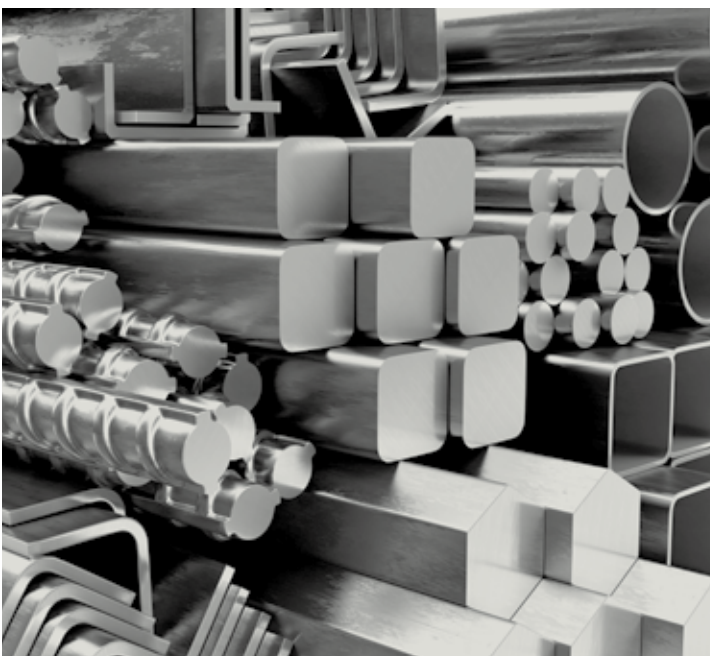


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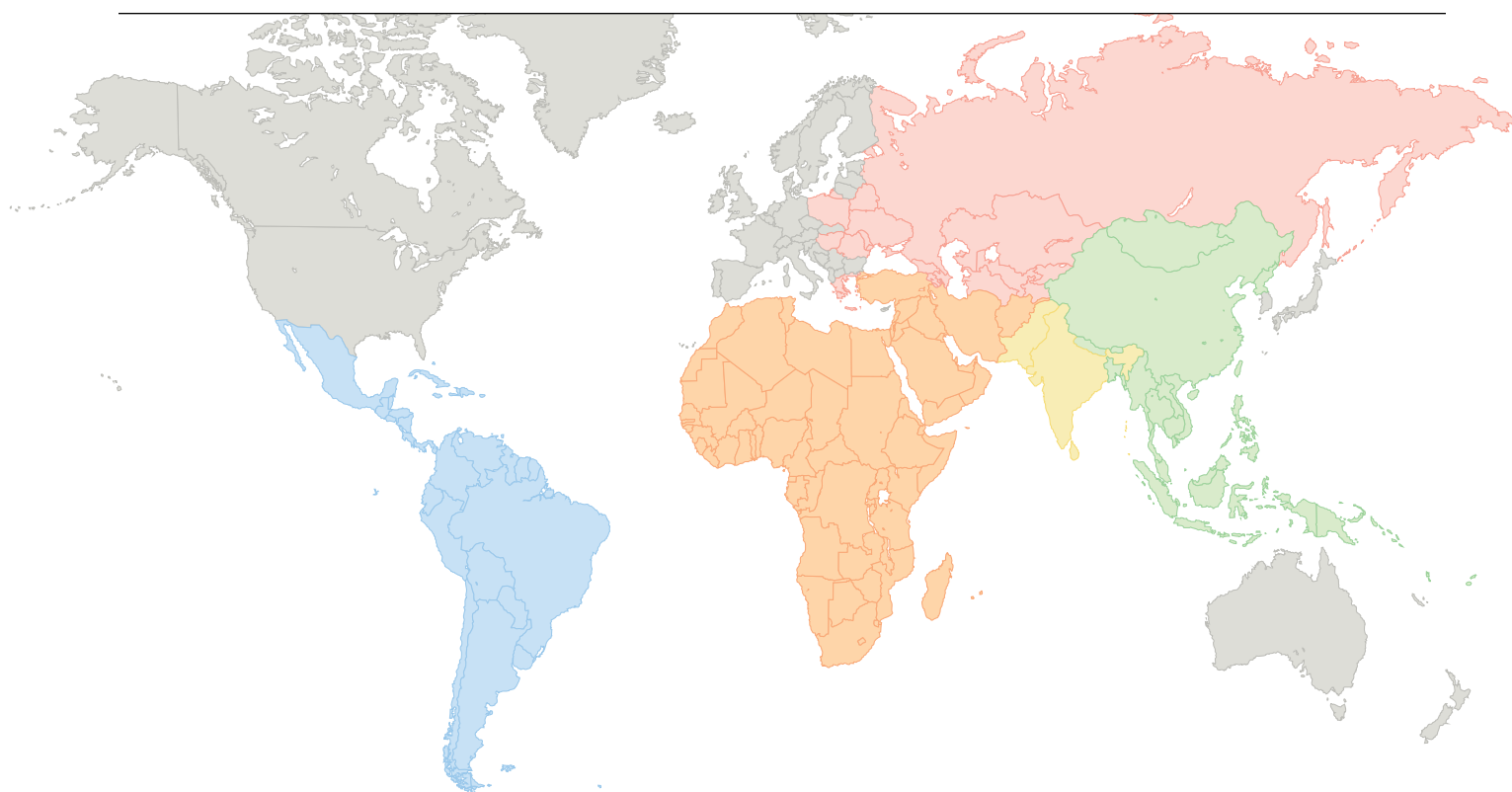
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Letter from the Editors



When this issue of the Emerging Markets Restructuring Journal is going to press, we are getting ready for our inaugural Emerging Markets seminar in London on 12 September 2017, which we hope will bring together a diverse group of investors, companies and practitioners with particular interest in emerging markets and spark discussions on a number of hot topics, including debt restructuring. We have stepped slightly out of our usual publishing routine to bring fresh news to this special event.



Our fourth issue covers a global trend in bringing the local insolvency and restructuring legislation in line with the 21st century requirements, including the recent legal reforms in Mozambique, Angola, the UAE and Poland. The trend reflects attempts to make the restructuring processes more predictable and business oriented as well as to overcome cultural resistance to restructurings. Within such framework, a couple of contributions also advocate for the need of reforms to the insolvency regimes in Venezuela and Brazil. In the meantime and while the reforms are unfolding, the market players in the Brazilian Banco Santos case have been developing creative solutions to address the systemic deficiencies of the Brazilian liquidation process.



The issue also provides continuous coverage on ways of addressing the NPL issues in Asia, this time dedicated to China and a new debt-for-equity conversion framework introduced by the regulators to address excessively high corporate debt levels in recent years. Further, we also present an interesting article analyzing the approach Mexican insolvency law takes on derivatives, as well as a contribution exploring the regime for public-private initiatives in Puerto Rico under PROMESA.



As always we hope you find this issue interesting and useful to your practice, and we encourage your comments and questions. For those attending our seminar, we hope you find it thought-provoking and enjoy the networking, and for the rest of our audience, please stay tuned for our next issue.

Polina Lyadnova, Adam Brenneman, Sui-Jim Ho and Denise Filaurio

Insolvency Proceedings in Venezuela: A 19th Century Statute is Ill-Equipped to Navigate Current Times

By FULVIO ITALIANI and CARLOS OMAÑA



Venezuelan bankruptcy law has its origins in a draft 19th century Italian statute and has remained largely unchanged for more than 100 years. Bankruptcy law, as contained in the Venezuelan Code of Commerce (“C.Com” or “Code of Commerce”), is applicable to individuals as well as to business entities such as *sociedades anónimas*.

There are two insolvency procedures under Venezuelan law: (i) the moratorium or *atraso* process, and (ii) the bankruptcy or *quiebra* process. Although the regime may be used to either liquidate business enterprises or to reorganize them, recent practice seems to show that if a company is salvable, most stakeholders prefer to have an out-of-court restructuring. Leading commentators see the Venezuelan bankruptcy process as vexatious, reflecting in part the fact that there is still a social stigma attached to businesses that go bankrupt.

What About Venezuelan Public Entities?

There is much speculation these days as to whether Venezuelan public entities could be subject to this bankruptcy law. Petróleos de Venezuela, S.A. (“PDVSA”) and its subsidiaries in Venezuela are organized as *sociedades anónimas* under the Code of Commerce and logic would dictate that the Code of Commerce’s bankruptcy provisions should apply to them.

However, one important legal scholar has argued that the bankruptcy provisions of the Code of Commerce are not applicable to state-owned companies and more specifically to PDVSA because state-owned companies are government instrumentalities and as such they “may not assume a quality of merchants” (*no podrán asumir la cualidad de comerciantes*).¹

Also, PDVSA’s oil and gas transportation and distribution infrastructure is protected from attachments. Specifically, any provisional remedy or remedy in aid of execution of judgments rendered against PDVSA’s oil and gas distribution infrastructure located in Venezuela must be automatically stayed for 45 days from the date on which the Attorney General is served with the remedy. Within this 45-day term, PDVSA itself and its regulators, such as the Ministry of Energy and Petroleum, must put together a plan that will ensure the uninterrupted supply of oil, derivatives and gas to the market². This protection from attachments and provisional remedies has been regarded by scholars as a type of immunity that would complicate the application of the bankruptcy regime of the Code of Commerce to PDVSA.

Other legal commentators have taken a different view. Neither doctrine has been tested in the Venezuelan courts. If the bankruptcy regime of the Code of Commerce were to be considered as not applicable to PDVSA by the competent court, which in our view would be the Venezuelan Supreme Tribunal, there would be no other specific set of rules that would regulate PDVSA’s insolvency or its liquidation.

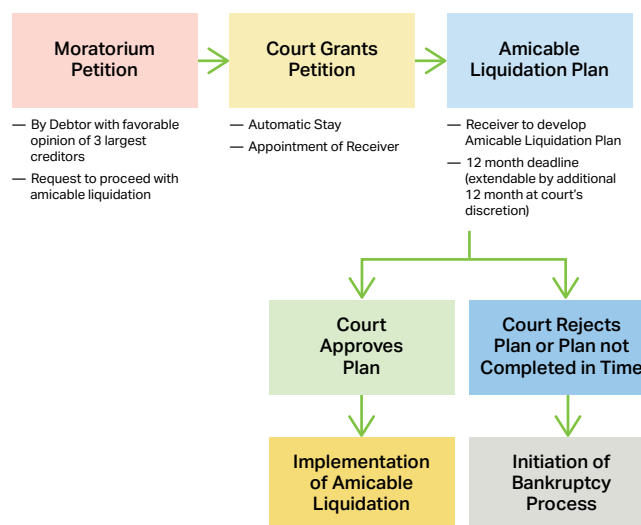
Moratorium (*Atraso*)

The moratorium or *atraso* process (i) needs to be voluntary (i.e., the debtor may not be involuntarily declared in *atraso*), (ii) does not provide for voidable preferences that allow for a claw-back of payments and transactions, (iii) automatically stays all enforcement actions against the debtor, (iv) allows for a debtor-in-possession regime whereby the management remains in charge of operations under court supervision, and (v) may only be granted for an initial one-year term (but may be extended by the court at its discretion). To be eligible for *atraso*, a debtor needs to show that its assets are greater than its liabilities.

To request the “benefit” of *atraso*, the debtor must file a petition with the commercial court with jurisdiction in its domicile. The petition must enclose the favorable opinion with respect to the *atraso* of the debtor’s three largest creditors. If the *atraso* is granted, the debtor, its creditors and the court-appointed receiver must work together to prepare an amicable liquidation plan that must be approved by the court.

If the debtor is not amicably liquidated within the term approved by the court, which may last up to two years, or the debtor is not able to successfully emerge from the *atraso* proceeding (as courts have allowed in the past), then the debtor will have to undergo a bankruptcy process.

Moratorium (*Atraso*) Process



Mortatorium v. Bankruptcy v. Out-of-Court Liquidation

Feature	Mortatorium	Bankruptcy	Out-of-Court Amicable Liquidation
Petition	Voluntary (by debtor)	Voluntary (by debtor) or Involuntary (by creditors)	Voluntary (by debtor)
Court Involvement	Yes	Yes	No
Automatic Stay	Yes	Yes	No
Voidable Preferences	Does not provide for voidable preferences	Provides for voidable preferences of transactions occurring after the suspect period date	Does not provide for voidable preferences
Management of Debtor's Assets	Allows for debtor-in-possession management	Receiver appointed to manage the debtor's assets and operations	Allows for debtor-in-possession management
Timing	May only be granted for an initial one-year term, extendable at the court's discretion for another year	Can last from a few months to several years	Can last from a few months to several years
Outcome	Amicable Liquidation (by liquidators appointed by court)	Restructuring Agreement or Liquidation	Amicable Liquidation (by liquidators designated by debtor)

Out of Court Amicable Liquidation (*Disolución Anticipada*)

The *atraso* process was conceived to facilitate an orderly liquidation of a business that is undergoing liquidity problems but that is solvent. On the other hand, the Code of Commerce contains two provisions dealing with the amicable winding down of business entities (*disolución anticipada*)³ that do not entail a court procedure, court oversight or the designation of a receiver. Under the Code of Commerce's winding down rules, the shareholders may resolve to wind down a company for any reason, before the expiration of its duration as set forth in its bylaws, and designate one or several liquidators that will undertake all actions necessary to wind down the company. This may explain why the *atraso* process has not been used in recent history. If a company can be amicably liquidated out of court, it does not make practical sense to go through a court proceeding that may turn vexatious. However, the *disolución anticipada* rules of the Code of Commerce do not provide for an automatic stay.

Bankruptcy (*Quiebra*)

The bankruptcy or *quiebra* regime (i) may be voluntary (requested by the debtor) or involuntary (required by an unpaid commercial creditor of any kind), (ii) provides for voidable preferences (described below) and (iii) automatically stays all collection actions against the debtor. It is not entirely clear if the Venezuelan bankruptcy regime would allow a debtor-in-possession arrangement.

Even though a bankrupt company may emerge from bankruptcy and be rehabilitated, both the legal regime and recent practice seem to suggest that the bankruptcy regime in Venezuela is largely used as a means to liquidate failing enterprises. However, this does not mean that failing enterprises may not be voluntarily liquidated by their owners without court intervention, using the *disolución anticipada* regime of the Code of Commerce, which is more common in practice.

Commencement of Bankruptcy Proceedings and Cessation of Payments

Bankruptcy proceedings begin with a petition that is made with a Venezuelan commercial court of the debtor's domicile (the "bankruptcy judge"). In Venezuela there are currently no specialized bankruptcy courts. Bankruptcies are heard by the ordinary commercial courts with subject matter jurisdiction in the debtor's domicile. The petition may be filed by the debtor company ("voluntary bankruptcy") or by any of its commercial creditors ("involuntary bankruptcy"). The debtor company is required to file a voluntary bankruptcy petition within three days after it is faced with a "cessation of payments" situation.⁴

Any single commercial creditor may file a bankruptcy petition against a debtor even if its credit has not yet become due and payable.⁵ The creditor's petition must demonstrate with factual and circumstantial evidence that there is a cessation of payments situation.⁶

Venezuelan law does not define what constitutes a cessation of payments, however, Venezuelan commentators have identified a number of indicators of a cessation of payments situation. The primary and normal (but not exclusive) external

manifestation of the cessation of payments is the debtor's default of its obligations as they become due (*impotencia patrimonial*).⁷ Other manifestations include the debtor's own confession of a cessation of payments situation, unsatisfied judgments, closure or transfer of the business, transfers of assets to creditors, fraudulent transfers, insolvency (liabilities in excess of assets or balance sheet test), the continuation of payments through sales of assets or through ruinous or fraudulent means, hiding of assets and so on.⁸

The determination of whether there is a cessation of payments situation is a factual analysis made by the bankruptcy judge who will have broad discretion on the issue. Generally, Venezuelan courts have tended to accept the commentators' definitions of cessation of payments and have used a debtor's default of its obligations as the primary (but not exclusive) element to determine if the debtor has in fact incurred in cessation of payments.⁹

Admission to Trial; Provisional Remedies

The bankruptcy judge must decide whether to admit the bankruptcy petition for trial. This order does not involve an analysis of the substance of the petition, and is generally rendered within one week or one month following the bankruptcy petition.¹⁰

If the bankruptcy judge admits the petition for trial, the judge may also issue provisional remedies to safeguard the debtor's assets, but is not required to do so, unless the debtor avoids service of process of an involuntary bankruptcy petition.¹¹ The injunctions may include the judicial occupation of all

the debtor's assets, ledgers, mail and other records, and the prohibition to receive payments and deliveries of goods.¹² The bankruptcy judge has broad discretion to issue these provisional remedies.¹³

Bankruptcy Declaration and its Effects

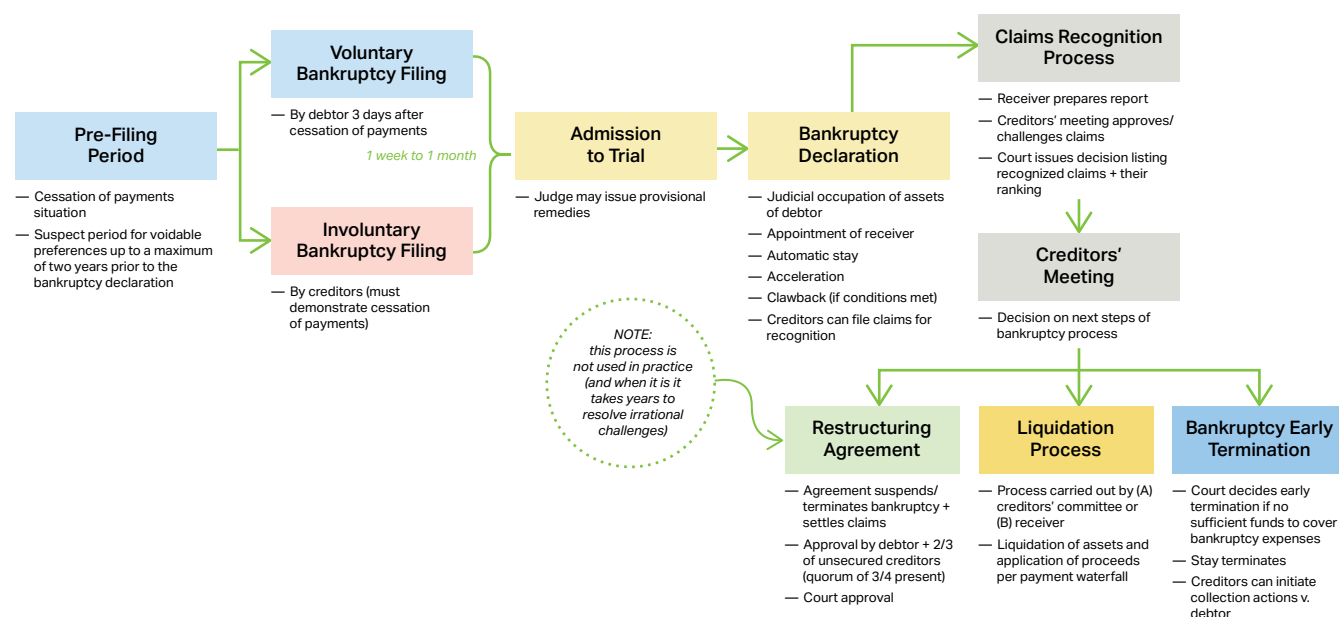
If the bankruptcy judge admits the petition for trial, the judge may also issue provisional remedies to protect the creditors' claims and the debtor's assets, but is not required to do so.¹⁴ The provisional remedies may include the judicial occupation of all the assets of the debtor, its accounting books, correspondence and other records, and the prohibition to receive payments and goods.¹⁵ The bankruptcy judge has broad discretion to issue provisional remedies.¹⁶

In an involuntary bankruptcy proceeding, the order to admit the petition for trial and the provisional remedies, if any, may be issued *ex parte*, before the debtor is served; however, the debtor has the right to challenge the involuntary bankruptcy petition itself and any provisional remedies.¹⁷

Upon admission of the involuntary bankruptcy petition for trial, the bankruptcy judge will issue a summons to be served on the debtor.¹⁸ The debtor company must appear before the bankruptcy judge within five judicial working days after the summons has been served.¹⁹

The debtor company may only assert the following defenses against the involuntary bankruptcy petition: (a) lack of jurisdiction, (b) lack of standing of the petitioner (i.e., that the petitioner is not a creditor), (c) defects in the power of attorney

Bankruptcy (Quiebra) Process





of petitioner's counsel, (d) lack of standing of the debtor company (i.e., that the debtor is not a commercial entity), or (e) that the debtor company is not in cessation of payments.²⁰ In addition, the debtor company may also file a motion for the granting of a moratorium (*atraso*) as a defense against the involuntary bankruptcy petition.

After the hearing, the parties to the proceeding will have an eight-day discovery period to produce evidence in support of the petition and the defense, respectively.

Upon termination of the discovery period, the bankruptcy judge must decide whether or not to declare the bankruptcy. The timing for the declaration of bankruptcy will depend on the complexity of the case and the workload of the bankruptcy judge. The bankruptcy judge may take several months and even years to render its bankruptcy declaration.

The bankruptcy judge must dismiss the bankruptcy petition if there is not sufficient evidence that the debtor company is in cessation of payments. In this case, the bankruptcy proceeding will be terminated together with any provisional remedies.²¹

The bankruptcy judge should only declare the bankruptcy if (a) there is sufficient evidence of the cessation of payments, (b) the petitioner is a commercial creditor (in case of involuntary bankruptcy), and (c) the defenses and objections of the debtor company are rejected.

Effects on the Business

Upon a declaration of bankruptcy the debtor company loses its ability to manage its affairs, transfer its assets and incur new

obligations.²² Management of the assets and the business is transferred to the receiver, who is under the oversight of the bankruptcy court and the creditor's meeting (*junta de acreedores*).²³

While the law does not expressly allow a bankruptcy court to permit all or part of the company's management to remain in place or have some power to manage the business, we see no legal reason why the court could not allow part of company's managers that have the operational and technical skills necessary to run the business, to remain in place, at least temporarily. The receiver, if the liquidation is to be carried out by the receiver; or a creditor-liquidator, if the liquidation will be carried out by the creditors, may be allowed by the creditors meeting to continue the debtor's business.

Automatic Stay

Upon the declaration of bankruptcy, litigation relating to the assets of the debtor company will be handled by the receiver.²⁴ All pending litigation against the debtor company that may affect its assets will be automatically stayed and consolidated into the bankruptcy proceeding.²⁵ It is not clear whether arbitration proceedings are also accumulated into the bankruptcy proceeding, but the receiver may take control of any such arbitration proceedings on behalf of the bankruptcy estate. Also, as a result of the automatic stay, all creditors are barred from individually enforcing their claims while the bankruptcy process is pending.

Effects on Debts and Contracts

Upon the declaration of bankruptcy, all debts of the debtor company are accelerated,²⁶ interest on unsecured debt will cease to accrue, and unmatured debt that does not contractually

accrue interest will suffer a principal reduction equivalent to six percent per annum until its maturity date.²⁸ Interest on secured or privileged debt will continue to accrue, but will only be payable out of the proceeds of the assets covered by the security or privilege.

Clawback

Certain transactions made by the debtor during the suspect period (or ten days before the beginning of the suspect period) may be void or voidable. The suspect period starts on the date on which the cessation of payments occurred (the “suspect period date”), as determined by the court.²⁹ The bankruptcy judge has broad discretion to set the suspect period date; however, the bankruptcy judge can backdate the suspect period date only up to a maximum of two years prior to the bankruptcy declaration³⁰. It is not uncommon for bankruptcy judges to set the suspect period date to precisely the day that is two years before the declaration of bankruptcy, even if the cessation of payments effectively occurred at a later date.

In addition, in at least two cases, bankruptcy judges determined that they had the power to backdate the suspect period date up to a maximum of two years counted from the date of filing of the bankruptcy petition (as opposed to the date of bankruptcy declaration),³¹ even though this interpretation was later reversed by the Civil Chamber of the Supreme Court (in one case with a dissenting opinion that concurred with the interpretation of the bankruptcy judges).³² Under article 945 of the Code of Commerce, the following transactions of the debtor (“art. 945 transactions”) are null and void if made on or after the suspect period date (the “suspect period”) or during the 10 days preceding the suspect period date:

- transfers of assets (movable assets or real estate) with no consideration for the debtor (gifts);
- granting of security (or other preferences in payment) on assets of the debtor to secure debt incurred before the suspect period;
- payments of non-matured debt; and
- payments of matured debt made in any matter other than cash or negotiable instruments, if the debt was payable in cash.

Under article 946 of the Code of Commerce, other payments of matured debt by the debtor or all other transactions with consideration (“art. 946 transactions” and together with art. 945 transactions, “suspect transactions”) made by the debtor during the suspect period (after the cessation of payments date) are voidable if the payees or other parties to such

transactions had knowledge of the cessation of payments of the debtor at the time of such payments or transactions.

To void a suspect transaction, the receiver must request to bring an action with the bankruptcy judge against the debtor and the third party to the suspect transaction. Note, however, that at least in two cases bankruptcy judges declared the nullity of suspect transactions in the judgment declaring the bankruptcy, without allowing the other parties to such transactions to exercise their right of defense,³³ although in one of these cases the Civil Chamber of the Supreme Court reversed the lower court’s decision for due process violation.³⁴

The statute of limitations to seek the nullity of suspect transactions is one year from the date on which the debtor and its creditors cannot agree on a restructuring agreement (*convenio*) to emerge from the bankruptcy process (as described further below).³⁵

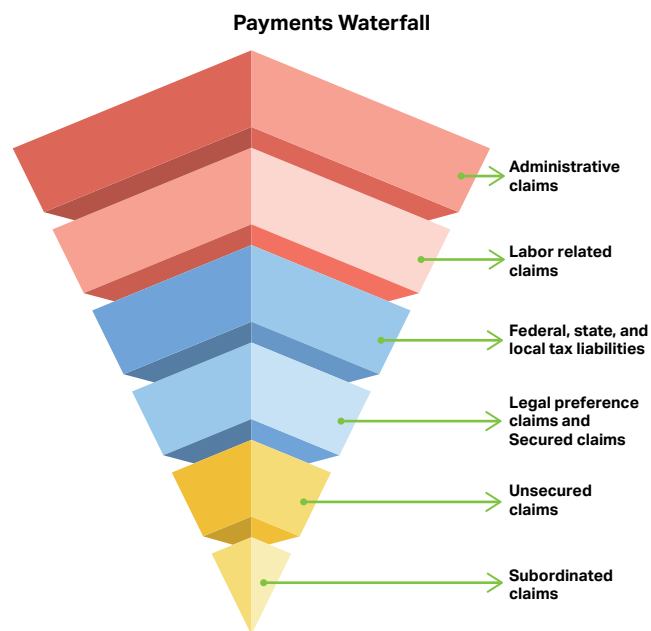
Recognition of Claims

To be eligible for a distribution from the bankruptcy estate, claims must be recognized by a creditors’ meeting where the receiver presents all the claims filed by the creditors. All the claims that are not challenged by any of the other creditors present at the meeting will be recognized.

From the date of the bankruptcy declaration by the court, all creditors may file with the court their requests for recognition of their claims, together with supporting evidence. After the receiver has been designated by the court, the requests for recognition must be made directly with the receiver.

The receiver has the duty to prepare a report to the creditors’ meeting describing all the claims submitted for qualification, including a description of any security interests granted to secure the claims or rights of preference. The receiver’s report is presented to the creditors’ meeting for its discussion at a meeting which must be held on the place, date and time set by the court, regardless of the number of creditors that attend the meeting. The purpose of this creditors’ meeting is to review all the claims filed with the court or the receiver. During this review process, all creditors and the debtor will be able to challenge the claims filed by creditors.

After the creditors’ meeting completes the recognition process, the court will render a decision listing all the recognized claims as well as their ranking. After the recognition process is completed, the creditors’ meeting may decide to either (i) liquidate the debtor and if so, designate one or more liquidators or (ii) enter into a restructuring agreement (*convenio*) with the debtor.



Liquidation and Payments Waterfall

The liquidation of the debtor may be carried out either (i) by a liquidator-creditor under the oversight of a creditors' committee (*comisión de acreedores*) formed by three creditors elected in a creditors' meeting by creditors that represent 2/3 of the qualified claims, or (ii) by the receivers if the liquidation by the creditors is not approved.

In the liquidation phase, either by the creditors or by the receivers, the settlement of all claims will be made collectively from the bankruptcy estate pursuant to the status of creditors decision rendered by the court. Pursuant to Venezuelan law, the payments waterfall should be made in the following order:

- *First*, to the receiver and other court-appointed or court-approved support contractors (auditors, experts, depositaries, security personnel, among other), this amount has a statutory cap of 10% of the value of the debtor's assets;
- *Second*, employees for any unpaid salaries and labor benefits arising from the law or any individual or collective bargaining agreements³⁶;
- *Third*, the federal, state and local treasuries for any unpaid taxes and interest;
- *Fourth*, creditors that have a legal preference or that have a valid security interest over the debtor's property;
- *Fifth*, all unsecured creditors; and
- *Sixth*, creditors who have voluntarily agreed, by contract or otherwise, to subordinate their claims.

Restructuring Agreement. Required Majority. Early Termination of Bankruptcy

The debtor and the required quorum and majority of qualified creditors may enter into a restructuring agreement (*convenio*) (i) to suspend or terminate the bankruptcy proceedings, and (ii) setting forth the terms and conditions of the settlement of the qualified claims.

The *convenio* needs to be approved in a creditors' meeting called by the bankruptcy judge. Secured creditors and creditors that have a legal preference are allowed to participate in the creditors meeting that will decide on the *convenio* but their presence will not be considered to determine the required quorum and majority, unless they waive their security interest or rights of preference. To approve a *convenio* (i) qualified creditors that represent 2/3 of the aggregate of qualified claims must vote in favor of the *convenio* in a creditors' meeting in which 3/4 of the aggregate of qualified claims are present, or (ii) qualified creditors that represent 3/4 of the aggregate of qualified claims vote in favor of the *convenio* in a creditors meeting in which 2/3 of the aggregate of qualified claims are present.³⁷

The *convenio* must be approved by the bankruptcy court which may do so as long as the bankruptcy is not found to be fraudulent by the criminal court in charge of making such determination.

The practical difficulties in achieving a definitive *convenio* typically arise from challenges made by irrational stakeholders and creditors, the resolution of which generally takes years.

The bankruptcy judge may terminate the proceedings if there are insufficient funds to cover bankruptcy-related expenses. In which case, each creditor recovers its right to bring individual collection actions against the debtor company.³⁸

Timing of Bankruptcy Proceedings — A Case for Out-of-Court Restructurings

Overall timing of Venezuelan bankruptcy proceedings depends on the number of creditors, the complexity of the case, the quantity and type of assets and liabilities, the number of employees and any political implications of the case. Depending on these factors, the proceedings may last from several months to several years.

The *Sudamtex* bankruptcy and the resulting liquidation process is currently still going on after eleven years.

On the other hand, the Siderúrgica del Orinoco, C.A. ("Sidor") restructuring was successfully completed out-of-court in eleven months.

The Sidor Case

Sidor, Venezuela's largest steel producer, restructured more than US\$1.8 billion of financial debt, the largest financial restructuring by a Venezuelan private company.

The First Restructuring (2000)

Sidor was privatized in 1998 and the Amazonia Consortium, a group of Latin American steel producers led by Argentina's Siderar, purchased 70% of Sidor's capital, while the Venezuelan government retained 30%. As part of the privatization, the Venezuelan government continued to be a financial creditor of Sidor for US\$734 million.

As a result of the plunge in steel prices in 2000-2001, Sidor experienced significant financial losses and cash flow problems leading up to its first debt restructuring in 2000. Under the 2000 financial restructuring, Sidor's shareholders agreed to make a combined US\$100 million capital contribution, and the banks agreed to refinance their debt. Sidor pledged most of its assets to its creditors pursuant to a security trust structure (fideicomiso).

The Second Restructuring (2003)

The adverse market conditions in the steel market continued after the 2000 restructuring, and led to the need of the second 2003 restructuring, under which:

- Sidor's financial debt with foreign financial institutions (including Citibank and Deutsche Bank) was reduced to US\$745.4 million (with substantial discounts exceeding 50%), and was restructured in three tranches, each with a one year grace period: US\$350.5 million to be repaid over 8 years; US\$26.3 million to be repaid over 12 years; and the remaining tranche of US\$368.6 million, to be repaid over 15 years.
- The Venezuelan government capitalized 50% of Sidor's financial debt with the government and increased its equity participation from 30% to 40% (half of the equity was distributed to Sidor's employees), and agreed to reschedule the remaining financial debt to be repaid over 15 years with a one-year grace period.
- The Amazonia Consortium contributed US\$133 million in cash, a portion of which (approx. US\$40 million) was used for the repurchase of a portion of Sidor's financial debt at a substantial discount.
- Sidor's US\$45.4 million commercial debt with its main state-owned suppliers (Edelca, PDVSA Gas and Ferrominera), was refinanced to be repaid over the next three to five years.
- Sidor provided additional collateral for the benefit of its creditors, and the Amazonia Consortium pledged its shares in Sidor to Sidor's creditors.
- The parties of the restructuring arrangement agreed that Sidor's excess cash would be used to prepay financial debt and to repay capital contributions made by Sidor's shareholders (the Amazonia Consortium and the Venezuelan government).

What Happened Next

After the 2003 restructuring, Sidor continued its operations and increased steel production to almost 5 million tons, prepaid financial debt and repaid capital contributions to its shareholders on an expedited basis.

In 2008, the Venezuelan government decided to nationalize Sidor, and in June 2009 the Venezuelan government agreed to pay the Amazonia Consortium US\$1.97 billion as compensation for the nationalization.

Conclusion

Venezuelan bankruptcy law needs to be brought into the 21st century. The extremely long suspect period creates uncertainty and unpredictability so much that the in-court bankruptcy process in Venezuela ultimately results in business liquidations. From a creditor perspective, a bankruptcy proceeding should be initiated only when all other alternatives have failed. As the only successful restructurings to date have been negotiated and implemented out-of-court, one obvious evolution of the bankruptcy law would be to allow for a pre-packaged type of bankruptcy reorganization process for salvable businesses. ■

Scorecard of Venezuela's Current Insolvency Regime

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

KEY PROCEDURAL ISSUES

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

1. See: MUCI ABRAHAM, José, *Consideraciones sobre la aplicabilidad a Petróleos de Venezuela, S.A. y a sus empresas filiales de las disposiciones del Código de Comercio relativas a la quiebra*, (1992). This doctrine is based on article 7 of the Code of Commerce which says that the state may not take the form of a merchant (*comerciante*).
2. Pursuant to article 111 of the Law of the Office of the Attorney General of Venezuela (*Ley Orgánica de la Procuraduría General de la República*) any provisional remedies or remedies in aid of execution of judgment, rendered on properties located in Venezuela that are used to the render a public service, such as oil and gas distribution and transportation, must be stayed for a period of 45 days after notice is given to the Attorney General. The Venezuelan government entity in charge of rendering the public service may take any action to avoid the interruption of the services, including, according to commentators, taking possession of the assets if such remedies endanger the continuity, quality or security of the public services provided. If the Attorney General does not notify the court about the provisional measures taken by the Venezuelan government to avoid discontinuance of the service entity within such 45-days notice, the court may continue with the enforcement.
3. Arts. 340(6), 341 and 342, Code of Commerce.
4. Art. 925, Code of Commerce.
5. Art. 931, Code of Commerce.
6. Art. 932, Code of Commerce.
7. A company may be in default and not be in cessation of payments, for example, if the defaulted debt is being contested by the debtor in good faith. See opinion of the former Supreme Court dated June 9, 1948 and opinion of the Civil Chamber of the former Supreme Court dated May 7, 1986 (*Barlovento Line de Venezuela S.A. vs. Importadora Laura*, Justice Carlos Trejo Padilla).
8. See Luis Cova Arria (*Interpretación del Concepto de Cesación de Pagos en el Derecho Mercantil Venezolano*, Revista de la Facultad de Derecho 32, Caracas, Universidad Central de Venezuela, 1965); Manuel Simón Egaña (*Notas sobre la Cesación en los Pagos*, Revista de la Facultad de Ciencias Jurídicas y Políticas 20, Caracas, Universidad Central de Venezuela, 1960); Hernán Giménez Anzola (*El Juicio de Atraso*, Caracas, 1963); Alfredo Morles Hernández (*El régimen de la crisis de la empresa mercantil*, Centenario del Código de Comercio Venezolano de 1904, Caracas, Academia de Ciencias Políticas y Sociales, 2004); Oscar Pierre Tapia (*La Quiebra según el Código de Comercio Venezolano*, Caracas, Editorial Sucre, 1983); and Hernan Jimenez Anzola (*El Juicio de Atraso*, Caracas, Librería Moderna, 1963).
9. Juzgado Segundo de Primera Instancia en lo Mercantil del Distrito Federal y Estado Miranda, opinion dated August 10, 1959 (bankruptcy of *Constructora Tamare, C.A.*, Judge Gonzalo Parra Aranguren); Juzgado Segundo de Primera Instancia en lo Mercantil del Distrito Federal y Estado Miranda, opinion dated February 20, 1961 (bankruptcy of *M. Lustgarten*, Judge Gonzalo Parra Aranguren); Juzgado Segundo de Primera Instancia en lo Mercantil del Distrito Federal y Estado Miranda, opinion dated July 7, 1962 (moratorium of *Seguros La Nacional*, Judge Gonzalo Parra Aranguren); Civil Chamber of former Supreme Court, opinion dated June 9, 1948; Civil Chamber of the former Supreme Court, opinion dated May 7, 1986 (*Barlovento Line de Venezuela S.A. vs. Importadora Laura*, Justice Carlos Trejo Padilla); Juzgado Noveno de Primera Instancia en lo Civil y Mercantil Bancaria con Competencia Nacional y Sede en la Ciudad de Caracas, opinion dated July 19, 2003 (bankruptcy of *Sudamtex de Venezuela, C.A.*).
10. If the bankruptcy judge does not admit the petition for trial, the bankruptcy process will not commence.
11. Art. 932, Code of Commerce.
12. Art. 932, Code of Commerce.
13. Constitutional Chamber of the Venezuelan Supreme Court (Tribunal Supremo de Justicia), opinion dated December 4, 2001 (bankruptcy of *C.A. Cervecería Nacional*, Justice Jesús Delgado Ocando).
14. Art. 932, Code of Commerce.
15. Art. 932, Code of Commerce.
16. Constitutional Chamber of the Venezuelan Supreme Court (Tribunal Supremo de Justicia), opinion dated December 4, 2001 (bankruptcy of *C.A. Cervecería Nacional*, Justice Jesús Delgado Ocando).
17. The debtor may appeal the order to admit the petition for trial and the order of preliminary injunctions before a superior court, but the filing of the appeal will not suspend the bankruptcy proceedings or the enforcement of the preliminary injunctions. The appeal process could take considerable time (several months).
18. If the bankruptcy proceeding directly or indirectly affects the interests of the Bolivarian Republic of Venezuela, the bankruptcy judge must also notify the Attorney General (*Procuraduría General de la República*) so that it has the opportunity to participate in the bankruptcy process. In this case, the bankruptcy process will be suspended for a period of 90 days following the receipt by the bankruptcy judge of evidence of the notice to the Attorney General (art. 96, Organic Law of the Attorney General of the Bolivarian Republic of Venezuela).

19. Art. 933, Code of Commerce. If the bankruptcy judge orders the notice of the Attorney General, the hearing will take place within five judicial days following the later of (a) the date on which the debtor is served with the summons and (b) the conclusion of the 90-day suspension period following receipt of evidence of the notice of the Attorney General.
20. Art. 933, Code of Commerce.
21. The petitioner may appeal this decision, but the filing of the appeal does not suspend the termination of the process and the lifting of the preliminary injunctions (art. 936, Code of Commerce).
22. Art. 939, Code of Commerce.
23. Art. 940, Code of Commerce.
24. Art. 940, Code of Commerce.
25. Art. 942, Code of Commerce.
26. Art. 943, Code of Commerce.
27. Art. 944, Code of Commerce.
28. Art. 944, Code of Commerce.
29. Art. 936, Code of Commerce. The bankruptcy judge may also determine the suspect period date on a separate judgment issued after the declaration of bankruptcy.
30. Art. 936, Code of Commerce.
31. Juzgado Noveno de Primera Instancia en lo Civil y Mercantil Bancaria con Competencia Nacional y Sede en la Ciudad de Caracas, opinion dated July 19, 2003 (bankruptcy of Sudamtex de Venezuela, C.A.), and Juzgado Accidental en lo Civil, Mercantil, Penal, de Tránsito y del Trabajo de la Circunscripción Judicial del Estado Yaracuy, opinion dated October 1, 1973 (bankruptcy of Carmelo Cianci). In these cases, the bankruptcy judges held that if the two-year limitation is counted from the date of declaration of bankruptcy (as opposed to the filing date of the bankruptcy petition), then in many cases the two-year limitation would have little or no practical implications to the detriment of the creditors, because in several cases the declaration of bankruptcy could take very long (even two years).
32. Civil Chamber of the Supreme Court, opinion dated May 11, 2005 (bankruptcy of Sudamtex de Venezuela C.A.), opinion of Justice Antonio Ramírez Jiménez; and Civil Chamber of the former Supreme Court, opinion dated November 14, 1974 (bankruptcy of Carmelo Cianci), opinion of Justice José Román Duque Sánchez, with dissenting opinion of Justice R. Rodríguez Méndez (the dissenting opinion agreed with the interpretation of the bankruptcy judge that the two-year limitation should be counted from the filing date of the bankruptcy petition).
33. Juzgado Superior Accidental en lo Civil, Mercantil, del Tránsito, del Trabajo con Competencia Transitoria de Protección del Niño y del Adolescente del Segundo Circuito de la Circunscripción Judicial del Estado Portuguesa, opinion dated November 25, 2002 (bankruptcy of Fiseca, C.A.), and Juzgado Accidental en lo Civil, Mercantil, Penal, de Tránsito y del Trabajo de la Circunscripción Judicial del Estado Yaracuy, opinion dated October 1, 1973 (bankruptcy of Carmelo Cianci).
34. See Constitutional Chamber of the Venezuelan Supreme Court, opinion dated December 1, 2004, (Asociación de Productores de Semillas Certificadas de los Llanos Occidentales (Aproscello), in connection with the bankruptcy of Fiseca, C.A., Justice Jesús Eduardo Cabrera Romero). See also Civil Chamber of the Venezuelan of Justice, opinion dated March 29, 2005 (BPCA Tubulares Petroleros, C.A. v Lloy's Don Fundiciones C.A., Justice Carlos Alberto Vélez). In the Carmelo Cianci bankruptcy, the Civil Chamber did not reverse the decision of the bankruptcy judge on the basis of lack of evidence by the claimant (Civil Chamber of the former Supreme Court, opinion dated November 14, 1974 (bankruptcy of Carmelo Cianci, Justice José Román Duque Sánchez), with dissenting opinion of Justice Luis Loreto (the dissenting opinion indicated that the Chamber should have reversed the decision of the bankruptcy judge that declared the nullity of certain transactions without the commencement of the action by the bankruptcy receiver).
35. Art. 948, Code of Commerce.
36. Pursuant to the Venezuelan Organic Labor and Workers Law of 2012, labor courts have exclusive jurisdiction to hear all claims filed against an employee who has been declared in bankruptcy or in *atraso* by employees with respect to salaries and other accrued labor benefits (art 150). *Prima facie*, this article reads as if labor claims are not suspended by the automatic stay and that they may go forward regardless of and in parallel to the qualification process in a separate proceeding to be carried out in a labor court. This matter is not entirely clear and we have not seen any recent precedents that clarify this issue.
37. Arts. 1,014 Et. Seq., Code of Commerce.
38. Arts. 1035 and 1036, Code of Commerce.



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He was honored with an award for "Outstanding Contribution to the Legal Profession" at the 2013 Chambers Latin America Awards for Excellence. According to *Chambers & Partners*, Mr. Italiani was selected for the prestigious award in recognition of "his business skills and legal expertise which have been of great benefit to national and multinational companies investing in the challenging economic climate of Venezuela." *Chambers & Partners* also mentioned that Mr. Italiani "handles some of the largest financing and M&A deals in the country" and "is particularly celebrated for his dedication to his clients and his ability to find creative solutions to the most challenging problems." Mr. Italiani has also been named one of "Latin America's Top 50 Legal Stars" by *Latin Business Chronicle*.

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Novel Structures to Solve Lengthy Liquidations in Brazil: The Banco Santos Case

By RAPHAEL NEHIN CORRÊA, LAURA MASSETTO MEYER, ANDRÉ MILESKI and RODRIGO YVES



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Given the remarkable events that took place in Brazil's financial and political scenarios within the last couple of years, notably the impeachment of former president Dilma Rousseff and the countless developments of Federal Police's Car Wash Operation (*Operação Lava Jato*) which involve high ranked politicians and businessmen, it comes as no surprise that, in the aftermath, the number of companies filing for judicial reorganization and bankruptcy liquidation or even having their bankruptcy liquidation requested by their creditors has grown significantly in Brazil. A survey conducted by the consulting firm *Serasa Experian* indicates that the requested filings for judicial reorganization proceedings in Brazil in 2016 increased 44.8% in comparison to 2015. Likewise, in 2016 there were 1,852 requested petitions for bankruptcy liquidation, against the already alarming number of 1,783 petitions requested in 2015.¹

Insolvency Statistics in Brazil – 2015-2016

	Judicial Reorganization Proceedings	Liquidation Proceedings
2015	1,287	1,783
2016	1,863	1,852

Source: Serasa Experian Study

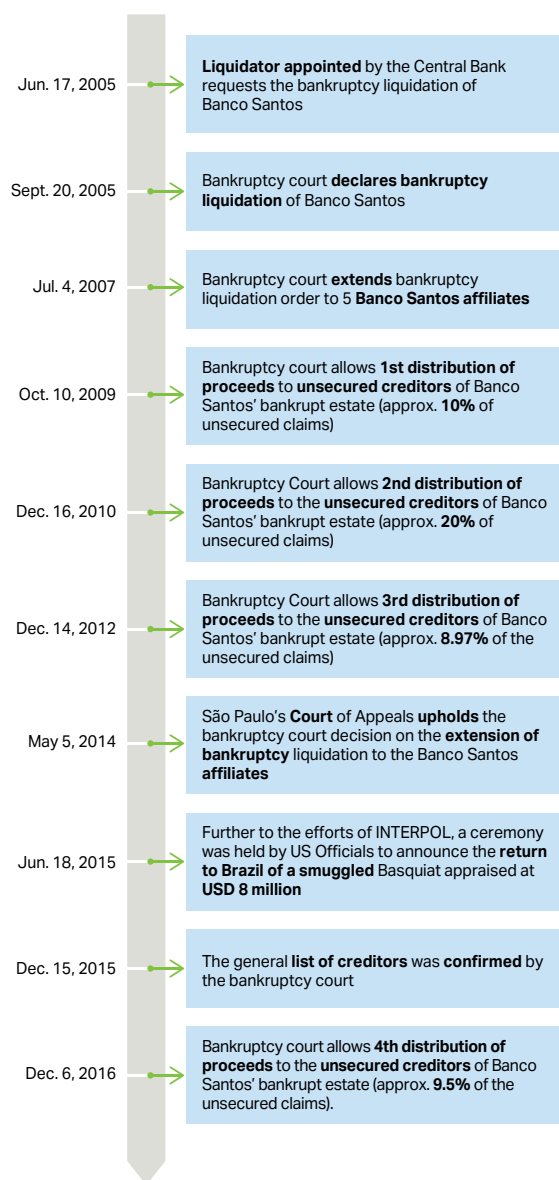
Against this backdrop, it has become increasingly necessary for creditors and debtors to negotiate outside-of-the-box solutions to overcome all sorts of issues related to bankruptcy liquidation proceedings before the Brazilian courts, from the lack of assets available to satisfy high levels of debt to the courts' backlog and countless procedural issues. One of the most remarkable ongoing proceedings on Brazil's track record thus far is the 12-year bankruptcy liquidation of Banco Santos S.A., a Brazilian medium-sized financial institution.²

The proceeding began on September 20th, 2005 when the 2nd Bankruptcy Court of Sao Paulo declared Banco Santos's bankruptcy, pursuant to the then-newly enacted Brazilian Bankruptcy Code of 2005. Ever since then, it has been one rocky road: criminal lawsuits against the former CEO of the bank, Mr. Edegar Cid Ferreira, internationally missing works of art (including an USD 8 million Jean-Michel Basquiat) and even the involvement of INTERPOL have marked this particular bankruptcy proceeding.

In spite of such setbacks, the court-appointed trustee has indeed managed to find, collect and appraise assets of Banco Santos's, as well as distribute the proceeds of their sales *pari passu* to the debtor's unsecured creditors. In December 2016, Banco Santos's bankrupt estate distributed approximately BRL 150.3 million (approximately USD 45.5 million)³ to the unsecured creditors, and since 2009 approximately 40% of the claims held by the unsecured creditors were paid through four distributions.

Now, on the verge of its twelfth anniversary, Banco Santos's bankruptcy liquidation is still pending: claims of all classes amounting to approximately BRL 2.1 billion (approximately USD 636 million) remain outstanding, the high maintenance costs of the court-appointed trustee (approximately USD 90,000 per month) continue to accrue, the search for hidden assets remains ongoing in Brazil and abroad, over 400 lawsuits (mostly enforcement and collection claims) against debtors with low chances of recovery remain unsettled, and the interventions of Mr. Ferreira himself⁴ and of some coordinated and

Key Dates in Banco Santos's Liquidation Proceeding: 2005-2016



Although the bankruptcy proceeding has been ongoing since 2005, the first payments to unsecured creditors only took place in 2009. Within the first years of the bankruptcy, all efforts were concentrated on procedural measures for enlisting of creditors, collection of assets and in-court discussions in connection with legal issues such as settlements between the bankrupt estate and its creditors, compensation, whether Mr. Ferreira should be held accountable with his own assets, amongst others.

independent blocks of creditors defending their own interests continue to permeate the proceedings.

Against this backdrop, earlier this year the Brazilian asset management company *Jive Investments*, a very active player in the distressed asset market in Brazil, has started a process

that could be a light at the end of the tunnel for Banco Santos's bankruptcy liquidation: an offer addressed to all holders of unsecured claims for the acquisition of all unsecured claims already confirmed by the bankruptcy court and included in the general list of creditors, which amounts to around BRL 1.8 billion (approximately USD 545 million – the “**Target Claims**”) held by approximately 2,000 creditors – which represent a significant amount of all outstanding claims of approximately BRL 2.1 billion. It is important to emphasize that, in spite of the assignment of claims within an insolvency proceeding being a common practice, a massive purchase of claims through an organized proceeding and overseen by a bankruptcy court in an effort to find a solution for a liquidation proceeding is indeed a novel mechanism.

Striving through a territory where others have previously failed (*Banco Paulista*, *Opus Gestora de Recursos* and *Credit Suisse*)⁵, Jive proposed a competitive and transparent proceeding, notably in order to avoid future challenges by the bankruptcy court, the Public Prosecutors' Office, creditors or other interested parties.

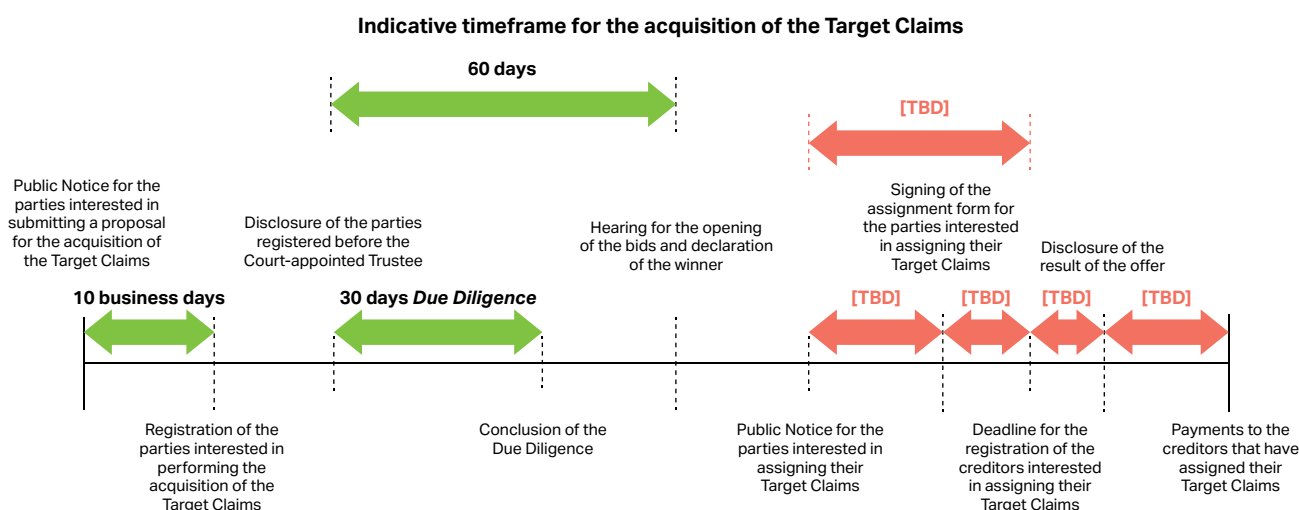
The outline of Jive's structure submitted before the bankruptcy court is relatively simple: any party interested in acquiring the Target Claims under the same terms and conditions proposed by Jive (except for the “haircut” level and payment term) will be able to submit its bid (after proper due diligence) in a competitive bidding process overseen by the bankruptcy court.

The bids will mainly be with respect to the different variations of payment terms and haircut towards the Target Claims. Hence,

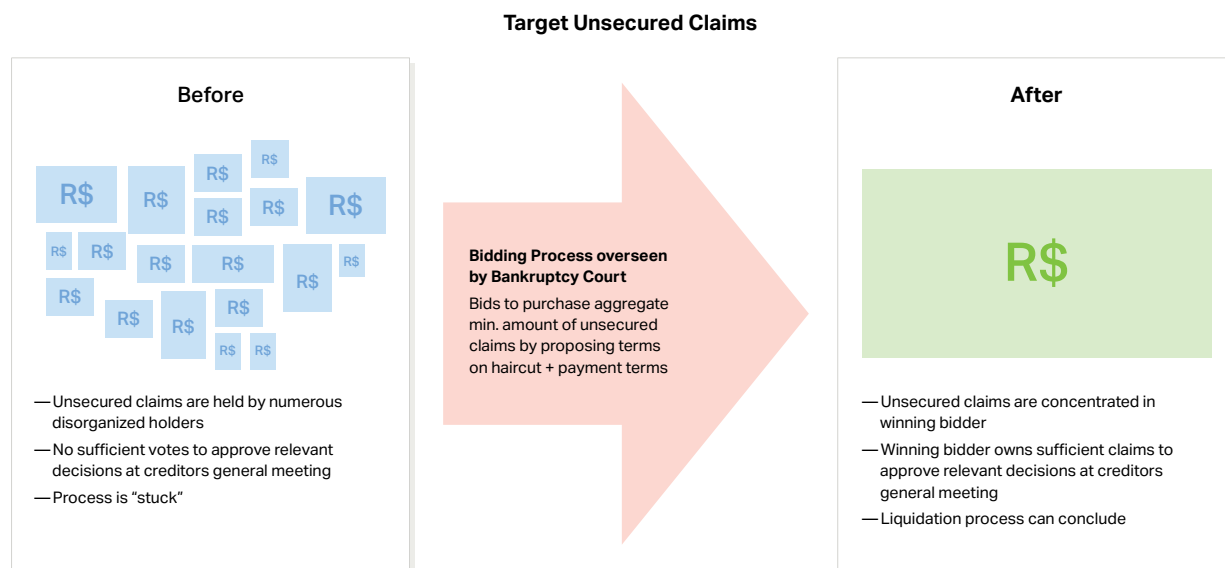
the party that offers the best payment conditions will be declared the winner of this competitive bidding process and thus allowed to launch an offer for the acquisition of the Target Claims within the original framework proposed by Jive (which shall comply with the further described timeframe). However, the completion of the offer may be conditioned to the acquisition of a minimum percentage of the Target Claims (the “**Minimum Amount**”). Secured or unsecured claims above the Minimum Amount that are not resolved will remain in the bankruptcy liquidation under its original conditions.

The party that succeeds in this competitive bidding process and manages to acquire the Minimum Amount will gain considerable influence over the bankruptcy proceeding with respect to all matters that are decided at the general meeting of creditors, even becoming able to approve alternative methods for the liquidation of assets — a solution that could result in the termination of the bankruptcy proceeding upon the approval of creditors representing two-thirds of the voting claims attending at the general meeting of creditors.

A structure that could be adopted for purposes of closing the bankruptcy proceeding is the incorporation of a civil law structure where assets are jointly owned (a “condominium”, which is a joint-ownership of assets (in rem) regulated by the Brazilian Civil Code, in which each holder (*condômino*) owns a notional fraction of such asset⁶), or the formation of Brazilian-regulated investment funds (e.g., credit rights funds, real estate funds, or equity interest funds) to which the Target Claims acquired would be transferred. Amongst other advantages,



[TBD] Deadlines to be determined in accordance with the terms of each party interested in performing the acquisition of the Target Claims.



moving claims outside of the bankruptcy process and utilizing this type of innovative structure would allow the acquirer of the Target Claims to liquidate the assets of Banco Santos's estate with much more flexibility and without the excess of formality inherent to the bankruptcy proceedings in general.

The initiative sponsored by Jive is still on its early stages and it may be subject to some adjustments along the way. Although expectations are high, there will be certainly challenges ahead, including obtaining the approval by the bankruptcy court, dealing with labor and tax claims, discussing terms with interested parties, reaching the Minimum Amount and contending with opposing parties.

Currently, the bankruptcy court has rendered a procedural order allowing all interested parties to submit comments and concerns on Jive's initial proposal. Further, the bankruptcy court has also ordered the Public Prosecutor's Office to submit its opinion as to whether or not the competitive bidding process should be indeed authorized.

In spite of its initial stage and of the long road ahead, this is clearly a noteworthy initiative that offers an optimistic prospect for the Banco Santos's creditors and the bankruptcy court, due to its realistic potential of both satisfying unsecured creditors

on a short-term basis and finally bringing closure to a proceeding that has been lingering before the Brazilian courts for the past 12 years. Moreover, if such structure is successfully implemented, it will have a positive impact in mitigating the stigma that a liquidation proceeding is a never-ending nightmare in Brazil with near-to-zero chances of recovery for most of the creditors, mainly unsecured creditors, once the resolution to Banco Santos's bankruptcy liquidation becomes a leading precedent in terms of investments in distressed assets under a court supervision for bankruptcy proceedings in Brazil. ■

1. The survey results can be accessed at <http://noticias.serasaexperian.com.br/blog/2017/01/03/recuperacoes-judiciais-batem-recorde-historico-em-2016-revela-serasa-experian/>.
2. Lefosse Advogados represents Jive Investments in connection with Banco Santos's liquidation proceeding.
3. Exchange rates used for calculations herein are as of July 3, 2017 (BRL:USD equal to 0.3029).
4. Mr. Ferreira has filed motions and appeals challenging several aspects of the bankruptcy proceeding, notably those related to the disposition of assets (e.g., auctions and appraisal of assets, the trustee's fees, settlements between the bankruptcy estate and its creditors, etc.).
5. These parties have proposed sophisticated structures aiming at managing Banco Santos's portfolio of lawsuits, through funds or civil condominiums. Creditors then chose the proposal made by Credit Suisse. However, the bankruptcy court annulled such option under the argument that this structure could allow Mr. Ferreira to receive assets from the bankruptcy estate even before all unsecured claims were paid.
6. In the Brazilian legal system, condominium does not have itself legal personality, but it may assume duties and obligations, as well as sue and be sued.



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Insolvency Reform in Brazil: An Opportunity Too Important to Squander

by RICHARD J. COOPER, FRANCISCO L. CESTERO and DANIEL J. SOLTMAN



When Brazil enacted its new insolvency regime in 2005 (Law No. 11.101/05, the “Brazilian Bankruptcy Law”), it was heralded as the most modern in Latin America and a significant improvement for creditors.¹ However, Brazil continues to lag behind its neighboring countries in terms of successful reorganizations and remains a decidedly debtor-friendly jurisdiction.² There are a number of reasons for this, including the general absence of a dedicated judiciary with expertise in insolvency matters,³ the fact that liquidation is not a viable alternative for creditors given the time, expense and destruction of value that it entails, the lack of an absolute priority rule to guide recoveries under judicial recovery plans, the failure of courts overseeing the *recuperação judicial* process to require that debtors affirmatively and timely move the restructuring process along within finite time periods and provide sufficient information to creditors during the pendency of the process for the purpose

of evaluating potential recoveries as well as possible claims against third parties that could bring value to the estate (often such claims are against affiliates of the debtor), the potential liability for creditors that seek to play an active role in the *recuperação judicial* process or even to vote against a plan and the weak or ineffective institutional protections embedded in the law (formal creditor committees, the Judicial Administrator, etc.) to protect creditor interests.

Selected Key Difficulties For Creditors In Brazilian Restructurings

- **Debtors maintain permanent exclusive right to file a plan of reorganization**
- Liquidation is often not a viable alternative
- Lack of absolute priority rule
- Lack of enforceable deadlines requiring the debtor to move the process forward
- Inadequate disclosure and reporting obligations for debtors
- Potential liability for creditors that take an active role in the process
- Weak or ineffective institutional protections embedded in the law
- Practical difficulties for bondholders in ensuring their rights to vote

However, perhaps the largest reason that Brazil remains such a debtor-friendly jurisdiction is that the debtor maintains the exclusive right to present plans of reorganization throughout the entire *recuperação judicial*⁴ process (i.e., creditors do not have the ability to put forward a plan of reorganization for a creditor vote). By the time a debtor does put forward a real and complete plan of reorganization for a creditor vote, creditors are often left with a “take-it-or-leave-it” scenario, where voting against the plan would force the company into liquidation (a slow-moving, costly, non-transparent and value destructive process that leaves all parties worse off), but voting for the plan leaves creditors with an unsatisfactory outcome, often from both a creditor-recovery perspective and with respect to the operational prospects of the reorganized debtor.

Under the Brazilian Bankruptcy Law, the debtor’s exclusive right to propose plans of reorganization was to be counterbalanced by a number of defined creditor protections, including, among others, the right to enforce fiduciary liens notwithstanding the stay imposed by the *recuperação judicial* process, definitive and non-extendable deadlines for the reorganization process, complete, timely and effective information sharing,

working creditor committees, the right to challenge pre-petition transactions that may be fraudulent or preferential and the unequivocal right to reject a plan of reorganization without liability. However, the application of the law has gradually and increasingly deprived creditors of these protections while keeping intact the debtor’s exclusive right to present plans of reorganization. The debtor’s exclusive right to propose a plan, when combined with the unpalatable nature of the Brazilian liquidation procedure and the erosion of creditor protections during the pendency of the *recuperação judicial* proceeding, has clearly tilted the restructuring landscape even further in the favor of the debtor and its shareholders. While the stated purpose of the law was to promote the reorganization of companies, the consequence of the application of this exclusive right, together with the weakening of creditor protections, has been to strengthen the leverage of shareholders to the detriment of fast and effective reorganization proceedings, often leaving the few companies that do recover with the same set of issues (and management and governance) that led them to file for *recuperação judicial* in the first place.

Recently, at least partly in response to Brazil’s recent recession⁵ and the rising number of bankruptcies in Brazil in the wake of the *Lava Jato* scandal, the Brazilian government has announced plans to reform the Brazilian Bankruptcy Law, with an intention to focus on shortening the average period that a debtor remains in bankruptcy, enhancing options for debtor in-possession financing and making the asset sale process easier. Any reforms should squarely address the imbalance of power that currently exists in favor of debtors in *recuperação judicial* proceedings, as only this will create the adequate framework to promote and accelerate effective reorganizations. Accordingly, when evaluating potential modifications to the existing Brazilian Bankruptcy Law,⁶ legislators would be wise to not only address some of the issues mentioned above but also to reconsider the debtor’s exclusive right to present plans of reorganization, as the ability of creditors to propose creditor-led plans has proven to be a very effective tool for many successful reorganization systems around the world.

The remainder of this article is divided into four parts. *Part 1* offers an overview of the Brazilian *recuperação judicial* process and a deeper explanation as to the features of the current regime that have caused it to be so debtor-friendly; *Part 2* provides a brief overview of the existing framework in the

United States and the state of play in selected other Latin American jurisdictions with respect to plan exclusivity; *Part 3* puts forward a proposal for reform in this area in Brazil; and *Part 4* offers a brief conclusion.

Part 1 – The Imbalance of Power In Recuperação Judicial Proceedings

Lack of Meaningful Deadlines

Creditors in *recuperação judicial* proceedings are disadvantaged from the outset because the deadlines imposed by the Brazilian Bankruptcy Law do very little in practice to influence the debtor’s behavior, and their position only becomes more difficult as the proceeding progresses, given the limited other options for creditors to meaningfully influence plan development aside from voting against one *after* it has been finally submitted for a vote.

Upon the filing of a *recuperação judicial* petition, the Brazilian Bankruptcy Law imposes three key deadlines designed to move the proceedings forward at a reasonable pace: (i) a plan must be filed within 60 days after the court’s order accepting jurisdiction over the proceedings;⁷ (ii) a creditor vote on a plan must be held within 150 days of the court’s order accepting jurisdiction over the proceedings (the meeting at which such vote takes place, the “General Meeting of Creditors”, or “GMC”);⁸ and (iii) the automatic stay that applies with respect to creditor actions against a debtor’s assets will terminate 180 days after the court’s order accepting jurisdiction over the proceedings.⁹ While these deadlines would seem to give some structure to the proceedings by imposing a series of interim deadlines and an outside date after which the balance of power might shift back to creditors, in practice, these deadlines are either unenforceable or extended as a matter of course.¹⁰

For example, with respect to the initial 60-day plan filing deadline, due to the clear mandate in the Brazilian Bankruptcy Law that such deadline is “non-extendable” and the statutorily imposed penalty of liquidation if no plan is on file, debtors often file plans with minimal detail (or “shell” plans) that they do not intend to put to creditor vote, but instead are filing simply to meet the statutory requirement. Although such plans are often brazenly one-sided, filed without consultation with creditors and arguably non-compliant with the Brazilian Bankruptcy Law requirement that the plan include “a detailed description of the means of reorganization to be used”, courts rarely, if ever, will impose consequences relating to the quality of the first plan filed.

Similar issues arise with respect to holding the GMC. *First*, the law does not provide, and thus courts will not impose, any consequence if a GMC is not held within the 150-day window. *Second*, and relatedly, in practice, regardless of when a GMC is

first scheduled, a debtor will typically adjourn the vote as many times as necessary until it believes that it has sufficient votes for plan approval.¹¹ These barriers to meaningful enforcement make the 150-day deadline for holding a GMC aspirational at best.

The 180-day stay termination deadline is no more of a stick for the debtor than the 60-day plan filing deadline or the 150-day GMC deadline. Notwithstanding that the Brazilian Bankruptcy Law states that the term of the stay is “non-extendable” and there would be real consequences for the debtor if the stay was not extended (i.e., creditors would likely bring actions against it immediately), in practice, the stay is usually extended as a matter of course. While the judicial standard for granting an extension is generally that the delay not be attributable to the debtor’s conduct, the standard is applied in very liberal and debtor-friendly terms.¹²

Erosion of Creditor Protections in Brazil

Brazilian Bankruptcy Law Text	Recuperação Judicial In Practice
A plan must be filed within 60 days after the court’s order accepting jurisdiction over the proceedings, and such deadline is “non-extendable”	Debtors often file “shell” plans that they do not intend to put to a creditor vote, but instead are simply to comply with the statutory requirement
A creditor vote on a plan must be held within 150 days after the court’s order taking jurisdiction over the proceedings	Even where scheduled within the 150-day window, GMC votes are typically adjourned as many times as necessary until the debtor believes it has sufficient votes for plan approval
The stay with respect to the debtor’s assets terminates 180 days after the court’s order taking jurisdiction over the proceedings, and such deadline is “non-extendable”	Notwithstanding that it is by its own terms “non-extendable”, the stay with respect to the debtor’s assets is extended in nearly 30% of <i>recuperação judicial</i> cases

The lack of meaningful deadlines is an unfortunate trend, because it demonstrates an erosion of a number of principles in the Brazilian Bankruptcy Law clearly designed to protect creditors (e.g., a debtor should begin negotiations with its creditors and develop a plan early on, debtors cannot be shielded from their creditors forever, etc.). Indeed, the matter of course stay extensions are particularly troubling, because it would appear to be in direct contravention of the plain language of the Brazilian Bankruptcy Law.¹³



Consequently, until the GMC, when creditors are provided with an opportunity to vote on a plan of reorganization, absent holding a position that is sufficiently large so a plan cannot be confirmed without them (which in turn raises concerns of abusive power and potential disregard of voting rights), there is often very little that creditors can do to pressure the company into meaningful negotiations or move the restructuring along at a quicker, value-preserving pace.¹⁴ To the contrary, absent unusual circumstances, debtors are mostly free to pursue the restructuring at their own pace and present a plan of reorganization on their own timeline.

Unfavorable Cramdown Rules

Compounding the balance of power issue, the applicable voting rules at the plan approval and confirmation stage only provide creditors with limited bargaining power. The Brazilian Bankruptcy Law provides for only four classes of creditors: labor, secured, unsecured and small companies. A plan is approved at the GMC if (all metrics are with respect to those actually present and voting at the GMC):¹⁵

- A majority in number of labor creditors vote in favor of the plan;
- A majority in number of small company creditors vote in favor of the plan;
- A majority in number of secured creditors and a majority in amount of secured claims vote in favor of the plan; and
- A majority in number unsecured creditors and a majority in amount of unsecured claims vote in favor of the plan.

Even if every class does not approve of the plan, a plan may be crammed down on a class if (all metrics are with respect to those actually present and voting at the GMC):¹⁶

- Three out of the other four classes approve the plan as described above;¹⁷

- A majority in amount of all claims vote in favor of the plan;
- More than one-third (in number for labor and small company and in both number and amount for the secured and unsecured classes) in the dissenting class vote in favor of the plan; and
- There is equal treatment among creditors in the dissenting class.¹⁸

Although the thresholds for approval and protections against cramdown are in some ways substantively similar to those in the United States, one important protective aspect present in the United States that is missing in the Brazilian regime is the absolute priority rule (or some variant of it), which provides, in brief, that in order for a plan to be crammed down on an unsecured class, for any given class of unsecured creditors, either (A) the unsecured class must be paid in full or (B) no class of claims or interests (i.e., equity) junior to such unsecured class shall receive any distribution on account of their prepetition claims or interests. The absolute priority rule is designed to prevent the company's equity holders from retaining the reorganized company's value by cramming down a plan on the company's prepetition unsecured creditors.

In Brazil, not only can debtors typically control the content and timing of submission of their reorganization plans, they can also cram down on a large dissenting class with the support of only one-third of such class, and can do so without any obligation to propose a plan that adequately compensates creditors for their sacrifices in a reorganization with any potential future value created as a result of such sacrifices.¹⁹ This problem is compounded by the difficulties and expenses faced by bondholders that wish to vote in reorganization proceedings, resulting typically in a low turnout at the GMC and increased risk of cramdowns.²⁰

It is important to make clear that the absolute priority does not prohibit shareholder recoveries. In fact, the U.S. Bankruptcy Code allows for confirmation of a *consensual* plan that pays unsecured creditors less than the full value of their claims but provides some recovery to equity, and there are judicially fashioned exceptions to the absolute priority rule to address situations where the results of the rule would be found inequitable, such as when equity holders provide post-petition “new value” in furtherance of the restructuring. In practice, in the U.S. the absolute priority rule principally serves to set a starting point for debtor and creditor negotiations, where the legislated presumption is that equity holders’ recoveries should be subordinated to creditor recoveries and shareholders are motivated to make the case as to why that should not be the case in any particular situation. Its absence in Brazil means that the starting point, and all too often the ending point, of any creditor negotiation is that the equity of the debtor is largely left intact.

Part 2 – Frameworks From Other Jurisdictions

United States

In contrast to Brazil, the United States has long imposed a balanced framework, which provides the debtor with an initial period of plan exclusivity, but gives creditors significant rights to intervene when appropriate progress is not being made.

Upon filing for Chapter 11 in the United States, the U.S. Bankruptcy Code provides an initial period of 120 days (the “*Initial Exclusivity Period*”) during which a debtor retains the exclusive right to file a plan of reorganization.²¹ The debtor may, “for cause,” make a motion to extend exclusivity beyond the Initial Exclusivity Period, and similarly, any party in interest may, “for cause,” make a motion to terminate exclusivity at any time (in either case, such motions are upon notice and hearing, and may be opposed by parties in interest²²).^{23 24}

As noted above, the debtor’s exclusivity may be extended beyond the Initial Exclusivity Period (and, in practice, is often extended more than once), but can never be extended beyond 18 months after the bankruptcy filing date.²⁵ Once the debtor’s exclusivity has terminated (either by statute or upon motion), any party in interest, including creditors, equity holders or otherwise, may file a plan of reorganization with the court. It is not uncommon for there to be competing plans of reorganization on file with a court in a Chapter 11 proceeding, though a court will typically not allow both to be simultaneously solicited for approval.

In practice, the ability of creditors to object to the debtor’s motion(s) to extend exclusivity, file motions to terminate exclusivity and submit competing plans of reorganization have

all been important leverage points in plan negotiations, which have frequently proven helpful in fostering the development of fair and equitable plans of reorganization, and perhaps more pertinent to the case at hand, fast and successful reorganizations.

Contrary to what some may expect, the right of creditors to propose plans of reorganization has not made debtor-proposed plans irrelevant. Debtor-proposed plans are still the norm in the United States, and the law protects debtors that indeed negotiate in good faith and fulfill their obligations. For example, if the debtor files a plan of reorganization during its exclusivity period (either the Initial Exclusivity Period or pursuant to an extension as discussed herein), the debtor is automatically provided with an additional two months to solicit votes on such plan, during which period no other party may file a competing plan. As with the absolute priority rule, the principal consequence of the right of creditors to propose plans of reorganization has been to incentivize good faith negotiation among the parties and confirmation of consensual plans of reorganization.

Argentina and Mexico

Other Latin American jurisdictions have also adopted limited exclusivity concepts, and in many cases, these frameworks have helped to help implement a balance of power between debtors and creditors. For example, under Argentina’s *concurso preventivo* regime, a debtor has an initial 90 business day period (running from the date upon which the court approves the debtor’s proposed classification of creditors) to formulate its plan of reorganization for unsecured creditors, which period is extendable for up to 30 business days at the court’s discretion.²⁶ Following the exclusivity period, if no debtor-proposed plan has been confirmed, either by class approval or by way of cramdown,²⁷ rather than move immediately to liquidation, creditors or other third parties may file a petition in court indicating their interest in acquiring the shares of the debtor and presenting an alternative plan of reorganization. During this period, the debtor may also propose modifications to its prior plan, or any proposed by creditors or other third parties, and seek creditor approval. If an alternative plan obtains the required creditor approval, the law contemplates the mandatory transfer of the shares of the debtor to the alternative plan proponent at a judicially approved valuation. Similarly, in Mexico’s *concurso mercantil* regime²⁸ during the first 185 days (extendable up to 90 days no more than twice) (the “*Reorganization Phase*”)²⁹, a court-appointed mediator (a *conciliador*) facilitates a discussion between the debtor and its court-recognized creditors³⁰ seeking an agreement on the restructuring with an aim of preserving the debtor as a going concern. If no plan is confirmed³¹ by the end of the Reorganization Phase, a liquidation results.³² The hard one-year deadline for approving a plan of reorganization effectively forces a negotiation among the parties and serves to incentivize debtors and creditors to work together to develop a consensual plan.³³

Part 3 – Proposal For Reform

With this background, the authors would propose that, whatever other reforms that the legislature may be considering to the Brazilian Bankruptcy Law, it adopt the following minimum reforms (the “Proposed Reforms”):

Proposed Reforms

- Eliminate the 60-day plan-filing deadline;
- Instead, provide the debtor with an initial exclusivity period of 90 days³⁴ (measured from the date on which the court accepts jurisdiction over the case) in which it alone may file a plan of reorganization (the “Initial Brazilian Exclusivity Period”);
- After the Initial Brazilian Exclusivity Period, allow for three additional exclusivity extensions,³⁵ each of up to 90 days (the “First Extension”, the “Second Extension”, and the “Third Extension”, respectively, and the entire period through which the debtor retains exclusivity, the “Brazilian Exclusivity Period”):
 - The First Extension and the Second Extension must be for cause and on notice to the bankruptcy court and can be opposed by parties in interest.
 - The Third Extension must also be for cause and on notice to the bankruptcy court and can be opposed by parties in interest, but will also only be granted if the debtor can demonstrate the support of 25% of its total third-party creditors by amount.
- At any point during the Brazilian Exclusivity Period, a party in interest may make a motion to terminate exclusivity for cause.
- At the end of the Brazilian Exclusivity period (whether at the end of day 360 or because it has otherwise been not extended or terminated before that), any party in interest may file a plan and seek to present it for a vote at the general meeting of creditors.³⁶
- As in the United States, if a debtor proposes a complete and good-faith plan within the established deadline, the debtor could be granted limited additional time to complete the approval process by the court.

This proposal combines some of the most important elements from other jurisdictions that contemplate creditor-led plans, such as an initial exclusivity period, opportunities to gradually extend it or terminate it early, and conditioning at least one subsequent extension on a threshold level of creditor support. Although this proposal would not directly solve many of the issues identified (e.g., unenforced deadlines, consistent stay

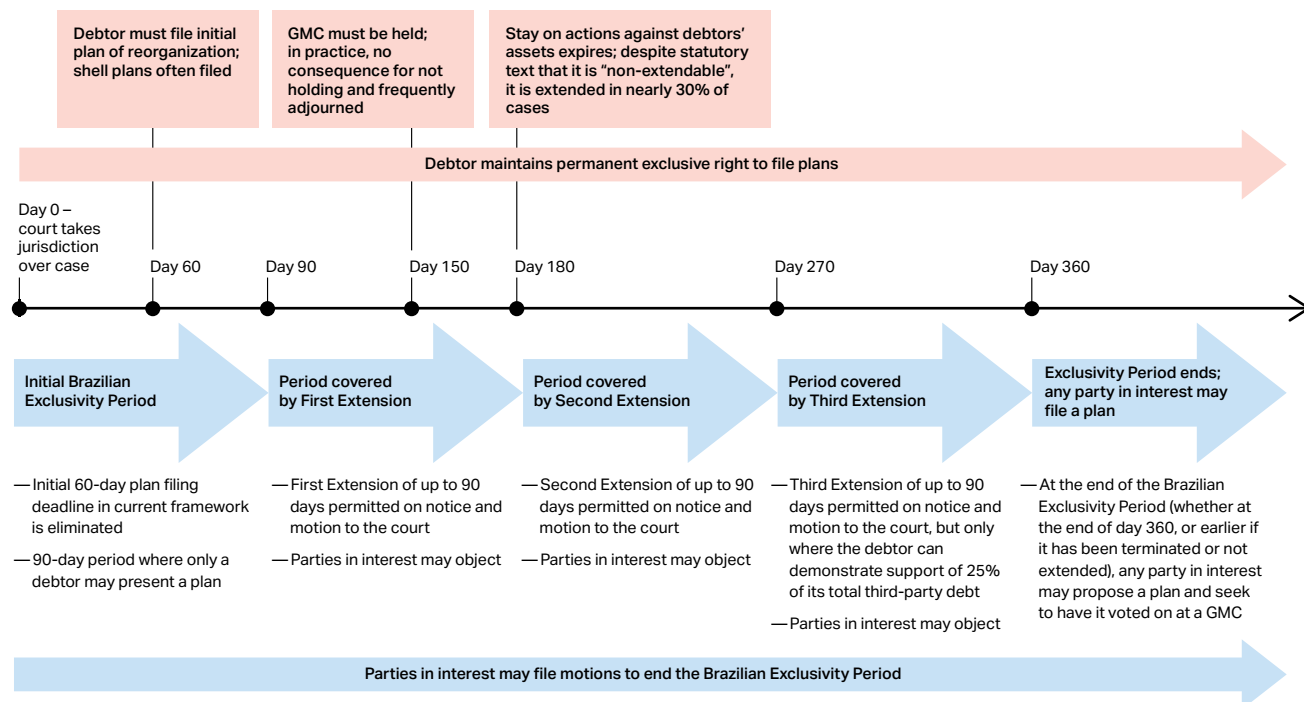
extensions, etc.), allowing creditor proposed plans in Brazil could substantially mitigate their impact and shift the balance of power back toward creditors in a way that will help make the entire regime more effective.

Needless to say, there are multiple alternatives to solve the central problem raised by this article, and many of the specifics of our proposal can be adjusted without materially altering its expected results. That said, creditor-led plans have proven to be a very useful and effective tool to promote fast and successful corporate reorganizations in many jurisdictions, and the idea deserves careful consideration in Brazil. The system, as is, does not work, and statistics show that. Some commentators have raised concerns that creditor-led plans may be unfair to shareholders who have continued exposure to the enterprise after its exit from reorganization proceedings. In our experience this concern is overstated — it is the rare case where creditor recoveries are so bloated that equity holders can rightfully claim that, even without creditor sacrifices, the company would have survived and prospered. Indeed, most often companies that thrive post reorganization do so because of the sacrifices that their creditors have made as part of the restructuring process (typically by deleveraging the company) and/or changes the debtor has made to its business plan and strategy and new money or management that it has brought in as a result of the reorganization. Furthermore, many of these concerns could be addressed, at least partially, in the plans themselves or as part of the proposed reforms (such as the release of non debtors). Finally, to state the obvious, leaving control of a troubled enterprise in the unfettered hands of the same controlling shareholder(s) that led it to problems is generally not the answer.

Part 4 – Conclusion

Although admittedly a creditor-friendly proposal in that it advocates shifting the power dynamic back toward creditors away from debtors, the Proposed Reforms would, in fact, benefit both creditors and debtors. For instance, allowing creditor-proposed plans would incentivize boards of directors to consider their relationships with creditors and a path to confirmation *before* filing, and to work with their creditors to develop consensual plans in good faith. Consequently, fully consensual plans would be more likely. In addition to making consensual plans more likely, the Proposed Reforms could also serve to incentivize creditors to make debtor in possession (“DIP”) loans in a way that they were not previously incentivized to do (particularly on a true emergency basis before a plan has been fully agreed to, DIP lenders can take comfort in the fact that creditors are likely to have strong voice in negotiating the plan that is ultimately confirmed). Moreover, the Proposed Reforms would fit within the stated goals of the Brazilian insolvency reforms — by allowing creditor-proposed plans, it would lessen the chances that a debtor would sit in insolvency

Current Framework



Authors' Proposed Reforms

Note: As set forth in footnote 36, the authors recognize that additional corresponding reforms may be necessary and/or advisable.

proceedings without taking action for an extended period, in turn ultimately bringing the proceedings to a speedier (and hopefully consensual) resolution.

Finally, following a three-year recession in Brazil, it is also important to consider the macro-level impact of shifting power toward creditors and, specifically, the Proposed Reforms. The wave of recent bankruptcies has made investors weary and made it more difficult for Brazilian companies to access international markets. Increased protection against downside risk by implementing greater protections for creditors in *recuperação judicial* proceedings may incrementally decrease the cost of borrowing internationally, and in a time where Brazil's economy needs bolstering, it would be in the public interest to enact reforms that may do just that. ■

1. In many ways, it has been an improvement. For example, average creditor recoveries have improved from .2%, in the previous regime, see Jeffrey M. Anapolsky and Jessica F. Woods, *Pitfalls in Brazilian Bankruptcy Law for International Bond Investors*, 8 J. Bus. & Tech. L. 307 (2013), to over 15%, see World Bank Doing Business 2017, *Resolving Insolvency in Brazil (Rio de Janeiro)*, available at <http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>. Assumptions and methodology with respect to the World Bank Doing Business statistics are available at <http://www.doingbusiness.org/methodology/resolving-insolvency>.
2. In addition to low average creditor recoveries as noted above, the average proceeding in Brazil can take several years to resolve. A recent study in Brazil found that the average time between the court's order accepting jurisdiction over the *recuperação judicial* proceeding and a creditor vote on a plan of reorganization was 507 days (nearly a year and a half). See <http://www.tjsp.jus.br/Noticias/Noticia?codigoNoticia=44867> (the "Insolvency Observatory Study"). Even where a speedy consensual resolution is reached, a debtor remains subject to the court's jurisdiction for 2 years after plan confirmation, during which time the failure to meet obligations as provided for under a plan can result in liquidation. See Brazilian Bankruptcy Law art. 61. Liquidation proceedings in Brazil take even longer than *recuperação judicial* proceedings. In a recent example, Banco Santos S.A.'s liquidation proceeding, commenced in 2005, remains unresolved and incomplete 12 years later.
3. Although there are bankruptcy courts in São Paulo and commercial courts in Rio de Janeiro, there is no nationwide dedicated bankruptcy judiciary.
4. The Brazilian Bankruptcy Law provides for three types of proceedings: *recuperação judicial* (in-court reorganization, analogous to a U.S. Chapter 11 proceeding); *recuperação extrajudicial* (out-of-court reorganization, a type of pre-packaged restructuring option) and *falência* (liquidation).
5. Brazil's GDP growth of just over 1% in the first quarter of 2017 marked the first quarter of GDP growth since 2014. While some analysts see this as a sign that Brazil is emerging from its three-year recession, others have noted that the growth in Q1 2017 was primarily due to growth in the agriculture sector and are not confident that the upward trend will continue across Brazil's economy.



6. The authors, as well as Brazilian practitioners, have recently published other articles regarding potential reforms to the Brazilian insolvency regime. See Richard J. Cooper, Francisco L. Cestero, Jesse W. Mosier and Daniel J. Soltman, *The Brazilian Insolvency Regime: Some Modest Suggestions – Part 1*, *Pratt's Journal of Bankruptcy Law* (February/March 2016); Richard J. Cooper, Francisco L. Cestero, Jesse W. Mosier and Daniel J. Soltman, *The Brazilian Insolvency Regime: Some Modest Suggestions – Part 2*, *Pratt's Journal of Bankruptcy Law* (April/May 2016); Giuliano Colombo and Thiago Braga Junqueira, *Ten Years of the Brazilian Bankruptcy Law: Some Lessons Learned and Some Wishes For Improvement*, *Cleary Gottlieb Emerging Markets Restructuring Journal*, Issue No. 1 (Spring 2016) (discussing suggested reforms to debtor in possession financing, asset sales and creditor-submitted plans).
7. See Brazilian Bankruptcy Law art. 53.
8. See *id.* art. 56, ¶ 1.
9. See *id.* art. 6, ¶ 4.
10. Additionally, although the Brazilian Bankruptcy Law refers to calendar days rather than business days, recent changes in Brazilian non-bankruptcy have spurred a trend among courts to begin counting applicable deadlines under the Brazilian Bankruptcy Law in business days, thus decreasing the impact of the deadlines even if they were enforced.
11. This is because the consequence of creditors voting against a plan is liquidation for the debtor and liquidations in Brazil are mired with problems and delays. See Brazilian Bankruptcy Law art. 56, ¶ 4.
12. In fact, the Insolvency Observatory Study found that the stay was extended in nearly 30% of *recuperação judicial* cases.
13. Anecdotal, the first year of Oi S.A.'s *recuperação judicial* proceeding has followed this path. The company filed for bankruptcy in June 2016, filed a shell plan in September 2016 and has yet to submit a credible plan or set a date for a general meeting of creditors more than a year after filing (as of August 1, 2017). Cleary Gottlieb represents the Steering Committee of an Ad Hoc Group of bondholders in connection with Oi S.A.'s restructuring.
14. Indeed, even where creditors are proactive throughout the process and in the Brazilian court, they face a number of risks, ranging from potential liability if they chose to sit on a creditors' committee to recent decisions holding that creditors' behavior was "abusive".
15. See Brazilian Bankruptcy Law arts. 41, 45.
16. See *id.* art. 58.
17. Until recently (when the small companies class was added), the Brazilian Bankruptcy Law only provided for three classes of claims. Unfortunately, when the small companies class was added, the provisions relating to cramdown were not amended correspondingly. As a result, Brazilian Bankruptcy Law art. 58, ¶ 1(III) still refers to a requirement of "approval of two (2) of the classes of creditors present . . . or if there are only two (2) classes with voting creditors, the approval of at least one (1) of them". Reputable scholars have differing views as to whether a class may be crammed down when only two classes approve of the plan, or whether by three out of four classes are required to cram down the fourth.
18. In practice, a "menu" of options is also possible under certain circumstances, provided that the various options offer reasonably equivalent recoveries.
19. A particularly alarming cramdown example recently occurred in Grupo Schahin's *recuperação judicial* proceeding. In short, a secured creditor with claims large enough to prevent cramdown had its vote disregarded at the GMC because the court found it was behaving "abusively" (an ill-defined and judicially created concept) based in part on the fact that the plan would have provided the creditor with a higher recovery than in liquidation (the statutorily mandated result of creditors not approving a vote at the GMC). This is a concerning precedent because it effectively amounts to the court superimposing its own commercial judgment on creditors and disenfranchising creditors when the court comes to a different commercial conclusion.
20. See Francisco L. Cestero and Daniel J. Soltman, *The Fight for Bondholder Suffrage in Brazilian Restructurings*, *Pratt's Journal of Bankruptcy Law* (January 2016) (discussing, *inter alia*, the risk of bondholders not being able to vote at GMCs).
21. See 11 U.S.C. § 1121(b) ("Except as otherwise provided in this section, only the debtor may file a plan until after 120 days after the date of the order for relief under this chapter.").
22. See 11 U.S.C. § 1121(d).
23. See 11 U.S.C. § 1121(d)(1).
24. "Cause" is not defined in the U.S. Bankruptcy Code, but courts have generally employed a totality of the circumstances analysis and analyzed factors such as the size and complexity of the case, whether the debtor has made progress negotiating with creditors, whether the debtor is proceeding in good faith, etc.

25. See 11 U.S.C. § 1121(d)(2)(A) ("The 120-day period specified in paragraph (1) may not be extended beyond a date that is 18 months after the date of the order for relief under this chapter.").
26. See *Ley de Concursos y Quiebras*, Ley 24.522 art. 43.
27. With respect to unsecured creditors, a plan is deemed approved by creditors if it is approved by a majority in number and 2/3 in amount of creditors in each class. See *id.* art. 45. With respect to secured creditors (to the extent applicable), 100% class consent is required (though secured creditors can opt to renounce 30% or more of their security interest and have their debt bifurcated into secured and unsecured claims). See *id.* art. 43. However, even without class approval, a plan may be confirmed if (i) the plan was approved by both (a) at least one impaired class of unsecured creditors and (b) unsecured creditors representing at least three-fourths of the aggregate outstanding unsecured claims voting on the plan, (ii) the plan provides at least liquidation value to creditors and (iii) the plan does not provide for discriminatory treatment among classes. See *id.* art. 67.
28. See *Ley de Concursos Mercantiles y de Reforma al Artículo 88 de la ley Orgánica del Poder Judicial de la Federación (última reforma publica 1/10/2014)* (the "Mexican Concurso Law").
29. The first 90-day extension may be requested by the *conciliador* (if it believes the parties are close to reaching an agreement) or creditors representing 50% of the recognized claims in the proceeding. The second 90-day extension may be requested by the debtor together with 75% of the recognized claims in the proceeding. See *id.* art. 145.
30. The *conciliador* is also responsible for making proposals with respect to which claims will be recognized in the proceeding.
31. A plan may be confirmed if it is approved by a majority of all voting creditors (subject to certain limitations on the voting power of intercompany claims). See Mexican Concurso Law art. 157. However, a plan can be vetoed by a majority in amount of unsecured creditors voting (excluding intercompany claims). See *id.* art. 163.
32. See *id.* art. 145.
33. The reorganization laws of Colombia also grant creditors the power to present plans of reorganization.
34. The framework for the Proposed Reforms assume that the relevant deadlines will in fact be counted in calendar days, notwithstanding the recent trend in Brazil to count in business days. See *supra* footnote 10.
35. The authors have not in this article proposed specific standards for the extensions or termination of exclusivity, but would suggest something similar to the U.S. system, where courts employ a totality of the circumstances analysis and will grant relief for "cause". See *supra* footnote 24.
36. The authors recognize that corresponding changes may need to be made elsewhere in the Brazilian Bankruptcy Law in order to account for creditor proposed plans. For example, the Brazilian Bankruptcy Law would likely need to be changed to provide for a result other than liquidation if a creditor-proposed plan was not approved at a GMC in order to avoid creditors having unchecked power to force a vote that they know will not be approved and force the debtor into a liquidation. Moreover, as a trade-off for legislation that encourages shareholders of debtors in recuperação judicial to negotiate with creditors, Brazilian legislators may also be wise to consider amendments to art. 49 of the Brazilian Bankruptcy Law, which prohibits releases of non-debtors. Specifically, the legislature may want to consider creating a limited carve-out that would allow individual shareholders to be released from guarantees as part of a confirmed plan of reorganization. Absent such a change, such shareholders (particularly where they have a controlling interest and cooperation may be necessary for plan consummation at least from a corporate law perspective) may not be sufficiently incentivized to work collaboratively with creditors, as they could not be personally released as part of a plan. The authors do not purport to address every such corresponding change, but instead simply note that the impact of the Proposed Reforms must be carefully considered.



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The Intersection of Derivatives and Insolvency under Mexican Law

By EUGENIO SEPÚLVEDA



The Mexican Insolvency Law, or *Ley de Concursos Mercantiles*, allows for the termination and closing out netting of individual and multiple derivative transactions under the relevant framework agreements, and the application of certain collateral to the payment thereof, upon a party's insolvency.

Financial Derivatives under the Mexican Insolvency Law

Contracts for difference (CFDs), futures contracts and other financial derivative transactions are executory contracts grouped and treated in the same manner by the Mexican Insolvency Law. Other than general contract law, tax law and certain regulatory rules applicable to banks and other financial intermediaries, derivatives instruments are mostly unregulated.

While CFDs or futures contracts are not specifically defined under Mexican law, these can be distinguished from ordinary purchase agreements because of their special characteristic that, when the contract term expires, instead of the seller transferring title to an asset against payment of the price, one of the parties pays to the other the difference in value of the underlying asset. This feature broadly encompasses all cash settled financial derivatives.

A financial derivative transaction, pursuant to the Mexican Insolvency Law, is one where the parties are obligated to pay money or to surrender other property based on an amount tied to the value of an underlying financial asset. There is no substantive difference between this legal concept of financial derivative transaction and that of CFDs.

Under Mexican law, financial derivatives also include those agreements deemed as such by Banco de México (Mexico's central bank) through its rules of general application. Pursuant to these rules, Banco de México recognizes futures, options, swaps and credit derivatives (including credit default derivatives, total return derivatives and credit linked securities) as derivative transactions.

Ipsa Facto Clauses

Mexican courts will not recognize the validity of an *ipso facto* clause in a contract that gives a party the right to terminate such contract or impose additional costs or burdens in the event of a petition or demand for, or declaration of, *concurso* of the other party.

The court appointed conciliator may, however, reject a contract on grounds that rejection is in the best interest of the estate. While such authority appears to be seldom exercised in practice, there is no reliable information to support this given the difficulty in accessing public dockets of insolvency cases in Mexico.

The continuation of contracts and the conciliator's powers to reject them are general principles applicable to all contracts. However, derivative transactions and other specifically designated contracts are subject to special rules.

Treatment of Financial Derivatives in *Concurso*

On the date of the declaration of *concurso*, each individual derivative transaction and multiple derivative transactions under a framework agreement are automatically terminated and netted out. Unless the derivatives contract provides its own rules concerning liquidation and close out netting of amounts owed thereunder, the value of the underlying assets or claims will be determined at their market value on the *concurso* declaration date. Any contract governed under the ISDA Master Agreement or its Mexican version, which in practice will be the case for most transactions, will include such rules. In the event there is no available or demonstrable evidence of market value, the conciliator may entrust a third party expert in the field to assign a value to such underlying assets or claims.

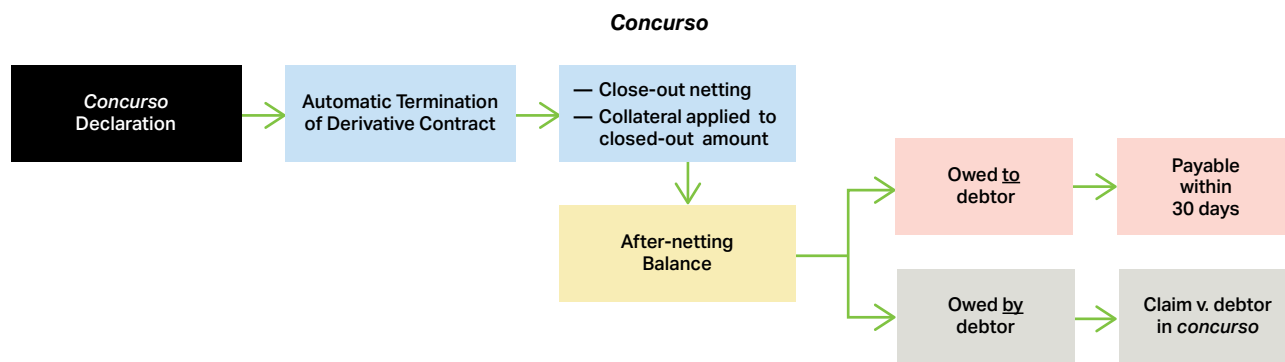


The after netting balance, if in favor of the debtor, shall be payable to the debtor within 30 days of the *concurso* declaration date or, if against the debtor, shall constitute a claim against the debtor subject to the *concurso* proceedings.

In principle, clauses providing for the automatic termination of derivative transactions following the declaration of a *concurso* proceeding would not be recognized by a Mexican bankruptcy court. However, such provision would be unnecessary since termination of derivative transactions operates *ipso jure* on the moment of the declaration of *concurso*, or, in the case of a liquidation of a commercial bank, within two business days after the publication of the revocation of the bank's charter.

Similarly, there is a contractual right for consent by the non debtor counterparty to transfer the debtor's assets, which requires the court appointed receiver, or *síndico*, to ask each non debtor counterparty to decide whether to continue or reject a contract in light of the sale of the debtor's estate being carried out as a transfer of the enterprise or parts thereof as a going concern. Failure of a non debtor counterparty to respond within ten business days shall be deemed as consenting to the continuation and transfer of the contract.

While this provision, which is applicable to all executory contracts, allows for a certain level of protection to the non debtor counterparty, in the author's view, the impact is irrelevant in



the case of financial derivatives transactions in light of the *ipso jure* early termination of such transactions of the debtor. That is, by the time the debtor is declared insolvent, the derivative transactions in question would have terminated. There would be no contract to assign.

Collateral; Exception to the Automatic Stay

As a general rule, once the court enters a *concurso* judgment, the attachment and foreclosure on the debtor's assets are generally stayed during the reorganization stage. This stay of execution operates only during the reorganization stage, or *conciliación*, and not during the liquidation stage, or *quiebra*.

An exception to this principle, the close out netting of derivative transactions as a result of the *concurso* declaration results in the automatic application of the collateral to the payment of the close out amount, provided that such collateral consists of a security instrument where title is transferred to the pledgee (e.g., pledge of cash or other fungible assets).

Recognition and Ranking

The Mexican Insolvency Law provides for the recognition and ranking of creditor claims, and for the distribution of proceeds from the sale of estate assets to be made in accordance with that ranking. No creditor from a lower rank can be paid until all creditors of a higher priority are paid in full.

The after netting balance of a financial derivative transaction or of multiple derivative transactions under their respective framework agreements, if owed by the debtor, shall constitute a claim against the debtor subject to the *concurso* proceeding. Depending on the level of collateralization of the after netting balance against the debtor, the claim may qualify as a secured claim (with relative seniority) or an unsecured claim. Partially secured claims would qualify as secured only to the extent covered by the collateral.

Costs and Expenses

An unresolved issue is whether the post termination payment would include obligations or amounts in excess of the market value of the derivative transaction (e.g., costs and expenses).

The fact that the Mexican Insolvency Law allows a derivatives contract to set its own rules concerning liquidation and close out netting of amounts owed, strengthens the argument that additional costs and expenses should be included in the calculation of amounts due if they were foreseen based on the terms of the derivatives contract.

On the other hand, the fact that Mexican courts will not recognize the validity of a clause in an agreement that gives the non defaulting party the right to impose additional costs or burdens over the defaulting party in the event of a petition or demand for, or declaration of, a *concurso* proceeding, suggests that any amount in excess of the market value of derivative transaction will be disallowed, if such amount arose solely out of a termination from a bankruptcy related event. As such, even if the ISDA Master Agreement (or its Mexican equivalent) provides for the payment of costs and expenses in connection with the close out netting of a derivative, such payment may not be permitted by the Bankruptcy court.

The Avoidance Powers of Courts

Some derivative transactions entered into before the *concurso* declaration can be set aside by the courts. Only courts have such avoidance power since other interested parties, such as creditors, must bring a suit or petition to the court to avoid them. All pre commencement *per se* fraudulent transactions are avoidable. Other pre commencement avoidable transactions can be set aside if carried out within the clawback period and include cases of constructive fraud, objective preferences and subjective preferences. Cases of constructive fraud include gratuitous transactions, transactions which differ from fair

market conditions and payment of immature debts. Objective preferences include granting or increasing collateral and making in kind payments. Subjective preferences include related party transactions.

The clawback period begins 270 days prior to the *concurso* declaration date or 540 days with respect to related party transactions. The judge may extend such period to an earlier date upon the request of the conciliator, the conservators or any creditor but up to a maximum of three years.

Close out netting is considered as a top priority issue of concern involving derivative transactions. As a safe harbor rule, close out netting of derivative transactions carried out during the clawback period is also allowed.

Re-couponing

Re-couponing is the process of setting the mark to market value of a swap to zero. The process involves the payer paying the early termination amount in cash and the swap being re executed at prevailing market rates.

While market practice has recognized Re-couponing as a sensible means of mitigating counterparty risk, more careful consideration should be given to the actual process in light of the court's avoidance powers, as Re-couponing may result in a *de facto* increase in collateral or the payment of immature obligations and, therefore, avoidable at a subsequent *concurso*.

Multibranch Netting

The issue of multibranch netting appears when a bank party to an over the counter derivative transaction books individual transactions to several branches located in different countries.

The analysis of how to treat the insolvency of such bank or its counterpart (multibranch netting) poses certain levels of complexity depending on the different possible scenarios based on the parties involved. The possible parties include:

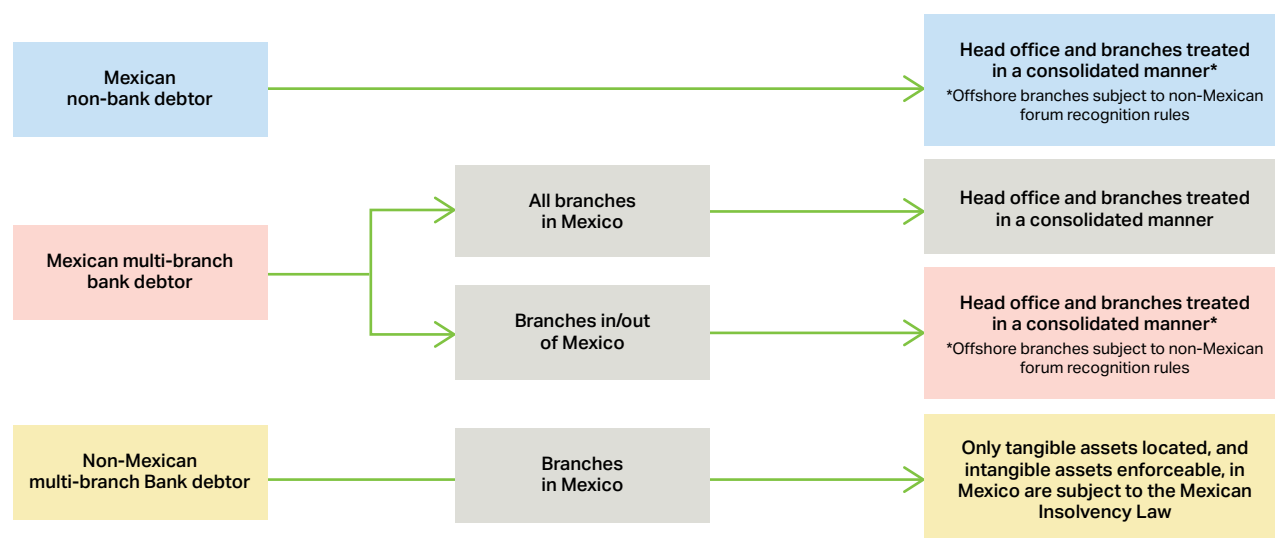
- A Mexican non bank debtor
- A Mexican multibranch bank debtor
- A non Mexican multibranch bank debtor, with one or more branches in Mexico

A Mexican non bank debtor

The Mexican Insolvency Law generally treats the head office and branches of a person or entity as the same body corporate and, therefore, a non debtor multibranch bank counterparty to the debtor would have no impact on the analysis: the non debtor bank's positions would also be treated in a consolidated manner.

The level of comity or recognition of these principles would depend on the laws of the place (outside of Mexico) where a branch of the non debtor bank is located.

Multi-Branch Netting



A Mexican multibranch bank debtor

The insolvency statutes applicable to banks take a consolidated approach to insolvency: it treats a cross border insolvency case and all of its components as part of the same insolvency proceeding.¹ Similar to the prior case, Mexican courts and the bank regulations in charge of overseeing an insolvent bank would recognize the bank and its branches as a single body corporate and all its dealings would be consolidated in the debtor bank's estate.

As in the prior case, the level of comity or recognition of these principles would depend on the laws of the place (outside of Mexico) where a branch is located.

A non Mexican multibranch bank debtor, with one or more branches in Mexico

As an exception to the principle that the head office and branches of a person or entity are treated as the same body corporate, the Mexican branch of a foreign debtor is subject to the Mexican Insolvency Law, but only in connection with tangible assets located, and intangible assets enforceable, in Mexico and with respect to claims held by creditors for operations with those branches.

The natural consequence of this statutory provision requires "ring fencing" the estate. Aside from the fact that, in this case, the Mexican Insolvency Law clearly strays from the consolidated approach and adopts a territorial approach, it requires carrying out an analysis of the estate for which the Mexican Insolvency Law is currently ill equipped to do:

- The location of tangible assets can be relatively straightforward when dealing with realty, but may get more complicated when dealing with chattel: Would a transfer of an asset from the relevant branch to the debtor's headquarters or to another branch be excluded from the estate? Would the transfer be avoided? Would the assets of different branches located in Mexico all be part of the relevant branch's estate?
- The issue is further complicated when dealing with intangible assets: When is an intangible asset enforceable in Mexico? What is the impact of an underlying bank debtor relocating outside Mexico? The Mexican Insolvency Law is silent as to these and other issues pertaining to the location of assets.
- Since a branch is not treated under law as a body corporate separate from the principal headquarters, it is unclear what situations could qualify as "operations with those branches." This issue is even harder to tackle under the Mexican Insolvency Law than it would have been under traditionally territorial statutes, since the nationality or residence of the creditor or the location of their collateral is not relevant to determining the estate of the branch.

- The author knows of no precedent of a main insolvency proceeding involving a branch of a foreign debtor. This lack of precedent and the silence of the Mexican Insolvency Law results in a poor and unsatisfactory framework for dealing with insolvent branches of foreign debtors.

Now, as a practical matter, this issue is moot: since 1994, there have been no foreign bank branches in Mexico. The only case in Mexico's recent history is Citibank's Mexican branch, which it spun off in 1994 to create a wholly owned Mexican subsidiary.

Representatives offices are not branches. While banks may (and many do) establish representative offices in Mexico, these offices are not allowed for booking transactions. This means that derivative transactions may not be booked to a representative office and, therefore, no multibranch analysis is required.

Conclusion

The Mexican Insolvency Law allows for the termination and closing out netting of individual and multiple derivative transactions under the relevant framework agreements, and the application of certain collateral to the payment thereof, upon a party's insolvency. In this sense, the Mexican Insolvency Law is a modern statute that provides a solid framework to mitigate netting risk in the case of insolvency.

However, some insolvency related issues concerning financial derivatives may still require legislative action for the sake of clarity, such as the application of costs and expenses, Re-couponing. Whether to lean on one side or another is a policy issue. Regardless of the stance taken by the lawmaker, precise rules on these issues would add value to the system by bringing clarity to these issues. ■

1. See, e.g., American Law Institute. *International Statement of Mexican Bankruptcy Law*. 2003; p. 107.



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Restructuring Financial Institutions in Angola

By RUI MAYER and ELSA SOUSA RODRIGUES



The Angolan Government approved the “Lei de Bases das Instituições Financeiras” on June 17, 2015 (Law No. 12/2015 or the “Financial Institutions Framework Law”) in response to the need to modernize Angola’s financial regulatory system in line with the current organization and development requirements of the international markets, thus contributing to the development of the national economy, as well as to fully integrate Angola in the international economic system. The Financial Institutions Framework Law provides for a special regime for the restructuring of financial institutions.

Like several other African countries, Angola is presently facing financial difficulties as a result of the effects of the marked drop in crude oil prices since 2015, which resulted in a significant reduction in the demand for imports and foreign services, and, consequently, in a decrease in foreign investment and a deterioration of several other indicators, such as employment

and external debt. The reduction of the volume and value of international transactions affected parts of the financial sectors, namely merchant and investment banks, some of which registered significant reductions in income and an increase in non-performing loans. Thus, this new regime, which specifically creates rules and instruments for the Central Bank to

intervene to control and redress the distress situation of a bank and prevent it from spreading to other entities, currently plays a key role for investors providing financing in Angola, including to Angolan banks.

Overview of the Financial Institutions Framework Law

Purposes and Guiding Principles

According to the Financial Institutions Framework Law, the entity mainly responsible for the regulatory oversight of the banking sector is the *Banco Nacional de Angola* or the “Central Bank of Angola.” To a smaller extent, the Ministry of Finance and other entities, such as the Securities Commission (“Comissão do Mercado de Capitais”), may also be involved regarding specific activities and operations of Angolan banks. The Central Bank may impose restructuring/intervention measures upon financial institutions in order to:

1. ensure that essential financial services continue to be provided;
2. avoid systemic risks;
3. protect the interests of the Angolan State and of the taxpayers; and
4. maintain depositors’ confidence.

The application of the restructuring measures is subject to the principles of appropriateness and proportionality, taking into consideration (a) the risk or the degree of non-compliance by the financial institutions with the legal or regulatory rules which govern their activity, as well as (b) the seriousness of the consequences of any such risks or non-compliance. The financial strength of the affected financial institution, the interests of the depositors and the stability of the financial system as a whole are factors taken into consideration to assess such seriousness of consequences.

On the other hand, the Central Bank must ensure that the institution’s shareholders and creditors bear the risk for the losses of the institution and, in the case of the creditors, according to the respective ranking and equally with the other creditors of the same class.

Duty to Report

When a financial institution becomes unable to meet its financial obligations, or there is a serious risk that it will be unable to do so without engaging in extraordinary measures, the directors or the supervisory board must immediately report the situation to the Central Bank, acting in its capacity as the

banking sector supervision agency. The notification should be submitted as soon as possible, though there is no fixed timeline set by the rules and there are no legal consequences to the directors or members of the supervisory board in the event a bank chooses to delay complying with the reporting requirement.

Remedial Measures

If a financial institution is found unable to meet its financial obligations, the Central Bank may recommend one or more of the following remedial measures:

- additional prudential requirements;
- stricter rules, proceedings, mechanisms and strategies concerning corporate governance, internal control and risks self-assessment;
- limitations on the riskiness of the financial institution’s activities, products and systems;
- limitations on the amount that may be paid to executives under variable remuneration schemes, whenever the underlying criteria is not directly tied to shareholder value creation;
- restrict or suspend certain persons from management functions in the financial institution, as well as order the suspension or replacement of managers or directors;
- restrict or suspend any payment to the company’s shareholders or with respect to transactions involving the company’s shares;
- subject any operational activities of the financial institution to the prior approval of the banking sector supervision agency;
- a full or partial audit of the financial institution by an independent entity appointed by the banking sector supervision agency;
- restrictions to the granting of credit and to the application of capital in certain assets; and
- restrictions to the acceptance of customer deposits.

It should be noted that, apart from these measures, the Central Bank may, in addition, impose penalties on the financial institution.

Recovery Plan

In the event the financial institution's solvency is under serious risk, the Central Bank has sole authority to instruct such financial institution to submit a recovery plan (creditors of the financial institution have no role in the development/negotiation of the recovery plan). The Central Bank may establish conditions for the approval of the plan, such as a capital increase or a disposal of shares and/or other assets. If the affected financial institution does not accept the conditions set by the Central Bank, or if it fails to comply with the approved recovery plan, the Central Bank may order the total or partial amendment of the recovery plan, the suspension or replacement of management or directors, or other measures, such as the appointment of a provisional management team, which may also be applied jointly with any other remedial measure. In more serious cases, the banking license of the financial institution may be revoked.

Supervisory Committee

The Central Bank may also appoint a Supervisory Committee for the affected institution in the event such financial institution does not accept the remedial measures taken by the agency or fails to comply with the approved recovery plan. The Supervisory Committee is appointed for a maximum period of one year, which may be renewed for an additional year. The Supervisory Committee has the powers and duties provided under the law and by the By-Laws to the Audit Committee or to the Sole Auditor.

Provisional Directors

The Central Bank may appoint one or more provisional directors to serve on the board of any financial institution in any of the following circumstances:

- when the financial institution is at risk of ceasing payments to creditors;
- when the institution is in a financially imbalanced situation which, due to its size or duration, constitutes a serious danger to its solvency;
- when management fails to discharge its responsibilities in a sound and prudent manner, thus endangering creditor interests;
- when the internal accounting team or the internal control proceedings have serious deficiencies;
- when a serious or repeated breach of legal or regulatory rules which govern the activity of the financial institution is detected;
- when there are sufficient reasons to suspect that the shareholders and directors are unable to ensure a sound and prudent management or the financial recovery of the institution; or
- when there are sufficient reasons to suspect the existence of other irregularities endangering depositor and creditor interests.

The appointed provisional directors have, among others, the following powers and duties:

- to veto rights over any actions derived from the general shareholders meeting and the institution's other corporate bodies, such as the Board of Directors, the Executive Committee or the Supervisory Committee and any committees thereof;

- to overrule previous decisions taken by the management body;
- to require a detailed assessment of the assets and financial situation of the institution;
- to present to the banking sector supervisory agency proposals aiming at the financial recovery of the institution;
- to strive to correct previous irregularities committed by the affected institution's corporate bodies or by any of their members;
- to facilitate an agreement between the shareholders and the creditors regarding measures aimed at the financial recovery of the institution, such as debt restructuring; and
- to provide all the information and collaboration as may be required by the banking sector supervision agency regarding any issue related with its activity.

Once provisional directors are appointed to any affected financial institution, the banking sector supervision agency will suspend the institution's management body members, as well as the members of the institution's other corporate bodies with similar functions.

The provisional directors are appointed for a maximum period of one year, which may be extended once, for a new period of up to one year.

It should be noted that the appointment of provisional directors can be effected simultaneously with the application of other remedial measures.

Other Measures

Apart from the aforementioned remedial measures, the banking sector supervisory agency may also:

- order a temporary exemption regarding the compliance of rules concerning the ratios/standards of own funds or monetary policy;
- authorize a temporary waiver of the deadlines relating to the compliance of other ongoing obligations previously undertaken; or
- the temporary closure of branches or other facilities where public transactions are maintained.

Said measures may be applied for a period of up to one year, which can be extended once, for the same period of time.

Suspension of Enforcement Proceedings

Whilst any remedial measures are in place, all the enforcement proceedings, including tax enforcement proceedings, against the affected institution, are suspended; the suspension extends the statute of limitations on the enforcement proceedings for the same period of duration.

Appeals

In general, appeals may be filed by any party who has a direct and personal interest in the outcome of the proceeding, including any unsuccessful parties and the public prosecutor, and such parties are afforded two ordinary appeals (one to the Central Bank and another to the Supreme Court).

The decisions of the Central Bank, which are related to the above-mentioned remedial measures, are deemed to have been made in the public interest. Therefore, appeals against such decisions do not suspend the effectiveness thereof, unless there is evidence that such suspension would not entail a serious injury to the public interest.

Resolution Measures

When a financial institution fails to comply, or is at risk of not complying, with the requirements for the maintenance of its banking license, the Central Bank may apply the following resolution measures if it determines that such measures are essential to ensure the continuity of the provision of essential financial services, to avoid the systemic risk, to protect the interests of the State and the taxpayers or to maintain depositor confidence:

1. partial or total disposal of the activity to another already existing financial institution authorized by the Central Bank to develop the same activity; and



2. partial or total transfer of the activity to one or more financial institutions created for that purpose.

Resolution measures are applied in the case the banking sector supervisory agency considers that the financial institution will not be able, within an appropriate time, to execute the necessary actions in order to return to adequate conditions regarding the soundness and performance of its management practices and prudential standards.

An institution is at serious risk of not complying with the requirements for maintenance of its banking license when:

- the institution has registered losses capable of consuming its equity, or there are serious reasons to consider that the institution will incur such losses;
- the institution is in insolvency, or there are reasons to consider that it will become insolvent; or
- the institution is unable to comply with its ongoing obligations, or there are serious reasons to consider that it may become unable to comply with said obligations.

It should be noted that the application of resolution measures is independent of the remedial measures mentioned previously.

It is the responsibility of the executive branch, led by the President of the Angolan Republic, to establish the terms and conditions governing the application of resolution measures.

The Financial Institutions Framework Law sets specific rules for dealing with the insolvency of financial institutions and the general preventive mechanisms in case of insolvency. The Framework Law does not contemplate a fund to provide the financial support to any bank executing the resolution measures (elsewhere referred to as the Resolution Fund) and states that only the President of the Republic has the necessary authority to create a fund which intends to guarantee the deposits of ordinary depositors in the event the bank must execute resolution measures that require the transfer/disposal of its activity to another financial bank (elsewhere known as the Deposit Guarantee Fund). However, the Deposit Guarantee Fund is not regulated in detail under the Framework Law. For example, no reference is made to the guaranteed deposit amounts, which is left for the President of the Republic to regulate when he creates the fund. This unresolved issue can contribute to reduced depositor confidence levels and increase the possibility of a “deposit run” in case of warning signals.

Regarding the ranking of credits, the Framework Law makes no explicit reference to who must first bear the losses, although the law states that the institution’s shareholders and creditors must absorb the losses of the institution and, in the case of the creditors, according to the respective ranking and equally with the other creditors of the same class. In practice, this often means that the civil and commercial law ranking of credits should apply and thus shareholders should absorb the losses first and subsequently creditors according to their legal priority ranking.

The Framework Law does not have any references to set-off or novation agreements, nor any provisions concerning the immediate consequences on the mandate of the members of a financial institution’s management and supervision bodies when a resolution measure is applied.

Finally, the Framework Law does not state that creditors and shareholders cannot assume, as a consequence of the resolution measure, a larger loss than they would bear if the institution had been liquidated, i.e., the no creditor worse off principle. That said, as mentioned above, the Central Bank must ensure that creditors bear the risk for the losses of the institution according to the respective ranking and equally with the other creditors of the same class. As to the shareholders, it is not clear if their equity is transferred to institution serving as the transferee, and if all shareholders are affected by such decision.

There are certain details from the arrangement between transferor bank and the transferee bank that are not adequately addressed in the Financial Institutions Framework Law, such as the terms of the agreement, whether or not the transferor bank should be permitted to continue its activity and whether

or not the banking sector supervision agency may/must revoke its banking license.

Liquidation of a Financial Institution

In case the adopted measures are not enough to enable the institution to recover, the Central Bank will revoke its banking license. The revocation of an institution’s license often leads to its dissolution and liquidation. The office of the General Attorney of the Republic (“Ministério Público”) will then ex-officio seek the judicial declaration of insolvency of the institution.

Directors considered to be responsible (under negligence or willful misconduct) for the insolvency of the institution are personally liable for the institution’s debts.

There are no special legal provisions applicable to the insolvency of the financial institutions, which may lead to awkward results as the general insolvency regime applicable to commercial companies is not properly suited for financial institutions. In fact, the liquidation of commercial companies and financial institutions have different goals. The liquidation of financial institutions aims to protect the depositors, investors and certain creditors’ interests, in order to ensure the normal working conditions of the monetary, financial and foreign exchange markets. On the other hand, the liquidation of commercial companies aims to satisfy the creditors for the all patrimony of the debtor, in accordance with the *par conditio creditorum* principle (i.e., the equal treatment of creditors).

Typical Liquidation Proceedings in Angola

The guiding principle of the commercial companies’ insolvency in Angola is the liquidation of the company which limits the possibility of its recovery. In fact, there are only two cases in which the debtor is granted the possibility of continuing to exercise its business activity after the liquidation procedure: (i) in the case in which the debtor presented a restructuring agreement (a “Concordat”) approved by 75% of its creditors and (ii) in the case where the debtor’s creditors agree to the creation of a limited liability company whereby the creditors are the shareholders of this new company.

The insolvency may be due to a force majeure cause or to a wrongful or fraudulent conduct and in some cases may involve a penalty as a result.

It should be noted that this aspect of the Framework Law has been criticized, particularly with respect to the need of restructuring measures in order to allow the debtor’s recovery.

Recent case studies of restructuring of Angolan Banks

Banco Espírito Santo Angola

In 2014, the Central Bank detected that Banco Espírito Santo Angola ("BESA") had registered an extremely high value of non-performing loans (approximately US\$5 billion dollars). In response to this situation, the Angolan State issued a sovereign guarantee.

Subsequently, on August 4, 2014, the Central Bank decided to apply extraordinary reorganization measures to BESA. Provisional directors were appointed, and a temporary waiver of the prudential rules was adopted. Following the implementation of these measures, the Central Bank decided that there was no longer a need for the sovereign guarantee and withdrew it shortly thereafter. A detailed assessment of the institution's loan portfolio, as well as a list of the assets which should be disposed of in the event of liquidation or restructured, were prepared. Simultaneously, restrictions were imposed on the commercial activity of the bank.

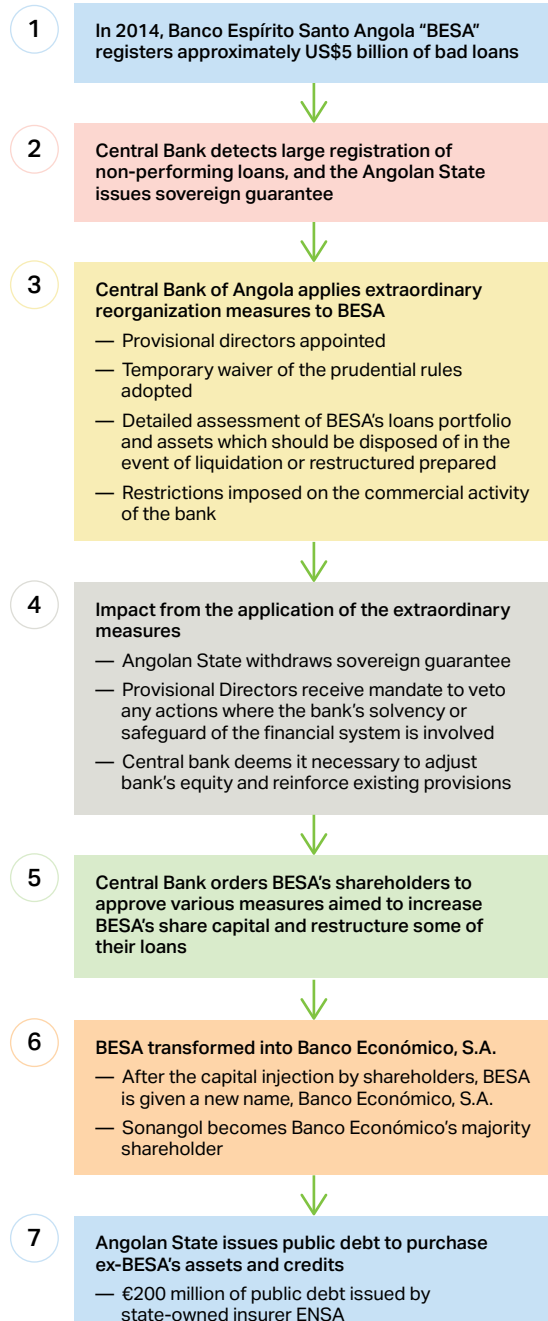
Considering the existence of high losses in the credit portfolios and in relation to other assets, which were not provisioned, the Central Bank deemed it necessary to adjust the bank's equity and to reinforce existing provisions in order to ensure the bank's sustainability.

The provisional directors received a mandate to veto any actions from BESA's general shareholders meeting, its board of directors and any other of its corporate bodies, in cases where the institution's solvency or the safeguard of the financial system is involved. Despite this, the board of directors remained in office together with the provisional directors, maintaining their powers and responsibilities with respect to BESA's current management.

At this stage, the Angolan State did not intervene in BESA's share capital, neither were any public funds allocated to the rescue of the institution.

On October 20, 2014, the Central Bank, after determining that BESA's equity was negative, ordered the shareholders of the bank to approve the following measures:

- an increase of the share capital by conversion of part of the senior interbank loan, followed of a reduction of the shareholders' equity by absorption of all of the accumulated losses;
- an increase of the share capital, paid in cash, to rebuild the share capital and ensure the performance of the minimum prudential standards;



- a conversion of part of the senior interbank loan into share capital;
- a conversion of part of the senior interbank loan into a common loan;
- a conversion of part of the senior interbank loan into a subordinated loan; and
- the placement of additional subordinated instruments to the market.

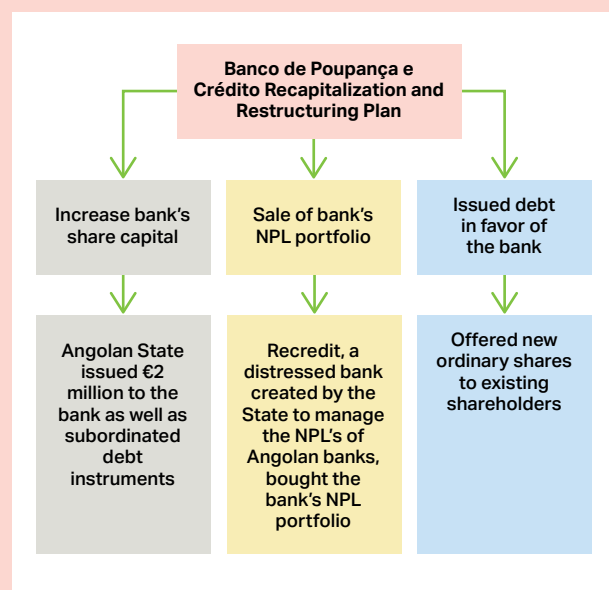
Subsequently, by decision of the new shareholders in accordance with the requirements imposed by the Central Bank, BESA was renamed Banco Económico, S.A. ("Banco Económico"). In June 2015, at the final stage of this procedure, and as a result of the measures that were adopted as per above, Sonangol (the State-owned oil company) became Banco Económico's majority shareholder.

Recently, the Angolan State issued public debt of approximately €200 million in order to ensure the purchase of ex-BESA's assets and credits by the state-owned insurer ENSA – Seguros de Angola. This represents a part of the public intervention through ENSA Group in the ex-BESA's restructuring procedure. It should be noted that in the Angolan State's communication of the mentioned measure it was highlighted that "considering the absence of a resolution fund [Angola already approved rules for those purposes but further regulation is still needed for their implementation] temporary resources of the National Treasury are necessary to enable the purchase of the referred assets by ENSA, through the issuance of Treasury Bonds in the amount corresponding to 10% of the assets and credit agreements to be purchased by ENSA." ENSA will deliver to the National Treasury the amounts resulting from assets sale and recuperation of credit agreements.

Banco de Poupança e Crédito

Banco de Poupança e Crédito, the biggest commercial Angolan bank, with a large non-performance loans (NPL) portfolio (approximately €2.640 million) is expected to implement a recapitalization and restructuring plan, which was approved by the Government in March 2017.

In this case, it was decided by the general shareholders meeting to increase the bank's share capital through an offering of new ordinary shares to existing shareholders and to proceed with the sale of the bank's NPL portfolio to "Recredit", a distressed bank created by the State with the purpose of managing the "toxic credits" (NPL) of the Angolan banks. The Angolan State issued debt (in multiple tranches) of approximately €1.200 million in favor of Recredit in order to purchase the Banco de Poupança e Crédito's NPLs. Currently, this bank is owned by the Finance Ministry of Angola. Subordinated debt instruments were also issued.



Conclusion

Following Angola's recent economic slowdown, it has become evident that a sound restructuring regime for financial institutions is important to maintain foreign investors' confidence in Angola. Instead of ad hoc State intervention of the past, the remedial and resolution measures highlighted in this article are now being used to effect restructurings for Angolan financial institutions. That said, certain practical obstacles remain, such as the regulations regarding the Resolution Fund and the Deposit Guarantee Fund, as well as the provision of a clear framework of who should bear the losses resulting from these restructuring measures. ■



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The Legal Framework For Restructurings and Insolvencies in Mozambique

By SAMANTHA CYRNE and RITA DONATO



Before the enactment of the Insolvency Law in 2013, Mozambique did not have a tradition of instituting insolvency or restructuring procedures. One of the main reasons for this was the extensive length of such procedures (which could take more than 5 years) as well as the stigma of “bankruptcy” and its reputational consequences.

The Insolvency Law introduced expedited procedures for insolvency, which replaced the previous references to the concept of “bankruptcy” with “insolvency”, and introduced the new concept of “restructuring”, providing the companies facing a situation of financial distress the possibility to recover their economic potential.

Even so, to date Mozambican entrepreneurs are still reluctant to use the Insolvency Law regime to embark on a process of

insolvency or restructuring and tend to delay this decision based on the argument that such regime still needs to be tested for efficiency, despite the consequent negative economic impact of such deferral.

To our knowledge, very few companies have used the Insolvency Law regime. Interestingly, most of the companies that used it so far have relied on the restructuring provision (and not the insolvency ones). In addition, the courts took some time

to become acquainted with this new regime. During such time, no decisions were being issued under the new regime. However, after a series of training programs that began in 2013, the judges seem now to be ready to issue decisions on these matters.

As such, there is no helpful statistical or other empirical data regarding restructuring and insolvency procedures in Mozambique. However, we expect the number of restructurings or insolvencies to increase based on the increased familiarity of judges with the Insolvency Law and in light of the recent economic and financial crisis (2014 through 2016) that affected Mozambique and its businesses.

Restructuring & Insolvency Legal Regime

The insolvency and restructuring of companies and partnerships in Mozambique is governed by the Decree-Law no. 1/2013, dated July 4, 2013, which approved the regime of insolvency and rescue of entrepreneurs (the “Insolvency Law”).

The Insolvency Law (i) regulates the procedures for restructuring or “business rescue” (judicial and extrajudicial) and for the insolvency of companies and (ii) defines the creditors’ rights and the insolvency administrator’s duties.

Commercial bench courts handle and supervise restructuring, liquidation and administration proceedings in Mozambique. There are no specialist judges for insolvency matters. While there is a generalized lack of confidence in the Mozambican court system, the introduction of specialized insolvency judges could raise the level of confidence among investors.

There are no specific restructuring and insolvency regimes applicable to banks and other credit institutions, insurance companies or undertakings, other entities operating in financial markets such as investment firms or entities engaged in payment systems and securities settlement, or any other sectors (such as power and energy, railways, water and ports etc.). While having special regimes for these sectors would be beneficial, considering that the Insolvency Law is still in its infancy, the existing legal regime should be the starting point to test for efficiency and any potential benefits and disadvantages of the Insolvency Law before sector-specific insolvency regimes are introduced.

Restructuring

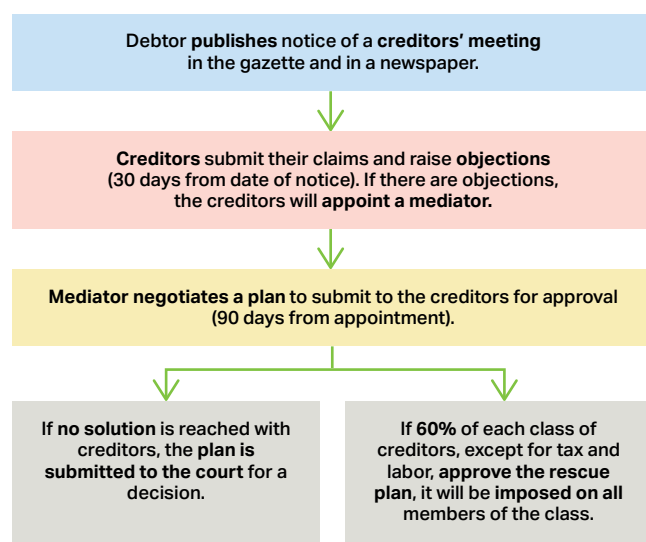
Before 2013, Mozambique did not have a tradition of processing either formal or informal consensual restructuring of distressed companies. The introduction of the Insolvency Law in 2013 included provisions regulating both the judicial and the extrajudicial (or consensual) recovery of companies.

The aim of any extrajudicial or judicial recovery plan is to reinstate the “good standing” of the company and its economic viability and to help overcome a debtor’s inability to comply with its obligations to creditors. It provides tools and conditions for those entrepreneurs who can still recover to avoid insolvency and liquidation, thus helping to maintain and stimulate employment, the economy, the social environment and growth.

In Mozambique, banks and credit institutions are typically supportive of companies experiencing financial difficulties and



Extra-Judicial Restructuring Process



have historically supported debt refinancing or restructuring in many cases.

Extra-Judicial Restructuring Process

In principle, the extrajudicial restructuring must be implemented under the rules of conciliation and mediation set forth in Law No. 11/99, dated July 8, 1999 (the “Arbitration Law”). Under this regime, a conciliator or mediator will be appointed by the creditors at the creditors’ general meeting. However, the debtor and creditors may also agree on other private agreements for the restructuring of the debtor. We have no knowledge of these informal procedures having ever been put in place in Mozambique.

While the Insolvency Law is relatively new, arbitration as a way to resolve disputes and reach agreement between parties (which can be applied to a company in distress regarding compliance with its obligations) has been applied in many cases.

Under the Insolvency Law, the debtor that (i) has not been declared insolvent by a competent court (or if it was insolvent, whose liabilities have been discharged by final judgment); (ii) has not been granted, within the last two years, a business rescue; and (iii) has not been convicted, and is not in the process of being convicted, as director or dominant shareholder, for a breach of criminal provisions set forth in the Insolvency Law, may negotiate with its creditors a plan for its extrajudicial recovery.¹

The debtor company (or the executor or the remaining shareholders of the debtor company, as the case may be) can request an extrajudicial restructuring process but must convene all of its creditors, for the submission of their claims, by publishing a notice (which could include the proposed recovery plan) in the

Government Gazette and in a newspaper with wide national circulation, or by registered letter addressed to the creditors with acknowledgement of receipt. During the extrajudicial restructuring process, existing management continues to operate the business and, unlike a judicial business rescue, there is no mandatory stay over other creditor claims applied by the courts.

The creditors then have 30 days to present their claims or to challenge the recovery plan. If there is such a challenge, the general meeting of the creditors will nominate a mediator or conciliator, who shall have access to all documents, projects and required information to the practicability of the plan and who shall, within 90 days from his or her nomination, negotiate, mediate, conciliate and formulate, with the creditors, the definitive recovery plan to be submitted for the approval of the general meeting of the creditors. If no solution is reached with the creditors under the guidance of the conciliation and mediation rules, the plan will have to be submitted to the judicial court for decision. Once the plan is presented to the court, the creditors preserve the right to challenge the plan.

The general meeting of creditors may propose the creation of a creditors’ committee and, upon a proposal of the debtor, the creditors may appoint an administrator who shall, together with the debtor’s single director or board of directors and eventual creditors appointed by the creditors’ committee (if existing), help the debtor with the conduct of business and implementation of the recovery plan.

If the recovery plan is approved by creditors representing three-fifths of the credits of the same class, with the exception of labor and tax credits, the plan provisions are imposed on all other creditors of the same class, with respect to claims constituted up to the date of submission of the extrajudicial rescue.

Labor credits are subject to the following rules under the Insolvency Law: the recovery plan cannot provide (i) for a period of more than one year for the payment of credits derived from labor legislation or from labor-related accidents due until the date of the petition for the extrajudicial business rescue; and (ii) for a period of more than 30 days for the payment (an amount which will equal no more than five minimum wages per employee) of labor remuneration credits overdue in the three months preceding the petition for the extrajudicial business rescue. As for tax credits, the debtor is entitled to pay them in instalments, as authorized by the tax authorities (upon request of the debtor after the approval of the recovery plan).

Without prejudice to the above, the extrajudicial recovery plan cannot impair the right or action by creditors who have not voted in favor of such plan to request a declaration of insolvency, which may lead to a significant setback for those creditors that had agreed to the plan.

Judicial Restructuring Process

A judicial business rescue is a voluntary procedure that may be petitioned by the debtor company through its board of directors (alternatively, by the executor or the remaining shareholders of the debtor company, if any) if, at the time of the petition, the debtor has conducted the business of the company for more than 12 months and meets all the same requirements mentioned above for the extrajudicial recovery (i.e., not being insolvent, not previously granted a business rescue and not being or having been convicted for breach of criminal provisions in the Insolvency Law).

The judicial business rescue will commence when the judge orders that the company be placed in business rescue and the rescue process shall remain in place for a period not longer than two years from the date that the business rescue was approved by the judge.

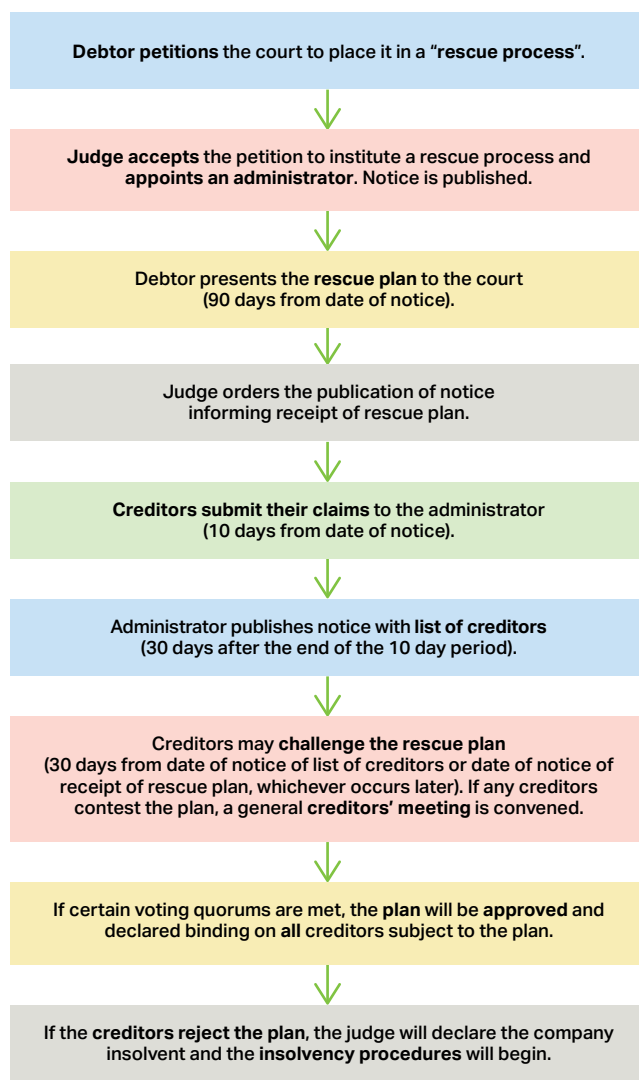
The judicial business rescue process is initiated through the courts and conducted by the insolvency administrator (appointed by the court) together with, if existing, a creditors' committee. This is a court-driven and court-supervised process as the insolvency administrator will have to submit to the judge a monthly report on the debtor's business activities and a final report on the execution of the rescue plan upon termination of the rescue process.

Once the petition for business rescue has been submitted to the court, the judge will analyze it in order to issue either its acceptance or denial. Due to the lack of precedents released publicly, there is currently insufficient information to estimate the average length of time for the judge to issue a decision.

If the judge accepts the request for business rescue, a notice of such acceptance is sent by letter to the creditors identified in the petition and the same notice is published in the Government Gazette and in a newspaper with wide circulation in the place where the judicial business rescue is petitioned. This will allow any creditor that was not previously identified to have the possibility of claiming credits.

The creditors, thereafter, have 10 days within which to submit their claims or objections to the insolvency administrator. The creditors may also contest the commencement of the business rescue process and the rescue plan itself within 30 days of the date on which the notice, including the rescue plan and the list of creditors, is published. The rules applicable to the labor and tax credits under the extra-judicial process also apply to the judicial rescue plan.

Judicial Restructuring Process



If the rescue plan is contested by any creditor, the judge must convene the general meeting of creditors to resolve the matter, and the meeting must be held no later than 60 days from the deadline to contest the plan.

The creditors are organized in a general meeting, according to their respective class of claims. There are mainly three classes:

- holders of credits derived from labor legislation or from labor-related accidents;
- holders of credits secured by real property rights; and
- holders of ordinary credits (unsecured credits), with special privilege (tax and social security) and with general or subordinated privilege.

The general meeting of creditors may form a creditors' committee composed of one representative of each of the aforesaid classes of creditors.

Once the rescue plan is submitted to the creditors for approval, all classes of creditors must approve the said rescue plan, according to the following thresholds:

- with regard to creditors of the classes (b) and (c) above, the rescue plan must be approved by a simple majority of the creditors present at the general meeting, provided that they also represent more than half of the total value of the claims submitted to the general meeting of creditors; and
- with regard to creditors of class (a) above, the rescue plan must be approved by a simple majority of the creditors present at the general meeting, regardless of the value of their credits.

Provided that (i) the debtor expressly agrees and (ii) the rights of the creditors not present at the general meeting are not impaired, the general meeting of creditors may change the rescue plan submitted by the debtor for approval. If the general meeting rejects the rescue plan, the judge will declare the insolvency of the debtor and insolvency procedures shall commence.

If the rescue plan is approved, it shall bind the debtor and all creditors (including those holding contingent claims) that are subject to the rescue plan.

Notwithstanding the above, the judge may declare that a rescue plan is binding on all creditors, even if it has not been approved by all classes of creditors in the same general meeting of creditors, provided the following quorums are cumulatively met:

- a favorable vote by creditors representing more than half of the total value of the claims submitted to the general meeting of creditors, regardless of the classes;
- a favorable vote by two classes of creditors (according to the thresholds indicated above) or, if there are only two classes of voting creditors, approval by at least one of them; and
- with respect to any class of creditors that rejected the plan, the favorable vote of more than one-third of the creditors (according to the thresholds indicated above).

The commencement of a judicial business rescue will impose a stay, for a non-extendable period of 180 days from the date on which the court accepts the petition for business rescue, on all pending and new claims and all actions and executions against the debtor company (including arbitration proceedings), except regarding credits derived from labor relationships.

During the business rescue process, the company is expected to conduct business under the supervision of the creditors' committee (if any) and of the insolvency administrator (appointed by the court) who shall handle the management of the company.

After the submission of the request to the court for judicial business rescue, the debtor company is not allowed to transfer or encumber any of the assets or rights of its permanent estate, save for what is authorized after the judge has heard the creditors' committee (if any) and the insolvency administrator. Exceptions are made for those contracts, transfers or encumbrances already contemplated in the rescue plan.

The business rescue procedure can be utilized to restructure and reorganize a corporate group on a consolidated basis for administrative efficiency provided it is established in the approved rescue plan.

Amongst other things, the following are permitted under a rescue procedure:

- Division, merger or conversion of the company, establishment of a wholly owned subsidiary or the transfer of shares, all subject to the rights of the shareholders in accordance with applicable law;
- Change of the company's control;
- Total or partial replacement of the debtor's managers or the modification of its corporate bodies;
- Share capital increase;
- The establishment of a management team selected by both the debtor and creditors;
- The incorporation of a creditors' company;
- The transfer of the commercial establishment, including to a company constituted by the debtor's employees;
- The incorporation of a specific purpose company to adjudicate, in payment of the claims, the debtor's assets; and
- A salary reduction, compensation schedules and reduction of work hours through an agreement or collective agreement.

The breach of any obligation contained in the agreed rescue plan by the debtor will lead to the conversion of the business rescue process into the insolvency of the company.

Insolvency

There is no obligation to commence insolvency proceedings within a specific timeline. The law provides that a debtor company will be considered insolvent if it is experiencing financial difficulties (which determination is made by the court on a case-by-case basis based on documentation presented by the petitioner) and believes it will not be granted a judicial business rescue or if, after having started an extrajudicial business rescue, no agreement has been reached with regard to the proposed rescue plan.

A request for declaration of insolvency (which will commence the liquidation within the insolvency process) may be submitted before the competent court by the debtor company or the shareholders of the debtor company, under the terms of the law or of the company's articles of association; and/or any creditor of the debtor.

As soon as the judge declares the insolvency of the debtor company, an insolvency administrator will be appointed and the liquidation process will commence.

From the insolvency declaration until the final and unappealable decision extinguishing the debtor's obligations, the insolvent debtor may not undertake any economic or business activity.

Insolvency Proceedings

Insolvency can be voluntary (the debtor company presents itself voluntarily in court requesting to be declared insolvent) or involuntary (the process is initiated by one or more creditors against the debtor).

Regardless of how it is initiated, the insolvency process will always result in the liquidation of the company (once it has been accepted by the court), unless, in case of involuntary insolvency, the debtor contests the insolvency procedure and such objection is accepted by the court.

The declaration of insolvency and the list of creditors of the insolvent company must be published in the Government Gazette. From the date of such publication, creditors have 10 days to prove any claim that they believe they have against the company.

Any claim against the debtor must be submitted to the insolvency administrator who will, within 30 days, publish a notice indicating the place, time and deadline for opposition to a creditor's claim.

The judgment declaring the insolvency will also order the suspension of any and all claims and executions against the insolvent company, save for those claims instituted or executed by the debtor's employees, which will continue in force. Furthermore, the same judgment will suspend any retaining right held by a creditor who must return any assets so retained to the insolvency administrator.

Any creditor may request that a debtor be declared insolvent whenever the debtor:

- Does not pay on maturity, without justification, a net obligation (no *de minimis* amount) which is subject to an enforceable title;
- Having been ordered to pay any net amount, does not, within the legal timeframe, pay, deposit or list, for attachment purposes, sufficient assets to cover the debt; and/or
- Carries out any of the following acts, except if they form part of a rescue plan:
 - Proceeds with a hasty liquidation or resorts to ruinous or fraudulent means to make payments;
 - Performs, or attempts to perform, in order to delay payments, or to defraud creditors, a simulated/false transaction or disposal, partial or total, of its assets to a third party, whether such third party is a creditor or not;
 - Transfers its business to a third party, whether such party is a creditor or not, without the consent of all creditors and without keeping sufficient assets to pay its liabilities;
 - Simulates the transfer of its principal business for the purposes of defrauding the law or in order to harm the creditor;
 - Gives or strengthens security granted to a creditor without keeping sufficient free and clear assets to pay its liabilities;
 - Becomes absent, without leaving a legal representative with enough resources to pay the creditors, abandons its business establishment or tries to hide from its domicile, place of registered office or main business establishment; and/or
 - Fails to comply, within the prescribed time period, with an obligation imposed on it in respect of any rescue plan.

In a situation of insolvency, the management of the company is fully replaced by the insolvency administrator. The board of directors relinquishes its responsibilities save for the requirement to assist the insolvency administrator in the winding-up of the company. From the moment that the insolvency is declared or the assets have been seized, the debtor can neither manage nor dispose of its assets, but it has the right to supervise the activity of the insolvency administrator and request appropriate measures for the preservation of its rights or seized assets.

During the insolvency proceeding, it is possible to set-off debts which matured up to the date of the declaration of insolvency. Set-off is not possible in regards to:

- credits transferred after the declaration of insolvency, except in cases of succession by merger, incorporation or division; and
- credits which, even if matured before the declaration of insolvency, were transferred when the economic/financial crisis of the company was already known, or those transferred with fraud or fault.

Sale of assets or a business is executed by the court in accordance with the rules of the Code of Civil Procedure. Under the Insolvency Law, the object of the sale will be sold free of any liens or encumbrances and does not imply the succession of the purchaser to the debtor's obligations, including tax obligations. The liquidation of the assets should occur immediately after the seizure of all the assets of the debtor, but there is no timeline imposed by the law.

Once the restitutions are made, the non-concurrent credits (as defined in the section below) are paid and the list of creditors is consolidated, all proceeds received from the sale of the assets are used to pay the creditors, taking into consideration the ranking of the respective credits.

Once the proceeds of the liquidation of assets are distributed to the creditors, the insolvency administrator must submit a preliminary report to the judge. Afterwards the insolvency administrator must submit a final report detailing the value of the assets and the proceeds obtained from each sale of such assets, the value of the liabilities of the company and payments made to creditors as well as the responsibilities that continue to be incumbent on the insolvent estate. Upon receiving this last report, the judge will hand down a judicial sentence terminating the liquidation which will be published in the Government Gazette.

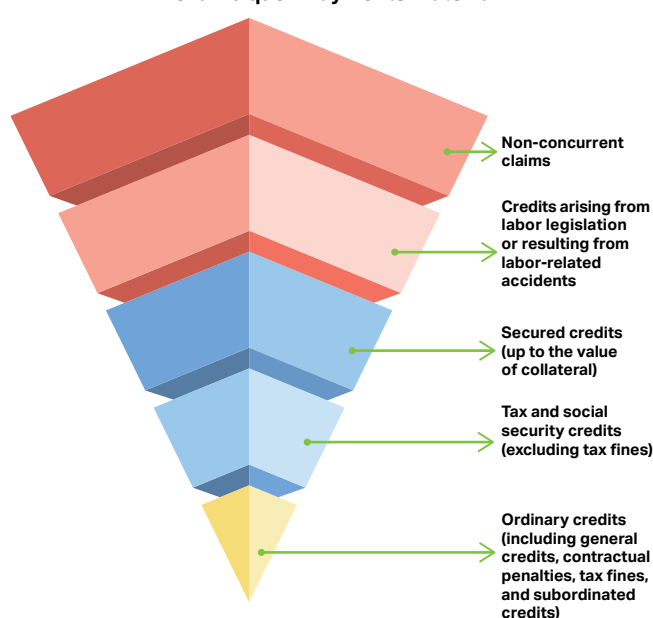
General considerations

Debt Trading

The Insolvency Law does not prohibit the trading of claims, which must be done in accordance with the general Civil Code. The transferee must submit its rights to the claims before the court with the insolvency administrator.

The customary legal mechanics of debt transfer are novation and assignment and the associated security is usually transferred with the debt.

Mozambique – Payments Waterfall



Priorities and Waterfalls

The following are considered priority claims (also called “**non-concurrent claims**”) in restructuring and insolvency procedures (according to the order set forth below):

- Remuneration owed to the insolvency administrator and his/her assistants;
- Credits arising from the labor legislation or from labor-related accidents regarding services rendered after the declaration of insolvency;
- Amounts that were provided to the insolvent estate by the creditors after the declaration of insolvency (a concept similar to but distinct from “debtor-in-possession financing” as it does not benefit from super-priority status);

- Expenses related to the apprehension, administration and sale of the assets, and distribution of the respective proceeds, as well as the costs of the insolvency process;
- Judicial costs regarding the actions and executions in which the insolvency estate has been overcome; and
- Obligations arising from valid judicial acts performed during the judicial business rescue or after the declaration of insolvency, and tax expenses generated after the declaration of insolvency.

The waterfall, or ranking of credits, is as follows:

1. Non-concurrent claims;
2. Credits arising from labor legislation or resulting from labor-related accidents before the declaration of insolvency;
3. Secured credits, up to the value of the collateral (any attempted “sharing” of the security with other creditors requires the prior approval of the secured creditor and the debtor. If the original security is amended to include other creditors, in that case such other creditors become secured creditors);
4. Tax and social security credits (excluding tax fines); and
5. Ordinary credits, including the general credits, the contractual penalties and tax fines and the subordinated credits.

Remedies Available to Unsecured Creditors

As can be seen above, unsecured creditors are typically ranked last in the waterfall. That said, unsecured trade creditors are generally kept whole during a restructuring process, provided they are identified and have their credits recognized under the restructuring procedure.

Unsecured creditors may also seek other protections. For example, Mozambican laws on civil proceedings allow for interim relief measures to be decided by the courts within a maximum of 30 days from the date on which the restructuring process is accepted and serve to protect an imminent risk of loss or aggravation of the risk to the claimant. The interim relief measure is only provisional, and it requires that a main suit begin within 30 days after the relief measure has been declared by the courts at the court of competence in accordance with the contract in dispute. If the main action does not start within such period of time, the court will be forced to release the order given under the interim relief measure.

However, as mentioned above, the commencement of the judicial restructuring will suspend, for 180 days, the course of all pending claims and all actions and executions against the debtor; and the declaration of insolvency will suspend all claims and executions against the debtor. The declaration of insolvency also suspends any exercise of retention rights and the exercise of the right to be exonerated or of the transfer of shares with regard to its shareholders.

In normal enforcement cases (i.e., outside of insolvency or recovery procedures), which is the more common form of seeking recovery, the timeline for enforcing an unsecured claim can be up to two years.

There are no special procedures or impediments that apply to foreign unsecured creditors. However, it should be noted that all credits in foreign currency will be converted into the national currency at the rate applicable on the date of the judicial decision (for both insolvency and restructuring procedures).

Secured Creditors: Security and Enforcement

Collateral available in Mozambique falls into two categories: (i) real property security such as mortgages and pledges; and (ii) personal security such as suretyships or promissory notes.

A pledge and other security may be enforced extra-judicially if the debtor agrees to it. If not, only the courts may enforce the security as Mozambican law does not allow for self-appropriation measures. Mortgages may only be enforced by courts.

In normal enforcement cases (i.e., outside of insolvency or recovery procedures), the timeline for enforcing security can be up to two years.

As for the cases within the insolvency and restructuring procedures, it should be noted that the enforcement of security outside these procedures will not be allowed as creditors will have to claim their rights and credits within the respective procedures.

Similar to foreign unsecured creditors, there are no special procedures or impediments that apply to foreign secured creditors but all credits in foreign currency will be converted into the national currency at the rate applicable on the date of the judicial decision (for both insolvency and restructuring procedures).

Transactions that may be set-aside

Under the Insolvency Law, the following transactions may be annulled:

- Payments by the debtor company of debts which are not due for payment;
- Payments of debts due and payable within their legal term in a manner not provided for in the contract;
- Creation of an *in rem* right of security, including the right of retention, in case the debt was previously contracted;
- Transactions for no consideration, within a period of two years prior to the declaration of insolvency;
- The sale or transfer of the business without the express consent of, or payment to, all creditors; and/or
- The registration of a real property right and the transfer of ownership thereafter, or the endorsement of an immoveable property, made after the declaration of insolvency.

In addition, any act performed by the debtor prior to the commencement of insolvency with the intent to cause harm to creditors is revocable.

Except for the situations where it is two years, as mentioned above, the claw back period prior to the onset of the insolvency, pursuant to which the transactions can be challenged, shall be the one determined by the court in the insolvency declaration, which cannot be more than 90 days before the judicial business rescue or insolvency request.

Claims regarding the aforesaid transactions can be brought by any of the creditors, the creditors' committee (if any), the insolvency administrator, or by the State's Public Prosecutor Office. Such claims can be brought in both restructuring and insolvency proceedings.

Conclusion

There is still significant cultural resistance in Mozambique to instituting insolvency or restructuring through court proceedings and the number of precedents is still very limited. These factors, together with the fact that there is no public record of the court decisions, inhibit investors and entrepreneurs from embarking on a process of insolvency or restructuring.

Scorecard of Mozambique's Current Insolvency Regime

Experience Level: Recently approved law or no established precedents

KEY PROCEDURAL ISSUES

Can bondholders/lenders participate directly? (i.e., do they have standing to individually participate in a proceeding or must they act through a trustee/agent as recognized creditor?)	Yes
Involuntary reorganization proceeding that can be initiated by creditors?	No
Can creditors propose a plan?	No (but they can vote to amend a plan proposed by the debtor)
Can a creditor-proposed plan be approved without consent of shareholders?	N/A
Absolute Priority Rule?	Yes
Are ex parte proceedings (where only one party participates and the other party is not given prior notice or an opportunity to be heard) permitted?	No
Are corruption/improper influence issues a common occurrence?	No
Viable prepackaged proceeding available that can be completed in 3-6 months	No
Secured creditors subject to automatic stay? ²²	Yes
Creditors have ability to challenge fraudulent or suspect transactions (and there is precedent for doing so)	Yes, but we are not aware of precedents
Bond required to be posted in case of involuntary filing or challenge to fraudulent/suspect transactions?	No
Labor claims can be addressed through a restructuring proceeding	Yes
Grants super-priority status to DIP financing?	No
Restructuring plan may be implemented while appeals are pending?	Yes, within the 10 days granted to the debtor to contest the insolvency request
Does the restructuring plan, once approved, bind non-consenting (or abstaining) creditors?	Yes
Does the debtor have the ability to choose which court in which to file the insolvency proceeding (or is it bound to file where its corporate domicile is)?	No
Other significant exclusions from automatic stay? ²²	Yes, credits derived from the labor in judicial restructuring and insolvency proceedings
Prevents voting by intercompany debt?	N/A
Strict time limits on completing procedure?	No
Management remains in place during proceeding?	Yes, in restructuring proceedings No, in insolvency proceeding

One recent known case is that of the restructuring proceeding of Moza Banco, S.A., a Mozambican commercial bank, with the purpose of restoring its prudential and financial stability. The Bank of Mozambique, as supervisor of the financial and credit institutions, unilaterally determined the application of reorganization measures, which included the recapitalization of the said bank by means of the increase of the respective share capital. These measures were adopted based on the legislation applicable to the credit institutions and financial companies only and without resorting to the restructuring regime set forth in the Insolvency Law. This is an example of the lack of confidence and possibly lack of knowledge still existing with regard to the Insolvency Law.

It is our opinion that this situation (of lack of confidence and knowledge) shall only be overcome once the current insolvency and restructuring regime has been tested and proved effective. To this end, investing in the training of specialist judges for insolvency and restructuring, reducing the response time of the courts on this matter and making public the court decisions would surely be important actions to improve the application of the said regime. Another option would be to explore the possibility of extrajudicial restructuring foreseen in the Insolvency law, using conciliators or mediators (under the Arbitration Law) which would be trained to become specialists in insolvency and restructuring.

Finally, there is one provision of the Insolvency Law which (to the best of our knowledge) has not been tested yet and may have an important impact on entrepreneurs in general and foreign creditors/investors in particular. The declaration of insolvency automatically accelerates the indebtedness of the debtor and converts all the credits in foreign currency into the national currency (Meticals) at the rate applicable on the date of the judicial decision. Taking into consideration the currency devaluation, which has been affecting Mozambique in recent times, this may have a very negative impact on the foreign credits as the foreign creditors will be impaired by the currency fluctuations between the time in which the respective credits are converted into Meticals and the time on which they are effectively paid. We do not believe this negative factor was considered at the time of approval of the Insolvency Law but taking into consideration the current Mozambican economic and financial situation it is definitely something that will need to be addressed with respect to insolvency proceedings involving companies with foreign creditors. ■



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1. There is no imposition to resort first to informal procedures before filing for a formal "statutory process".
2. There is no automatic stay in extrajudicial restructuring proceedings.

Debt for Equity Swaps, a solution to China's NPL problems?

By ALESSANDRO NOLET and CAMILLA WONG



China has been under increasing pressure to address its excessively high corporate debt levels in recent years. To that end, in March, 2016¹, Chinese regulators introduced a new debt-for-equity conversion framework — a promising approach, notwithstanding certain limitations and potential weaknesses.

Based on data from the Bank for International Settlements (“**BIS**”), China’s total outstanding debt reached 260% of its gross domestic product (“**GDP**”) by the end of 2016, up significantly from 160% at the end of 2008.² According to S&P Global Ratings, Chinese corporate leverage is the highest in the world, standing at approximately US\$18 trillion.³ While other countries, such as the U.S., may have experienced similarly high debt levels⁴, there are growing concerns that this high

credit-to-GDP ratio is not sustainable under the current institutional and regulatory framework in China.⁵

Indeed, the rising level of corporate debt, coupled with various market factors, including slowed earnings growth, industrial overcapacity and operating difficulties, has resulted in a growing number of corporate credit defaults.

China Debt Metrics

- Total Debt: 255% of GDP
- Corporate Leverage: \$18 Trillion
- 'At Risk' Bank Loans: \$1.3 Trillion

The challenges experienced by the corporate sector also mean that China's banking sector faces a growing number of non-performing loans ("NPLs"). The latest International Monetary Fund ("IMF") Global Financial Stability Report suggests that up to US\$1.3 trillion of the total commercial banks' loans to corporations are at risk.⁶ In addition, narrowing profit margins have increasingly challenged Chinese banks due to a significant loosening of monetary policy introduced by the People's Bank of China.⁷ Together, deteriorating corporate-sector credit quality and a less favorable macro environment are putting the banking sector in China under significant stress.

In an effort to address the problems of excessive corporate debt and the growing number of impaired bank loans, the Chinese government and regulators have introduced various new measures, including a new debt-for-equity conversion scheme. The aim of this scheme is to reduce the number of NPLs weighing down on the banks' books and to alleviate the levels of debt burdening corporations. Through ownership restructuring and a re-alignment of each respective parties' incentives, it is believed that the indebted companies will receive a necessary lifeline to overcome their present challenges while enhancing banks' balance sheet liquidity and thereby releasing capital for new investments.

Debt-for-equity conversion schemes are not unfamiliar to China: in 1999, the government introduced a similar program by setting up four state-owned asset management companies ("AMCs") to exclusively purchase bad debts of state-owned enterprises ("SOEs") from four large state-owned commercial banks, and the AMCs then disposed of underperforming loans by converting them into equity with a strategy envisaging a 10-year holding and exit period. In this earlier program, a total of 580 companies entered into debt-for-equity swaps for an amount of approximately US\$60 billion, representing around one-third of the total bad debt at the time.⁸

Contrary to its predecessor, however, the new scheme embodies a more market-oriented approach and envisages much less involvement by the Chinese central government. In particular, the scheme will not be solely limited to SOEs and commercial banks will be free to choose whether to participate in any given

transaction. While investors around the world have generally welcomed the market-oriented approach of the new scheme, there are still some doubts as to how the scheme will be implemented and whether it will be successful in addressing the underlying NPL problem.

In a recent report, the IMF identified a number of features which are generally necessary in order to ensure the success of a debt-for-equity conversion scheme. However, investors and commentators alike have found China's new scheme to be lacking in each of these criteria to some degree or another.

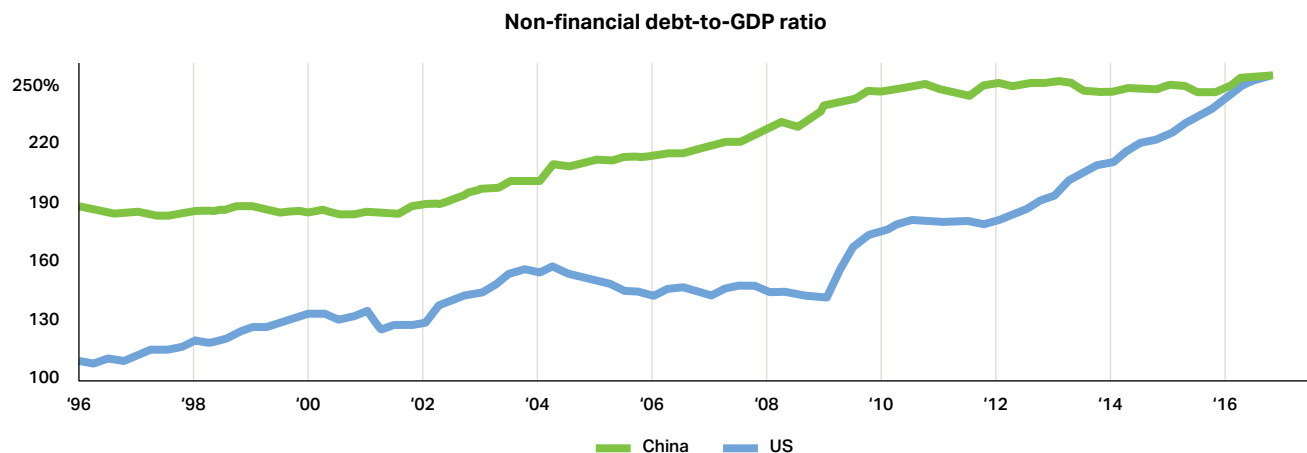
IMF Criteria for Successful Debt-to-Equity Conversion

- Creating strict viability and eligibility criteria for corporations
- Sound corporate governance
- Limiting the scope and time of bank ownership of equity
- Converting debt at fair value and recognizing losses

Creating strict viability and eligibility criteria for corporations

The IMF stressed that banks should only convert debt to equity where there are clear advantages to do so and where there is an opportunity to exit the relevant position over the short-to-medium-term. This will require assessing potential targets to ensure that the scheme is made available only to companies with a high chance of success and filter out so-called "zombie" firms. Indeed, this was one of the Chinese government's stated goals. However, the new scheme does not provide any tangible guidance as to what the eligibility criteria should be. Instead, the scheme relies heavily on the principle of hinging on a market-oriented approach. In a recent directive issued by the China Banking Regulatory Commission ("CBRC"),⁹ "zombie" SOEs are expressly prohibited from participating

Deteriorating corporate-sector credit quality and a less favorable macro environment are putting the banking sector in China under significant stress.



Data: Bank for International Settlements

in the scheme. While this directive supports the views that the scheme is intended only for firms with a high chance of success, it does not provide any guidance on the eligibility criteria for the scheme; short of clarifying that it should not apply to entities with “no hope of turning around their losses, and have already lost any prospect for survival and development”. This is probably evidence of the Chinese Government’s reluctance to interfere with such assessment and, instead, let market players draw their own conclusions on the prospect of success of any particular transaction (other than cases which are glaringly across the “zombie” line). This means, among other things, that the relevant investors will need to make their own assessment of potential targets. In turn, this may open the scheme to a wide spectrum of possible outcomes, considering also the range of potential participants which may seek to take advantage of this instrument (each with very different underlying agendas and appetite for risk).

Sound corporate governance

The proper management of a company is also a key element in optimizing a debt-for-equity conversion program. The IMF suggests that, in their role as new equity holders, the converted creditors should have the ability to replace management, even when they hold a minority stake only. The IMF reasons that this is likely to induce management to address existing problems and propose new strategies to attract fresh investors as well as enable former creditors to exit. The new Chinese regime does not expressly contemplate this option. There is no explicit right or obligation on the banks to manage the relevant distressed target. Nor is there an obligation on the distressed companies to manage their business in accordance with the directions of the creditors engaged in the swap. In practice, the actual

involvement of the former creditors in the management of the debtor is likely to vary from case to case – depending also on the nature of the creditors in question. To an extent, the fact that banks and financial investors may not necessarily have the ability and expertise to run a company in a particular sector argues against this scheme. Nevertheless, they can always use their powers as shareholders to appoint new management. Moreover, it seems only natural that the debtor’s management would cooperate with the former creditors in order to agree on any necessary reforms and discuss their potential exit strategies.

Limiting the scope and time of bank ownership of equity

While the IMF recognizes that a bank should only hold its equity stake in a company for a limited period of time, it acknowledges that this should be assessed on a case-by-case basis. The new Chinese scheme seems to share this approach even though it provides no specification as to what such a period of time should be.

Converting debt at fair value and recognizing losses

As part of a comprehensive strategy, the IMF suggests including regulatory and supervisory measures to ensure that banks proactively identify and manage impaired assets in an effort to flush out losses. However, the inherent desire to over-value loans in an effort to minimize the impact of realizing losses raises concerns that there will be a conflict of interest or, at the very least, minimal incentives to follow the market-oriented approach as suggested by the Chinese government. Without

Contrary to its predecessor, however, the new scheme embodies a more market-oriented approach and envisages much less involvement by the Chinese central government.

any guidance on how debt should be valued, there is a risk that the advantages of the debt-equity conversion will be utilized for short term gains without addressing the true underlying problems which initially contributed to the growing debt problem.

Conclusion

Despite these drawbacks, the new debt-for-equity conversion framework is still one of the few concrete measures introduced by the Chinese government to tackle the growing problem of NPLs and to free up liquidity on banks' balance sheets; indeed it has already been used in a number of high profile cases, with the aggregate value of such transactions already exceeding US\$ 70 billion of bank debt at par value.

By way of example, China Construction Bank recently announced that it would carry out a debt-for-equity swap of RMB 2.35 billion (approximately US\$ 340 million) with respect to its position in Yunnan Tin Group. Other high profile target companies include Sinosteel and China First Heavy Industries, while the list of banks which have started swapping debt for equity under the new scheme includes Industrial and Commercial Bank of China, Agricultural Bank of China, China Construction Bank, Bank of China and Bank of Communications.

Additionally, China Construction Bank recently launched Jianxin Financial Assets Investment Co., Ltd., the first market-based debt-to-equity swap vehicle with a registered capital of RMB12 billion⁹⁰. The approval by the CBRC for the establishment of this vehicle is significant as it illustrates the nation's policy to support further deleveraging by way of a market-oriented based approach pursuant to the debt-for-equity swap program.

While the new debt-for-equity swap program represents a step in the right direction, the market perception is that it remains an interim solution only and that the Chinese government will need to introduce additional measures, likely based on the IMF guidelines, in order to optimize the benefits of the scheme. ■

1. See Financial Times, *China Explores Debt-for-Equity Swaps to Defeat Bad Debt Pile-Up*, available at: <https://www.ft.com/content/c6e7ccc2-eb44-11e5-bb79-2303682345c8>
2. The applicable BIS statistic is "total credit to the non-financial sector (core debt)," expressed as a percentage of GDP, available at: <http://stats.bis.org/statx/srs/table/f1.1?p=20164&c=>
3. S&P Global Ratings estimates China's current corporate debt-to-GDP ratio to be at 166%, up from 96% at the end of 2008.
4. The total outstanding debt in the US in 2015 amounted to 331% of its GDP. https://ycharts.com/indicators/us_total_debt_gdp
5. Sahay and others (2015) found that China's financial depending has been excessive relative to advancements in its institutions and regulations. See IMF report page 3: <https://www.imf.org/external/pubs/ft/wp/2016/wp16203.pdf>
6. See page 16: <https://www.imf.org/external/pubs/ft/gfstr/2016/01/pdf/text.pdf>
7. In 2015 alone, the PBOC cut the deposit and loan interest rates five times.
8. See statistics from Xinhua news: http://news.xinhuanet.com/english/2016-10/10/c_135743737.htm
9. The Commercial Bank Newly Established Debt-Equity Swap Implementation Organization Administrative Measures (Trial) (商业银行新设债转股实施机构管理办法 (试行)) dated 7 August 2017.
10. Please refer to: <http://www.chinabankingnews.com/2017/07/24/beijing-accelerates-deleveraging-state-owned-enterprises-debt-equity-swaps/> AND https://translate.google.com.hk/translate?hl=en&sl=zh-CN&u=http://www.ccb.com/cn/ccbtoday/news/20170802_1501645390.html&prev=search AND http://www.ccb.com/cn/ccbtoday/news/20170802_1501645390.html



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The New Polish Restructuring Law: a “Second Chance” for Businesses

By: KLAUDIA SZYMANSKA-RUTKOWSKA and SZYMON GALKOWSKI



The new Polish Restructuring Law of 15 May 2015 (the “**Restructuring Law**”) effective as of January 2016 provides for a variety of brand new restructuring procedures implementing the so-called “second chance” policy for businesses, with an emphasis on maximising the speed and effectiveness of restructuring and bankruptcy proceedings. After nearly one and a half years since its entry into force the number of bankruptcies has fallen and debtors are more and more often choosing to initiate restructuring proceedings.

The World Bank Group Doing Business Report 2017 noted that “Poland introduced new restructuring mechanisms and established a centralized restructuring and bankruptcy register”. It also pointed out that “Poland made resolving insolvency easier by introducing new restructuring mechanisms, changing voting procedures for restructuring plans and allowing creditors greater participation in insolvency proceedings.” As a result,

Poland’s rank in the area of “Resolving Insolvency” improved from 33 (in 2016, adjusted¹) to 27 in 2017.

The Restructuring Law also introduced a range of major changes to the Polish Bankruptcy and Restructuring Law of 28 February 2003, which from 1 January 2016 was renamed the Bankruptcy Law (the “**Bankruptcy Law**”).

General overview

The Restructuring Law regulates how insolvent debtors or debtors threatened with insolvency may enter into an arrangement with their creditors. It introduces new procedures, allowing the restructuring of a debtor's business and preventing its bankruptcy as well as substantial amendments to the Bankruptcy Law. Restructuring proceedings set forth in the Restructuring Law ensure the possibility to choose the form of restructuring suited to the exact needs of a business and its financial situation.

The main difference between restructuring proceedings is the scope of protection granted to the debtor and the role of the court in the proceedings.

Determining a limit of 15% of the disputed claims with respect to the arrangement approval proceedings and the accelerated arrangement proceedings is due to the need to ensure that in all circumstances a decision on the conclusion of the arrangement may be taken by a majority of creditors. In situations where it is necessary to obtain approval of creditors having at

least 2/3 of the sums owed to voting creditors, even omitting all voting creditors having disputed claims (up to 15%), eventually the decision is made by creditors holding at least 51% of the total sum of claims of voting creditors.

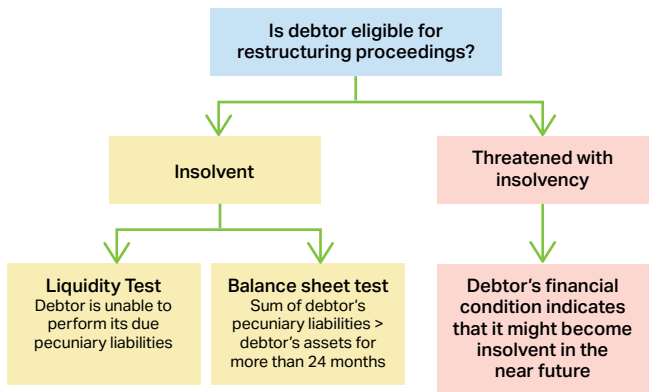
The Restructuring Law also provides for a new type of restructuring tool in the form of a partial arrangement, which can be achieved in restructuring proceedings with a selected group or groups of creditors.

Restructuring proceedings are collective proceedings. Participants of these procedures are all personal creditors of the debtor, whose economic interests may be different. In principle, with the assumption of joint action, the common interest of creditors takes priority over the interest of a single creditor or group of creditors. Other interests include creditors with security over the debtor's assets in a way that guarantees them 100% satisfaction in the event of liquidation of that property, and employees who are primarily interested in maintaining their jobs. The Restructuring Law provides for instruments to balance and, where possible, jointly pursue these interests.

The Restructuring Law provides for the following four types of restructuring proceedings:

	Description	Debtor in possession	Stay on execution
Arrangement approval proceedings (pre-pack)	A debtor independently collects the creditors' votes on the restructuring plan prepared by supervisor. Minimal role of the court. May be initiated only if the sum of the disputed claims does not exceed 15% of the total claims entitled to vote on the arrangement.	Yes.	No.
Accelerated arrangement proceedings	The court calls a creditors' meeting to vote on the restructuring plan prepared by a supervisor. Minimal role of the court. May be initiated only if the sum of the disputed claims does not exceed 15% of the total claims entitled to vote on the arrangement.	Only with respect to ordinary course of business. For extraordinary course of business – consent of the supervisor or the creditors' committee required.	Yes.
Arrangement proceedings	The court supervisor prepares the inventory of assets and liabilities. The court calls a creditors' meeting to vote on the restructuring plan prepared by a supervisor.	Only with respect to ordinary course of business. For extraordinary course of business – consent of the supervisor or the creditors' committee required.	Yes.
Remedial ("sanation") proceedings	Involves complex reorganization under the strict supervision of the court, allows restructuring tools like conversion of debt to equity or the sale of the debtor's assets.	No. Ordinary administration by debtor may be permitted with the court's consent.	Yes.

Initiation of the proceedings



The possibility of initiating these proceedings is not available to those entrepreneurs who have the capacity to settle their obligations and are under no threat of insolvency, and nevertheless are seeking to profit from the restructuring procedures without any merit. Adoption of restructuring procedures is however available to insolvent debtors for who, mainly due to the interests of creditors, it may be more advantageous to obtain satisfaction as a result of the implementation of an arrangement than by liquidation of the debtor's assets in bankruptcy proceedings.

An application for the commencement of restructuring proceedings may only be filed by the debtor (except for remedial proceedings, where the application for the opening of remedial proceedings in respect of an insolvent legal person may also be filed by a personal creditor).

Concurrent restructuring and bankruptcy proceedings

If a restructuring application and bankruptcy application are filed at the same time, the court will examine the application for the commencement of restructuring proceedings first. However, if withholding the application for a declaration of bankruptcy is contrary to the creditors' interests, the court will consider the application for a declaration of bankruptcy for joint recognition with the application for the commencement of restructuring proceedings.

The insolvency of an entrepreneur cannot be declared in the period between the opening of the restructuring proceedings and the completion of the restructuring proceedings or its final discontinuance (i.e., without a resolution on the restructuring).

Restructuring proceedings may be initiated if a debtor is insolvent or threatened with insolvency:

Definition of "insolvent"	<p>A debtor who meets:</p> <ol style="list-style-type: none"> 1. the balance sheet test: <p>A debtor will be deemed insolvent when the sum of its pecuniary liabilities exceeds the value of its assets, and this situation continues for longer than 24 months.</p> <p>Pecuniary liabilities do not cover future liabilities, including liabilities under suspensory conditions and liabilities towards a shareholder under a loan or similar.</p> <p>Insolvency will be presumed if, according to the balance sheet, the debtor's obligations (excluding reserves for liabilities and liabilities towards affiliates) exceed the value of its assets, and this situation continues for longer than 24 months.</p> <p>or</p> <ol style="list-style-type: none"> 2. the liquidity test: <p>The debtor will be deemed insolvent if it is unable to perform its due pecuniary liabilities.</p> <p>The insolvency will be presumed if a delay in payments exceeds three months.</p>
Definition of "threatened with insolvency"	<p>A debtor whose financial condition indicates that it might become insolvent in the near future.</p>

Restructuring plan

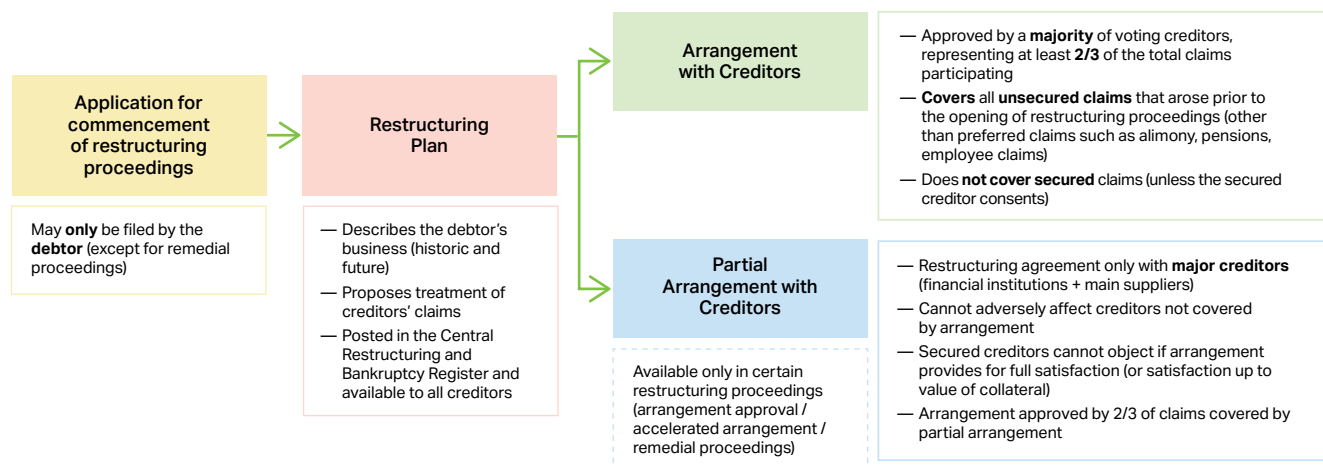
The main focus of restructuring proceedings is the restructuring plan. It should comprehensively describe the debtor's business (both historically and in the future) and the environment in which it operates.

The restructuring plan will be posted in the Central Restructuring and Bankruptcy Register (available from 1 February 2018 and described below in further detail) and will thus be available to all creditors. This will enable it to be a factor on the basis of which the creditor will decide on the acceptance of the proposed arrangements and the creditors will be able to verify progress in implementing it. At the moment, until the day of the establishment of the Register, the restructuring plan shall be available in the court's secretariat.

Arrangement

Each of the restructuring proceedings is intended to lead to an arrangement with creditors upon obtaining consent from the relevant majority of them.

General Process for Commencement and Approval of a Restructuring Proceeding



In essence, the arrangement shall cover all personal claims (together with interest) that arose prior to the day of opening of restructuring proceedings. However, *inter alia*, maintenance, alimony and acquisition of inheritance, receivable debts and pensions, receivable debts under an employment relationship as well as claims secured by the debtor's property through a mortgage, pledge, registered pledge, treasury pledge or ship's mortgage (and, accordingly, secured by a transfer of title), to the extent covered by the value of the object of security, are excluded from the arrangement. The secured creditor may, however, consent to the arrangement covering the secured debt.

A very important feature of the restructuring proceedings is that an arrangement is approved when a majority of the voting creditors, representing at least two-thirds of the total claims participating in the voting, vote in favour of the arrangement. Under previous regulation the requirement of the majority of creditors voting for the arrangement referred to the total amount of claims entitled to vote on approval of the arrangement — even the claims of creditors not participating in the voting.

At present, acceptance of an arrangement will not be affected by passive creditors. If voting on an arrangement will take place in creditors' groups of interest categories, the arrangement will be adopted if in each group the majority of the voting creditors in that group, which together collect at least two thirds of the sum of the debt owed to voting creditors in that group, votes for it.

The Restructuring Law provides for the so-called “ban on obstruction” to allow some groups of creditors to be disregarded if the appropriate majority is counted from all the voting creditors and the opposing creditors are satisfied at least on the same level in hypothetical insolvency proceedings.

An additional element that secures the rights of creditors in the voting on an arrangement is the introduction of a quorum. At the meeting of creditors, an arrangement may be concluded if at least 1/5 of the creditors entitled to vote on the arrangement participate in the voting. This regulation is to make the arrangement representative of the majority.

An arrangement adopted by the creditors' meeting is subsequently approved by the court. The Restructuring Law introduced the possibility for the participants (the debtor and creditors) to file objections against the arrangement. Objections are not a means of appealing, but merely a negative evaluation of the arrangement. Properly placed objections are taken into account by the court when deciding on the approval of the arrangement. Hence, in the grounds of the court's decision (if it is drawn up), reference should be made to the objections raised.

The Restructuring Law provides for mandatory and optional grounds for court refusal to approve the arrangement.

Obligatory basis for refusal of approval of the arrangement	Optional basis for refusing the approval of the arrangement
<ul style="list-style-type: none"> — The arrangement violates the law. — It is clear that the arrangement will not be executed. It is presumed that the arrangement will not be executed if the debtor has not fulfilled obligations arising after the opening of proceedings. — In the proceedings for the approval of the agreement and in the accelerated arrangement proceedings, the sum of the disputed claims giving rise to voting over the arrangement exceeds 15% of the sum of the claims giving rise to voting over the arrangement. 	<ul style="list-style-type: none"> — The terms of the arrangement are grossly unfair to creditors who voted against the arrangement and raised objections.

Creditor's rights

The Restructuring Law introduces features increasing the influence of creditors on the course of proceedings while limiting the role of the court and the judge-commissioner, who performs judicial acts in the course of the restructuring proceedings (save for those acts for which the court is competent), directs the course of the restructuring proceedings, exercises supervision over acts of the court supervisor and receiver, designates acts the performance of which by the court supervisor or receiver shall be inadmissible without his permission or without permission of the committee of creditors, and points out deficiencies in their performance thereby.

Creditors will be able effectively to demand the appointment of a creditors' council, and their application will oblige the judge-commissioner to appoint it. In addition, the judge-commissioner will be required to appoint a creditor designated by the creditors holding a certain part of the claims as a member of a creditor's committee. Similarly, the judge-commissioner will be required to change the composition of the creditors' council. Creditors with 30% of the claims will be able to apply together with the debtor to appoint a particular person as a court supervisor or administrator. The judge-commissioner will be able to refuse to appoint a designated person only in exceptional cases.

The creditors' council will be able to change the court supervisor or the administrator or allow the debtor to manage the business to the extent not exceeding the scope of ordinary management duties. The Restructuring Law also provides

for many regulations to prevent delaying the procedure, in particular introducing terms for the court supervisor or administrator, judge-commissioner and court.

The main purpose of the Restructuring Law is to strengthen the position of creditors in the course of the proceedings and to give them real influence on its course. The creditors' committee is the authority representing the interests of creditors in the course of the proceedings. Its powers and whether it can effectively execute them depends therefore on the realization of the main aim of the restructuring, which is to avoid declaration of bankruptcy of a debtor.

Hardening periods

The Restructuring Law also provides for certain hardening periods which apply in the case of the opening of remedial (*sanation*) proceedings. Among other things, such hardening periods result in the ineffectiveness of security interests which, on the day when the security was established, exceed by more than half the value of the secured receivables received by the debtor if the security was established within one year before the day of filing of the application for the opening of restructuring proceedings.

Important:

Hardening periods in the Restructuring Law will not apply to agreements for the establishment of financial collateral referred to in the Polish Act on Specific Collateral of 2 April 2004.

Hardening periods in the Restructuring Law will apply to suretyships, guarantees, and similar acts performed in order to secure a claim.

Secured creditors

Secured creditors are not covered by a restructuring arrangement unless they give their consent to have their claim included in the arrangement, in which case the security interests secure the claims on terms and conditions set in the arrangement. As a rule, during the restructuring proceedings, enforcement by the secured creditors may be conducted solely with regard to the specified collateral. The enforcement may be suspended for a maximum of three months, if the object of security is necessary for the running of the debtor's business. This rule is exempted with respect to the remedial (*sanation*) procedure, where execution proceedings directed

at the debtor's assets included in the remedial estate initiated prior to the day of the opening of remedial proceedings shall be suspended by operation of law on the day of opening the proceedings (irrespective of whether the creditor's claims are included in the arrangement or not).

Partial arrangement

The law introduces a new type of restructuring tool - a partial arrangement. It is not always necessary to conclude an arrangement with all creditors in order to effectively restructure the company. This applies especially to large and very large companies with multiple creditors, but for whom it is important only to agree with the major creditors, who are often financial institutions or principal suppliers. In such a situation, there is no need for all creditors to be involved in the proceedings, as the debtor expects that, as a result of the arrangement, it will be able to satisfy in full the remaining creditors.

The partial arrangement may be accepted and approved only in the arrangement approval proceedings or in the accelerated arrangement proceedings. In the arrangement proceedings and remedial (*sanation*) proceedings, due to the greater scope of protection of the debtor against creditors and also creditors not covered by the arrangement (e.g. suspension of all enforcement proceedings due to the opening of the remedial proceedings), the conclusion of a partial agreement is not possible (with exception that in the course of remedial proceedings it shall be permissible to file an application for approving a partial arrangement or an application for opening accelerated arrangement proceedings in which a partial arrangement is to be adopted provided that creditors covered by the partial arrangement are creditors not covered by an arrangement by operation of law and in remedial proceedings they did not express consent for being covered with an arrangement).

The separation of creditors covered by the partial arrangement should be based on objective, unequivocal and economically justified criteria concerning the legal relationships linking the creditors with the debtor, from which relationships the obligations covered by arrangement proposals result. In particular, creditors covered by the partial agreement may be:

- a. in respect of financing the debtor's activity with granted credits, loans and other similar instruments;
- b. under contracts of critical importance for the operation of the debtor's business, in particular in respect of supply of the most important materials or contracts of leasing of assets indispensable for the activity carried out by the debtor;



- c. secured by a mortgage, pledge, registered pledge, treasury pledge or ship's mortgage on objects and rights indispensable for running the debtor's business; and/or
- d. creditors with the highest claims.

Arrangement proposals may include the same means of restructuring the obligations of the debtor as in the case of an arrangement with all creditors but with two reservations.

First of all, a partial arrangement cannot provide covered creditors any benefits which reduce the possibility of satisfaction of receivable debts not covered by the arrangement.

Secondly, the law also provides for a different regulation of the legal position covered by the partial arrangement of creditors, whose claims are secured by security in rem (for example pledges and mortgages over assets). If the debtor presented to the secured creditor arrangement proposals providing for (i) full satisfaction, within the time limit specified in the arrangement, of his receivable debt along with collateral receivables which were provided for in the collateral contract, even if said contract was effectively terminated or expired, or (ii) satisfaction of the creditor to a degree not lower than that he can expect by enforcing the relevant collateral, the consent of such secured creditor shall not be required for the receivable debt to be covered by a partial arrangement.

The search for an agreement between secured creditors and the debtor would not entail a restriction on the rights of unsecured creditors, since their will to conclude a deal is not decisive for the rescue of the company anyway.

Only creditors covered by the partial agreement will be entitled to vote. The requisite majority needed to accept the arrangement (2/3) will be calculated on the sum of the claims owed to the creditors covered by the partial arrangement and entitled to vote.

Central Restructuring and Bankruptcy Register

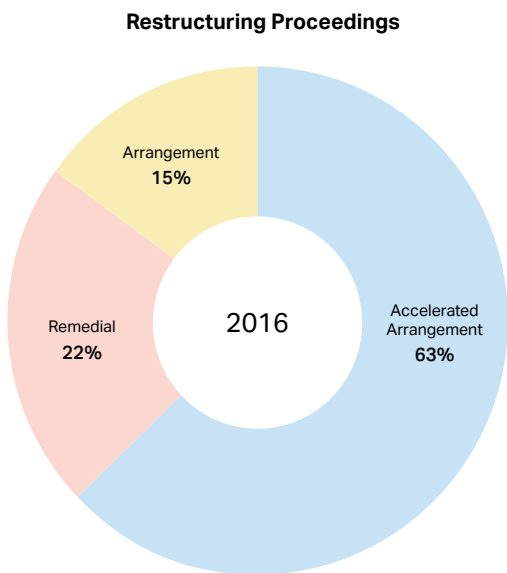
In order to streamline restructuring and bankruptcy proceedings, facilitate the access to information on these proceedings, streamline the communication between the authorities of these proceedings and their participants, and reduce the costs of proceedings related to the obligation to make announcements, the Central Restructuring and Bankruptcy Register (“CRRU”) was established (with an effect from 1 February 2018).

The CRRU will be a register of regulated proceedings (restructuring, bankruptcy proceedings, recognition of a foreign insolvency and secondary insolvency proceedings, and proceedings with respect to decisions on the prohibition of business activity). Data from this register will be available to participants of the proceedings.

In the information section, the CRRU will act as a publisher of all data that is subject to notice in the course of the regulated proceedings and of the prohibition on doing business. This section will include also legal acts, forms and templates of pleadings, list of bankruptcy and restructuring courts and list of persons holding licenses as restructuring advisors.

The CRRU communication section will serve to exchange pleadings and documents between the authorities and participants in the proceedings.

Does the new law work in practice?



Restructurings vs. Insolvencies

	2013	2014	2015	2016	2017 (First Half)
Restructurings	N/A	N/A	N/A	212	154
Liquidation Insolvencies and Semi-Insolvencies	888	807	750	606	272

From the point of view of creditors, not necessarily. Relatively few of them are interested in taking part in lengthy procedures aimed at a debtor’s restructuring. This is especially apparent of creditors with security over assets (mostly financial institutions), as well as “treasury” creditors (tax authorities and social insurance institutions). The reason for them is the lack of benefits and the obligation to participate in the process. On the other hand, the number of debtors that are actually or potentially interested in effective restructuring is rapidly growing. The reason for this is strong protection from creditors, in particular in remedial proceedings, where even secured creditors cannot enforce their claims from the debtor’s property (even from collateral).

In 2016 there were in total 212 restructuring proceedings opened, compared with 154 in the first half of 2017. As for 2016, over 63% of them were accelerated arrangement proceedings, whereas over 22% constituted remedial proceedings and approximately 15% arrangement proceedings.

The growing number of restructuring proceedings goes hand in hand with a decrease in liquidation insolvencies (272 in the first half of 2017, 606 in 2016 as opposed to 750 in 2015, 807 in 2014 and 888 in 2013 – however, the data for 2013-2015 also include insolvencies with a possibility to conclude an arrangement, which was a semi-insolvency regime under former Bankruptcy Law). As a result, the first year of the application of the Restructuring Law brought an increased interest in new forms of business rescue through restructuring. The number of liquidation bankruptcies has clearly decreased and is the lowest since 2009.

However, there are still no significant cases of successful restructurings of large entities that would pave the way and encourage hesitant entities to initiate restructuring.

Alma Market - Case Study

Alma Market S.A. is a Polish public company, listed on the Warsaw Stock Exchange since 1994. It is the owner of a nationwide network of delicatessen.²

Between July and September 2016, a lot of information about Alma Market's troubles appeared in the media.

Alma Market on Thursday, September 15, 2016 filed a request to the court in Cracow to open the remedial (*sanation*) proceedings. On September 19, after the official statement about the proceedings and the correction of the year's revenue forecasts from 900 million to just PLN 660 million (down about 26%), the stock price fell between

the opening of the exchange and 2 p.m. by 12.5%.

On October 27, 2016 Alma Market's online shop Alma24.pl was closed. From September 2016 physical stores were also gradually closed. At the beginning of December 2016, the network had only 10 stores.

Date	Event
September 15, 2016	Alma Market files for opening of remedial (<i>sanation</i>) proceedings.
September 20, 2016	One of the creditors files for Alma Market's bankruptcy.
October 2016	One bank terminates credit loan agreements with Alma Market and demands repayment (within 7 days) due to the threat of insolvency.
October 12, 2016	The restructuring court decides to appoint a temporary court supervisor over Alma Market's business. Applications for opening of restructuring and bankruptcy proceedings were combined for a joint recognition.
October 14, 2016	Management Board of Alma Market files for bankruptcy. The board stated in the report that: "(...) it supports in its entirety the request for the opening of restructuring proceedings – <i>sanation</i> , expressing the conviction of the success of the Company's remedial activities and deeply supporting it, but for the sake of prudence, due to the fact that so far a judicial decision was not issued on its subject, the Management Board also decided to file a bankruptcy petition". Under Polish law the management board is required to file for bankruptcy within 30 days of bankruptcy, and a failure to submit a motion within the term may result in the liability of the management board for damage caused to creditors by failing to file for bankruptcy in due time.
December 15, 2016	The court decides to open the remedial (<i>sanation</i>) proceedings and discards the motions for bankruptcy.
January 17, 2017	The court received a motion of Alma Krakow Sp. z o.o. for consent to conclude an agreement for the lease of an organized part of Alma Market's business, comprising a group of property and non-property assets related to commercial activity and the establishment of the right of pre-emption of these components. It was predicted that the lease would take 25 months from the date of signing, and in the event of concluding an arrangement with creditors - 12 months after the valid end of remedial (<i>sanation</i>) proceedings conducted with the company by way of approval of the agreement.

Date	Event
January 30, 2017	Administrator files for discontinuance of the remedial (<i>sanation</i>) proceedings. Under Polish law, the administrator can do so if he finds that there is no way to restore the company's ability to pay its liabilities. According to the Restructuring Law, the remedial (<i>sanation</i>) process is discontinued when its conduct "would be aimed at harming creditors" and the company loses its ability to meet current operating costs and "there is no real possibility of restoring the debtor's ability to perform obligations." These were the grounds in the administrator's application for discontinuance of the remedial (<i>sanation</i>) proceedings.
February 10, 2017	The court decides to discontinue the remedial (<i>sanation</i>) proceedings, the decision became final in July 2017. The court dismisses the motion for appointment of the creditors' committee composed of three major creditors. The creditors lodge an appeal against the court decision on discontinuance of the remedial (<i>sanation</i>) proceedings. The decision has not become final and valid yet.
February 14, 2017	Alma Market files simplified motion for bankruptcy due to the decision (although not final) of the court on discontinuance of the remedial (<i>sanation</i>) proceedings.
February 15, 2017	The court consents for a lease agreement with Alma Market Krakow sp. z o.o. of one shopping mall in Cracow. The motion of January 17 for lease of the organized part of Alma Market's business with the pre-emption right is dismissed.
March 2017	Two major creditors file for Alma Market's bankruptcy. On 27 and 31 March the court suspends recognition of the motions until the court order on discontinuance of the remedial (<i>sanation</i>) proceedings becomes final and valid.
March 28, 2017	The company publishes a report for 2016 with a loss of PLN 234 million, which represents a loss greater than the sum of profits from its entire history. Revenue in that year amounted to over one billion zlotys.
April 7, 2017	Two major creditors file a simplified petition to declare Alma Market's bankruptcy.

From the above timetable it is evident that the court decided to open a remedial (*sanation*) proceedings of Alma Market 3 months after the filing of an application. According to the law, the application should be considered within two weeks, unless there is a need for a hearing (in which case the term is six weeks). Maintaining a state of uncertainty for a public company (listed on the Warsaw Stock Exchange) is disastrous and leads to real financial loss. It also exposes the company to creditors' actions. However, the application itself could contain formal deficiencies, and only after their completion the above mentioned terms apply (in addition the terms are only instructive). The application for the opening of the remedial process of such a large company as Alma Market certainly was not straightforward.

Moreover, the court decision for discontinuance of the remedial proceedings of February 10, 2017 became final in July 2017. But there is another way for Alma Market to survive: it turned out in July that Alma Market managed to find a potential investor who might be interested in buying the company without liabilities. Therefore, Alma Market filed in July a motion to the bankruptcy court for pre-pack, which should be examined in the coming weeks.

The other significant example of remedial proceedings is a case of Praktiker, a chain offering home improvement and do-it-yourself goods in Poland. The remedial proceedings were opened in November 2016 and discontinued in April 2017. According to Praktiker's representatives, the realization of the restructuring plan became impossible in view of the enforcement proceedings initiated and conducted against the company by its creditors in February 2017, which resulted in loss of liquidity. Praktiker concluded that it did not have liabilities under credit facilities, but their financial problems resulted from real estate leases. Again, there might be an investor interested in buying the company in pre-pack formula during its bankruptcy proceedings.

Successful restructuring of Alma Market or Praktiker would induce other companies to initiate restructuring proceedings. Unfortunately, these cases highlight that Polish entrepreneurs and the courts are not yet prepared to carry out restructuring at an early stage of debtors' financial troubles. On the other hand, the legal framework for restructuring does not provide effective mechanisms inducing the debtor's contractors to co-operate with the debtor given its limited cash liquidity. It is the lack of liquidity, not the over-indebtedness of the debtors, which appears to be the main shortcoming of the new regulation and which causes uncertainty as to whether the restructuring proceedings will serve as an effective and popular tool for restructuring of the debtor's business at an early stage, which would be of social and economic importance due to saved jobs

and uninterrupted realization of contracts if the bankruptcy can be avoided. Currently, debtor-in-possession financing is allowed only to fund the implementation of a restructuring plan. Although the lenders providing such financing in connection with the restructuring benefit from the highest priority in case of bankruptcy, in no event DIP financing can impair the rights of other pre-existing secured creditors. If all or most assets of a company in restructuring are encumbered in favor of certain creditors (usually financial institutions), it is very difficult for the company to find a new potential lender to finance the restructuring. Thus, revision to the Restructuring Law to permit new lenders providing debtor-in-possession financing to benefit also from existing secured assets, even in part and/or subject to consent of secured creditors, may increase chances of the debtors to find new DIP lenders, improve cash liquidity and therefore successfully complete a restructuring process. ■

1. 2016 rankings are adjusted as regards the published report. For details see <http://www.doingbusiness.org/data/data-revisions>.

2. The below information is based mainly on the public reports published by Alma Market.



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and real estate finance projects. He also has experience in financial restructuring projects, mergers and acquisition transaction and in international capital markets projects, such as IPOs and dual listings on foreign exchanges, in particular the LSE. Szymon received his Master of Law degree from the University of Warsaw and is a member of the Warsaw Bar of Advocates.



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including *sauegarde* and scheme of arrangement procedures, domestic and cross-border project finance, acquisition and asset finance transactions. She is experienced in providing legal assistance in securitization projects, as well as advising banks on internal banking regulations and bank product documentation. Klaudia received her Master of Law degree from the Warsaw University and is a member of the Warsaw Bar of Advocates.

The New Bankruptcy Law of the UAE: Towards A More Business-Oriented Bankruptcy Regime

By LAWALE LADAPO and MOHAMED TAHA



On September 20, 2016, the new UAE Bankruptcy Law No. 9 of 2016 (the “**New Bankruptcy Law**”) was issued to replace the provisions regulating bankruptcy in the UAE contained in the Commercial Transactions Law and the Penal Code. The New Bankruptcy Law was published in the official gazette on September 29, 2016 and came into force on December 29, 2016. Together with the new Commercial Companies Law issued in 2015¹ and the implementing regulations of the Competition Law issued in 2016, the New Bankruptcy Law is part of the government’s plans to introduce legislative reform to modernize the business laws in the UAE. The New Bankruptcy Law seeks to support this modernization initiative by introducing new measures to rescue businesses in distress, such as preventive compositions and debt restructurings, and by reforming the bankruptcy regime. Notably, the New Bankruptcy Law establishes the Financial Restructuring Committee to, among other things, supervise restructuring proceedings for licensed financial institutions.

Scope of Application

The New Bankruptcy Law applies primarily to corporate entities established under the laws of the UAE. Contrary to earlier press releases suggesting that the New Bankruptcy Law will be limited to corporate bankruptcies, the New Bankruptcy Law applies to individuals trading for profit (but excludes non-merchant individuals). The New Bankruptcy Law also applies to companies wholly or partially owned by the government where their charters expressly subject them to the provisions of the New Bankruptcy Law and companies can “opt-in” to the new regime by amending their charters. The New Bankruptcy Law will also apply to companies established in free zones with no specific regulations governing preventive composition, debt restructuring or bankruptcy. Companies established in the Dubai International Financial Centre (DIFC) and the Abu Dhabi Global Market (ADGM), which are self-legislating financial centres, each with their own comprehensive insolvency legislations, are excluded from the scope of the New Bankruptcy Law.

The New Bankruptcy Law is broadly composed of two main schemes that debtors undergoing financial difficulties can resort to, namely: preventive composition and bankruptcy.

Who Can Use The New Law

- UAE corporations
- Individual merchants
- Government-owned companies (if they opt-in)
- Companies established in free zones (if no specific regulations)

Preventive Composition

Preventive composition is similar to the voluntary arrangement schemes under English law and the safeguard proceedings (*procedure de sauvegarde*) under French law, as it provides a scheme for a solvent debtor to avoid liquidation by agreeing with its creditors to repay all or part of its debts pursuant to a court-approved settlement plan.

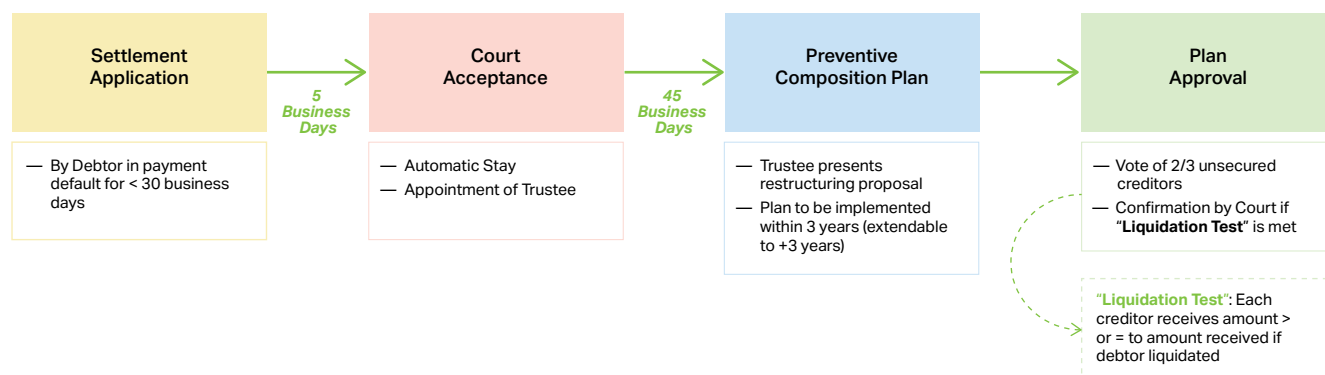
Initiating the Preventive Composition Application

An application for preventive composition can only be made by a debtor who has defaulted on repaying its debts due to financial difficulties, but is not insolvent; provided that the debtor has not been in default for more than 30 business days. The application is made to the court, and must outline, among other things, the debtor’s cash flow projections, the proposed preventive composition plan and “guarantees”, or assurances, for the implementation of the plan. The court will decide within five business days whether to accept or reject the application on an *ex-parte* basis and may appoint experts who will prepare a financial report on the debtor to assist the court in assessing the application.

The court may reject the application if, among other things, the applicant is already subject to existing debt restructuring or preventive composition proceedings, is found to be acting in bad faith, is convicted of a bankruptcy-related crime, or if the court decides that a preventive composition is inappropriate given the circumstances.

Interestingly, similar to the prohibition on *ipso facto* clauses seen in U.S. bankruptcy law, the initiation of preventive composition or restructuring proceedings under the New Bankruptcy Law will not constitute an event of default under any existing financing agreements. Any agreement to the

Preventive Composition



contrary will be void. This new approach introduced by the New Bankruptcy Law is inconsistent with the prevailing market practice, which generally considers a restructuring of the borrower's debts as an event of default under financing agreements.² Due to the novelty of this requirement in the UAE, it is not yet clear whether courts will tolerate an avoidance of this provision when a credit agreement of a UAE debtor is subject to a foreign law, or whether this requirement will be deemed an overriding mandatory provision that cannot be circumvented by simply changing the governing law clause in a credit agreement.³ It is also worth noting that a court decision to accept the preventive composition application does not terminate any existing contracts between the debtor and third parties, unless the court so decides based on a request from the trustee.

In furtherance of the objective of the New Bankruptcy Law to address one of the major concerns under the old regime, which imposed strict criminal liability on issuers of bounced cheques, the New Bankruptcy Law provides that criminal proceedings against a debtor who has issued bounced cheques will be automatically stayed once a preventive composition proceeding is initiated.

Acceptance of the Application

If the court accepts the debtor's application for preventive composition, it will appoint one or more trustees to supervise the settlement process. The debtor may continue to manage its business through the preventive composition process, but the trustee enjoys broad powers to act on behalf of the debtor, including by applying to the court to secure new financing, and requesting the court to terminate any contract that the debtor is party to if such termination serves the interests of the creditors at large without materially prejudicing the interests of the counterparty to such contract.

Once the preventive composition application is accepted, the debtor is restricted from disposing of its assets or obtaining new loans unless it receives prior consent from the trustee or the court. In addition, a moratorium is automatically imposed on all claims and enforcement proceedings against the debtor (including enforcement proceedings by any secured creditors) until the preventive composition plan is approved, and no new guarantees will be enforceable on the debtor's assets unless pre-approved by the court. Secured creditors may, however, subsequently apply to the court requesting that it enforces their debts during this period.

Preparing and Adopting the Preventive Composition Plan

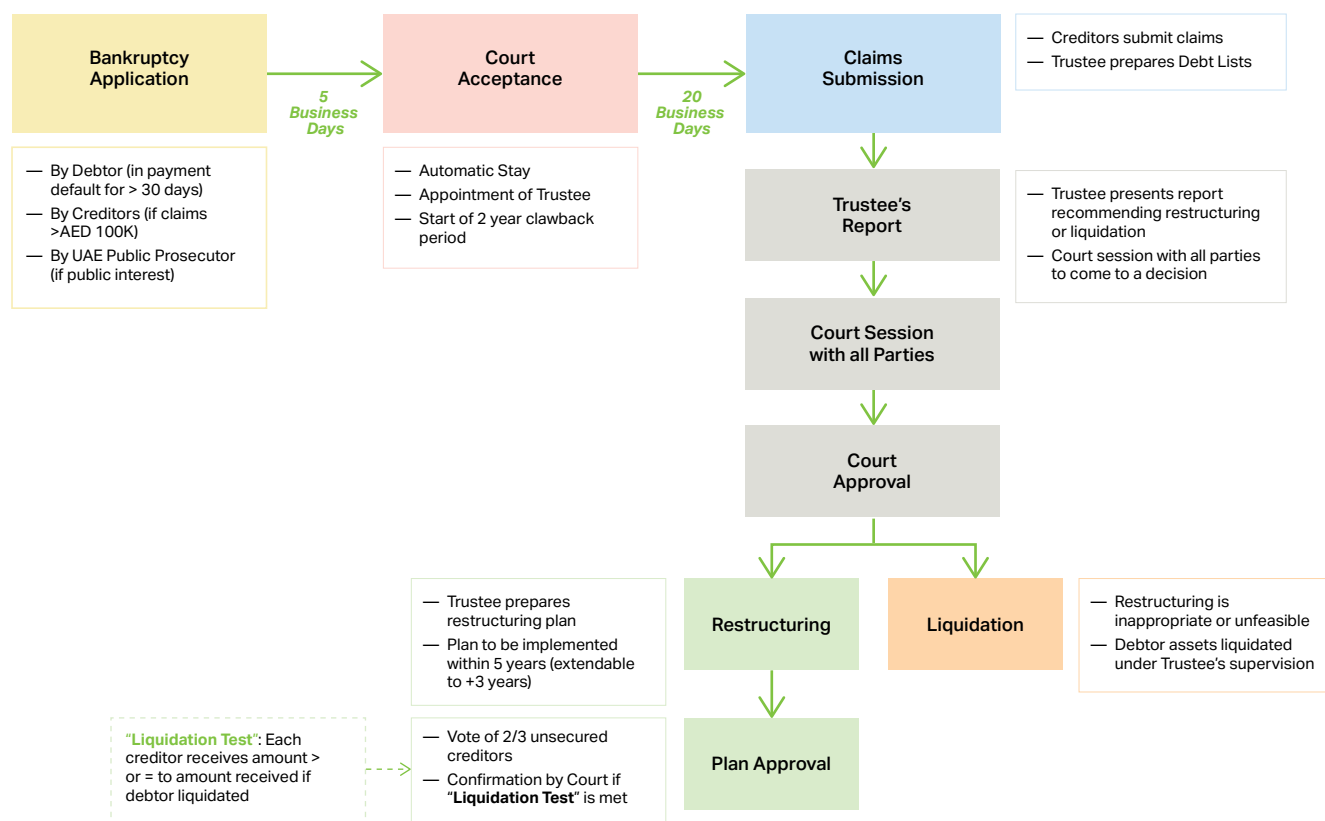
The trustee shall, with the debtor's cooperation and input, prepare a draft preventive composition plan and submit it to the court within 45 business days of the court's decision to accept the application for preventive composition, which period can be extended by up to a further 20 business days with the consent of the court. The preventive composition plan should outline, among other things, the profitability prospects of the debtor, the possibility of converting the debt into equity of the debtor and a timeline for the implementation of the plan, which should not exceed three years subject to an extension for a further three years with the approval of unsecured creditors holding at least two-thirds of the then unpaid debts.

With the permission of the court, the preventive composition plan will be voted on by the unsecured creditors and can only be approved by a two-thirds majority vote of such creditors. Upon such approval, the preventive composition plan will be sent for final approval by the court, which will also decide on any objection to the preventive composition plan raised by a creditor. In approving the preventive composition plan, the court must be satisfied that each affected creditor will receive an amount not less than what it would have otherwise received had the debtor been liquidated at the time of the vote (the "Liquidation Test"). Once finally approved by the court, the preventive composition plan binds all unsecured creditors. Note that secured creditors are not permitted to vote on the preventive composition plan and are not bound by an approved preventive composition plan, unless they waive their security in advance of the vote, which waiver will only take effect if and when the preventive composition plan is approved.

Bankruptcy

The New Bankruptcy Law introduced substantial reforms to the bankruptcy regime in the UAE. Bankruptcy proceedings will no longer necessarily lead to a liquidation of the debtor under the New Bankruptcy Law, as was the case under the old regime. Rather, the bankruptcy proceedings will primarily aim to restructure the debts of the insolvent debtor with a view to rescuing it as a going concern. The debtor will only be declared bankrupt or liquidated, in the case of corporate debtors, where a restructuring proves or is deemed inappropriate.

Bankruptcy Process



Initiating the Bankruptcy Proceedings

The bankruptcy proceedings can be initiated by the debtor, the creditors or the Office of the Public Prosecutor in the UAE. A debtor must apply to the court to initiate bankruptcy proceedings if it is in default of paying its debts for more than 30 business days due to financial difficulties. A debtor's failure to initiate bankruptcy proceedings in this circumstance is no longer a criminal offence as was the case under the old regime.

For unsecured creditors to be eligible to apply to the court to initiate bankruptcy proceedings against the debtor, the New Bankruptcy Law requires that the value of the debt of such creditors be greater than AED 100,000 (USD 27,174).⁴ However, the New Bankruptcy Law retained the requirement in the old regime that the creditors must first serve the debtor with a 30-day written request to pay the debts before initiating bankruptcy proceedings. The Public Prosecutor can initiate bankruptcy proceedings against an insolvent debtor if it determines that it is in the public interest.

In determining whether a debtor is insolvent, the New Bankruptcy Law applies a balance sheet test, as opposed to the cash flow test traditionally used in the UAE. According to the current test, a debtor is deemed insolvent if it appears that its assets do not, and will not at any time, cover its due liabilities.

The court will decide on the application to initiate the bankruptcy proceedings on an *ex-parte* basis within five business days from the submission thereof. In deciding on the bankruptcy application, the New Bankruptcy Law empowers the court to order any person with information relevant to the request to provide the court with any reasonable information it may request. A similar provision applies for an application for preventive composition. It is unclear to what extent this obligation overrides legal privileges such as the attorney-client privilege as attorneys may well be expected to be in possession of such relevant information under privileged circumstances.

Acceptance of the Application

If the court accepts the application, it will appoint one or more trustees to supervise the proceedings. The rules for appointing trustees in bankruptcy proceedings are similar to the rules for appointing trustees in the preventive composition proceedings, described above. Similarly, once the application is accepted, a moratorium will be imposed on all claims and enforcements proceedings against the debtor unless the court decides otherwise.

The New Bankruptcy Law designates the two-year period preceding the decision to accept the bankruptcy application as a “suspicion period” for clawback purposes and reviews all transactions conducted by the debtor during this period. Transactions occurring during this period, which are determined by the court to have been carried out with no consideration or to have been undervalued, will not be enforceable against other creditors unless with court authorization.⁵ The statutory determination of a fixed two year “suspicion period” represents a more conservative approach compared to the previous regime, which allows the courts to designate a “suspicion period” of less than two years.

A court’s approval of the bankruptcy application will automatically invalidate any set-off of new debts arising after such approval with creditors’ claims, unless such set-off is approved by the court or included in the restructuring plan.

The trustee will publish the decision to initiate the bankruptcy proceedings in two daily newspapers that are widely circulated in the UAE and will invite the creditors (including secured creditors) to submit their claims together with the supporting documents within 20 business days of the date of the publication of the decision.⁶ The trustee will then prepare a list of creditors and their claims (the “**Debts List**”) and submit it to the court within 10 business days, which will again be published in two daily widely circulated newspapers. The court will hear any objection from the debtor or other creditors on the Debts List and decide on it within seven business days.

Based on its review of the Debts List and the debtor’s resources, the trustee will prepare a report outlining whether the restructuring of the debtor’s debts is feasible, or if the debtor should be declared bankrupt and, in case of corporate debtors, liquidated. The court will then hold a session with the trustee, the debtor and the creditors included in the Debts List to decide whether to restructure the debts of the debtor (provided the debtor so agrees), or to declare the debtor bankrupt. The two potential outcomes of the proceedings are considered below.

Debt Restructuring Proceedings

If the court decides to restructure the debts of the debtor, the trustee will prepare a draft restructuring plan within three months of the date of the court decision, which will outline the same elements as the preventive composition plan (e.g. profitability prospects of the debtor and the possibility of converting the debt into equity). The restructuring plan must include a timeline for its implementation, not exceeding five years, which can be extended for up to a further three years with the approval of two-thirds of the unsecured creditors. The draft restructuring plan will be voted on by the unsecured creditors who were included in the Debts List and, if approved by a two-thirds majority vote, will be referred to the court for a final approval. As with the preventive composition plan, secured creditors are not allowed to vote on the restructuring plan unless they waive their security, effective from the approval of the restructuring plan. The court will approve the restructuring plan if it meets the Liquidation Test.

As with the preventive composition proceedings, the debt restructuring proceedings will impose an automatic stay on all criminal proceedings against the debtor predicated on issuing bounced cheques.

Liquidation Proceedings

The New Bankruptcy Law provides for an exhaustive list of events that can lead to declaring the debtor bankrupt (and, in case of corporate debtors, liquidated), all of which imply that debt restructuring is either inappropriate or unfeasible. These events are:

- a. if the court terminates the preventive composition proceedings because the preventive composition plan proved impossible to achieve or because the debtor has been in default for more than 30 business days due to its insolvency;
- b. if the bankruptcy application was made by the debtor in bad faith or with the intention to avoid its financial obligations;
- c. if the restructuring of the debts is deemed inappropriate for the debtor based on the trustee’s report;
- d. if the restructuring plan is not approved by the required creditor majority vote;
- e. if the court disapproves the restructuring plan (including if it does not meet the Liquidation Test); or
- f. if the court terminates the restructuring plan (including due to the debtor’s commission of a bankruptcy-related crime or its inability to meet the conditions of the restructuring plan).

If the debtor is declared bankrupt, its assets will be liquidated under the trustee's supervision and all future obligations will become due.⁷

Other Notable Issues

Liability of Directors of a Bankrupt Company

Despite the New Bankruptcy Law's attempt to restrict the criminal liability of the debtor in certain bankruptcy-related offences, directors of insolvent companies are still subject to certain civil and criminal liabilities if the company is declared bankrupt and if the directors are deemed to have contributed to the company's bankruptcy.

For instance, if the assets of the bankrupt company are insufficient to satisfy at least 20% of its debts, the court may require the directors, jointly or severally, to pay the company's debts. Furthermore, the court may order the directors to pay a portion of the company's debts if it finds that, within two years from the date of accepting the bankruptcy application, the directors carried out the company's business without due risk assessment, entered into transactions with third parties that are undervalued, or paid any of the company's debts with a view to prejudicing other creditors.

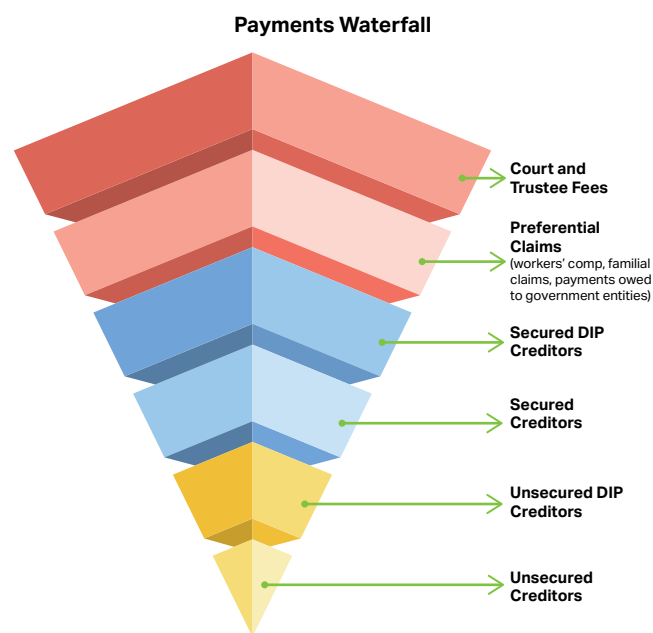
Directors may be criminally liable for imprisonment and a fine for criminal conduct leading to the bankruptcy of the company or fraudulent conduct during the bankruptcy proceedings⁸. For the purposes of such criminal liability, any of the company's employees who effectively participates in the decision making process is deemed to be a "director". This also extends to any "shadow directors" whose instructions the directors are accustomed to following.

Applying for New Financing

In line with the objective of protecting a debtor from liquidation and rescuing it as a going concern, the New Bankruptcy Law introduced new provisions regulating the extension of new financing to a debtor who is subject to preventive composition or debt restructuring proceedings, similar to a debtor-in-possession (DIP) financing. The new financing must be approved by the court and the debt arising therefrom (the "New Debt") will take precedence over other unsecured debts of the debtor. The New Debt can also be guaranteed by any of the assets of the debtor; provided that such asset is not otherwise subject to any liens, or is subject to a lien guaranteeing a debt of a lesser value than the value of the asset, in which case the New Debt will rank below such existing lien. The court may exceptionally allow the New Debt to be guaranteed by a security ranking *pari passu* with or higher than an existing security if the court is satisfied that the New Debt will not prejudice the holder of the existing security.

Payments Waterfall

In the case of a preventive composition plan or the restructuring plan, The New Bankruptcy Law gives first priority to court and trustee fees. Payments approved by the court or the trustee after the approval of the preventive composition or debt restructuring plan come second, followed by unsecured DIP financing, and lastly, payments to the unsecured creditors in accordance with the preventive composition plan or the restructuring plan. As noted above, the preventive composition plan or restructuring plan does not bind secured creditors, unless they waive their security, in which case such creditors will rank *pari passu* with unsecured creditors.



If the debtor is declared bankrupt and is to be liquidated, the trustee will deduct reasonable fees and expenses incurred in connection with the sale of the secured asset from the sale proceeds before distribution to the secured creditors, as appropriate. Secured creditors will have priority over new secured DIP creditors, unless the original secured creditors agree at the time the new DIP financing is obtained that the right of the DIP creditors should rank higher than or *pari passu* with their rights over the relevant security. Any surplus after the secured creditors are repaid in full will be distributed among the unsecured creditors. Note that secured creditors who are unable to realise the full debt from the proceeds of the sale of the security will become unsecured creditors in respect of the outstanding amount.

Scorecard of UAE's Current Insolvency Regime

Experience Level: Recently approved law or no established precedents

KEY PROCEDURAL ISSUES

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

The New Bankruptcy law includes a class of “privileged debt”, which is to be paid in the following order: court and trustee fees, certain categories of workers’ compensations, familial claims, payments due to government entities and payments made after the approval of the bankruptcy application, as approved by the court or the trustee. Privileged debt will rank ahead of all other unsecured creditors but the law is silent on whether all privileged debt will rank ahead of secured debt, save for trustee fees, which are expressly given first priority in a bankruptcy.

Conclusion

The government of the UAE set out to introduce a more sophisticated, streamlined and widely used bankruptcy regime that eases the restructuring of companies, supports troubled businesses, mitigates bankruptcy risk and ensures a safe and attractive business environment in the UAE. The law was highly anticipated by businesses and advisors alike. While it is still early to assess the success of the regime, there are a number of issues that have not been addressed by the law. For example, the inability to bind secured creditors may undermine large corporate restructurings. There is also still no consolidated regime that addresses personal bankruptcies. On the whole, it is expected that the introduction of the preventive composition and debt restructuring options, which allow for a rescue of the debtor facing bankruptcy, will go a long way to aid struggling businesses. ■

1. Federal Decree Law No. 2/2015.
2. For example, Clause 22.5(e) of the LMA Standard Form Single Currency Term Facility Agreement for Developing Market Jurisdictions states that the borrower will be deemed in default if any member of its group "by reason of actual or anticipated financial difficulties, commences negotiations with one or more of its creditors...with a view to rescheduling any of its indebtedness."
3. This question may still be relevant even if a non-UAE court is deciding upon the validity of a clause designating restructuring of the borrower's debts as an event of default in a credit agreement closely connected to the UAE (e.g. concluded between two UAE parties). For example, a court in a European Union jurisdiction applying the Rome 1 Regulations might invoke Article 3(1) of the Rome 1 Regulations to uphold the UAE rule invalidating such a designation of event of default, notwithstanding the provision of the law chosen by the parties in the agreement. Article 3(1) of the Rome 1 Regulations states that "*where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement.*"
4. This threshold amount can be amended by a decision from the Council of Ministers. The USD equivalent is based on an exchange rate of 3.68 AED to 1 USD.
5. This also includes granting a guarantee to a creditor for a pre-existing loan.
6. A creditor who fails to submit its claim within this timeline may still submit it to the trustee who may accept it and include it in the Debts List if there was an acceptable reason for the delay in submitting the claim.
7. The court may discount a portion of the future obligations if such portion was not subject to interest.
8. Such conduct includes concealment of any of the company's records, misappropriation of its assets, fraudulently admitting non-existing loans, fraudulently entering into preventive composition or debt restructuring for the company, misrepresenting the company's capital, declaring illegal dividends or bonuses, overspending on speculative transactions, failing to keep records as prescribed by law, or granting one of the company's creditors a guarantee or other advantage to induce it to accept a preventive composition or debt restructuring proceedings.
9. But creditors can propose changes to the plan proposed by the debtor and the trustee.
10. New regime.
11. No separate prepackaged bankruptcy regime other than the debt restructuring procedure described.
12. But secured creditors can apply to court for permission to enforce their securities.



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▼ **Mohamed Taha** is an associate based in Cleary's London office. Mohamed's practice focuses on mergers and acquisitions, capital markets, and general corporate practice. Mohamed joined the firm in December 2014. Before joining Cleary, he worked with a leading Egyptian firm for two years, where he advised on various cross-border transactions. Mohamed is a member of the bar in New York and is admitted as a solicitor in England and Wales.

PUERTO RICO WATCH



Recent Publication – Puerto Rico’s Public-Private Partnership Initiatives Under PROMESA

By ANTONIO J. PIETRANTONI (apietrantoni@cgsh.com)

With the bankruptcy filings under Title III of PROMESA for the Commonwealth of Puerto Rico, and various of its public instrumentalities, including the Puerto Rico Highways and Transportation Authority (HTA) and the Puerto Rico Electric Power Authority (PREPA), Puerto Rico’s efforts to address its fiscal and economic crisis are now firmly in the hands of a bankruptcy court. While the initial phases of the Title III proceedings will focus on stabilization and relative creditor rights, any long-term return to fiscal health will necessarily depend on the Puerto Rican economy’s ability to return to the path of economic growth. Without economic growth, Puerto Rico will not be able to repay creditors or offer its residents the promise of a better future.

The certified fiscal plans for the Commonwealth and other public instrumentalities specifically identified the entry into a series of public-private partnership (PPP) transactions, with an estimated value of approximately \$5 billion over the next two years, as the vehicle to both right-size the government and spur private investment in the economy. Normally, many potential PPP lenders or sponsors may be dissuaded by the risks involved in a jurisdiction such as Puerto Rico and the legal uncertainty clouding many of its assets and

revenues. In an effort to demonstrate how PROMESA’s Title III could be used to facilitate PPP transactions, lawyers from Cleary Gottlieb recently published an article in *Law360* that discusses how the Title III restructuring tools, largely based on existing provisions of the Bankruptcy Code, can help remove many of the risks inherent to a PPP under Puerto Rico’s current circumstances and perhaps facilitate the execution of these transactions with key stakeholders, including off-shore creditors and local retail creditors, as well as new investors.

The article and the authors are listed below, and are linked directly in the electronic version of this issue.

Turning Bust To Boom: P3 Initiatives Under PROMESA

July 19, 2017

by Richard J. Cooper, Luke A. Barefoot,
Adam Brenneman and Antonio J. Pietrantoni



Counsel to The **Commonwealth of Puerto Rico** with the financial restructuring of U.S. **\$73 billion** of indebtedness.

Restructuring Deal of the Year OAS SA

International Financial Law Review, 2017

Counsel to **Oman Investment Fund**, the Omani sovereign wealth fund, as senior creditor in connection with the restructuring of Blue City, the **\$15 billion** megacity project in the Sultanate of Oman.

Americas Law Firm of the Year

International Financial Law Review, 2015-2017

Counsel to participants in various **Latin America restructurings** totaling over **\$47 billion in debt** in Q1 2017, more than any other firm.



Top 5 Firm

Global Restructuring Review's GRR 30, 2017

Counsel to the **Republic of Argentina** in connection with its **\$16.5 billion debt offering**, marking the country's return to international markets after 15 years of absence.

Leading Cross-Border Cooperation in a Specific Insolvency or Restructuring Matter (Nortel)

Global Restructuring Review Awards, 2017

Practice Highlights

Counsel to **Eurasian Resources Group** in its **\$5.2 billion** dual-track debt restructuring, a complex transaction involving parallel negotiations with VTB and Sberbank with bifurcated terms including different security/covenant packages.

Counsel to participants in **over \$330 billion in capital markets offerings** by Latin American issuers since 2006

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

Ranked No. 1 in Latin America

Restructuring Mandates Debtwire, Q1 2017

Counsel to the **Hellenic Republic** in connection with its bond buyback, both the largest-ever bond exchange and **largest-ever sovereign debt restructuring**.

Counsel to over **50 sovereigns clients**.

Russian Law Firm of the Year International

Financial Law Review, 2017, for the fifth consecutive year, and eighth year in total

Counsel to **Eurasian Resources Group** in its **\$5.2 billion** parallel track debt restructuring.



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.

Counsel to **The Republic of Iraq** in its **\$1 billion** international capital markets debut, backed by a full faith and credit guarantee issued by the U.S., acting by and through the U.S. Agency for International Development.

Africa Deal of the Year and Sukuk Deal of the Year

State of the Côte d'Ivoire CFA150 billion Sovereign Sukuk
Islamic Finance News, 2016



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