concentrate the minds of individuals who might otherwise follow the wrong path. There would be the added benefits of whistle blowing protections for the brave and the incentive of bargains for guilty pleas like the one entered by Ms. Subeva. ■

▼ **Andrew Shutter** is a partner based in Cleary Gottlieb's London office. His practice focuses on the origination and restructuring of international financing transactions.

He represents corporates, sovereigns, funds, and financial institutions, as debtors or creditors in the origination and restructuring of complex financial transactions including leveraged and high-grade syndicated loans, high-yield and investment-grade bonds, derivatives, and securitization transactions. Andrew also has experience in mergers and acquisitions, joint ventures, and strategic investments.

Andrew joined the firm in 1997 and became a partner in 2001. Prior to joining Cleary, he worked in the Madrid and London offices of Clifford Chance.

▼ **Sui-Jim Ho** is a partner based in Cleary Gottlieb's London office. Jim's practice focuses on cross-border finance and restructuring. He advises on a broad range of financial products including loans, bonds and derivatives. He is particularly noted for his expertise in complex emerging markets and sovereign-related matters. He holds a law degree from the London School of Economics and Political Science where he graduated with First Class Honours.

▼ **Barthélemy Faye** is a partner based in Cleary Gottlieb's Paris office, with a practice focused on corporate and financial transactions related to Africa. He has extensive experience in sovereign debt borrowing and restructuring, private equity and M&A, and project development & financings in the natural resources, power and infrastructure sectors.

Barthelemy joined the firm in 1998 and became a partner in 2008. From 1998 to 2001, he was resident in the New York office.

Bahrain's New Bankruptcy Law

By **BUTHAINA AMIN** *and* **DAVID BILLINGTON**

On May 30, 2018 the Reorganisation and Bankruptcy Law (Bahrain Law No. 22/2018) (the "**Bankruptcy Law**") was adopted in the Kingdom of Bahrain. The Bankruptcy Law aims to maximise the value of bankrupt estates in the country and encourage corporate reorganisation over liquidation. Whilst local in its implementation, the Bankruptcy Law is international in scope and design. The Bankruptcy Law utilises restructuring concepts drawn from the U.S. Bankruptcy Code's Chapter 11 procedure, including a moratorium on enforcement proceedings, the ability to sell assets out of the bankrupt estate free from security, obtain financing on superpriority terms and implementing a reorganisation plan. These 'debtor-friendly' restructuring tools are familiar to, and popular with, international companies and investors. The message here is clear – the introduction of the Bankruptcy Law is intended to show that Bahrain is an increasingly frictionless place in which to do business.

This article will explore the origins of the Bankruptcy Law and outline some of its key features. It will further contextualise the Bankruptcy Law within the sphere of global restructurings.

Historical Context

Previously, the Bankruptcy and Composition Law No. 11 of 1987 and aspects of the Commercial Companies Law No. 21 of 2001 together comprised the legislation that applied to bankruptcies, reorganisations and insolvency matters in the Kingdom of Bahrain. There is also the Central Bank of Bahrain and Financial Institutions Law 2006 that holds separate and further detailed insolvency rules for financial institutions licensed by the Central Bank of Bahrain and continues to operate as the new Bankruptcy Law does not apply to these institutions as noted below.

The purpose for the development of a new Bankruptcy Law is twofold. The first is to provide further increased certainty and protection to those currently operating in the market including those that wish to start a new business and secondly, to allow for a restructuring component, which is critical for companies with heavy debt. The new Bankruptcy Law allows for cross border insolvency and the ability to restructure business which had been missing from the previous law.

Additionally, one of the key focus areas for the government has also been to galvanize the Kingdom's plans for a thriving ecosystem of start-ups. Bahrain is looking at fostering innovation and entrepreneurship and in a key effort to do so, has put in place a bankruptcy framework that decriminalises failure, enhances impartiality and transparency in the hopes of transforming the ecosystem.

Key Features of the Bankruptcy Law

Scope

Debtors that are companies or trading individuals are within the Bankruptcy Law's scope, but persons licensed by the Central Bank of Bahrain are excluded. In addition, a debtor's personal, family and consumer debts are excluded from the scope of the Bankruptcy Law.

Commencing a Claim

Under the Bankruptcy Law either the debtor or its creditors can commence proceedings. To fall within the Bankruptcy Law's jurisdiction, the debtor must also have failed to pay its debts for a period of thirty days, or be incapable of paying its financial liabilities as they fall due. In addition, the petitioner can present evidence that the debtor's financial obligations exceed the value of its assets.

The purpose of a new Bankruptcy Law is to provide further increased certainty and protection to those currently operating in the market and to allow for a restructuring component, which is critical for companies with heavy debt.

Management stay in place

The Bankruptcy Law adopts a 'debtor-in-possession' framework. Whilst the administrative and management arm of the company remains in place, an independent "Bankruptcy Trustee" is appointed. The Bankruptcy Trustee owes a fiduciary duty to act in the best interests of the estate and performs a myriad of functions, including helping prepare the Reorganisation Plan (as discussed below) and producing an inventory of the debtor's assets. Importantly, the approval by the court of the opening of bankruptcy proceedings allows the debtor to utilise the restructuring tools identified below.

Moratorium

A critical feature of the Bankruptcy Law is the moratorium on claims against the bankrupt estate. Activated when the court approves the opening of bankruptcy proceedings and lasting for an initial period of 120 days in the case of secured creditors, the stay on enforcement proceedings should provide critical breathing room to manage the reorganisation of the estate and encourage continued trade. The moratorium can be extended at the Bankruptcy Trustee's request, provided consent is obtained from the secured creditors or the court deems the extension as essential to maximising the estate's value.

There are certain exceptions to the moratorium's scope. Financial derivative contracts are not subject to the stay. The court also maintains discretion to terminate the moratorium. Along with certain other conditions, the stay can be lifted upon the motion of a secured creditor if the value of their secured funds decreases and they do not receive adequate protection against impairment or any other losses during the moratorium. Unsecured creditors may apply to terminate the stay if their claim has been previously litigated or is subject to a right of set-off, but only where the adjudication of the claim or exercise of the set-off would facilitate administration.

Sale of assets

The Bankruptcy Law allows assets to be sold out of the bankrupt estate. For the sale to be sanctioned, the court must deem the disposal in the best interests of the bankrupt estate. A method of sale that maximises value should in principle also be utilised.

Providing flexibility to the sales process and enhancing the saleability of the assets, secured assets can be sold free from security if:

— the secured creditor consents;

— the cash proceeds from the sale is not less than the secured debt;

— the cash proceeds from sale is not less than fair market value; or

— the sale is made under a Reorganisation Plan (as explained at more length below).

If the property is sold free of security, the security rights automatically attach to the proceeds of the sale with the same priority. Secured creditors can also request to bid for the purchase of the property and apply any right of set off among the purchase price and the secured claim.

DIP Financing

Similar to Chapter 11 in the USA, the Bankruptcy Law introduces provisions that allow the debtor to raise credit whilst in bankruptcy, with court approval. Providing a potential lifeline to the company and encouraging continued trade, the court can approve the funding if the terms are fair and reasonable and the financing is necessary for the proper administration of the bankruptcy estate.

The clear advantage of DIP financing is the ability to provide priority credit. Unless otherwise agreed between the parties, unsecured DIP loans will be given first priority status and can be repaid without court approval. Secured DIP loans will rank behind existing security unless the existing secured creditors agree to relinquish priority. However, the court can authorise the creation of security rights with priority even if the existing creditor objects if:

— the secured creditor has the opportunity to be heard;

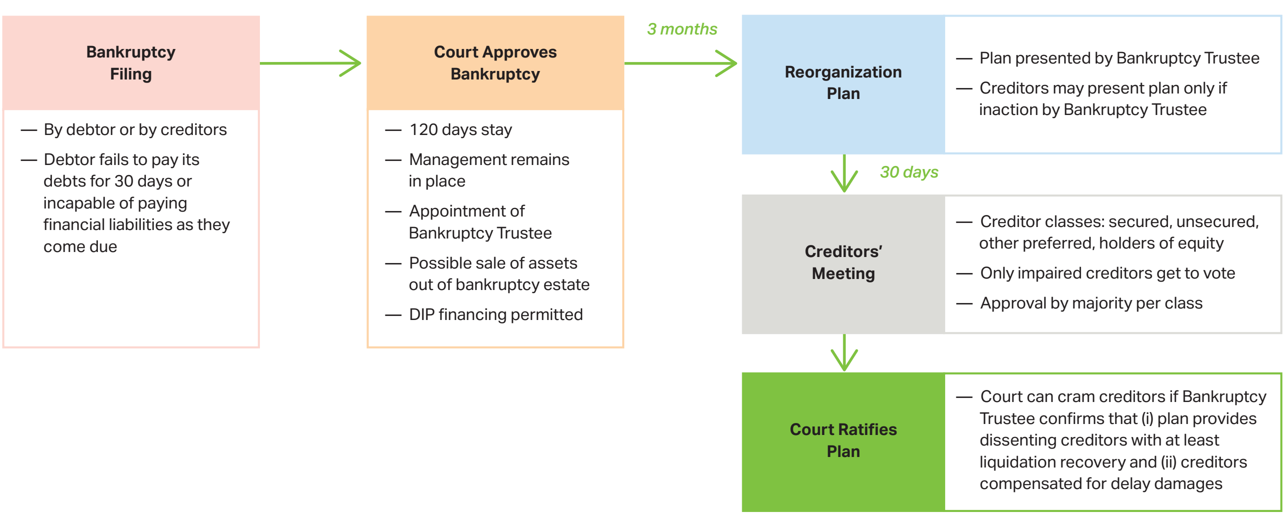
— the debtor cannot obtain alternative financing; and

— security is provided to the existing creditor.

Guarantees can also be given on the funds of the bankrupt estate, but these are subject to any existing liens on the property.

These provisions should encourage lenders to extend credit to companies in financial distress and help keep the company afloat during the reorganisation process.

Bahrain Bankruptcy Process Overview



Reorganisation Plan

Introduction

The Bankruptcy Law provides a framework to help debtors engage with creditors and attempt to agree a restructuring plan for the company (the "**Reorganisation Plan**").

Within three months of the opening of bankruptcy proceedings, the Reorganisation Trustee must submit a Reorganisation Plan. A committee of creditors (the committee representing unsecured creditors) or creditors holding at least one third of total claims can file a Reorganisation Plan, but only when proceedings have been pending for at least six months and the Reorganisation Trustee has failed to make progress.

The Reorganisation Plan can be a broad range of different things, allowing for a comprehensive alteration of the debtor's capital structure:

— a sale of property;

— an investment by third parties into debt or equity securities issued by the debtor;

— a recapitalization of the debtor;

— a merger or other transaction; and

— the continuation, rescission or assignment of contracts.

The Reorganisation Plan can propose a myriad of treatments in relation to the existing debt, including modifying its terms and conditions, such as the maturity date or interest rate. Alternative techniques such as issuing new securities to creditors in exchange for their existing claims and cancelling equity interests without consideration can also be deployed.

Procedure

A disclosure statement must be prepared for consideration by the creditors. Amongst other details, the statement should include information on the debtor's financial position, the grounds on which the debtor will continue to operate and information on the voting mechanics. Similar to documentation requirements for U.K. schemes of arrangement, a comparator analysis must be presented showing the returns that creditors are expected to receive under the Reorganisation Plan as compared to liquidation. When deciding whether to sanction the Reorganisation Plan, the court will consider whether the disclosure statement contains sufficient detail to enable the creditors to make an informed decision on whether to accept or reject its terms.

Within thirty days of its submission, the court will convene a meeting of the creditors to vote on the Reorganisation Plan. Creditors are classified into different classes for voting purposes. The Bankruptcy Law outlines the following classes, although a special category could be established if it would facilitate proceedings: secured creditors, unsecured creditors, other preferred creditors and holders of equity interests. Critically, only those creditors whose rights will be affected by the Reorganisation Plan are entitled to vote.

The Reorganisation Plan will be approved if it is accepted by the majority of creditors in each category, provided those creditors account for at least two thirds of the total amount of the debts of such category. Creditors whose debts will be fully discharged by the Reorganisation Plan or whose rights will not be affected are deemed to have approved the plan.

Following the vote and the hearing of any objections by creditors who did not approve the Reorganisation Plan, the court will decide whether to ratify the Reorganisation Plan and issue a decision to proceed with its implementation. The court can cram through the Reorganisation Plan even if it is not approved by a class of creditors, provided that the Reorganisation Trustee confirms that the Reorganisation Plan will give any creditor that has not voted in favour at least the same return as they would get in liquidation, and that creditors will be compensated for damages that occur from the delay.

Effect

If the Reorganisation Plan is approved by the court it is binding on all persons, wherever they are located and whether or not they voted for or against the plan.

International Context

Global Reforms

The introduction of the Bankruptcy Law has occurred during a period of global reform in bankruptcy regimes. The aftermath of the 2008 financial crisis emphasized the importance of having robust legislation that can facilitate corporate rescue on a cross-border basis. Jurisdictions such as India, Egypt and the United Arab Emirates have recently introduced new bankruptcy laws which reflect this shift in focus.[1] In the U.K., the government has presented proposals for a new form of reorganisation plan which allows for the cross-class cram down of creditors.

The most well-known bankruptcy reorganization tool is Chapter 11 of the U.S. Bankruptcy Code, and there is much in the Bankruptcy Law that will be familiar to American practitioners. In our view, the key reasons Chapter 11 has worked so well as a tool for rehabilitation of distressed companies are as a follows:

IT IS A PURPOSE-BUILT TOOL

In the first wave of distress after the financial crisis many European jurisdictions realized that their insolvency laws did not explicitly legislate for restructuring of companies. The focus of many legal regimes was on protecting creditors and providing them with mechanisms to enforce their claims. Where tools were available, often they were not specifically designed for debt restructuring, and had to be adapted (English schemes of arrangement being the best example).

Having a purpose-built legal mechanism for corporate restructuring gives all stakeholders a degree of certainty as to the timing and process for resolution of the situation. Have increased predictability on these aspects reduces the overall execution risk of any restructuring, and should lead to better outcomes.

IT FACILITATES RESTRUCTURINGS WITHOUT ALL CREDITORS PROVIDING CONSENT

Allowing a restructuring to be imposed on all stakeholders with the consent of a super-majority of creditors is helpful in two respects:

— **First**, if the debtor has a complex capital structure, it will be practically impossible to obtain active engagement and support from all creditors.

— **Secondly**, it mitigates the hold-out creditor risk. If unanimity is required for a plan of reorganization to be approved, the debtor will have to negotiate to the lowest common denominator – pacifying the most aggressive creditors in return for their support. That creates the risk that an individual creditor (or small group of creditors) can de-rail the process for the majority.

IT ALLOWS THE DEBTOR'S BUSINESS TO CONTINUE AS A GOING CONCERN

A big risk with any bankruptcy process is that the process itself leads to a destruction of value. In most cases that is because the debtor's business struggles to continue as a going concern when it comes under stress. If the business cannot continue to trade, often there will not be enough time to negotiate and agree a restructuring deal before the debtor is at risk of liquidation.

Three elements of the Bankruptcy Law help to mitigate this risk:

— **First**, management stay in place – absent fraud, they will be best-placed to run the business, deal with customers, suppliers, employees and creditors and generally to steady the ship whilst a deal is put together.

— **Secondly**, a moratorium on enforcement action by creditors allows management to focus on stabilizing the situation, and on putting together a restructuring plan that benefits all or a majority of the creditors. If individual creditors are able to take their own action in an un-coordinated manner, very quickly the management will be in a fire-fighting situation and confidence in the business will evaporate, further exacerbating the distress.

— **Thirdly**, having a DIP financing regime should give providers of capital the confidence to supply liquidity to a debtor at a time when it would otherwise be difficult or impossible to obtain. Furthermore, in addition to the cash supplied, the availability of a DIP loan should inspire confidence among other creditors (particularly trade creditors), who will be encouraged to continue to deal with the debtor without fear it is going to run out of money in the short term.

International Recognition

Cross-border recognition of bankruptcy rulings is a very complicated area. To give an example: imagine a Dutch company has debt governed by Italian law, and significant assets in Bahrain. How would you go about restructuring that in such a way as to be legally robust in each of those jurisdictions? Broadly, there are two options:

— *Option A*: Conduct some sort of court-process in each of those countries, and possibly also in countries where key creditors are located. Unfortunately that is very costly, and can lead to odd results where the consent thresholds and procedural requirements are different in each jurisdiction.

— *Option B*: Conduct one process in the company's centre of main interests, and then seek to have that court ruling recognized in all relevant jurisdictions.

Option B is clearly preferable, and there are various international frameworks that seek to facilitate recognition (the European Insolvency Regulation being the prime example). The Bankruptcy Law takes inspiration from the UNCITRAL Model Law on Cross-Border Insolvency (1997) in its adoption of provisions designed to facilitate cross-border insolvencies. Under the Bankruptcy Law, a foreign representative may apply to the Bahraini court to have foreign insolvency proceedings recognised. If a foreign proceeding is recognised, the court is empowered to grant relief most importantly in the form of staying actions against the debtors assets and suspending the right to transfer, encumber or otherwise dispose of the assets. Parallel proceedings to the foreign proceedings can also be commenced in Bahrain in regards to the debtor's assets in the country. The intention is to facilitate cross-border proceedings and provide legal certainty for trade and investment.

In this vein, the Bankruptcy Law also provides for enhanced cooperation with other bankruptcy jurisdictions, with foreign courts and representatives permitted to communicate and coordinate directly with the Bahraini courts and share certain information.

However, there are limits to how far domestic courts in certain countries are prepared to take Option B. Restructuring laws by their nature allow for some fairly significant consequences to be imposed on creditors, in some cases against their will. Some countries have 'red lines' which restrict the extent to which they can recognize the orders of foreign bankruptcy courts. For example, in England we have an ancient rule that says English law contractual obligations can only be discharged by an English law governed process. In practice this means that

English-law governed debt could not be discharged or modified in a Bahraini proceeding unless the creditor agreed to submit to the jurisdiction of the Bahraini court. If the creditor did not submit, they could seek to enforce their claims in the English courts. The scope of the Bankruptcy Law is therefore not without limits. A parallel U.K. Scheme of Arrangement, or alternative process, will be required in regards to English law governed debt obligations or for jurisdictions where a similar approach is taken to creditors rights.

CASE STUDY

There has also recently a case filed at the Bahraini courts by Garmco, the Bahrain-based international aluminum rolling mill, for a voluntary petition for relief under Section 3 of Law No 22 of 2018 which should serve as a useful case study for the implementation of the new processes and mechanisms.

Therefore, whilst some questions may remain regarding how the Bankruptcy Law will work in practice, its implementation represents a huge leap forward for businesses and their creditors alike. The Bankruptcy Law represents a clear shift in the Bahraini legislative environment towards more business-friendly laws designed to encourage investment in the country.

For more information about the Bankruptcy Law, visit www.bahrainedb.com. ■

1. For more details on the UAE and Egyptian bankruptcy regimes see, Mohamed Taha, *Egypt's New Bankruptcy Law: A Step Forward in the Business Legislative Reform Process*, Emerging Markets Restructuring Journal, Issue No.7 (Summer 2018); Lawale Ladapo and Mohamed Taha, *The New Bankruptcy Law of the UAE: Towards A More Business-Oriented Bankruptcy Regime, Emerging Markets Restructuring Journal, Issue No. 4* (Fall 2017).

Buthaina Amin is the Director of Legal Affairs at the Bahrain Economic Development Board. Buthaina is responsible for managing the EDB's legal responsibilities, and also directs the Kingdom of Bahrain's legislative outreach to executive, regulatory and corporate bodies at a regional and international level. Buthaina previously worked as an international projects lawyer based in London, specializing in corporate acquisitions, PPP, restructuring and large scale infrastructure projects.

David J. Billington is a partner based in Cleary Gottlieb's London office. David's practice focuses on international financing transactions and restructuring transactions. David joined the firm in 2006 and became a partner in 2012. Prior to Cleary, David worked at Allen & Overy in London.

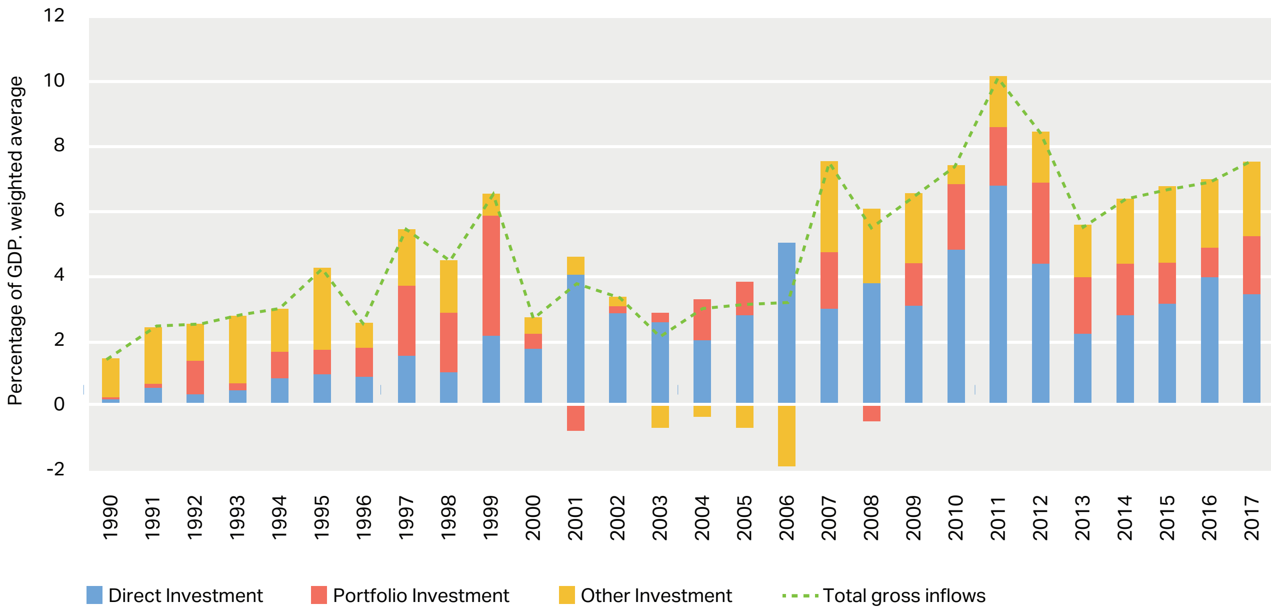
David has experience across a broad range of debt financing products, advising both borrowers and lenders on bank lending, leveraged finance transactions, high yield bonds and structured debt. David also acts for a range of stakeholders in international restructuring and insolvency matters.

Towards or Away from Investment Treaty Arbitration in Africa?

By NAOMI TARAWALI

Developments in certain African jurisdictions have led some commentators to question the future of investment treaty arbitration as a means of resolving investment disputes with African states. This article explores the factors that might be driving the apparent 'backlash' against investment treaty arbitration from some states, and examines whether there is in fact an identifiable trend away from investment treaty arbitration across Africa. In conclusion, the article offers some observations on the way forward for investment treaty arbitration involving African parties.[1] Unless otherwise stated, 'investment treaty arbitration' is used to refer broadly to arbitration conducted pursuant to a bilateral or multilateral treaty that provides a direct investor-state dispute settlement mechanism ("**ISDS**").

Evolution of Gross Capital Inflows to Sub-Saharan Africa



Source: International Monetary Fund Balance of Payments BPM 6.0.

Note: Aggregate figures represent GDP-weighted averages of the radio of gross capital inflows to GDP across countries in Sub-Saharan Africa. GDP = gross domestic product.

Why the Apparent 'Backlash'?

There are many, well-rehearsed criticisms of investment treaty arbitration that contribute to claims that it is a system of dispute resolution adverse to the interests of African states (and indeed, to the interests of other African participants in investment treaty arbitration). The inclusion of ISDS in investment treaties and trade agreements has become increasingly controversial globally, raising questions as to whether African states should continue to engage in investment treaty arbitration when (some) developed nations and entire regions appear to be abandoning the same.[2]

These criticisms all indicate that the current investment treaty arbitration frameworks may not appropriately balance the interests of its users, and demand reform. That said, upon closer analysis of some of these complaints, the position becomes less clear cut.

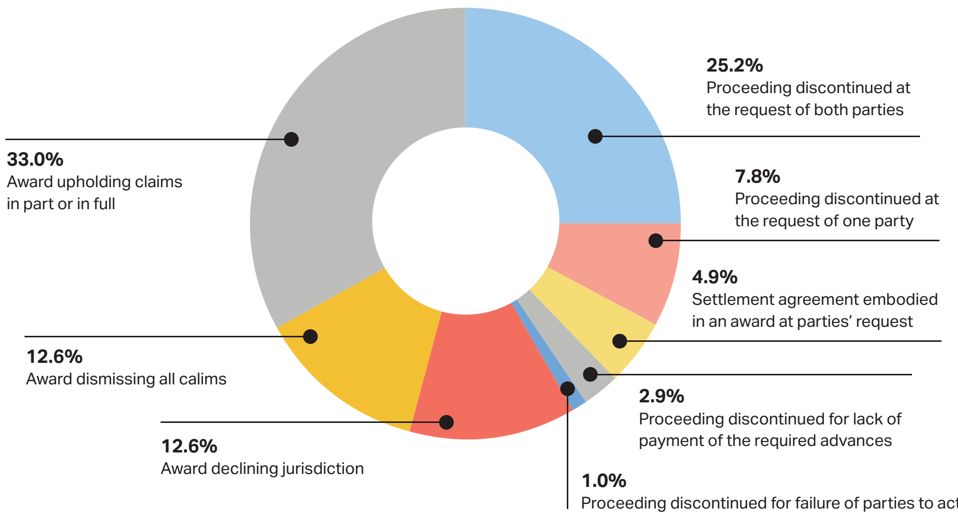
SOME OF THE CRITICISMS INCLUDE THE FOLLOWING:

— **Uncertain benefit to host states** – Part of the historical rationale for investment treaties is that they benefit the host state by attracting foreign investment and by raising standards of governance not only for foreign investors but also for the host state overall. However, improvement of governance is inherently difficult to measure and as of yet, there is no clear empirical evidence that ISDS do in fact have this result.[3] Furthermore, it is not clear that the existence of investment treaties necessarily increases foreign investment. Some studies have found that it does, but often subject to caveats that the impact of the existence of an investment treaty is difficult to measure and any increase may only be marginal.[4]

— **Interference** – There are criticisms that investment treaties and the related threat of investor claims pursuant to ISDS unduly interferes with the host state's rights and ability to properly govern and regulate.

For example, a large award against a state in investment treaty arbitration, whilst unwelcome to the state party (whose budget is likely already subject to numerous pressing demands), does not necessarily reflect a bad or bias decision. The outcome would not necessarily have been any different were the dispute pursued in an alternative forum such as international commercial arbitration or even in the national courts of the state. It is also not clear that African states fare worse than investors in terms of outcome of claims. In fact, according to ICSID's Special Focus Africa statistics (as at May 2017) only 33% of cases registered against African states resulted in an award that upheld (in full or in part) the investor's claim.[7]

The ICSID Caseload Statistics, Special Focus – Africa (May 2017), page 16
Chart 8a: Arbitration Proceedings under the ICSID Convention and Additional Facility Rules involving a State Party involving an African State – Tribunal Rulings, Settlement & Discontinuances



— **Costs and process** – Investment treaty arbitration can be a lengthy and expensive process, often involving international counsel and perhaps a seat in an inconvenient or unfamiliar jurisdiction.

— **Anti-state bias** – In terms of case outcome, there is at least a perception that investment treaty arbitration is biased against African states and overly favours the position of the investor.

— **Magnitude of awards** – Investment treaty claims are often for tens or hundreds of millions of U.S. dollars. A recent exceptional example is the circa. USD 9 billion award against Nigeria which is currently being challenged by Nigeria in U.S. and U.K. courts.[5] Although this was in the context of a commercial rather than investment treaty arbitration, headlines like these perhaps contribute to the perception that engaging in international arbitration processes with investors invites the risk of 'mega-awards' against the state.

— **Public accountability and transparency** – Although some investment treaty arbitration proceedings are public, many are not and some only partially so. A frequently raised criticism of investment treaty arbitration is that matters of public importance relevant to governance of the state can be determined behind closed doors, by a privately appointed tribunal and at the behest (and perhaps to the benefit of) a single private foreign investor.

— **Lack of African representation** – Despite the rise of international arbitration references with a connection to Africa, there is a lack of proportionate representation of African participants in the administration of both investment treaty and commercial arbitration (as counsel, arbitrators and in terms of the seat of arbitration proceedings).[6] This may be a factor dissuading African states and other stakeholders from continuing to engage in investment treaty arbitration.

A Pan-African Trend Away from Investment Treaty Arbitration?

Nevertheless, perhaps in response to the criticisms above, some African states have taken steps that move away from investment treaty arbitration such as terminating bilateral investment treaties (e.g., South Africa) and introducing legislation requiring foreign investment disputes to be resolved via different mechanisms. Regarding the latter, Tanzania's recent Public Private Partnership (Amendment) Act goes so far as to require foreign investors to resolve disputes in the domestic courts, prohibiting recourse to any international arbitration process (not only investment treaty arbitration).

Notwithstanding developments of this nature, it does not yet seem that there is a consistent move away from investment treaty arbitration across Africa. For every 'anti-arbitration' development there is a countervailing example of a state presenting itself as 'pro-arbitration' (e.g., Nigeria, Kenya, Egypt – notably, these examples include states that have been on the receiving end of some significant investor claims). On one hand, the 2012 SADC Model BIT states that the "preferred option" is to exclude ISDS because "several States are opting out or looking at opting out of investor-State mechanisms."[8] On the other, the OHADA Arbitration Rules of the Common Court of Justice were specifically expanded in their most recent revision to include ISDS provisions, with the intention that this should become a more widely used mechanism enabling investor-state disputes to be administered in the region.[9]

OHADA Arbitration Rules	SADC 2012 Model BIT
Article 2 "...The Court may also administer proceedings based on an instrument related to an investment, in participation on investment code or a bilateral or multilateral investment treaty"	**Article 29 Special Note** "...the preferred option is not to include investor-State dispute settlement. Several States are opting out or looking at opting out of investor-State mechanisms, including Australia, South Africa and others..."

Some Observations on the Way Forward

On the issue of investment treaty arbitration, it therefore seems that Africa is not speaking with one voice, so where to from here, and is it even appropriate to be seeking a 'pan-African' approach?

The criticisms discussed above suggest that there are significant flaws with the current investment treaty arbitration mechanisms and that they do not appropriately balance participants interests, particularly from the perspective of African participants. However, simply abandoning investment treaty arbitration will not necessarily result in a better outcome. So long as there is foreign investment, disputes will continue to arise and a more productive response might be for African stakeholders to engage with investment treaty arbitration and drive reform.

This is particularly so at a point in time where the nature of African stakeholders' participation in the investment arbitration process appears to be shifting for a number of reasons. Foreign investment into African states has grown dramatically over the past couple of decades, and Africa continues to attract significant investment.[10] There is also an increased focus on fostering Africa-to-Africa investment as route to growth across the continent.[11] With this, there is the expectation that African states should over time become increasingly capital exporting as well as capital importing nations. This impacts upon African states' interests and position as regards investment treaties and specifically ISDS.[12] Already there are indications that the use of ICSID procedures by African *investors* and the number of intra-African ICSID cases are increasing.[13] Also although there is arguably a long way to go, the conversation has at least started regarding the participation and representation of Africans as counsel and arbitrators in investment treaty arbitration.

There are already some signs of innovation - to give but one example, the Nigeria-Morocco BIT (signed on December 3, 2016) has been hailed as progressive, including the obligations it imposes on the investor regarding environmental regulations and sustainability, as well as expressly preserving the host state's ability to regulate.

Conclusion

Against this background, rather than disengaging entirely with investment treaty arbitration as a mechanism for dispute resolution, African participants should be encouraged to engage and shape a system that is reflective and supportive of these developments and which better reflects the interests of African States and other participants. The investor protection and ISDS provisions of the African Continental Free Trade Area (AfCFTA, which entered into force on April 2, 2019) are now to be negotiated during Phase II of the negotiations, scheduled for completion by June 2020. This presents a timely and significant opportunity for African stakeholders to begin transforming the shape of investment treaty arbitration across Africa, and the outcome of these negotiations will be observed with great interest. ■

1. The themes in this article were discussed by the author on a panel entitled '*Investment Arbitration Developments in Africa: We Are Awake But Are We Smelling the Coffee*', (at the First Annual Arbitration Conference of the African Arbitration Association held in Kigali, Rwanda on April 3-4, 2019). The panelists included the author, Vlad Movshovich (partner, Webber Wentzel) and Tarek Badawy (partner, Shahid Law Firm), and was moderated by Shan Greer (consultant, Floissac Fleming Law).
2. For example, the EU.
3. See Sattorova, M. (2018). *Do Developing Countries Really Benefit from Investment Treaties? The impact of international investment law on national governance*. Accessed May 2, 2019 at https://www.iisd.org/itn/2018/12/21/do-developing-countries-really-benefit-from-investment-treaties-the-impact-of-international-investment-law-on-national-governance-mavluda-sattorova/.
4. See Bonnitcha, J. (2017). A*ssessing the Impacts of Investment Treaties: Overview of the evidence*, IISD Report. Accessed May 2, 2019 at https://www.iisd.org/sites/default/files/publications/assessing-impacts-investment-treaties.pdf.
5. The US$ 9 billion figure is inclusive of interest. Process and Industrial Developments Limited v The Ministry of Petroleum Resources of the Federal Republic of Nigeria, Final Award dated January 31, 2017. Accessed May 2, 2019 at https://pacer-documents.s3.amazonaws.com/36/194469/04516479471.pdf.
6. See the SOAS Arbitration in Africa Survey (2018), *Domestic and International Arbitration: Perspectives from African Arbitration Practitioners*. Accessed May 2, 2019 at https://eprints.soas.ac.uk/25741/1/SOAS%20Arbitration%20in%20Africa%20Survey%20Report%202018.pdf.
7. See The ICSID Caseload Statistics, Special Focus – Africa (May 2017), page 16. Accessed May 2, 2019 at https://icsid.worldbank.org/en/Documents/resources/ICSID%20Web%20Stats%20Africa%20(English)%20June%202017.pdf.
8. 2012 SADA Model BIT, Article 29 SPECIAL NOTE.
9. OHADA Arbitration Rules of the Common Court of Justice and Arbitration November 23, 2017, in force March 2018.
10. See e.g., World Bank '*Africa's Pulse, an analysis of issues shaping Africa's economic future* (October 2018, Volume 18), Figure 2.2 (Evolution of Gross Capital Inflows to Sub-Saharan Africa). Accessed May 2, 2019 at http://documents.worldbank.org/curated/en/881211538485130572/pdf/130414-PUBLIC-WB-AfricasPulse-Fall2018-vol18-Web.pdf.
11. See, e.g., *African Development Bank, Africa to Africa Investment, a First Look*.
12. See generally J-P Le Cannu. *Foundation and Innovation: The Participation of African States in the ICSID Dispute Resolution System*. ICSID Review, Vol. 33, No. 2 (2018), pp. 456-500.
13. *Ibid*. See also *Global Telecom Holding SAE v Canada*, ICSID Case No. ARB/16/16.

▼ **Naomi Tarawali** is an associate in the dispute resolution team at Cleary Gottlieb Steen & Hamilton LLP in London. Naomi's practice focuses on international arbitration (both commercial and investor-state disputes) and cross-border commercial litigation. She has worked on a number of contentious and pro-bono matters with links to different countries across the continent including Ghana, Guinea, Nigeria, South Africa and Tanzania.

Naomi currently serves as secretary to the Board of Africa International Legal Awareness ("AILA") and on certain sub-committees of the organisation.

Prior to qualifying as a solicitor, Naomi spent time living and working in West Africa (Nigeria) and East Africa (Kenya, Ethiopia) including at the Office of the Legal Counsel of the African Union working on public international law matters.

The Delinquent Director in South Africa: No Tolerance for Errant Directors?

By **ERIC LEVENSTEIN, NASTASCHA HARDUTH** *and* **MAHATMA KHWIDZHILI**

The South African courts have declared directors, who have failed to discharge their duties under the South African Companies Act 71 of 2008 (Companies Act), to be delinquent, and have granted leave to the companies involved to claim damages from such director for losses incurred as a result of such director's conduct.

It is therefore incumbent on South African directors to take cognisance of the impact of section 162 of the Companies Act (declaration of delinquent directors) and to take steps to ensure that they do not open themselves up to the possibility of being declared delinquent.

SECTION 162 – DELINQUENCY

In terms of section 162 of the Companies Act, a company, a shareholder, a director, company secretary or prescribed officer of the company, a registered trade union that represents employees of the company, or any other representative of the employees of the company, may apply to court for an order declaring a person delinquent or under probation if:

— the person is a director of that company, or within 24 months immediately preceding the application, was a director of that company; and amongst other things –

— such director has:

- whilst under a probation order in terms of the Companies Act or the Close Corporations Act, acted in a manner that contravened that order;
- grossly abused the position of a director;
- intentionally, or by gross negligence, inflicted harm upon the company or a subsidiary of the company, contrary to the provisions of the Companies Act;
- acted in any manner that amounts to gross negligence, wilful misconduct or breach of trust in relation to the performance of such director's duties.

Furthermore, the Companies Act provides that a director may be declared delinquent if he or she uses his or her position or any information obtained while acting in the capacity of a director to:

— gain an advantage for him- or herself or for another person other than the company or a wholly owned subsidiary of the company; or

— knowingly cause harm to the company or a subsidiary of the company.

Any organ of state responsible for the administration of any legislation may also apply to court for an order declaring a director delinquent, if such director has repeatedly been personally subjected to a compliance notice or similar enforcement mechanism for substantially similar conduct in terms of any legislation.

A court will be obligated to declare a person to be a delinquent director if the person consented to serve as a director while ineligible or disqualified.[1]

Any person who has at least twice been personally convicted of an offense or subjected to an administrative fine or similar penalty in terms of any legislation could also be subject to an application for a declaration of delinquency.

Any declaration of delinquency will subsist for the lifetime of the person declared delinquent on account of having consented to serve as a director whilst ineligible or disqualified under the Companies Act, or whilst under a probation order in terms of the Companies Act that person acted in a manner that contravened the probation order.

Any declaration made by the court may be made subject to any conditions that the court considers appropriate, including a limitation of the application of such a declaration to one or more particular categories of companies.

As an alternative to a declaration of delinquency, a court may make an order placing a person under probation instead. This would occur under circumstances where the court is satisfied that the declaration is justified, having regard to the circumstances of the company's conduct and the person's conduct in relation to the management, business or property of the company at the time. Such order for probation (similar to a suspended sentence) will be made subject to conditions that the court considers appropriate and may subsist for a period not exceeding five years.

It is important to note that an order for probation applies to directors who were present at meetings of companies and failed to vote against a resolution despite the inability of the company to satisfy the solvency and liquidity test as set out in section 4 of the Companies Act. The solvency and liquidity test would apply to directors and any person who is obligated to consider whether, having regard to the reasonably foreseeable financial circumstances of the company at a particular point in time that the assets of the company are fairly valued, are equal to or exceed the liabilities of the company, and it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months thereafter.

Furthermore, any person may be placed under probation if he or she:

— acts in a manner materially inconsistent with the duties of a director; or

— acts in or supports a decision of a company to act in a manner which results in oppressive or prejudicial conduct; or

— on some basis acted in a manner which constituted an abuse of the separate juristic personality of such company.

The court may further make an order placing a person under probation if, the person has been a director of more than one company (irrespective whether concurrently, sequentially or at unrelated times) and during the time that the person was a director of each of such companies, two or more of those companies each failed to fully pay all of its creditors or meet all of its obligations, except in terms of a business rescue plan as contemplated in Chapter 6 of the Companies Act or a compromise with creditors in terms of section 155 of the Companies Act.

Without limiting the powers of the court, a court may order as conditions applicable or ancillary to a declaration of delinquency or probation that the person concerned:

— undertakes a designated programme of remedial education relevant to the nature of the person's conduct as director;

— carries out a designated programme of community service; or

— pays compensation to any person adversely affected by the person's conduct as a director to the extent that such a victim does not otherwise have a legal basis to claim compensation.

If a person is placed under probation, he or she is to be supervised by a mentor in any future participation as a director while the order remains in force or be limited to serving as a director of a private company or of a company of which that person is the sole shareholder.

Any person who has been declared delinquent or subject to an order of probation may apply to court to suspend the order of delinquency and substitute an order of probation, with or without conditions, at any time more than three years after the order of delinquency was made, or to set aside an order of delinquency at any time more than two years after it was suspended, or an order of probation at any time after such order was made. This will not be available to a person declared delinquent on account of having consented to serve as a director whilst ineligible or disqualified under the Companies Act or whilst under probation in terms of the Companies Act or the Close Corporations Act and acted in a manner that contravened that order.

Case Law

In the case of *Kukama vs Lobelo, Peolwane Properties (Proprietary) Limited, Diphuka Construction (Proprietary) Limited and CIPC*, South Gauteng High Court, Johannesburg, 12 April 2012, Kukama, the sole director of Diphuka Construction Proprietary Limited (Diphuka), allowed payments from the South African Revenue Services (SARS) in the amount of R22 million and R39 million destined for Peolwane Properties Proprietary Limited (Peolwane), of which he and Lobelo are directors, to be made to Diphuka. Kukama then utilised the two amounts for the benefit and interest of other companies to the detriment of Peolwane.

The Presiding Judge ruled that the director concerned had contravened section 22 (reckless trading) and section 76 (standards of director's conduct, including the duty to communicate to the board at the earliest practicable opportunity any information that comes to such director's attention) of the Companies Act. The court found that the director's conduct did "*not measure up to the standard required and expected of a director*" and as a result found that he was in breach of his fiduciary duties to the company.

The court held that the director's conduct was grossly negligent, constituted wilful misconduct, a breach of trust and a gross abuse of his position as a director. As a result, the court ruled that the director should be declared delinquent in terms of section 162 of the Act. The court did not order the director's removal, as such would occur automatically as a result of such declaration. The court further granted leave to the company that had suffered damages as a result of the director's conduct, to institute legal proceedings for such losses against the director personally.

Following the aforementioned decision in Kukama, in the case of *Cook v Hesber Impala (Pty) Limited and others* [2016] JOL 36194 (GJ), the applicant sought a declaration of delinquency on grounds which were not stipulated in section 162 of the Companies Act. The High Court warned that a declaration of delinquency can only be made in relation to one of the legislated grounds stipulated in section 162 of the Companies Act, and that there must be clear "evidence" of any conduct that warrants a director being declared delinquent.

With this in mind, if such "evidence" is available, then the directors can also be held personally liable under section 218 of the Companies Act for the losses incurred by any person as a result of the directors' delinquent conduct.

In the case of *Companies and Intellectual Property Commission v Cresswell and Others* 921092/2015) [2017] ZAWCHC 38, the Western Cape High Court expanded upon the meaning to be ascribed to the words "gross negligence" or "wilful misconduct" within the prescripts of section 165(5)(c)(iv)(aa). In this case, a director of a company allowed the company to carry on trading, while knowing that the company was insolvent. The director, *inter alia*, made withdrawals from the company's bank account and also received payments from the company's bank account into his personal account.

In finding that the director's conduct constituted gross negligence or wilful misconduct, the court referred to the case of *S v Dhlamini* 1998 (2) SA 302 (A), where the Appellate Division indicated that gross negligence is characterised by an attitude of reckless consideration for the consequences of one's actions.[2]

SOUTH AFRICAN SUPREME COURT OF APPEAL – GIHWALA CASE

In the more recent judgment of the South African Supreme Court of Appeal (SCA) in the case of *Gihwala v Grancy Property Limited* 2017 (2) SA 337 (SCA), the constitutionality of section 162 of the Companies Act was called into question.

The directors challenged the constitutionality of section 162 of the Companies Act on the following grounds:

— that the provisions of section 162(5) apply retrospectively. In support of this argument, the directors indicated that the events relied upon by the court *a quo* to justify the order of delinquency occurred before the commencement of the Companies Act on May 1, 2011;

— that after consideration of the provisions of section 162(5)(c) as read with section 162(6)(b)(ii), the aforementioned provisions vested no discretion on the courts to make an order of delinquency, which order subsist for a period less than 7 years; and

— that the provisions of section 162(5) infringes upon their right to choose a trade and occupation or profession, their right to access courts and their right to dignity.

The SCA took the view that in assessing the directors' arguments, it was the purpose and intent of section 162 which had to be examined. The court found that the purpose of section 162 is to protect the investing public against the type of conduct that leads to an order of delinquency, and also to protect those who deal with companies against the damage caused by the misconduct of delinquent directors. Section 162 of the Companies Act was therefore found to be Constitutional.

Lesson Learned for South African Directors?

There is no doubt that directors of South African companies will have to carefully consider the manner in which they conduct the affairs of companies, particularly where there is the possibility of being declared delinquent and incurring personal liability. Directors who find themselves on the receiving end of such an order will not be nominated and, in fact, cannot be appointed to any other boards of companies.

Furthermore, the word "delinquency" carries criminal connotations. The various dictionary definitions refer to "offender," "guilty of a crime or misdeed," "failing in one's duties" or "failing to perform an obligation," the most telling and damning being "a person guilty of serious antisocial or criminal conduct." In this regard, directors who are declared to be delinquent may also be held criminally liable under section 214 of the Companies Act.

Directors will need to understand whether or not they are complying with the provisions of the Companies Act. In particular, a director is obligated to ensure that he or she is not trading his or her company recklessly, i.e. in a position of financial distress, which might push the company into a situation where it becomes insolvent and unable to pay its creditors.

Clearly these provisions significantly increase the expected level of directors' duties to companies in South Africa and the standard of conduct required. Coupled with the provisions of the King Code on Corporate Governance (King IV), directors need to carefully consider whether they are adhering to their duties as set out in section 75 and 76 of the Companies Act, or face an order of delinquency with all of its negative and unfortunate consequences. Once an order declaring a person to be a delinquent director is made, that person may also be held liable towards the company under section 77(5) or to any person under section 218 of the Companies Act, for any loss or damage suffered as a result of that person's conduct.

Conclusion

Directors have no choice but to take these provisions seriously. They need to be aware of the increased obligations set out in the Companies Act; particularly in regard to their potential exposure to claims whilst sitting on boards of companies in South Africa.

The provisions of the Companies Act require South African directors to make important decisions on company issues at board level and to comply with the standards of conduct expected of them and as set out in the Companies Act.

Directors who allow companies to continue to trade in situations of financial distress or insolvent circumstances must recognise that such trading may result in a declaration of delinquency.

In current local and world financial markets, a frank and realistic review by directors of the manner in which their companies trade will be essential for survival and to avoid personal liability.

Worldwide, there is an expectation that directors' duties to their companies be elevated to ensure that the correct decisions are made for the financial benefit of the companies at all times. Failure to maintain a particular level of knowledge of these issues can result in directors being severely criticised, being held liable for company debts as a result of reckless and negligent behaviour or being declared delinquent. ■

1. Such disqualifications are set out in section 69 of the Companies Act and include that such person: (i) was an unrehabilitated insolvent; or (ii) is prohibited in terms of any public regulation to be a director; or (iii) has been removed from an office of trust on the grounds of misconduct involving dishonesty; or (iv) has been convicted in the Republic or elsewhere for theft, fraud, forgery or any conduct involving fraud, misrepresentation or dishonesty or offences involving various statutes such as the Insolvency Act, the Close Corporation Act, the Competition Act, the Financial Intelligence Centre Act (FICA), the Securities Services Act or the Prevention and Combating of Corrupt Activities Act.
2. The Western Cape High Court further indicated that the concept of gross negligence was developed in a number of cases such as Transnet Ltd t/a Portnet v Owners of the MV "Stella Tingas" and another 2003 (2) SA 473 (SCA). In this case, the Supreme Court of Appeal ("SCA") indicated that for conduct to qualify as gross negligence, "… it must demonstrate, where there is found to be conscious risk taking, a complete obtuseness of mind or, where there is no conscious risk taking, a total failure to take care".

▼ **Eric Levenstein** is a director at Werksmans Attorneys and is based in South Africa. He studied law at the University of Pretoria, Pretoria, Gauteng, South Africa. He has BCom and LLB degrees, Higher Diplomas in Company Law and Tax, a Diploma in Insolvency Law and a Doctorate of Laws in Business Rescue. Eric has been a director of Werksmans Attorneys since 1993 and is the head of the firm's Insolvency, Business Rescue & Restructuring practice. He specializes in litigation and dispute resolution with a particular focus on business rescue, insolvency and restructuring, banking and finance and corporate recovery of debt. He is the Chairperson of the South African Restructuring & Insolvency Practitioners Association (SARIPA) and sits on the board of INSOL International, a worldwide group of insolvency practitioners.

▼ **Nastascha Harduth** is a director at Werksmans Attorneys and is based in South Africa. She has been a director within the firm's Insolvency, Business Rescue and Restructuring practice since 2014. She has wide ranging experience in dispute resolution and commercial litigation, as well as corporate debt recoveries, insolvency, business rescue and restructuring. Nastascha often advises on the duties and responsibilities of directors, the risk of incurring personal liability, and how to mitigate it. Her experience in these areas of law extends well beyond the South African jurisdiction, and includes cross-border experience in the United States of America, Mauritius, Seychelles, Zambia and Botswana. Nastascha is a member of the South African Restructuring and Insolvency Practitioners Association (SARIPA) and a fellow of The International Association of Restructuring, Insolvency & Bankruptcy Professionals (INSOL).

▼ **Mahatma Khwidzhili** is an associate at Werksmans Attorneys and is based in South Africa. He works in the Insolvency, Business Rescue & Restructuring practice area. He advises on general commercial litigation, commercial recoveries, liquidations, sequestrations, restructurings and dispute resolution. Mahatma holds an LLB (with distinction) from the University of the Witwatersrand.

Bankruptcy and Restructuring in the GCC: An Update on Recent Developments

By **POLINA LYADNOVA, FATEMA AL-ARAYEDH, MAHA ALALI, LUCINDA SMART** *and* **MOHAMED TAHA**



The global impact of the financial crisis, a slump in oil prices and a growing realisation that insolvency and restructuring laws in the Middle East have not kept pace with the speed of developments in the business environment have all fuelled a recent wave of restructuring law reforms in the GCC over the past few years.

While bankruptcy regimes have never been a focus for legislators in a region where corporate difficulties tend to be resolved privately, an emerging awareness that robust policies and procedures and certainty of outcomes are critical to foreign investors has led to the advent of several new legal and regulatory regimes.

The first mover was the United Arab Emirates, which in September 2016 published a new bankruptcy law that came into force that year. As part of the government's plans to modernise business laws, the new law introduced measures to rescue businesses in distress, such as preventive compositions and debt restructuring, and reformed the bankruptcy regime.

Then, in 2018, came two further pieces of legislation: in May, Bahrain adopted its new Reorganisation and Bankruptcy Law; and new bankruptcy laws in Saudi Arabia came into effect in August.

In both cases amendments are focused on attracting foreign investors, removing stigmas and modernising the existing regime to offer debtors greater opportunities for reorganisation, provide a simplified liquidation process, and ensure fair treatment of creditors.

We are yet to see anything similar in Kuwait, though reforms have been suggested to bring its bankruptcy and insolvency regime more in line with the Chapter 11 process in the United States, while Oman is lagging behind on reform and Qatar is pursuing a different path. It is also worth noting that wholly different regimes operate in the free zones of the Dubai International Financial Centre (DIFC) and the Abu Dhabi Global Market (ADGM).

In this paper, we review developments in bankruptcy legislation in the UAE, Bahrain and Saudi Arabia, highlight recent developments, and seek to showcase common themes and points of differentiation between the new regimes.

Key Features of New GCC Bankruptcy Regimes

	UAE	Bahrain	Saudi Arabia
Available proceedings	Preventive composition; bankruptcy.	In court reorganisation; pre-packaged reorganisation and liquidation proceedings.	Preventative settlement, financial reorganisation and liquidation proceedings.
Court role	The court appoints a bankruptcy or reorganisation trustee, authorizes the bankrupt debtor to carry on its trade and supervises and ratifies the reorganisation plan or liquidation.	The court appoints a bankruptcy or reorganisation trustee, approves transactions outside the ordinary course and supervises and ratifies the reorganisation plan or liquidation.	The court appoints a bankruptcy trustee in financial reorganisation and liquidation, ratifies the proposals in preventive settlement and financial reorganisation.
Creditors' rights to initiate restructuring and propose a plan	Creditors cannot initiate involuntary reorganisation but can participate directly, and, while they cannot propose a plan, they can propose changes to the plan put forward.	Creditors can commence proceedings and, in certain circumstances, can file a reorganisation plan.	Creditors can initiate a restructuring procedure and propose to the court the name of the trustee he/she wishes to appoint in the case of a financial reorganisation and may request a liquidation order if certain conditions are met.
Plan approval levels	2/3 majority of unsecured claims.	Majority of creditors in a class provided they represented at least 2/3 of the total amount of voting claims in a class; court has discretion to ratify a plan without a class approval if such class receives pursuant to the plan more than in liquidation.	2/3 of the value of claims in the same category, including creditors whose claims represent more than half of the value of the debts of a non-related party (if any).
Secured creditors' status	Secured creditors allowed to vote only if they forego security. Plan binds unsecured creditors only.	Plan binds all affected creditors.	Proposals bind all affected creditors.
Debtor's right to initiate restructuring	A preventive composition application can be made by a debtor who has defaulted on debts but is not insolvent, provided it has not been in default for more than 30 business days.	A debtor can commence proceedings if it has failed to pay its debts for 30 days, will be incapable of paying its financial liabilities as they fall due, or if the value of its liabilities exceeds the value of its assets.	A debtor can initiate a preventive settlement procedure if it expects financial distress, has ceased paying debts as they fall due, or if its assets are not sufficient to pay off its debts.
Moratorium	A moratorium is imposed on all claims and enforcement proceedings until the plan is approved and unless the court decides otherwise.	A moratorium on claims against the bankrupt estate is activated when the court approves the commencement of proceedings and lasts for an initial period of 120 days.	Under a preventative settlement and liquidation process, the court may grant a suspension order with respect to any claims arising from the creditors in which they aim to declare the debtor bankrupt or to execute on the debtor's assets. Under a financial reorganisation, a moratorium is automatically imposed on all claims until the date on which the court either rejects or ratifies the proposal or the proceedings terminate at an earlier date.

United Arab Emirates[1]

The new UAE Bankruptcy Law No. 9 of 2016 came into force on December 29, 2016, establishing the Financial Restructuring Committee's ability to, among other things, supervise restructuring proceedings undertaken by licensed financial institutions.

The law primarily applies to corporate entities, including financial institutions established under the laws of the UAE, excluding companies in the DIFC and ADGM. It is broadly composed of two main schemes for debtors in financial difficulties – preventive composition and bankruptcy. The amendments were aimed at ensuring survival of the business undergoing financial difficulties, while addressing one of the major concerns under the old regime, namely strict criminal liability on issuers of bounced cheques; without, however, fully removing the risk of criminal liability in conjunction with insolvency proceedings.

Amendments further sought to make the restructuring process as orderly as possible, by prohibiting *ipso facto* clauses (similar to the U.S. bankruptcy law) making void any provisions in a financing agreement qualifying commencement of the preventive composition proceedings an event of default. Both types of proceedings are coupled with a moratorium on any claims and enforcement proceedings unless the court decides otherwise. Further, to enhance the chances of a successful restructuring, the amendments introduced new provisions regulating the extension of new financing to a debtor who is subject to the debt restructuring proceedings.

Preventive Composition: Process in a Nutshell

Preventive composition is similar to the voluntary arrangements under English law and *sauvegarde* proceedings under French law, providing a scheme for solvent debtors to avoid liquidation by agreeing with creditors to repay debts via a court-approved plan. An application can be made by a debtor who has defaulted on debts but is not insolvent, provided it has not been in default for more than 30 business days.

The application to the court sets out cash flow projections and a proposed plan, and, if the application is accepted, the court then appoints a trustee to supervise the settlement process. The debtor and the trustee put together a settlement plan, which is then, with the permission of the court, voted on by unsecured creditors and can only be approved by a two-thirds majority vote.

Once approved, the plan is sent to the court for final approval, following which it binds all the unsecured creditors whether or not they voted in its favour. The regime does have its drawbacks, however, not least due to it being limited to unsecured creditors only. Secured creditors are allowed to vote but only if they forego all of their security.

Bankruptcy: Process in a Nutshell

Bankruptcy proceedings no longer necessarily lead to a liquidation of the debtor, as was previously the case, and the primary aim is now to restructure the debts of an insolvent debtor with a view to it continuing as a going concern. The proceedings can be initiated by the debtor, the creditors or the Office of the Public Prosecutor. For unsecured creditors to be able to apply, the value of their debt must exceed AED 100,000 and they must first serve the debtor with a 30-day written request for payment. The Public Prosecutor can initiate proceedings if it deems them in the public interest.

Once the petition is approved, the court appoints a trustee to supervise proceedings and the initiation of the proceedings is publicly announced. As part of proceedings, the trustee prepares a list of claims and, based on its review of those and debtor's resources, prepares a report outlining whether the restructuring is feasible or if the debtor should be declared bankrupt. The proceedings can have two possible outcomes: restructuring or liquidation.

In the first instance, a restructuring plan is prepared and put to a vote by the unsecured creditors (with thresholds, process and effect similar to preventive composition). In the latter case, the debtor's assets are liquidated and all its debt becomes due. It is worth noting that the law provides an exhaustive list of events that can lead to declaring the debtor bankrupt or liquidated, where debt restructuring is deemed either inappropriate or unfeasible.

CASE STUDY 1 – ABU DHABI

In March 2019, it was reported that the Abu Dhabi Judicial Department had saved a company from bankruptcy through restructuring, in the first case under the new law. The case in the Abu Dhabi Court of First Instance involved a limited liability company that was unable to pay debts that exceeded its available capital by 18 times.

The court restructured the business after appointing a trustee to implement and oversee the restructuring, allowing the business to pay off debts, renew its commercial license, achieve a liquidity level of five times its capital and resume business.

Bahrain[2]

Bahrain adopted its new Reorganisation and Bankruptcy Law (Bahrain Law No. 22/2018) on May 30, 2018, with the stated aim of maximising the value of bankrupt estates, creating a safety net for start-ups and encouraging corporate reorganisation over liquidation. The law introduces a purpose-built tool for commercial companies and merchants (with respect to their trade liabilities) that borrows restructuring concepts from the U.S. Bankruptcy Code's Chapter 11 and the U.K.'s pre-packaged insolvency procedures—both familiar, and popular with, international companies and investors.

Key highlights include the ability to cram down across classes, a moratorium on enforcement proceedings, the ability to sell assets out of the bankrupt estate free of liens, the ability to obtain DIP-type financing, and the right of the debtor to continue to manage its business in the ordinary course. The debtor also has the option to submit a pre-packaged reorganisation plan for ratification by the court, substantially similar to the English law pre-pack procedure.

In-Court Reorganisation: Process in a Nutshell

Under the new law, either a debtor or its creditors may commence proceedings if the debtor has failed to pay its debts for a period of 30 days from their due date, will be incapable of paying its financial liabilities as they fall due, or if the value of its liabilities exceeds the value of its assets. An independent reorganisation trustee is appointed to prepare a reorganisation plan and produce an inventory of assets.

Upon the commencement of the proceedings, the court will form a creditors' committee consisting of up to five unsecured creditors. Within three months of the commencement of reorganisation proceedings, the reorganisation trustee, acting as the debtor's supervisor, must submit a reorganisation plan that it prepares in consultation with the debtor and the creditors. Alternatively, the creditors' committee or creditors holding at least one-third of the total claims can file a reorganisation plan, but only when proceedings have been pending for at least six months and the supervisor has failed to make progress.

A meeting and vote of the creditors is required to be held within 30 days of filing the initial reorganisation plan, or within 20 days of filing a modified plan. No quorum is required for a class to approve the plan. If the majority of creditors that participate in the vote in each affected class accepts the plan it will be approved, provided creditors voting in favour of the plan account for at least two-thirds of the total amount of debts in that class that participated in the vote. Classes that are unaffected or are fully discharged pursuant to the plan are deemed to have approved it without a vote.

The plan duly approved by the creditors is submitted to the court and, once ratified by the court, becomes binding on all creditors, wherever located and regardless of whether or not they voted for it. The court has the discretion to ratify the plan even if it is not approved by a class of creditors, if such creditors will receive more pursuant to the plan than they would have in a liquidation. Ratification of the plan discharges and releases the debtor from all affected debts and liabilities that arose prior to such date.

CASE STUDY 2 – GARMCO OF BAHRAIN

In the first test case for Bahrain's new Reorganisation and Bankruptcy Law, in January 2019, Bahrain-based Gulf Aluminium Rolling Mill (Garmco) filed a voluntary petition for relief and was granted a moratorium on all claims pending finalisation of its reorganisation plan. The company disclosed that it had undertaken an accelerated effort in 2018 to prepare a strategic plan for reorganising the business, but that it required additional time to build consensus among stakeholders, including bank lenders. The protections under the new law will enable it to meet its legal obligations and obtain the necessary protection to continue operating while undergoing a full reorganisation, the company said in a statement.

Saudi Arabia

Saudi Arabia's Ministry of Commerce and Investment (MOCI) published a new set of investor-friendly rules and regulations in 2018, including a new bankruptcy law that came into effect in August 2018. Similar to other jurisdictions, the law aims at providing bankrupt or insolvent debtors with an opportunity to reorganise and rescue their businesses, while also providing for a simplified liquidation process and a fairer distribution to creditors upon liquidation.

The law introduces the formation of a specialist bankruptcy committee that reports to the MOCI and is an independent administrative and financial legal body. The committee's responsibilities include managing a bankruptcy register and coordinating the relevant liquidation and bankruptcy procedures.

The law provides for three main procedures: preventive settlement, financial reorganisation and liquidation proceedings. Short of liquidation, a debtor now has two options to reach an agreement with its creditors to settle its debts, both with the involvement of the court: in preventative settlement the debtor maintains the management of its business, while the financial reorganisation procedure is run under the supervision of a bankruptcy trustee.

Preventive Settlement: Process in a Nutshell

The debtor can submit a settlement request to the court and may also request that the court suspend any claims arising from the creditors in which they aim to declare the debtor's bankruptcy, or any requests to execute on the debtor's assets.

This procedure is available to debtors with expected as well as actual financial distress and also to debtors who are already bankrupt (but not to debtors who have been granted settlement within the previous 12 months). Qualifying debtors may submit a preventative settlement request to the court and the court will then determine a hearing date, which must occur within 40 days of the debtor submitting the request.

When and if the court rules to open the preventive settlement process, it shall set a date for the vote of the creditors on the proposal for preventive settlement usually within a period not exceeding 40 days from the date of opening the proceedings.

Any settlement proposal shall be approved by creditors whose claims represent two-thirds of the value of the claims in the same class, including creditors whose claims represent more than half of the value of the claims of non-related parties (if any). Proposal is then ratified by the court and even if the creditors fail to vote on it, the Court may still rule in its favour if it deems it appropriate.

The debtor may request that the court suspend any claims arising from the creditors in which they aim to declare the debtor's bankruptcy or any requests to execute on the debtor's assets for a period not exceeding 180 days. In order to make such a request, however, it must be accompanied by a report prepared by a bankruptcy licensed trustee and the court will be unable to accept a request if the trustee's report does not confirm that the majority of the concerned creditors are likely to approve the settlement proposal.

Financial Reorganisation: Process in a Nutshell

A debtor, competent authority or creditor may submit a request for reorganisation, and the court will then appoint a bankruptcy trustee and notify creditors. Once initiated, the trustee will replace the debtor in managing the business.

Once appointed the trustee shall prepare a proposal for financial reorganisation and file it with the court. The proposal shall include a description of the debtor's financial situation and the effects of the economic situation upon it. The trustee must also give the court an indication of the likelihood of the creditors' approval of the proposal. Once the proposal has been filed with the court, the court shall set a date upon which the proposal will be put before the creditors. As above, a proposal shall be approved by creditors whose claims represent two-thirds of the value of the claims in the same class, including creditors whose claims represent more than half of the value of the claims of non-related parties (if any). Proposal is then ratified by the court and even if the creditors fail to vote on it, the Court may still rule in its favour if it deems it appropriate.

The registration of the petition to open the financial reorganisation proceeding results in a suspension of claims. The suspension period will remain in effect until the date on which the court either rejects or ratifies the petition, or the financial reorganisation proceeding terminates.

Liquidation: Process in a Nutshell

Finally, the law sets out new liquidation procedures and details the ranking of debt in the Kingdom (with rough ranking (top down): secured debts, certain priority debts (e.g., worker's wages; family expenses; continuing business expenses during liquidation process); unsecured debts and, unusually, last ranking - taxes), so that any proceeds obtained from a liquidation process will be distributed in accordance with a clear order of priority.

Before a debtor or creditor may seek an order for liquidation the following conditions need to be met: (i) the debt must have matured and be of a fixed amount; (ii) the debt must not be below the amount stipulated by the Bankruptcy Committee; and (iii) the creditor must prove that it has requested the debtor to pay its claim 28 days before the date of registration of the petition with the court. Liquidation process is supervised by a court appointed trustee and shall be completed when the Trustee applies to the court to terminate the liquidation proceeding. The Trustee may only make such an application upon completion of: (i) the procedure for the sale of bankruptcy assets; (ii) the end of the legal proceedings to which the debtor is a party; and (iii) the final distribution to creditors. The Trustee must provide final accounts and financial reports with its petition and notify the creditors before filing the petition. An interested party may object to the Trustee's petition before the court within 14 days of its filing.

Upon the registration of a liquidation proceeding or of the Court judgment to open such proceedings, there shall be a period of suspension of all claims until the date of the Court's judgment dismissing the petition or terminating the proceeding. However, the court may *sua sponte*, or at the request of an interested party, rule the recovery of any assets disposed of during the period of suspension of the claims, as it deems appropriate. The court also has the ability (at the request of the relevant interested party) to suspend the time limit for suspension of specific claims for which an action has been taken prior to the suspension, if it is found to be in the interests both of the debtor and the majority of creditors. Note, however, that no one other than the court may take any legal action during the duration of the suspension of claims against any guarantor who has provided a personal guarantee or real security to secure the debtor's obligation.

CASE STUDY 3 – SAAD

In March 2019, the Saudi Court approved an application by the detained and indebted billionaire Maan Al Sanea and his company, to be resolved under the new bankruptcy regime. Saad defaulted in 2009, leaving banks with unpaid debts of about USD 22 billion. Over the last ten years, creditors have pursued Saad for claims between USD 11 billion and USD 16 billion. A court in Dammam has approved an application for financial reorganisation under the terms of the Saudi Bankruptcy law and a trustee has been appointed to oversee the process. The new laws have provided creditors and debtors with greater options and could lead to the resolution of one of the kingdom's largest and longest-running debt issues.

The Road Ahead

The implementation of these more sophisticated and streamlined regimes has been much anticipated and represents a significant cultural shift for the Gulf region. It is hoped the new laws will ease the restructuring of companies, support troubled businesses and mitigate bankruptcy risk for investors.

It is too early to assess the success of these regimes, which will depend on the way in which the judiciaries in each jurisdiction choose to apply and implement the new rules and will require the support of key players across the economy. ■

1. See Lawale Ladapo and Mohamed Taha, "The New Bankruptcy Law of the UAE: Towards A More Business-Oriented Bankruptcy Regime," *Emerging Markets Restructuring Journal Issue No. 4 – Fall 2017.*
2. See David Billington and Buthaina Amin, "Legislation Watch: Bahrain's New Bankruptcy Law," *Emerging Markets Restructuring Journal Issue No. 9 – Summer 2019.*

▼ **Polina Lyadnova** is a partner at Cleary Gottlieb's London office. Polina's practice focuses on financial transactions, including debt capital markets and debt restructuring, involving emerging markets businesses. Recent representations include Rusal, MATSA, Russian Railways, NKNH and FESCO as well as a number of Middle Eastern sovereign wealth funds.

▼ **Fatema Al-Arayedh** is an associate based in Cleary Gottlieb's New York office. Her practice focuses on a broad range of commercial and financial transactions, including forming and investing in private equity funds, financing private equity investments, and developing and financing infrastructure projects, joint ventures and public-private partnerships. She received her J.D. from Columbia Law School, where she was a Harlan Fiske Stone Scholar, and her B.A. with honors from Yale University. Fatema is a recipient of the Crown Prince of Bahrain International Scholarship and formerly an associate at the Economic Development Board of Bahrain. She joined Cleary Gottlieb in 2012.

▼ **Maha Alali** is an associate at Cleary Gottlieb Steen & Hamilton LLP based in the firm's Abu Dhabi office. Ms. Alali graduated from the University of Exeter with a law degree and qualified as a solicitor in England and Wales. Ms. Alali's practice areas include corporate and financial transactions, particularly securities offerings, mergers and acquisitions, cross-border transactions, as well as corporate restructurings and regulatory matters, particularly in the Middle East and Europe.

▼ **Lucinda Smart** is a trainee at Cleary Gottlieb's London office. Lucinda is currently working in the Abu Dhabi office, having completed three, six-month rotations in the IP, Corporate and Disputes teams in London. Lucinda graduated from Oxford University in 2015, and completed her legal studies at the University of Law, London in 2017.

▼ **Mohamed Taha** is an associate based in Cleary Gottlieb's London office. Mohamed's practice focuses on mergers and acquisitions, capital markets, and general corporate practice. Mohamed joined the firm in 2014.

Before joining Cleary Gottlieb, Mohamed worked with a leading Egyptian firm for two years, where he advised on various cross-border transactions. Mohamed has authored and published many papers in internationally recognized journals. Mohamed received his Master in Law degree from the Georgetown University Law Center and his diploma in law and bachelor's degree from the Cairo University, Faculty of Law.

TREND WATCH

Sub-Saharan African Sovereign Debt

By **ANDREW SHUTTER, SUI-JIM HO** *and* **BATHÉLEMY FAYE**

1

Greater debt level

In recent years, we have witnessed rising levels of sub-Saharan African sovereign debt. The surge in the debt of many sub-Saharan African countries has sparked concerns about the sustainability of their debt burden, especially against the challenging economic context, the dependency of some sub-Saharan economies on the export of natural resources and adverse movements of interest rates. The foreign exchange risk is a further concern for those sovereigns whose debt is denominated in foreign currency. While the refinancing risk of sub-Saharan African sovereigns is highly heterogeneous, as of 2019 as many as 14-16 sub-Saharan African countries are classified by various international financial institutions as at high risk of debt distress or in distress.

2

Greater non-concessional debt

The structure of sub-Saharan Africa's debt profile has changed markedly over the last decade where we have witnessed a fall in concessional loans and a move towards market-based non-concessional financing. Among the different sources of non-concessional financing, commercial loans were historically the main source of financing among sub-Saharan African sovereigns. In the last ten years, Eurobonds have become a more popular choice of financing for many sub-Saharan African sovereigns, with some issuers tapping the market on an annual basis. The aggregate amount of Eurobonds of African countries (excluding Egypt, Nigeria and South Africa) requiring refinancing in the 2020s totals approximately USD 37.7 billion.

3

Greater complexity

As issuers move towards non-concessional debt with generally higher interest rates than concessional financing, the forms of market-based financing available to them have also become increasingly complex. This could range from commodity prepayment transactions secured on natural resources to securitised instruments supported by guarantees from international financial institutions. While such financing is structured to reduce the interest burden on the issuer, there is a concern that such financial instruments could be more difficult to restructure as we approach more challenging economic times.

4

Greater portion of official debt provided by non-Paris Club lenders

An increasing portion of official sector debt in sub-Saharan Africa is now being provided by non-Paris Club emerging markets lenders. China, for example, has gained prominence in the media recently for being the largest single creditor nation in sub-Saharan Africa, largely through the increase in funding of infrastructure projects as part of the Belt and Road Initiative. As the official sector creditor group changes, coordination among the traditional official bilateral creditors and the new cohort of non-Paris Club lenders would be key in any future restructuring scenario.

5

Greater transparency

The calls for debt transparency as a means of anticipating and preventing debt distress have become increasingly vocal given concerns about potentially hidden debt and also the growing complexity of sovereign borrowing. The IMF and the World Bank are working with sovereigns around the world to improve the quality of data and also processes in recording, monitoring and reporting data. There is no one-size-fits-all solution for this problem; the increase in transparency will require increased and progressive co-operation of various stakeholders including the private sector.

▼ **Andrew Shutter** is a partner based in Cleary Gottlieb's London office. His practice focuses on the origination and restructuring of international financing transactions.

He represents corporates, sovereigns, funds, and financial institutions, as debtors or creditors in the origination and restructuring of complex financial transactions including leveraged and high-grade syndicated loans, high-yield and investment-grade bonds, derivatives, and securitization transactions. Andrew also has experience in mergers and acquisitions, joint ventures, and strategic investments.

Andrew joined the firm in 1997 and became a partner in 2001. Prior to joining Cleary, he worked in the Madrid and London offices of Clifford Chance.

▼ **Sui-Jim Ho** is a partner based in Cleary Gottlieb's London office. Jim's practice focuses on cross-border finance and restructuring. He advises on a broad range of financial products including loans, bonds and derivatives. He is particularly noted for his expertise in complex emerging markets and sovereign-related matters. He holds a law degree from the London School of Economics and Political Science where he graduated with First Class Honours.

▼ **Barthélemy Faye** is a partner based in Cleary Gottlieb's Paris office, with a practice focused on corporate and financial transactions related to Africa. He has extensive experience in sovereign debt borrowing and restructuring, private equity and M&A, and project development & financings in the natural resources, power and infrastructure sectors.

Barthelemy joined the firm in 1998 and became a partner in 2008. From 1998 to 2001, he was resident in the New York office.

The New European "Relative Priority": An Analysis of its Impact in the EU Restructuring Directive and Dutch Insolvency Regime

By SEBASTIAAN VAN DEN BERG

On June 6, 2019 the European Council formally adopted the directive on preventive restructuring frameworks, on discharge of debt and disqualifications, on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (the "**EU Restructuring Directive**").[1] The formal vote of the European Council marks the end of the legislative procedure after the proposed EU Restructuring Directive was adopted by the European Commission on November 22, 2016. The directive on preventive restructuring frameworks will now be formally signed and enter into force twenty days following its publication in the Official Journal of the European Union. Member States will then have two years to implement the EU Restructuring Directive (plus an additional year if they encounter particular difficulties during implementation). Likely implementation date would thus ultimately be June/July 2021 or, in special cases 2022.

The EU Restructuring Directive is a minimum harmonization directive. It introduces a set of principles along with more targeted rules in some specific cases, while allowing Member States to go further when transposing the rules into national law. This article is mainly focused on the purpose of introducing a preventive restructuring framework (including a restructuring plan) in all Member States. The EU Restructuring Directive has primarily been inspired by Chapter 11 of the U.S. Bankruptcy Code and provides for a cross-class cram down provision in respect of dissenting classes of capital providers.

Initially, the EU Restructuring Directive prescribed the application of the "absolute priority rule" in the context of the cram down provision. However, the final version of the EU Restructuring Directive includes the ability of Member States to opt for a certain "relative priority rule" (the "**European Relative Priority Rule**"). Under the European Relative Priority Rule, dissenting voting classes are to be treated at least "as favourably" as any other class of the same rank and "more favourably" than any junior class. Although the European Relative Priority Rule aims to provide for more restructuring flexibility, it is not only very different from the concept of the "relative priority rule" as developed in U.S. literature (and can thus be misleading), but it may actually lead to forum shopping within the EU, which is contrary to the objective of the harmonization of European preventive restructuring frameworks.

Following an analysis of the EU Restructuring Directive, we provide an update and summarize the mechanics of the envisaged Dutch pre-insolvency scheme. For the purpose of the Dutch pre-insolvency scheme, a draft bill was made public in 2017. It is currently expected that the revised and official bill will be submitted to the Dutch Parliament this summer.

Absolute Priority Rule	European Relative Priority Rule
A dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution or keep any interest under the restructuring plan	Dissenting voting classes are to be treated at least "as favourably" as any other class of the same rank, if the normal ranking of liquidation priorities under national law were applied, and "more favourably" than any junior class

Overview of the EU Restructuring Directive

The overall objective of the EU Restructuring Directive is to reduce the most significant barriers to the free flow of capital stemming from differences in Member States' restructuring and insolvency frameworks and to enhance the rescue culture in the EU. Furthermore, the directive also aims to reduce the amount of non-performing loans (NPLs) on banks' balance sheets and to prevent the accumulation of such NPLs in the future.

THE MAIN PURPOSES OF THE EU RESTRUCTURING DIRECTIVE ARE:

1. to ensure that Member States have a preventive restructuring framework, which includes a restructuring plan;
2. to ensure that entrepreneurs have a second chance through an effective debt discharge mechanism; and
3. to ensure that Member States put in place measures to increase the efficiency of restructuring, insolvency and discharge of debt procedures more widely.

With respect to the preventive restructuring framework, the EU Restructuring Directive indicates that Member States must provide debtors with access to a preventive restructuring framework that enables them to restructure, with a view to preventing insolvency and ensuring their viability, in case there is "a likelihood of insolvency" (but importantly where insolvency proceedings which could end in the liquidation of the debtor under national law have not yet been opened in respect of the debtor).

Some key features of the restructuring framework include:

— Debtor in possession: Member States shall ensure that debtors accessing preventive restructuring procedures remain totally, or at least partially, in control of their assets and the day-to-day operation of their business.

— Stay of individual enforcement actions (including secured claims and preferential creditors, except for employees' claims unless payment of these is guaranteed for the duration of the preventive proceeding): the initial duration of a stay of individual enforcement actions shall be limited to a maximum period of no more than four months, but Member States may permit courts to extend it to a total duration of not more than 12 months. Such a stay shall suspend, for the duration of the stay, the opening, at the request of one or more creditors, of insolvency proceedings which could end in the liquidation of the debtor.

— Continued performance of essential executory contracts: Member States shall provide for rules preventing creditors to which the stay applies from withholding performance or terminating, accelerating or, in any other way, modifying essential executory contracts to the detriment of the debtor, for debts that came into existence prior to the stay, solely by virtue of the fact that they were not paid by the debtor.[2]

— Prohibition of *ipso facto* clauses: creditors are not allowed to invoke *ipso facto* clauses which make reference to negotiations on a restructuring plan or a stay or any similar event connected to the stay.

— Initiative: the debtor will have the right to submit a restructuring plan. Member States may also provide that preventive restructuring frameworks provided for under the EU Restructuring Directive are available at the request of creditors and employees' representatives, subject to the agreement of the debtor. Member States may limit that requirement to obtain the debtor's agreement to cases where debtors are SMEs.

— New financing and interim financing: Member States shall ensure that new financing and interim financing are adequately protected, i.e., new financing and interim financing shall not be declared void, voidable or unenforceable.

— Voting in classes, including the "best-interest-of-creditors test"[3] and a cross-class cram down provision (to be explained below).

The Relative Priority Rule under the EU Restructuring Directive

Initially, the cram down provision in the 2016 draft of the EU Restructuring Directive was predominantly based on the absolute priority rule as applicable in Chapter 11.[4] At the end of 2018 and at a fairly late stage in the legislative process, an amendment was made in respect of article 11 (*cross-class cram down*) of the EU Restructuring Directive. In order to let a plan become binding upon dissenting voting classes, the restructuring plan essentially has to fulfill the following conditions:

> *"1. [...](c) it ensures that dissenting voting classes of affected creditors are treated at least as favourably as any other class of the same rank and more favourably than any junior class; and*
>
> *(d) no class of affected parties can, under the restructuring plan, receive or keep more than the full amount of its claims or interests[...]"*

> "2. *By way of derogation from point (c) of paragraph 1, Member States may provide that the claims of affected creditors in a dissenting voting class are satisfied in full by the same or equivalent means where a more junior class is to receive any payment or keep any interest under the restructuring plan.*"

Although a plan cramming down dissenting classes has to be proposed by the debtor or with the debtor's consent, Member States may limit the requirement to obtain the debtor's agreement to cases where debtors are Small and Medium Enterprise (SME) Businesses, basically making it possible that creditors propose a certain plan.

The introduction to the October 2018 draft provides the following explanation for the revised cross-class cram down provision:

> "*The cross-class cram down mechanism was new to a number of Member States and raised some concerns[...] [the fear for the consequences of the absolute priority rule] has been addressed in the compromise text by providing an alternative option for Member States to introduce a different benchmark - a 'relative priority rule' - to protect dissenting creditor classes when using a cross-class cram down mechanism[...] This provides Member States with more flexibility in implementing this rule.*"

Furthermore, recital (55) of the EU Restructuring Directive indicates that Member States should be able to protect a dissenting class of affected creditors by ensuring that it is treated at least as favourably as any other class of the same rank and more favourably than any more junior class.

Consequently, this optionality was introduced and the European Relative Priority Rule was added in article 11 of the EU Restructuring Directive. As a result, Member States are now free to opt for the absolute priority rule (article 11 section 2(a)) or the "more favourably" approach (relative priority rule; article 11 section 1(c)). Although the "relative priority rule" is presented as the default rule, Member States may choose to prescribe the "absolute priority rule."

The responses to this amendment were mixed. Some say that it creates the desired optionality and counters disadvantages of the absolute priority rule,[5] others argue that this test of "more favourably" will inevitably lead to an arbitrary analysis and thus more uncertainty. More specifically, it is argued that it is unclear how the test should be applied. For example, the position of shareholders (who qualify only as residual claim holders which position cannot be measured by a pay-out percentage – and it thus seems difficult to establish whether creditors have been treated "more favourably" than shareholders). In addition, looking at only pay-out percentages does not seem to be sufficient in order to fully compare the financial position of respective classes. Lastly, looking at absolute pay-out amounts at class level may not be fair when taking into account the outcome in relative terms (i.e., lower class receiving slightly lower absolute amount, but perhaps resulting in a substantially higher pay-out percentage).[6]

The European Relative Priority Rule seems to enable the redistribution of value, allowing for the reshuffling of pre-bankruptcy rights in a manner that is unpredictable. This is incompatible with the desire to create legal certainty for investors, and thus undermining the Commission's pursuit of a true capital markets union. The optionality of the various parts of the EU Restructuring Directive (amongst others this choice between the absolute priority rule and the European Relative Priority Rule) can create considerable differences between preventive restructuring frameworks throughout the European Union. It is expected that these disparities will continue to incentivize forum shopping within the EU.[7]

Developments in the Netherlands: New Dutch Restructuring Scheme

In accordance with these European developments, the Netherlands is one of the Member States that has already been preparing for the introduction of a mechanism for implementing out of bankruptcy, private restructuring plans. The respective bill will be a revised version of the public draft that was published for consultation in September 2017. It is currently expected that the bill will be submitted to the Dutch Parliament this summer.

At the moment, Dutch law does not provide for an effective scheme-like restructuring mechanism. Debtors can only offer a compulsory composition plan to their creditors as part of formal proceedings. Apart from the stigma that these proceedings carry, this plan procedure is rarely used as it only binds unsecured creditors, making it ineffective against shareholders or secured or preferential creditors. Outside of formal insolvency proceedings, there is no statutory route to bind dissenting creditors to a restructuring plan. The lack of an effective restructuring mechanism has meant that many Dutch companies have had to avail themselves of the Chapter 11 proceedings and the U.K. scheme of arrangement to restructure their debts.[8]

The new Dutch restructuring scheme combines elements from the U.K. scheme, such as the ability to implement a plan outside formal insolvency proceedings, with elements from Chapter 11, such as a cross-class cram down mechanism. The result is a fast and flexible procedure that is designed to avoid unnecessary court involvement.

For the purpose of the voting process, creditors with equal rights are placed in classes and a vote is then taken per class. If the plan is supported by a two-thirds majority in amount of the class in question, creditors voting against the plan may also be forced to cooperate. The main economic requirement for confirmation of a consensual plan is that *individual* creditors under the plan receive rights with a value that is not materially lower than the amount that they would expectedly have received upon liquidation in bankruptcy ("best-interest-of-creditors-test").

In addition, even in the event that the two-thirds majority required within a class is not achieved, a pre-insolvency private plan may be sanctioned by the court, resulting in a cross-class cram down of the respective class of dissenting capital providers. For a cram-down, the main economic requirements are inspired by the Chapter 11 procedure and the current version of the Dutch bill, which prescribes the absolute priority rule.

These criteria aim to ensure that creditors in a dissenting class receive their share of the reorganization value in accordance with their ranking in the capital structure. To protect senior creditors' exit rights – and this is different compared to the US system – creditors in a dissenting class must also have the right under the plan to opt for a distribution in cash equal to their share in accordance with their ranking of the liquidation value ('cash-out option'). Thus, unlike what is the case under the American system, under the proposed Dutch bill, creditors in a dissenting class cannot be forced to continue financing the business against their majority will at terms imposed by the court. If a senior class dissents, it must have the right to be "cashed-out."

The proposed Dutch bill has the ability to transform the Dutch restructuring landscape for both domestic and foreign debtors. It will give debtors in the Netherlands an effective option to restructure their debts. The result is a modern and light-touch restructuring procedure with minimal court involvement, but which does include cross-class cram down and the necessary flanking measures.

The consultation version of the draft bill does not yet determine whether the contemplated Dutch scheme will or will not fall under the European Insolvency Regulation.[9] There are advantages and disadvantages to both.

Inclusion of the Dutch Scheme in the European Insolvency Regulation

Advantages	Disadvantages
— Automatic recognition in other Member States (except Denmark)	— May only be used for debtors with their COMI in the Netherlands — It would render a restructuring plan ineffective against creditors with security rights over assets located abroad and would render third party releases ineffective where the third party has its COMI in another Member State.[10] This makes it difficult if not impossible to restructure cross-border groups.

Dutch Scheme Falls Outside of the European Insolvency Regulation

Advantages	Disadvantages
— It could – similar to the U.K. scheme of arrangement – also be applied to debtors, assets and third parties located or having their COMI outside the Netherlands.[11]	— It will not benefit from automatic recognition under the European Insolvency Regulation. As the Dutch scheme would in all likelihood also not fall within the scope of the Brussels I regulation (recast),[12] recognition of the plan would depend on the domestic private international law of each individual member state where the debtor has assets.

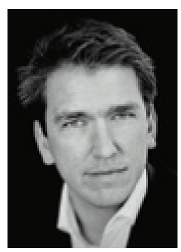
Because of various pros and cons, it could be preferable to have the instrument fall in- or outside-the-scope of the European Insolvency Regulation, depending on the situation. This is one of the reasons why the Dutch ministry of justice is currently contemplating a dual track system whereby the debtor has the ability to choose between a public or a confidential procedure. This choice directly influences whether or not the procedure falls under the scope of the European Insolvency Regulation, as the recast of the European Insolvency Regulation only applies to public insolvency proceedings. The fact that the Dutch scheme seeks to offer great flexibility in cross-border situations, by giving the option to be used both within and outside the scope of the European Insolvency Regulation, adds to its effectiveness.

Conclusion

Following the formal adoption of the EU Restructuring Directive, Member States now have two years to implement it (plus an additional year if they encounter particular difficulties during implementation). In respect of the cross-class cram down provision, Member States have the possibility to choose between the U.S. style "absolute priority rule," which was recently confirmed by the U.S. Supreme Court,[14] and the European Relative Priority Rule. Although the European Relative Priority Rule aims to provide for more restructuring flexibility, it is different to the concept of "relative priority rule" as developed in U.S. literature and it may actually lead to forum shopping within the EU, which is contrary to the objective of the harmonization of European preventive restructuring frameworks.

The proposed Dutch bill as currently prepared provides for a cross-class cram down provision that is to a large extent based on the Chapter 11 procedure. In the current draft it thus includes the absolute priority rule and although it is generally expected that the absolute priority rule as explained above will also be included in the final version of the bill, this will become clear once the bill will be submitted to the Dutch parliament; it is currently expected that this will happen this summer. ■

1. https://www.consilium.europa.eu/en/press/press-releases/2019/06/06/giving-entrepreneurs-a-second-chance-new-rules-on-business-insolvency-adopted/
2. "Essential executory contracts" shall be understood to mean executory contracts which are necessary for the continuation of the day-to-day operations of the business, including contracts concerning supplies, the suspension of which would lead to the debtor's activities coming to a standstill.
3. Under the EU Restructuring Directive it seems that the "best-interest-of-creditors test" also has a different meaning compared to Chapter 11 of the US Bankruptcy Code, namely "a test that is satisfied if no dissenting creditor would be worse off under a restructuring plan than such a creditor would be if the normal ranking of liquidation priorities under national law were applied, either in the event of liquidation, whether piecemeal or by sale as a going-concern, *or in the event of the next-best-alternative scenario if the restructuring plan were not confirmed*;"
4. Under the 2016 draft of the EU Restructuring Directive, the "absolute priority rule" was given the meaning that a dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution or keep any interest under the restructuring plan (https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0723&from=EN). It was, thus, not yet explicitly indicated that "no class of affected parties can, under the restructuring plan, receive or keep more than the full amount of its claims or interests" (sometimes referred to as the "no more than 100% rule"), as is the case in the current EU Restructuring Directive (article 11(1)(d)).
5. See: R. Mokal and I. Tirado, 'Has Newton has his day? Relativity and realism in European Restructuring'
6. Eurofenix 2018/19.
7. See: R. de Weijs, A. Jonkers and M. Malakotipour, "The Imminent Distortion of European Insolvency Law: How the European Union Erodes the Basic Fabric of Private Law by Allowing 'Relative Priority' (RPR).", Amsterdam Law School Research Paper No. 2019-10, Centre for the Study of European Contract Law Working Paper No. 2019-05, March 2019; Moritz Brinkmann, "Die relative Vorrangregel aus Art. 11 (1) (c) der Insolvenzrichtlinie: nicht nur untauglich, sondern brandgefährlich!", European Insolvency & Restructuring, TLE-009-2019, March 2019.
8. A. Mennens, "Puzzling Priorities: Harmonisation of European Preventive Restructuring Frameworks", Oxford Law Blog, 25 March 2019.
9. Examples of Dutch companies turning to the scheme of arrangement include Magyar Telecom B.V. (Re Magyar Telecom BV (2013) EWHC 3800 (Ch.), Van Gansewinkel Groep B.V. (Re Van Gansewinkel Groep BV [2015] EWHC 2151 (Ch) (Snowden J, 22 July 2015)) and Indah Kiat International Finance Company B.V. (Re Indah Kiat International Finance Company B.V. [2016] EWHC 246 (Ch)). Examples of Dutch companies using the Chapter 11 procedure include: Almatis B.V. (Re: Almatis BV et al., case number 10-12308-mg, in the U.S. Bankruptcy Court for the Southern District of New York), Versatel Telecom International N.V. (Re: Versatel Telecom International N.V, case number 02-13003 (RDD), in the U.S. Bankruptcy Court for the Southern District of New York) and Global Telesystems Europe B.V. (Re: Global Telesystems Europe B.V., case number 01-11280 (EIK) in the U.S. Bankruptcy Court for the District of Delaware).
10. Regulation (EU) 2015/848 of the European Parliament and of the Council of May 20, 2015 on insolvency proceedings (recast).
11. European Court of Justice December 15, 2011, ECLI:EU:C:2011:838, Case C-191/10 (*Rastelli Davide e C. Snc v Jean-Charles Hidoux*).
12. In this scenario, jurisdiction of the Dutch court will determined on the basis of Article 3 DCCP, which stipulates that the Dutch court has jurisdiction if: (a) the applicant or, if there are more applicants, one of them or one of the interested parties mentioned in the request is domiciled or habitually resident in the Netherlands, or (b) the case is otherwise sufficiently connected with the legal sphere of the Netherlands.
13. Regulation (EU) 1215/2012 of the European Parliament and of the Council of December 12, 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast).
14. Article 1 of the European Insolvency Regulation (recast).
15. *Czyzewski v. Jevic Holding Corp.*, 137 Supreme Court 973 (2017).



▼ **Sebastiaan van den Berg** is a Advocaat at RESOR N.V. and is based in Amsterdam, The Netherlands. Sebastiaan studied law at the Erasmus University Rotterdam, The Netherlands. He has an LLM Dutch Law, MSc in Financial economics, MSc in M&A and Valuation and a PhD in Law. Sebastiaan is specialised in insolvency law and corporate litigation, focusing on distressed and special situations. His practice includes advising and litigating for (multinational) companies, management and court-appointed administrators on all insolvency or restructuring related issues, in particular in cross-border situations. Sebastiaan has a special interest in (distressed) valuation and wrote his dissertation about valuation issues in insolvency law. His recent representations include the cross-border restructuring of Brazilian Telecom company Oi (representing one of the finance subsidiaries in the Netherlands), representing a security agent in foreclosure proceedings in the first Dutch case before the Netherlands Commercial Court (NCC), representing various clients in enquiry proceedings before the Enterprise Chamber (Court of Appeal of Amsterdam), and assisting with the legal analysis of the valuation and damage quantification in various disputes.

Introduction of an In-Court Restructuring Mechanism: The Turkish Concordato Scheme

By **MELTEM AKOL**

Coinciding with the general downturn in the Turkish economy, concordato, re-introduced in 2018, is currently the only in-court reorganization proceeding available for Turkish companies, which may be initiated by either the debtor company or a creditor.

The re-introduction followed the repeal of the postponement of a bankruptcy mechanism, which, though not designed as a restructuring tool, was being used opportunistically as one. Lessons learned have been and are still being incorporated into the concordato scheme. Since its re-introduction, there have been a number of cases even though its use has been limited to (in practice, but not in law) small to mid-size enterprises. The restructuring of large size companies has so far still been done on an out-of-court basis, led by refinancing of financial indebtedness and combined with asset disposals and equity injections.

Nonetheless, financial lenders and corporates dealing with suppliers and customers that may be impacted by counterparty concordato proceedings have been analyzing the new concordato rules to update their loan underwriting standards and to build in trade protections.

Concordato is aimed at being a preventative, pre-insolvency tool. It is not available to companies with an unsustainable debt burden. To take advantage of the concordato scheme, the applicant must show the court that the debtor is unable to, or may become unable to, pay its debts as they become due, but, would be able to pay its debts or avoid bankruptcy if granted a maturity extension or a discount on principal and debt.

Concordato Proceedings

At the initiation of the concordato proceedings, in addition to a creditors list and financial statements, the applicant must present to the competent court: (i) a preliminary restructuring plan detailing the proposed payment plan, which may include proposed haircut, plans for asset disposals, equity injection and procurement of new financing; (ii) a comparison of the liquidation proceeds that creditors would receive upon a bankruptcy process versus the expected recovery amounts that would become available following the proposed concordato plan; and (iii) an audit report from an accredited independent audit firm giving reasonable assurance that the preliminary restructuring plan can be realized.

Protection Available to the Debtor Pending Concordato Proceedings

Upon a duly made application, which could be made by a debtor or creditor, the competent court shall, without having to assess the merits in detail, grant a temporary protection term to the debtor for up to five months and appoint a temporary concordato officer(s) to assess the viability of the restructuring plan. The grant of the temporary protection term is notified to government institutions and is announced to the public. The announcement further invites creditors to file their claims and objections.

As such public announcement is made at the outset, before commencement of the final concordato proceeding, this potentially puts a strain on the continuous relationship of the debtor with its creditors, suppliers and employees (even though certain protections against termination of the contracts are offered in the concordato institution – more on this below).

The court will eventually decide whether to grant a final protection term by reviewing the claims of the debtor, the objections of the creditors and the temporary concordato officer's report. The final protection term is granted for one year, which may be extended twice, each such extension being for a period of 6 months. Such extensions may be requested to enable potentially lengthy divestment required to implement the restructuring, lengthy negotiations between creditors and investors, or due to conditionality attached to new financing. The court may terminate the final protection term if the financial status of the debtor ameliorates or the opening of bankruptcy due to certain reasons including the deterioration of the financial status of the debtor.

The most important protections extended to the debtor during the protection term (which are the same for the temporary and final period) include the following:

— No collection proceedings may be initiated or continued against the debtor, including for tax and other receivables of the state.

— As a major exception, secured creditors may initiate and continue foreclosure proceedings up to the point of sale of the pledged asset.

— Sale of pledged assets or return of property subject to financial lease to the lessor may, however, be postponed up to one year following the concordato order of the court, if the pledged or leased asset is crucial to the operational viability of the debtor.

— Interest ceases to accrue on any unsecured debt, unless the approved concordato plan proposes otherwise.

— Any transfer by the debtor of contingent receivables that crystalizes during the protection term is deemed invalid.

— Creditors that have non-monetary claims must calculate and submit the cash value of their claims, unless the debtor elects to continue with specific performance. Such valuations may not always reflect the true value of the claims. If the debtor objects to the quantum of the creditor's claim, the court shall re-evaluate the creditor's valuation.

— Contractual terms stating that a concordato filing constitutes an event of default, a ground for termination or acceleration of debt (the so-called ipso facto clauses) are not enforceable in the case of contracts that are material to the overall viability of the business of the debtor.

— Debtor may terminate, with the consent of the concordato officer and the court, contracts (except employment contracts) that impose continuous performance obligations on the debtor and hinder the chances of success of the concordato. Any compensation that may result from such termination shall be subject to the concordato terms *pari passu* with other unsecured creditors.

Control of the Debtor's Business

The control of the business remains with the debtor in principle, subject to the supervision of the concordato officer. The court may require certain actions and transactions be approved by the concordato officer or, alternatively, the court may at its discretion, transfer management control to the concordato officer altogether at any time during the concordato proceeding. The authority of the debtor to encumber or dispose of property such as machinery, equipment, real estate, vehicles required for the operation of the business or provide sureties during the protection periods is restricted. Violation of these restrictions or instructions of the concordato officer may result in removal of management control or even declaration of bankruptcy.

Concordato Officer

Amongst the concordato officer's duties are to compile an inventory of the debtor's assets and conduct a valuation, invite creditors to submit their claims for recognition, hear the objections of the debtor to creditors' claims, examine the debtors' books and records, make conclusions in his report to the creditors and invite the creditors to negotiate the debt restructuring plan.

Given the breadth of the concordato officer's duties and further in view of the potential shift of the management of the debtor as described above, concerns have been voiced in the market that candidates for concordato officer roles lack the necessary skills and capabilities to fulfill these duties.

Role of Creditors and the Approval of the Concordato Plan

Creditors are represented during the process by a creditors' board comprising of up to seven creditors, selected by the court representing diversified kinds of debt. The creditors' board role is to supervise the concordato officer and make recommendations to the court. In determining whether to terminate the protection term for the debtor due to amelioration or deterioration of the financial situation of the debtor or to invalidate any encumbrance or disposal of property conducted by the debtor during the protection term, the court must consult with the creditors' board.

All recognized creditors are invited to meet with the concordato officer, in the attendance of the debtor, to negotiate and vote on the proposed concordato plan. The concordato plan remains available for review and execution for seven days following the meeting.

Quorum for acceptance of the concordato plan is more than 1/2 of the recognized creditors in number and the aggregate amount of the recognized debts, or 1/4 of the recognized creditors in number and 2/3 of the aggregate amount of the recognized debts. Disregarded in the voting are claims of employees (the terms of which may not be amended by the concordato terms) and secured debt, subject to the below. The court has discretion as to whether to grant voting rights to holders of contingent or disputed claims.

Creditors may not formally propose an alternative plan. Shareholders typically play an indirect role in formulating the concordato plan through existing management.

The court or the creditors may not force the substantive consolidation of the debt and receivables of group companies where a concordato plan is submitted for a single member of a corporate group. Concordato provides no specific treatment for intercompany loans.

Secured Creditors

If the debtor has requested a restructuring of its secured debt as part of the concordato, separate negotiations will need to be held with the secured creditors. Secured debt continues to accrue interest at the rates set in their original contracts, as from the date of the concordato request.

Any agreement for a haircut on principal and interest amounts and any debt rescheduling is binding on dissenting secured creditors only if approved by secured creditors holding more than 2/3 in aggregate principal amount of the secured debt, provided that the concordato plan is also approved by the required majority of the unsecured creditors.

Dissenting secured creditors are deemed to have accepted the longest of the rescheduled maturity terms approved by the requisite majority of the secured creditors.

Default of the debtor vis-à-vis even a single secured creditor of the terms of the concordato plan entitles such creditor to revoke its consent to the concordato plan. If secured creditors holding 2/3 or more of the secured debt revoke their consents, the concordato plan is no longer binding on the remaining secured creditors.

Concordato Order by the Court and its Effects

The court will approve the final terms of the concordato plan that has been accepted by the creditors, if it determines that: (i) the projected recovery amount under the proposed plan is more favourable than the recovery that bankruptcy liquidation proceeds would yield; (ii) the projected recovery amounts are proportionate to the resources available to the debtor (and the court has discretion in considering the extent to which expected future income of the debtor should be taken into account); (iii) meeting requirements (quora and approval levels) were duly met; (iv) employee claims can be paid in full; (v) sufficient reserves are set aside to perform obligations undertaken with the consent of the concordato officer during the protection period; and (vi) concordato proceeding costs are covered. The court order sets forth the haircut ratio and the maturities rescheduling.

Following approval of the concordato plan, the court may appoint an administrator to oversee and manage the implementation of the concordato terms and provide update reports to the court as to the ongoing ability of the debtor to service its debt. Such reports remain available to creditors for review but are not otherwise made publicly available.

The concordato order may require provisions for debts in dispute. Creditors with claims that were not recognized during the concordato proceedings may bring their challenges within one month following the court order for concordato. Concordato orders may also be appealed against by the debtor or any objecting creditor. An appeal would not halt implementation of the concordato, unless provided otherwise in the approved concordato plan.

The concordato plan approved by the court order is binding on all creditors, except the following which are excluded from the scope of the concordato coverage:

— employee receivables,

— secured creditors' receivables to the extent covered by the security,

— receivables of the state, such as tax,

— obligations which the debtor undertakes during the concordato proceedings with the consent of the concordato officer; and

— receivables of the counterparties under the continuously performed contracts which were approved by the concordato officer.

Attachments on property of the debtor given effect prior to the commencement of concordato proceedings will cease to be effective, except for those relating to claims excluded from the concordato plan. Any commitment of the debtor to any other creditor, beyond the approved concordato plan is invalid.

Debtor default vis-a-vis an unsecured creditor entitles such creditor to revoke concordato as it applies to it, upon application to the court.

Actions of bad faith that aim the concordato to be accepted by any creditor or the debtor may result in the concordato being revoked in its entirety. As an example, if the debtor makes or promises a secret additional payment (which is not covered by the terms of the concordato project) to a creditor in exchange for that creditor's vote in favour of the concordato project, that may be deemed as bad faith. Additionally, if the debtor presents fictional debts to be included in the concordato, then the relevant concordato project may be revoked.

Concordato documentation and financing provided during proceedings benefit from certain tax incentives.

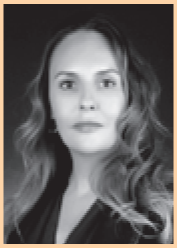
Rejection of the Concordato

If the plan is not accepted, the court may convert concordato proceedings into bankruptcy proceedings, where the criteria for direct bankruptcy exists, such as suspension of payments by the debtor.

The court may also switch to bankruptcy proceedings during the protection term: (i) upon failure by the debtor to comply with the terms of the approved concordato plan or instructions of the court; (iii) upon the court becoming aware that the concordato is unlikely to be successful; or (iii) the debtor withdraws from the concordato proceedings where the proceedings were initiated by the debtor. ■

Comparison with Proceedings in Other European Jurisdictions

	Turkish law *Concordato*	English law		Italian law *Judicial composition with creditors (concordato)*
		Administration	*Scheme of arrangement*	
Debtor's right to initiate the proceedings	Yes – by formal application made to court	Yes – by formal application made to court (the *court route*) or filing of documents at court (the *out-of-court route*)	Yes – by filing application in court for an order summoning meetings to vote on the scheme	Yes – by formal application made to court.
Creditors' rights to initiate the proceedings and throughout the process	Yes – by formal application made to court or following the public announcement, by filing documents to concordato officer	Yes – by the *court route* or, if the creditors are qualifying floating charge holders, by the *out-of-court route*	Yes – by filing application in court for an order summoning meetings to vote on the scheme	No, only debtor is entitled to initiate the proceedings. If the plan does not provide for repayment of at least 40% of unsecured claims in cash (or 30%, in case the plan does not envisage a liquidation), holders of at least 10% of debt may propose competing plans.
Court's role	Hearing of application; granting temporary term and final protection term to debtor or dismissing application	Hearing of application; making administration order or dismissing application	Deciding whether a meeting on the scheme should be called; holding court hearing and court meeting; sanction the scheme if seen fit	Hearing of application, authorizing transaction outside of the ordinary course (including new financings), ruling on creditors' challenges, ratifying the plan, or dismissing the application.
Class composition / approval requirements	Quorum for acceptance of the concordato plan is more than 1/2 of the recognized creditors in number and the aggregate amount of the recognized debts, or 1/4 of the recognized creditors in number and 2/3 of the aggregate amount of the recognized debts	Generally by deemed consent procedure: decision deemed approved within 14 days of notification unless objected by ≥10% in value of creditors, following which decision is voted on by majority.	For each relevant class of creditors, majority in number, representing ≥75% in value.	Plan to be approved by unsecured creditors (and secured creditors to the extent of any collateral deficiency) holding a majority of claims by value entitled to vote. If classes of creditors are formed, the plan must also be approved by majority of claims in a majority of classes.
Secured creditors' status	Secured receivables are not affected by the concordato in principle, unless the debtor requests the restructuring of the secured debts and the agreements are approved by more than 2/3 of such receivables in value. Secured debt continues to accrue interest.	Generally protected, main risk to security is if granted during hardening period	Creditors are only bound by the scheme from the date of filing of the sanctioned scheme with the Companies House	Generally protected (assuming hardening). The plan must provide that secured creditors be paid in full for the value of their claims.
Moratorium	Statutory moratorium when application is submitted to court	Statutory moratorium when company enters into administration' Interim moratorium may be imposed pending entry into administration	No moratorium; under limited circumstances court may stay claims of dissenting creditors; a contractual moratorium is quite often implemented prior to the scheme	Automatic stay on creditors enforcement actions for pre-petition claims.
Timing	Creditors' meeting should be convened at least 15 days later following the public announcement of the court and within temporary protection term	Creditors' decision on the administrator's proposal should be made within 10 weeks upon the company entering into administration (subject to possible extension)	Approximately two months from announcement of the proceedings to the scheme becoming effective	Court typically ratifies the plan within nine months from the filing of the application.



Meltem Akol graduated from Istanbul University, Faculty of Law in 1991 after completing her education at Robert College Istanbul. She received her master's degree from Harvard University School of Law.

Her legal career started at White & Case LLP in 1991. By 2007, she was appointed as Partner which was followed by her role as the Managing Partner of the Istanbul Office from 2009 until the end of 2015. Since 2016, she has been continuing her career as the Founding Partner of Akol Namlı & Partners Law Firm.

Meltem's experience of over 25 years mainly concentrates on cross-border mergers and acquisitions, capital markets, private equity transactions, joint ventures, bank financing, structured finance and PPPs.

Meltem assisted many leading multinational strategic investors, private equity funds, financial institutions and funds in connection with their investments in various sectors including retail, infrastructure, financial institutions, healthcare, automotive, industrial and manufacturing, energy, ports, construction and real estate in Turkey. She has been involved in numerous major large-size international M&A, capital markets and finance transactions across a wide range of sectors, including "first of their kind" and "most complex of their kind" transactions. Her career was shaped within the investment environment of Turkey with a unique insight to the perspectives of foreign investors.

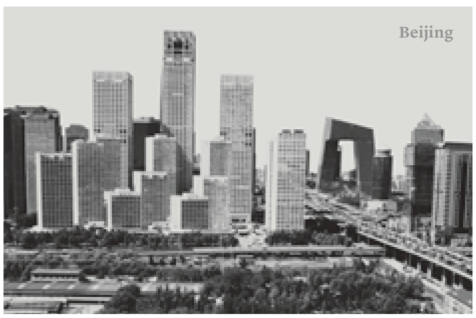
Meltem has been recognized as one of the best and most experienced lawyers by international ratings agencies, widely accepted in the international arena and described as one of the undoubted leading M&A and Capital Markets lawyers of Turkey, her success being ranked as Tier 1 by all well-known legal directories and bringing her various awards given to selected women leaders and best lawyers around the world.

Counsel to the **Republic of Argentina** in the settlement of all remaining defaulted Series 4°, 5°, 6°, and 7° Japanese yen bonds (samurai bonds).

Leading Firm for Finance: Restructuring (Including Bankruptcy): Corporate
The Legal 500 U.S., 2019

Only International Law Firm Ranked Band 1 for Capital Markets in South Korea
Chambers Asia-Pacific, 2019

Counsel to **Petróleos Mexicanos** and certain affiliates in successful defense of Chapter 15 litigation in the Oro Negro proceedings.

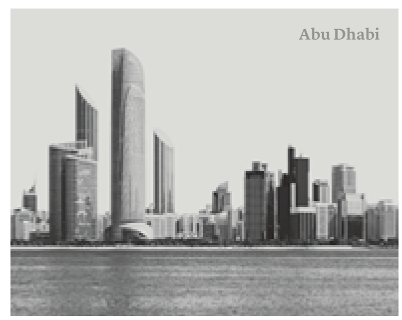


Practice Highlights

Counsel to Ad Hoc Group and Haitong in connection with the restructuring of **Arendal**'s obligations to the Ad Hoc Group and Haitong in the form of an exchange offer and consent solicitation for a Chapter 11 prepackaged bankruptcy.

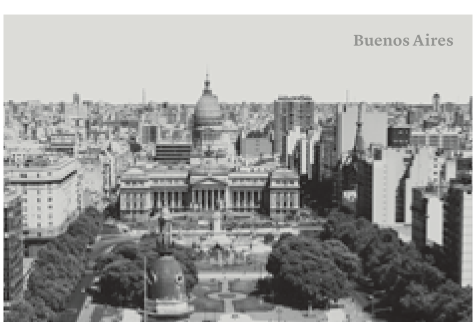
Counsel to ad hoc group of bondholders in connection with the potential enforcement of rights or taking of other actions relating to certain proposed transactions of **General Shopping e Outlets do Brasil S.A.**

Restructuring Deal of the Year
(Oi's $20 billion restructuring)
IFLR Americas Awards and Latin Lawyer, 2019



Best Law Firm in Latin America
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.



Deal of the Year
(Petrobras in a $4 billion liability management transaction)
LatinFinance, 2018

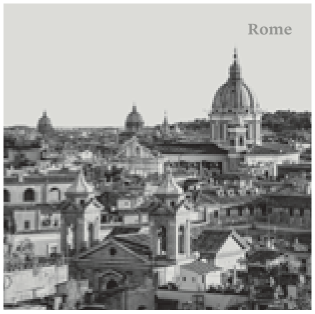
Counsel to **Punjab National Bank**, the victim of a **$2 billion** fraud by international fugitive Nirav Modi, in the U.S. bankruptcy proceeding of Modi's subsidiaries in blocking sale of assets because of tainted sales process and obtaining of Chapter 11 trustee.

International Deal Firm of the Year

ALB Korea Law Awards, 2016-2018

Leading Firm for Restructuring & Insolvency

IFLR1000, 2019



Counsel to an ad hoc group of secured project finance lenders in connection with the U.S. **$1.7 billion** potential restructuring, recapitalization and reorganization of **QGOG Constellation S.A.** and its subsidiaries.

Counsel to **SMP Ltd**, a leading polysilicon manufacturer based in Korea, in connection with its request for Chapter 15 recognition of its Korean insolvency proceedings, as well as its adversary proceeding against SunEdison, Inc.

Top-Tier Ranked for Bankruptcy

Benchmark Litigation, 2017–2019

Restructuring Deal of the Year

(Odebrecht Óleo e Gás' debt reorganization)

Latin Lawyer and IFLR, 2018

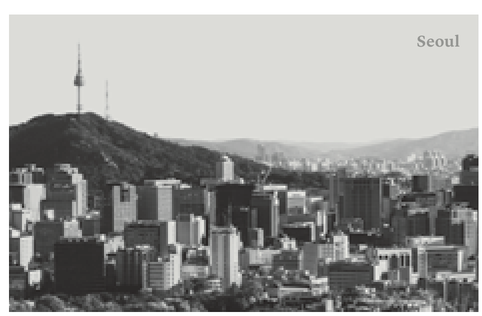
Russia Deal of the Year

(The Far Eastern Shipping Company's restructuring)

CEE Legal Matters Awards, 2018

Counsel to investors in **Venezuela** and/or PDVSA debt and multinational companies with exposure to Venezuela on various legal aspects and implications of a potential Venezuela/PDVSA default or related to restructuring/liability management transactions by Venezuela and/or PDVSA.

Counsel to **UC RUSAL** in its **$5.15 billion** restructuring and its previous **$16.8 billion** restructuring, the largest-ever restructuring of a company with main operations in Russia and the CIS.



CLEARY GOTTLIEB STEEN & HAMILTON LLP

Founded in 1946 by lawyers committed to legal excellence, internationalism, and diversity, Cleary Gottlieb Steen & Hamilton LLP is a leading international law firm with approximately 1,200 lawyers around the world. The firm has 16 closely integrated offices in New York, Washington, D.C., Paris, Brussels, London, Moscow, Frankfurt, Cologne, Rome, Milan, Hong Kong, Beijing, Buenos Aires, São Paulo, Abu Dhabi, and Seoul.

19.0402.04_062619