INSOL INTERNATIONAL

DISTRESSED INVESTING ACROSS JURISDICTIONS

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PRESIDENT'S INTRODUCTION

With rising debt levels in the midst of turbulent economic conditions – higher interest rates, tight liquidity, weakening consumer and business confidence and a volatile geopolitical landscape, not to mention tariff wars, all posing significant downside risks – opportunities for distressed debt investment in the private capital market have increased in tandem. Loan-to-own strategies have become particularly prevalent, as lenders in many, but not all, jurisdictions seek to identify creative means to maximise value in distressed scenarios.

Alternative lenders and private capital providers have emerged as a critical source of funding for distressed companies, which often encounter difficulties in seeking additional finance (or funding extensions) from more risk-averse traditional bank lenders. This can take the form of "rescue finance", which – in tandem with substantive insolvency laws – may enhance the likelihood of a successful restructuring for a distressed entity, averting a premature liquidation or bankruptcy scenario. This has been demonstrated to be in the interests of long-term economic and financial stability and can be a key driver of growth. But while this message has been delivered globally, it has not been universally understood and acted upon, in part due to cultural differences and political will to make changes.

This landmark new publication, "Distressed Investing Across Jurisdictions", is therefore very timely. The publication was led by Professor Omar Salah, Partner of Norton Rose Fulbright LLP in the Netherlands. It comprises chapter contributions from 22 jurisdictions across Asia, Africa, Europe, the United States, Latin America and the Middle East.

Each chapter explores the legal and institutional framework for distressed investing in these jurisdictions, including the regulatory requirements and practical risks faced by investors purchasing distressed debt and non-performing loans. There is also an analysis of the key restructuring tools available in each jurisdiction to incentivise distressed debt investment – including informal workout mechanisms, pre-packs and formal processes such as schemes of arrangement and restructuring plans.

Many of these processes – including the United Kingdom's restructuring plan and the WHOA process in the Netherlands, have had considerable (but not universal) success in encouraging distressed debt investment in support of a restructuring attempt. These processes, when linked to strong bank capital adequacy requirements, have created the conditions necessary to allow new, very significant, capital providers to access the markets. In jurisdictions such as Singapore and the United States, DIP finance (which can lead to the priming of senior debt as a means to encourage new funding to a debtor) offers an additional incentive and has resulted in the building of an active distressed debt market. Key is predictability of outcome. The vast quantity of secondary trading (and therefore investment) in the French market, for example, shows that countries can adapt and attract funders, where previously there were few options outside of local banks.

In drawing together the key regulatory issues, recent investment trends and the risks and opportunities for distressed debt investment in each of the covered jurisdictions, this publication is a valuable resource for INSOL's members, particularly those who work in complex cross-border restructuring matters.

I extend my sincere thanks and appreciation to Professor Salah and each of the country authors for their time, expertise and dedication in bringing this publication to fruition. I also extend my appreciation to the INSOL Technical Team for their commitment and sustained work on this book over the last 2 years. Congratulations and enjoy the read.

Alastair Beveridge
President, INSOL International

January 2026

FOREWORD

This book is a special INSOL International publication which explores the legal considerations for distressed investing across various jurisdictions. The global landscape for the investor base of companies in financial distress has changed significantly in recent years, with investors in distressed assets setting their mark on restructurings.

These investors may be special situations and distressed debt funds that are providing rescue financing to companies in financial distress or buying non-performing loans from the existing lenders of those companies, in some cases with a loan-to-own strategy. They can also be hedge funds or private equity funds specialising in investing, owning and managing companies in financial distress with a value-add strategy. In some cases, they have particular expertise in a specific asset class, such as distressed real estate.

Importantly, distressed investors have been able to raise significant amounts of capital in the last few years, which means they have a great deal of "dry powder" to deploy.

Companies in financial distress are no longer seen as a threat only for investors. Rather, they may pose significant opportunities for certain investors that are ripe for the taking. Likewise, the involvement of and engagement with distressed investors is not only deemed a threat in a financial restructuring, but it can instead also pose opportunities for different stakeholders involved in a financial restructuring to collaboratively work together to achieve a creative solution that maximises all of their interests. For example, existing lenders of a company in financial distress that are seeking an exit may find that exit through a trade of their debt to distressed debt investors.

From the perspective of a company in financial distress, distressed investors may provide liquidity either through a rescue financing or through an equity injection. They could also provide a solution in other ways. For example, the involvement of a distressed investor may lead to a breakthrough in restructurings. Where the existing financial creditors may not able or willing to accept a debt write-off, a distressed investor may accept a haircut on the nominal value of its claim provided that the haircut is lower than the discount against which the distressed debt is purchased from the exiting lender.

Geographically, distressed funds (investing in distressed debt, equity or a specific asset class) predominantly were based in, and invested across, the United States. While the United States – and more broadly, North America – still remains one of the most important jurisdictions for investors in distressed companies, we have seen increased activity across other jurisdictions in Latin America, Europe, Asia, Australia and Africa in recent times. Hence, an understanding of the legal regimes in jurisdictions across the world has become increasingly relevant for investors of companies in financial distress.

This book aims to provide exactly that – a comprehensive analysis of the legal regime for distressed investing in 22 jurisdictions across the United States, Latin America, Asia, Europe, Africa and the Middle East, and the practical risks and issues relevant to debtors, investors, practitioners and other stakeholders.

Each chapter of the book addresses the legal framework for distressed investing across a specific jurisdiction. In each chapter, the contributors discuss: (1) distressed M&A and debt investing outside of formal insolvency processes; (2) enforcement processes; (3) pre-insolvency processes; and (4) pre-pack sales.

We have chosen this set-up to provide an overview for the entry and exit strategy of investors. While distressed investing may take place outside of any formal insolvency processes, most distressed investors step in with an exit strategy already mapped out. This strategy may entail an enforcement process whereby, through the enforcement of security rights, assets may be sold or possibly acquired through credit bidding and / or a debt-for-equity swap (in jurisdictions where these concepts are permitted), but it may also entail a more intense restructuring through a pre-insolvency regime or a pre-pack sale. Therefore, we have aimed to describe these considerations for each of the jurisdictions that are covered by this book.

FOREWORD (CONTD.)

We have aimed to provide a global overview that will aid investors, funds, financiers, practitioners and academics in getting an understanding of the legal framework and key considerations for distressed investing. Our objective was to present a book that will be useful for investors in practice – such as distressed investors, debt funds, hedge funds, private equity funds and litigation funders – as well as for companies in distress searching for a financial solution or their existing lenders (banks or direct lenders). The chapters in this book will give them a basic understanding when making an assessment of the legal framework for investing in companies in financial distress in a specific jurisdiction.

The publication of this book would not have been possible without the significant efforts of many others who have contributed to this project. I would like thank the Technical Research Committee of INSOL International and the Technical Team, in particular Dr. Sonali Abeyratne, Dr. Kai Luck and Ms. Waheeda Lafir. I owe them much gratitude for their wonderful collaboration on this project.

A special thanks also goes to all the excellent authors who have contributed to the chapters of this book, as the project simply would not have been possible without their contributions.

Last but certainly not least, I would like thank and acknowledge the assistance of various team members of the restructuring group of Norton Rose Fulbright LLP, Amsterdam, that assisted me while editing this book: Bas van Hooijdonk (associate), Sven Stommels (student intern) and Alexandra Komorek (student intern).

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ARGENTINA

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

There are no specific rules in Argentina for purchasing shares or other equity interests of distressed companies. The rules that govern the sale and purchase of non-distressed shares would apply to a sale and purchase of distressed equity. Such rules are contained in the Civil and Commercial Code (CCC), the General Companies Law N° 19,550 as amended (GCL) and, in the case of listed companies, the Capital Markets Law N° 26,831 as amended (the Capital Markets Law).

In the case of the sale of distressed equity of public utilities subject to government regulation, either an authorisation of, or a notification to, the federal or provincial government is normally required, depending on the applicable regulatory framework. Further, in the case of change of control and provided certain thresholds are met, anti-trust authorisation may also be required and, in the case of listed companies, a mandatory tender offer may be triggered.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

The purchase of a claim stated in a loan (either a performing or non-performing loan) may take place through the assignment of rights, assignment of debts or assignment of the "contractual position". Except in the case of assignment of portfolio loans by financial entities (see below), there are no specific rules that apply to the assignment (or sale and purchase) of non-performing loans.

The assignment of rights is regulated in article 1614 et seq. of the CCC. It must be concluded in writing and, to produce effects *vis-à-vis* third parties, the assignment must be notified to the debtor by public instrument (normally, through a notary) or private instrument with a certain date (*fecha cierta*). When the assignment involves loans which are part of a portfolio and which guarantee debt securities listed in the public markets (or would constitute the assets of a mutual fund) – and when there is an applicable contractual provision on assignment – Law 24,441 grants full effects to the assignment of portfolio loans without the need to serve notice to the debtors. If no contractual provision is included, article 72 of Law 24,441 provides that the assignment can be notified to third parties by means of a public notice to be published on the website of *Comisión Nacional de Valores*, which is the governmental agency that supervises publicly traded securities and listed companies.

The assignment of debts (article 1632 of the CCC) and the assignment of contractual position (article 1636 of the CCC) are consensual contracts governed by the autonomy of the parties. In practice, they require the creditor's express consent to release the original debtor. Otherwise, the original debtor and the assignor would remain as obliged parties vis-à-vis the creditor. The creditor's consent may be granted prior, simultaneous to or after the assignment.

In case of an assignment of a loan portfolio owned by financial entities, Communication "A" 3337, as amended, of the Argentine Central Bank (BCRA) must also be followed regardless of whether the assignment is with or without recourse to the assignor. BCRA Communication "A" 3337, as amended, sets forth that an assignment of a loan portfolio to an affiliated entity requires prior authorisation from the BCRA. In all cases, payment by the assignee must be deposited in an account of the financial entity assignor opened at the BCRA. Failure to comply with the requirements set forth in the BCRA Communication will result in the application of sanctions foreseen in the Financial Institutions Law.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

There are no further regulatory requirements. Work councils are not regulated under Argentine law.

1.4 What risks exist for an investor of a distressed business?

There are several risks that any investor in an Argentine distressed business must be aware of. The main risk is that the transaction would be deemed without effects *vis-à-vis* the debtor (*inoponible*) under the "*pauliana actio*", regulated in the CCC, or, if the seller ends up in bankruptcy liquidation (*quiebra*), the fraudulent conveyance and preference rules of the Argentine Bankruptcy Law N° 24,522 as amended (ABL). The applicable rules regarding the avoidance actions both in bankruptcy and outside of bankruptcy are described below.

Further, investors should also be aware of the risks relating to successor liability, notably labour risks. When the acquisition of the distressed business is structured as a "transfer of establishment" (instead of a sale of shares of the distressed company owning the business), article 225 of the Argentine Labor Law N° 20,744 provides that the purchaser or successor will assume all the labour obligations that the seller would have, with the employees as of the time of the transfer, including those that originates as a consequence of the transfer. Further, the labour contracts and any right that the employee may have had – including the seniority – will continue with the successor or purchaser.

1.4.1 *What risks exist for the transaction to be challenged and overturned outside of bankruptcy?*

Outside of a bankruptcy proceeding, this type of transaction may be challenged under the revocatory action, known as "*pauliana actio*", which is set forth in article 338 and subsequent of the CCC. The "*pauliana actio*" entitles any creditor to petition the court to declare that an act performed by the debtor shall have no effects vis-à-vis such creditors. In practice, this action aims to restore assets that were taken out of the debtor's assets by the defendants, and therefore making them once again available for attachment by unsatisfied creditors of the debtor.

The requirements for the "*pauliana actio*" to proceed are the following:

1. the creditor's claim pre-dates the act that is being contested;
2. the act either caused or aggravated the insolvency of the debtor; and
3. the third party (or parties) to the act that is being contested knew, or should have known, that the act was causing or aggravating the insolvency of the debtor.

The statute of limitation of the "*pauliana actio*" is 2 years from the date the creditor knew, or should have known, the act took place.

In case the debtor ends up in bankruptcy liquidation (*quiebra*), normally the receiver, or any creditor if the receiver fails to act, would prefer to initiate bankruptcy avoidance actions and not the "*pauliana actio*", because in bankruptcy avoidance actions the burden of the proof shifts to the defendants, who must prove that the act has not caused any prejudice to creditors. This is normally difficult when the transaction involves dealing with an affiliate or causes the debtor to transfer a registered asset to a third party.

1.4.2 *What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?*

Bankruptcy avoidance actions (*acciones de ineficacia concursal*) are broadly regulated in articles 118 to 120 of the ABL. Generally, the ABL allows the receiver (or any admitted creditor, upon failure to act by the receiver) to demand the avoidance of any act performed by the bankrupt debtor during the "suspicious period".

The "suspicious period" is the term running from the date when the cessation of payment starts until the filing of the reorganisation proceedings (*concurso preventivo*) or the declaration of bankruptcy liquidation (*quiebra*), as applicable, and for the purpose of the avoidance actions cannot extend beyond 2 years as from such dates, whichever is prior (normally, the reorganisation proceeding filing date).

These actions are admitted only in a bankruptcy liquidation proceeding (*quiebra*) and the applicable statute of limitation is 2 years from the date of the bankruptcy liquidation decision.

The following acts performed by the debtor during the suspicious period are recognised as avoided acts as a matter of law, without any proof-taking process:

(i) any gratuitous act performed by the debtor;

(ii) advance payments of debts scheduled to mature on the date of the bankruptcy decision or thereafter; and

(iii) the granting of mortgages, pledges or any other kind of priority right as security for obligations that are not due and which originally were not entitled to such priority rights.

Additionally, the ABL provides that any other transaction executed by the debtor within the suspicious period may be subject to avoidance by the court if the following conditions are met: (i) at the time the act was executed, the third party was aware of the cessation of payment status of the debtor; and (ii) the act is detrimental to the debtor's creditors. The defendant must prove that the act has not caused any prejudice to creditors, which is normally difficult when a valuable asset was transferred by the debtor to a third party and the debtor ends up in insolvency.

The avoidance power rules have been criticised for covering a long period of time before filing without distinguishing between affiliates (or insiders) and non-affiliates, which tends to provide uncertainty to third parties when dealing with distressed companies that afterwards end up in bankruptcy. Likewise, the fact that the initial date of cessation of payment needs to be determined by the court prior to reaching a decision on these cases normally provides an incentive to the debtor and any prospective defendant to challenge the proceeding when the initial date of cessation is determined by the court, which normally increases the litigation costs and reduces the actual recovery for creditors.

1.4.3 What risks exist for a new lender investing in a distressed business?

There are no specific rules for lenders investing in distressed businesses. The loans made by a lender in a distressed business that ends up in bankruptcy liquidation would be subject to the risk of avoidance actions, as described in paragraph 1.4.2 above.

Argentine courts have decided several cases deeming acts performed by the debtor to be without effect (*ineficaz*) in circumstances where a security interest or any other type of guarantee is granted by the debtor for the benefit of a financial entity or any other lender.

The act remains valid, but it is unenforceable against the bankruptcy estate and creditors. In other words, for bankruptcy purposes, the court treats the act as if it had never been performed, but only *vis-à-vis* creditors. For example, an insolvent debtor may grant a mortgage to a lender shortly before bankruptcy. The mortgage remains valid, but the bankruptcy court may declare it unenforceable against the creditors, so the lender cannot rely on that mortgage to obtain priority in the liquidation. In turn, the bankruptcy estate effectively takes the place of the original creditor. As a result, if there were lower-ranking mortgages, they would not move up in priority when the first mortgage is deemed unenforceable; rather, because of that substitution, the proceeds of the sale of the asset would first be allocated to the bankruptcy estate and only, if anything remains, to the second-ranking mortgagee.

Further, in certain specific cases in which the lender has a day-to-day involvement with the debtor so that the debtor cannot adopt any management decisions without the lender's authorisation, the lender might incur a responsibility as a de facto director, in which case the provisions regulated in the GCL or ABL, as applicable, would apply.

Articles 59 and 274 of the GCL provide that directors may be liable in case of violation of their duty of loyalty or their duty of care. Article 173 of the ABL provides that any representative, manager, attorney-in-fact or agent of the debtor that has – with malice – "contributed, facilitated, permitted or worsened the debtor´s economic situation or its cessation of payment status" shall be responsible for any prejudice to creditors.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

In addition to the risks described above (avoidance actions risks and liability actions risks), in the case of a subsequent bankruptcy liquidation (*quiebra*) proceeding of the distressed debtor, controlling shareholders might face the risks of bankruptcy extension actions, regulated in articles 161 et seq. of the ABL, concerning abuse or commingling of assets with the debtor.

The ABL distinguishes three situations in which the debtor's bankruptcy liquidation (*quiebra*) may be extended to a third party, each of them subject to different legal requirements, as follows:

(i) *the "maittre d´affaire" extension*. Bankruptcy liquidation shall be extended to any person that, under the appearance of the operation of the bankrupt entity, has undertaken actions in their own personal interest and disposed of the debtor's assets as if they were the person's own property in fraud to the creditors;

(ii) *the "abuse of dominant position" extension*. Secondly, bankruptcy shall be extended to any controlling entity that has unduly deviated the corporate interest of the debtor and has applied it to a unified management for the benefit of the controlling entity or economic group to which it belongs;[1] and

(iii) *the "commingling of debts and assets" extension*. Finally, the third situation entitles the bankruptcy extension to a third entity whenever there is a commingling of assets and debts situation between the debtor and the third entity that impedes the clear delimitation of all, or almost all, assets and debts.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

The CCC contains a specific Title (Title XII) regulating security interests (*derechos reales de garantías*) created on any type of claims, existing or contingent.

This Title establishes several common rules (i.e. not specifically applicable to distressed debt investors and M&A investors) regarding all types of security interests, such as mortgages and pledges. It sanctions as null and void any provision of an agreement that allows the creditor to acquire or dispose of the collateral in a different way or through a different modality to those stated in the law for each particular security interest (article 2198 of the CCC).

Except for non-possessory pledges, which are subject to special legislation (Decree 897/1995), the CCC provides that the rights arising from the pledge subsist only as long as the pledged property is in possession of the creditor or the designated third party.

Generally, creditors holding a security interest would be entitled to the following foreclosure actions:

a) Mortgages

(i) non-judicial enforcement according to the special regime set forth by Law 24,441[2] when expressly agreed upon in the mortgage agreement;

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[1] For these purposes, "controlling entity" shall be considered: (a) any such company that either in a direct way or by means of a subsidiary holds a participation by any title that conferred the necessary votes to form the corporate will; and (b) each of the entities that, acting jointly, holds participation in the proportion mentioned in (a) and is responsible of the relevant contravening conduct (article 161 of the ABL).

[2] The main characteristics of this regime are the following: (i) upon default, the debtor must be notified to pay the debt within 15 days under threat of enforcement,; (ii) if the deadline passes without payment, the creditor can request judicial verification of the occupancy status of the property and demand possession; (iii) the defences that the debtor can raise against this request are extremely limited; (iv) if no defences were opposed by the debtor or those opposed were dismissed by a final ruling, the debtor will be ordered to vacate the property within 10 business days under threat of eviction; (v) once the property is vacated, possession is handed over to the creditor who may then sell it at a public auction without judicial

(ii) enforcement through the specific mechanism expressly agreed upon in the mortgage agreement;[3] or

(iii) judicial enforcement through the proceeding provided by the applicable procedural code.

b) Pledges

(i) sale of the collateral (as pledged shares or other tangible objects) according to a public auction announced with at least 10 days' notice in the Official Gazette;

(ii) sale of the collateral through a special proceeding agreed by the parties in the pledge agreement, which may consist of the appointment of a third party to perform the sale pursuant to the market price set forth by certain institutions at the time of the sale; or

(iii) direct acquisition of the collateral by the creditor at a stated value to be set by an expert appointed by the parties, by the courts or by the procedure specified on the pledge agreement.[4]

2.2 What involvement does the court have in these processes?

If the mortgage foreclosure is carried out under Law No. 24,441 or through a similar non-judicial mechanism provided for in the constitutive instrument of the guarantee, the involvement of the court is minimal and typically includes:

(i) notifying the debtor of the creditor's request to verify the occupancy status of the property as well as the demand for possession;

(ii) resolving any potential defence raised by the debtor;

(iii) ordering the vacation of the property and delivering possession to the creditor;

(iv) ordering the auction of the property (which shall be conducted extrajudicially); and

(v) approving the rendering of accounts by the creditor.

If the foreclosure is carried out under the judicial process provided for in the respective procedural code, a court's decision shall be required to foreclose the collateral.

Likewise, if the pledge enforcement is carried out in accordance with the procedure set forth in the pledge agreement, the involvement of the court (and the eventual need for its approval to enforce) will depend on what has been agreed upon. Generally, involvement is minimal and does not include the court's approval to enforce, but its intervention is merely foreseen: (i) to resolve any conflict that may arise during the enforcement process; and (ii) to appoint a third party to carry out the sale process if the parties have failed to include any provision regarding this process, which is rarely the case.

If the pledge enforcement is carried out judicially, the court's approval will be required to enforce the collateral.

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intervention, through a designated auctioneer under usual market conditions; and (vi) after the auction, the creditor must submit a statement of the amount owed and the execution costs to the court, retaining the sale proceeds to cover the credit amount and depositing any surplus for the debtor's withdrawal.

3 This procedure generally involves the participation of a security agent who may, at its sole discretion, choose to carry out either a judicial or a non-judicial enforcement. For the case of a non-judicial enforcement, it is typically established that: (i) it may be carried out by the security agent itself or by an agent or brokerage firm according to the agreed procedure; (ii) all expenses, costs, fees, and / or taxes related to the auction are paid by the shareholders; and (iii) the pledged shares can be purchased by the lender or by the security agent for the benefit of the lenders, in which case the net price is usually set off up to the sum equivalent to the outstanding secured obligations.

4 Article 2229 of the CCC.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

Yes. Article 2229 of the CCC states that the share pledge agreement includes a provision that authorises the creditor to adjudicate the collateral (pledge shares) for the amount owed by the debtor, estimated by the expert appointed by the parties or pursuant to the proceeding stated by the parties or appointed by the courts at the request of the creditor.

2.3.2 Is a public auction mandatorily required or are private sales possible?

A public auction is not mandatorily required. The share pledge agreement may include public (judicial or non-judicial) or private auctions, or other sale mechanisms not involving auctions. For example, if the pledged shares are listed on capital markets, the sale can be made in the usual way applicable in those markets, at the market price. Further, the share pledge agreement may also set forth that the shares be adjudicated to the creditor at a price determined by an expert appointed by the parties or by the competent judge.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

No, restrictions regarding transfer of shares stated in the bylaws shall supersede and prevail over any terms included in the share pledge agreement.

2.3.4 Is "market testing" mandatorily required?

No. Market testing is not mandatory, but as a market practice it may be implemented through:

(i) public auction;

(ii) if agreed by the parties, the appointment of a third party to sell the pledged assed pursuant to the market price set forth by certain institutions at the time of the sale; or

(iii) direct acquisition of the collateral by the creditor at a stated value to be set by an expert appointed by the parties, by the courts or by the procedure specified in the pledge agreement.

2.3.5 Are valuation reports mandatorily required?

Yes, in the following cases:

(i) if the share pledge agreement sets forth a sale procedure which contemplates a report;

(ii) if the share pledge agreement provides for the direct acquisition of the shares by the pledgee at a value to be determined by an expert appointed by the parties, or by the procedure established in the share pledge agreement or by the competent judge; and

(iii) in the case of judicial execution, once the auction of the shares is ordered.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

In Argentina, there are two alternatives to complete out-of-court restructuring agreements during a pre-insolvency situation, which the ABL defines as "general economic and financial difficulties", as follows:

a) workout agreements, which are negotiated and signed completely out-of-court and are binding only between the signing parties. Like any other contract, they are subject to and governed by the terms of the agreement and the CCC;

b) *acuerdo preventivo extrajudicial* (APE), which in essence is a workout agreement judicially filed, which – provided certain requirements are satisfied and court homologation is issued – is binding not only on consenting but also on non-consenting pre-petition creditors. However, it is possible for a debtor to sign an APE with its creditors, without requiring court homologation (in which case the APE would be binding only among its signing parties, as is the case with any workout agreement).

There is no limitation in the ABL on the terms of the debtor's proposal to its creditors under an APE. In general, the debtor and creditors are free to negotiate and agree on any restructuring terms they deem appropriate.

After the debtor obtains the required consent from its creditors, it files the APE agreement with certain documentation related to its economic and financial situation with the relevant commercial court seeking judicial confirmation of the plan. Upon filing of the APE, provided the legal requirements are met, the court shall mandate that the notices be published in the Official Gazette and in an Argentine major newspaper for the duration of 5 business days. Once the court mandates the publication of the APE notices, all creditors holding pre filing claims are prevented from taking any legal action against the debtor.

In order to receive court homologation, the restructuring plan included in the APE must have been approved by: (i) an absolute majority of unsecured creditors; and (ii) a 2/3 majority of the total outstanding amount of the unsecured indebtedness being restructured under the APE. Although not expressly stated in the law, courts have permitted the debtor's aggregate unsecured indebtedness to be calculated only taking into account such liabilities which are included in the debtor's proposal, leaving aside claims which are not impaired.

Unless they agree, secured creditors are not impacted by the APE.

During a 10-day term counted as from the last publication of notices, affected creditors may object to the court's confirmation of an APE based on:

(i) the inaccuracy of the company's statements of assets and liabilities;

(ii) the failure to obtain the required consents needed for approval; or

(iii) on the ground that the proposal made by the debtor is abusive and / or fraudulent.

Once any opposition has been determined, the court shall consider whether to grant judicial approval or homologation to the APE, which if granted shall make the APE binding on all unsecured creditors included in the plan, even those that did not agree to the debtor's proposal.

During the following 6months after confirmation, the APE may be declared null and void if it is proved that: (i) the debtor intentionally altered the amount of its assets or liabilities, whether by exaggerating its liabilities or by hiding assets; and (ii) the debtor's wrongdoing was discovered only after the opposition period.

Further, and although it is not a pre-insolvency proceeding as it is operative upon the failure of a reorganisation proceeding of certain eligible debtors (notably, corporations and limited liability companies, among others), article 48 of the ABL regulates a so-called "Argentine cramdown". This authorises third parties to present their offers to acquire the equity interests of the debtor, prior to initiating a liquidation proceeding of the debtor.

Article 48 works as a last chance to avoid liquidation, with the goal of preserving the business, when the debtor's plan did not get the required consents.

In essence, it opens a "second round" proceeding, during which any third party (including the debtor) is entitled to propose a new plan to the admitted creditors. The first party that obtains the required consents from the creditors is entitled to take control of the debtor, with the current equity holders being obliged to transfer to such party the equity interests of the company.

In the event the court concludes that the equity interests have a positive value, the third party will have to pay (or guarantee) such positive value diminished in the same proportion as the debtor's liabilities, as per the terms of the plan to be approved. If the court concludes that, due to the amount of liabilities, the equity interests have a negative value, then the third party that has obtained the consents from the majority of the creditors representing 2/3 of the unsecured liabilities has the right to receive the shares without any further payment or consideration to the equity holders.

3.2 What involvement does the court have in these processes?

In a private workout agreement, there is no intervention of the courts, as this type of agreement is negotiated and signed completely out-of-court and binds only its signing parties.

In an APE, the court intervenes if and when the debtor files the restructuring plan – drafted as an agreement – with the required consents granted by its creditors and asks for judicial homologation, upon completion of the restructuring. Prior to the filing, there is no court intervention.

However, in a few cases involving a debtor with a relevant part of its liabilities as debt securities (*obligaciones negociables*) – in which the trustee had failed to call a bondholders' meeting or when the court considered that the consents provided by bondholders out-of-court needed to be ratified – prior to deciding on the homologation of the plan, the court summoned a bondholders' meeting to vote (or ratify, if already voted) the debtor´s proposal under the APE.[5]

The main task of the court is to verify that the debtor is an eligible debtor and that the requirements to grant judicial approval (homologation) to the restructuring plan agreement have been met. Any opposition must be grounded on:

(a) the inaccuracy of the company's statements of assets and liabilities;

(b) the failure to obtain the required consents needed for approval; or

(c) the debtor's proposal being abusive and / or fraudulent.

Finally, in a sale conducted under the procedure set forth by article 48 of the ABL (normally referred to as Argentine cramdown) – which as mentioned is not a pre-insolvency process as such – the proceeding is fully led by the court, which plays a relevant role. These transactions only involve equity interests of the corporate debtor, not assets. They are extremely rare in Argentina mainly due to the fact that the proceeding can only be initiated after the debtor´s failure to obtain the required consents to its proposal presented during the exclusivity period of the reorganisation proceeding, which may happen 2 years (or more) after the filing for reorganisation.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

In the APE, the main players are the debtor and its creditors and, in contested APEs, also the court.[6] There is no court-appointed receiver. Typically, when the debtor is a large company, financial advisors would be involved, with the main task of negotiating the economics of the deal with the main creditors' financial advisors.

In the case of sales of assets of debtors undergoing a reorganisation (*concurso preventivo*) or bankruptcy liquidation (*quiebra*) proceedings, as well as in the case of the transfer of shares due to article 48 of the ABL, receivers also play a relevant role in addition to the court.

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5 *See in re "Cablevisión S.A. s/ Acuerdo preventivo extrajudicial"*, SAIJ National Court of Appeals on Commercial Matters, Chamber D, 31 March 2008.

6 In the city of Buenos Aires – where the commercial courts are located and which is the natural forum for the APEs of large debtors – there are 31 Commercial Courts and 6 Court of Appeals.

3.4 Is there a typical due diligence process followed?

There is no typical due diligence process followed by distressed investors that decide to invest in a debtor which has undergone (or has successfully concluded) an APE with its main creditors. While the scope of the due diligence will ultimately depend on the industry involved as well as the type of company, the matters which are normally reviewed in depth are labour, environmental and tax matters, particularly due to successor liability concerns.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

M&A sales of companies undergoing pre-insolvency proceedings are not common in Argentina and therefore it is not possible to state a typical timeline of distressed sales.

The timeline will be highly impacted by whether the selling party would be in the vicinity of insolvency (or directly in reorganisation proceedings or APE). If the selling party is in the vicinity of insolvency, the purchaser may require that the seller files for reorganisation and asks for court authorisation to sell the assets, in order to avoid claw back actions.

If the seller is already in reorganisation (*concurso preventivo*), the transaction could not be completed without prior court authorisation. While there is not a standard proceeding, normally the third party would present an offer to buy certain assets from the debtor, which would in turn present a writ to the reorganisation court asking for permission to accept the offer. The court would require the opinion of the court-appointed receiver and of the creditors' committee and would then make a determination, taking into account the benefit of the offer for the continuance of the debtor's activity and the protection of creditors' rights. Although not mandatory, the court may also resolve to publish notices in a newspaper or the Official Gazette asking third parties to present offers.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

M&A sales or asset sales under pre-insolvency process are not *per se* protected in Argentina. Therefore, they are subject to avoidance actions in case the seller, after the sale is completed, ends up in bankruptcy liquidation (*quiebra*).

Notwithstanding that, the parties may decide to implement these transactions with court authorisation, either by including the sale offer presented by the third party as part of the debtor´s restructuring plan presented to the creditors during the reorganisation proceeding or by requiring the court to authorise the sale of assets of the debtor pursuant to article 16 of the ABL.

On the basis of article 121 of the ABL, which limits avoidance actions against transactions performed during the reorganisation proceeding upon court approval, the doctrine has traditionally concluded that these court-approved transactions are safe from claw-back actions in case the seller subsequently ends up in bankruptcy liquidation.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Pre-pack processes in which the debtor agrees to transfer most (or directly all) of its assets to a third party purchaser and then file for court approval (either through a restructuring plan approved under an APE or *concurso preventivo*) – while not strictly prohibited under the ABL – are not commonly used in Argentina.

Nothing restricts a debtor from negotiating with a third party an agreement to sell some or most of its assets, subject to court authorisation. Once the commercial terms are agreed, the debtor may either: (i) include the proposed sale as part of the restructuring plan, seek consents from its creditors and then – once such consents are obtained – require that the court homologates the plan under an APE; or (ii) file for reorganisation and simultaneously require court authorisation to complete the deal under article 16 of the ABL.

The court will make a decision after hearing the opinions of the receiver and of the creditors' committee and should take into account the benefit of the transaction for the continuance of the debtor's activity and the protection of the creditors' rights.

Alternatively, a debtor which is already undergoing a reorganisation proceeding may include the sale of some, or most, of its assets as part of the plan presented to its creditors. In this case, for the plan to be approved, it must – as with any other plan – receive consents from an absolute majority of unsecured creditors that represent at least 2/3 of the total outstanding amount of the unsecured indebtedness affected by the plan.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Argentine insolvency law does not expressly regulate "pre-pack" sales in the strict sense in which they are understood in certain common law jurisdictions (notably the United Kingdom) – that is, pre-negotiated sales of all or a substantial part of the debtor's business implemented immediately upon, or very shortly after, the commencement of formal insolvency proceedings.

Notwithstanding the absence of an explicit statutory framework, however, pre-packaged sales are not prohibited under Argentine law and, in practice, may be structured and implemented through different legal mechanisms available under the ABL.

In broad terms, a pre-pack sale in Argentina may be defined as a transaction where the debtor negotiates in advance, outside of court, the commercial terms of a sale of assets or business units with a third party purchaser and subsequently seeks to implement that transaction with some degree of judicial involvement or approval. The objective is to preserve the going concern value of the business and minimise value destruction associated with prolonged insolvency proceedings.

From a structural standpoint, Argentine law allows pre-pack-like transactions to be implemented mainly through the following avenues:

- ***Inclusion of the sale as part of an APE restructuring plan***

  A debtor may negotiate with a third party purchaser the sale of all or a substantial part of its assets and incorporate this transaction into the terms of an APE. In this scenario, the sale is embedded in the restructuring plan presented to creditors, who are requested to grant their consent not only to the financial restructuring but also, indirectly, to the contemplated transfer of assets.

  Once the required majorities are obtained and the plan is judicially homologated, the transaction benefits from the effects of court approval, which, according to prevailing doctrine, significantly reduces the risk of subsequent avoidance actions in a later bankruptcy liquidation.

- ***Court-authorised sale under article 16 of the ABL in a reorganisation proceeding***

  Alternatively, the debtor may file for reorganisation proceedings and, either simultaneously with the filing or shortly thereafter, request court authorisation to complete a pre-negotiated sale of assets pursuant to article 16 of the ABL. This provision allows the court to authorise acts outside the ordinary course of business, including the sale of registered assets or business units, provided the transaction is deemed beneficial for the continuation of the debtor's activity and the protection of creditors' rights. In this context, the court must hear the opinion of the court-appointed receiver (*síndico*) and, if applicable, the creditors' committee, before issuing a decision.

- ***Incorporation of the sale into a reorganisation plan submitted during the exclusivity period***

  A debtor already undergoing reorganisation proceedings may also structure a pre-packaged sale as an integral component of the reorganisation plan submitted to creditors during the exclusivity period. In this case, the approval of the plan by the required majorities and its subsequent judicial homologation effectively validates the transaction, subject to compliance with general insolvency principles.

While these mechanisms allow for the practical implementation of pre-pack sales, Argentine practice shows that such transactions remain exceptional rather than standard. This is largely due to structural features of the Argentine insolvency system, including the absence of a statutory safe harbour for pre-pack transactions, the broad scope of avoidance actions, and a judicial culture traditionally cautious with respect to transactions negotiated prior to court involvement.

Nevertheless, landmark cases demonstrate that Argentine courts are willing to authorise and uphold pre-negotiated sales of substantially all of the debtor's assets at an early stage of insolvency proceedings when the transaction clearly maximises value, preserves employment and offers better recovery prospects for creditors than a piecemeal liquidation. These cases suggest that, although not formally codified, pre-pack sales are functionally feasible under Argentine law when properly structured and supported by compelling economic and social considerations.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Given the absence of a formally regulated pre-pack regime under Argentine law, the identification of the main players involved in pre-pack sales necessarily depends on the legal mechanism through which the transaction is structured. In all cases, however, pre-pack sales in Argentina involve a combination of private actors and, at some stage, judicial oversight.

At a minimum, the core participants in a pre-pack sale are:

- ***The debtor and its management***

  The debtor, acting through its management and corporate bodies, plays a central role in the negotiation and structuring of the pre-pack sale. As the transaction is typically negotiated prior to court involvement, management is responsible for identifying potential purchasers, negotiating the commercial terms of the sale and assessing whether the proposed transaction maximises the value of the business as a going concern. In distressed scenarios, directors' duties are heightened and management must balance the interests of shareholders with those of creditors, particularly where the sale may result in a change of control or the transfer of substantially all of the debtor's assets.

- ***The purchaser or investor***

  The purchaser is usually a strategic investor or a financial sponsor with the capacity to assume operational, labour and, in certain cases, environmental contingencies associated with the business. In Argentine practice, successful pre-pack transactions have generally involved purchasers willing not only to pay a competitive price, but also to assume employment-related obligations and ensure continuity of operations, which courts tend to view as a decisive factor when authorising early-stage asset sales.

- ***Creditors and, where applicable, ad hoc creditor committees***

  Although creditors are not directly involved in the negotiation of the sale in purely out-of-court stages, they play a critical role when the transaction is embedded in an APE or a reorganisation plan, as their consent is required for approval. In practice, financial creditors – particularly banks and bondholders – often exert significant influence over the structure of the transaction, either through restructuring support agreements or informal negotiations conducted in parallel with the debtor and the purchaser.

- ***The court***

  Judicial involvement arises once the transaction requires approval or homologation, either through an APE, a reorganisation plan or a request under article 16 of the ABL. Unlike jurisdictions with formal pre-pack regimes, Argentine courts do not supervise the negotiation phase, but they retain broad discretion at the approval stage to assess whether the transaction is compatible with insolvency principles, including the preservation of the business, the protection of creditors' rights and the absence of fraud or abuse.

- ***Court-appointed insolvency practitioners***

  There are no court-appointed insolvency practitioners involved in pre-pack sales structured exclusively through an APE prior to court filing. However, once the debtor is subject to a reorganisation proceeding, a court-appointed receiver (*síndico*) becomes a key participant. The *síndico* is required to issue a reasoned opinion on the proposed sale, focusing on whether the transaction benefits the continuation of the debtor's activity and improves creditors' recovery prospects when compared to alternative scenarios, such as liquidation.

  Although the *síndico* does not negotiate the transaction and has no decision-making authority, its opinion carries significant weight in the court's assessment. In practice, adverse opinions by the *síndico* substantially reduce the likelihood of court approval, while favourable opinions often facilitate an expedited decision.

  Unlike some foreign pre-pack regimes, Argentine law does not allow creditors or investors to influence the appointment of the *síndico*. The practitioner is appointed by the court pursuant to statutory rules, and parties have a limited ability to challenge the appointment, except on general grounds of conflict of interest or lack of independence.

  In summary, pre-pack sales in Argentina are characterised by a hybrid governance structure: negotiations are led by private actors outside of court, while judicial authorities and court-appointed insolvency practitioners intervene at the approval stage, primarily as ex-post reviewers of the transaction rather than as active participants in its design. This structural feature distinguishes Argentine pre-pack practice from more institutionalised models and partially explains both the limited use and the cautious judicial scrutiny of such transactions.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

As a general rule, M&A or distressed debt investors have no ability to control or influence the appointment of court-appointed insolvency practitioners in connection with pre-pack sales under Argentine law.

This is a direct consequence of two structural features of the Argentine insolvency framework: (i) the absence of a formally regulated pre-pack regime; and (ii) the mandatory and court-driven system for the appointment of insolvency practitioners once formal insolvency proceedings are commenced.

In Argentina, insolvency practitioners are appointed exclusively by the competent commercial court from officially approved lists, pursuant to the rules in the ABL and the applicable procedural regulations. The appointment is based on objective criteria, including rotation systems and professional qualifications, and is not subject to party nomination or contractual agreement. As a result, neither the debtor nor its creditors – and, *a fortiori*, third party investors – may designate, propose or veto a particular practitioner in advance.

This lack of influence applies equally to all scenarios in which a *síndico* becomes involved in a transaction that may qualify, in economic terms, as a pre-pack sale, including sales of assets authorised under article 16 of the ABL during a reorganisation proceeding, as well as transactions embedded in a reorganisation plan subject to judicial approval.

The only limited exception arises after the appointment has taken place, where parties may seek the removal or replacement of the *síndico* on general legal grounds, such as lack of independence, conflict of interest or serious breach of duties. However, these challenges are exceptional. They are subject to a high evidentiary threshold and cannot be used as a mechanism to appoint a preferred practitioner.

From a practical standpoint, this structural feature has relevant implications for distressed investors. Unlike jurisdictions where pre-pack regimes allow a high degree of investor influence over the appointment of insolvency professionals – often as a means of ensuring speed and transactional certainty – Argentine law prioritises institutional neutrality and judicial control over efficiency considerations. While this approach reinforces the perception of procedural fairness, it may also limit the predictability of outcomes from the investor's perspective, particularly in complex or time-sensitive transactions.

In this context, experienced investors typically mitigate this limitation by focusing their efforts on structuring transactions that are robust on their merits, economically sound and clearly aligned with the interests of creditors and the continuity of the business. In practice, transactions that demonstrate these characteristics are more likely to receive favourable opinions from court-appointed practitioners, regardless of the identity of the *síndico* involved.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Argentine law does not provide a specific or bespoke statutory regime granting special protection to certain categories of creditors exclusively in the context of pre-pack sales. Instead, the protection of particular creditors – most notably employees – derives from general labour and insolvency rules, which remain fully applicable regardless of whether the transaction is structured as a pre-pack sale or as a traditional asset sale during insolvency proceedings.

From a labour law perspective, employee protection constitutes the most significant constraint in the structuring of pre-pack sales in Argentina. Pursuant to article 225 of Argentine Labour Law No. 20,744, when a transaction qualifies as a "transfer of establishment" (*transferencia de establecimiento*), the purchaser is deemed to be the successor employer and automatically assumes all labour obligations existing at the time of the transfer. This includes not only accrued salaries and benefits, but also seniority, ongoing employment relationships and liabilities arising as a consequence of the transfer itself.

As a result, pre-pack sales involving the transfer of a going concern – rather than isolated assets – typically entail the automatic continuation of employment contracts with the purchaser, unless specific agreements are reached with employees or labour authorities. This regime operates independently of court approval and applies even where the sale is authorised under article 16 of the ABL or embedded in a court-approved restructuring plan.

From an insolvency law standpoint, labour claims enjoy a high level of statutory protection. The ABL grants employees special privileges over certain categories of assets and establishes priority rules that remain applicable in any insolvency scenario. However, these privileges do not translate into a distinct procedural role for employees in pre-pack sales, nor do they grant employees veto rights over transactions. Instead, employee interests are typically represented indirectly through the court's assessment of whether the transaction preserves employment and maximises value for the estate.

In practice, Argentine courts have shown a strong inclination to favour pre-pack-like transactions that preserve jobs and maintain business continuity. Landmark cases illustrate that judicial authorisation of early-stage asset sales has been significantly influenced by the purchaser's commitment to retain employees, assume labour liabilities and ensure uninterrupted operations. While these commitments are not formally mandated by insolvency law, they have become a de facto condition for court approval in transactions involving substantial workforces.

In contrast, other categories of creditors do not benefit from special statutory protections tailored to pre-pack sales. Secured creditors retain their rights in accordance with the general rules governing security interests and unsecured creditors' protection is limited to the safeguards inherent in the applicable insolvency mechanism, such as majority approval requirements and judicial scrutiny for abuse or fraud. There is no equivalent to a "ring-fencing" regime or statutory carve-outs designed specifically for pre-pack transactions.

In summary, while Argentine law does not establish a pre-pack-specific creditor protection framework, employee rights and labour liabilities operate as a central structural constraint in the design and execution of pre-pack sales. The combination of strict successor liability rules and a judiciary traditionally protective of employment has shaped market practice, effectively requiring that successful pre-pack transactions address labour continuity as a core element of their economic and legal rationale.

4.5 Is there a typical due diligence process followed?

Argentine law does not impose a mandatory or court-supervised due diligence process in connection with pre-pack sales. As pre-pack transactions are negotiated primarily outside of court and only later submitted for judicial approval, the scope, depth and methodology of due diligence are determined by market practice rather than by statutory or procedural requirements.

In practice, however, pre-pack sales in Argentina are characterised by highly targeted and risk-driven due diligence exercises, shaped by the legal risks inherent in acquiring assets or a going concern from a distressed debtor. Unlike standard M&A transactions, where comprehensive due diligence across all areas is customary, distressed investors tend to prioritise specific risk areas that may materially affect value or generate post-closing liabilities.

The areas most commonly subject to enhanced scrutiny include:

- ***Labour and employment matters***

  Given the automatic successor liability regime applicable to transfers of establishments, labour due diligence is invariably the most critical component of the process. Investors typically focus on the number of employees, seniority, collective bargaining agreements, outstanding wage claims, social security contributions and the existence of pending or threatened labour litigation. Particular attention is paid to identifying contingent liabilities that may crystallise upon transfer, as well as to the feasibility of workforce continuity in operational and economic terms.

- ***Tax and social security exposure***

  Distressed investors routinely conduct in-depth reviews of federal, provincial and municipal tax liabilities, including audits, assessments and enforcement proceedings. While asset purchases may allow for some degree of ring-fencing, tax authorities in Argentina have historically sought to assert successor liability claims in certain circumstances, making this area a key focus of diligence.

- ***Environmental liabilities***

  Environmental due diligence has gained increasing relevance in recent years, particularly in transactions involving industrial assets, energy infrastructure or regulated activities. Investors seek to assess not only existing contamination or remediation obligations, but also ongoing compliance with environmental permits and the potential exposure to administrative sanctions or civil claims. This area is especially relevant in pre-pack contexts, as environmental liabilities may survive insolvency proceedings and materially affect the economics of the transaction.

- ***Title, regulatory and operational matters***

  Investors typically verify title to key assets, the existence and enforceability of material contracts and compliance with sector-specific regulatory regimes. In regulated industries, the ability to transfer licences or obtain regulatory approvals may be a condition precedent to closing and is therefore analysed early in the process.

As regards ESG considerations and energy transition targets, Argentine practice remains at an early and uneven stage when compared to more developed markets. While ESG-focused due diligence is not yet standard in domestic distressed transactions, international investors and strategic buyers – particularly those subject to foreign regulatory or reporting obligations – are increasingly incorporating ESG-related assessments into their diligence processes. This trend is more pronounced in sectors such as energy, natural resources, agribusiness and infrastructure.

Notwithstanding this evolution, ESG diligence in Argentina remains largely pragmatic rather than normative. It is driven by risk mitigation and future compliance considerations rather than by formal insolvency or M&A requirements. Courts do not currently require ESG disclosures or assessments as a condition for approving pre-pack sales. Such considerations typically influence the transaction indirectly, through pricing adjustments or purchaser commitments, rather than through procedural safeguards.

In summary, while there is no typical or mandated due diligence process for pre-pack sales in Argentina, market practice reflects a selective but intensive approach, focused on labour, tax and environmental risks. The scope of diligence is closely aligned with the specific risk profile of distressed acquisitions and continues to evolve as international standards and investor expectations gradually permeate the local market.

4.6 Is "market testing" mandatorily required?

Argentine law does not mandate "market testing" as a formal or procedural requirement for pre-pack sales. The ABL does not impose an obligation to conduct competitive bidding processes, public tenders or other market-testing mechanisms as a condition for the validity or enforceability of pre-negotiated asset sales implemented through an APE or authorised under article 16 of the ABL.

That said, the absence of a statutory requirement does not mean that market testing is irrelevant in practice. On the contrary, market exposure operates as an implicit and highly relevant factor in the judicial assessment of pre-pack transactions, particularly when the sale involves substantially all of the debtor's assets or a going concern.

In cases where court authorisation is required – most notably sales approved under article 16 of the ABL during reorganisation proceedings – courts routinely assess whether the agreed price and terms reasonably reflect market value. While the court is not bound to require a competitive process, it retains broad discretion to do so if it considers that the lack of market exposure may prejudice creditors' interests. In this context, courts may request the publication of notices inviting third parties to submit competing offers or may condition approval on the absence of better proposals within a certain period.

From a practical perspective, debtors and purchasers often proactively incorporate elements of market testing into the transaction structure to mitigate judicial scrutiny and reduce the risk of subsequent challenges. These elements may include:

- informal canvassing of potential buyers prior to entering into exclusivity with the selected purchaser;
- submission of evidence demonstrating that other potential purchasers were approached but did not submit binding offers; or
- acceptance of a limited "overbid" process following the filing of the request for court authorisation.

However, these practices are not standardised and vary significantly depending on the court, the complexity of the case and the economic relevance of the assets involved. Unlike jurisdictions with formal pre-pack regimes, Argentine law does not provide a framework to balance speed against transparency through predefined market-testing protocols.

The lack of mandatory market testing has been one of the main sources of doctrinal criticism of pre-pack-like transactions in Argentina. Critics argue that pre-negotiated sales without adequate market exposure may facilitate undervaluation, favour insiders or undermine creditor confidence. Conversely, proponents emphasise that excessive market testing may erode going concern value, delay transactions and ultimately reduce recoveries.

In practice, Argentine courts have tended to adopt a case-by-case approach, weighing the urgency of the transaction and the risk of value destruction against the benefits of broader market exposure. Transactions that convincingly demonstrate that speed is essential to preserve value – particularly where operations have effectively ceased or liquidity has been exhausted – are more likely to be approved without extensive market testing.

In summary, while market testing is not mandatorily required for pre-pack sales under Argentine law, it plays a de facto evidentiary role in judicial decision-making. Parties structuring pre-pack transactions must carefully assess whether, and to what extent, some form of market exposure is advisable to support the legitimacy and robustness of the transaction.

4.7 Are valuation reports mandatorily required?

Argentine law does not impose a general or automatic requirement to obtain valuation reports in connection with pre-pack sales. The ABL does not establish mandatory valuation standards or appraisal obligations specifically applicable to pre-packaged transactions, nor does it require that an independent valuation be conducted as a condition precedent for court approval of a pre-negotiated sale.

As with market testing, the role of valuation in pre-pack sales is governed by judicial discretion and market practice, rather than by statutory mandate. Whether a valuation report is required – formally or in practice – depends on the legal mechanism used to implement the transaction and on the particular circumstances of the case.

In transactions structured through an APE, valuation reports are not legally required. Since the sale is embedded in a restructuring agreement approved by the requisite creditor majorities, courts tend to focus on the existence of informed creditor consent and the absence of abuse or fraud, rather than on the formal production of valuation evidence. In this context, creditors are presumed to have assessed the economic rationale of the transaction when granting their consent.

By contrast, where a pre-pack sale is submitted for court authorisation under article 16 of the ABL during a reorganisation proceeding, valuation considerations become more relevant. While the court is not obliged to require an independent valuation, it must assess whether the transaction is reasonably aligned with the interests of the estate and creditors. To that end, the court-appointed receiver is required to issue an opinion on the proposed sale, which typically includes an assessment – explicit or implicit – of whether the price offered reflects market conditions and exceeds expected liquidation value.

If the court considers that the receiver's opinion is insufficient, incomplete or inconclusive, it may request additional evidence, including the appointment of a financial expert to issue a valuation report. This power is discretionary and is exercised primarily in cases involving significant assets, related-party transactions or allegations of undervaluation raised by creditors.

In practice, parties to pre-pack transactions often voluntarily produce valuation materials – such as fairness opinions, liquidation value analyses or comparative transaction benchmarks – to support the court's review and pre-empt objections. These materials are not required by law, but they do serve an important evidentiary function, particularly where the transaction lacks extensive market testing or is negotiated with a limited pool of potential purchasers.

From a policy perspective, the absence of mandatory valuation requirements has been both defended and criticised. Proponents argue that flexibility allows courts to adapt their level of scrutiny to the urgency and complexity of each case, avoiding rigid procedures that may delay value-preserving transactions. Critics, however, contend that the lack of formal valuation safeguards increases uncertainty and may undermine transparency, particularly in transactions involving insiders or accelerated timelines.

In summary, valuation reports are not mandatorily required for pre-pack sales under Argentine law. Nevertheless, valuation evidence plays a material practical role in judicial decision-making and risk mitigation. In the absence of statutory requirements, parties must assess, on a case-by-case basis, whether the production of valuation materials is advisable to support court approval and enhance the robustness of the transaction.

4.8 What is the typical timeline of "pre-pack" sales?

There is no typical or standardised timeline for pre-pack sales in Argentina. The absence of a formally regulated pre-pack regime, combined with the discretionary nature of judicial intervention, means that the duration of such transactions varies significantly depending on the legal structure adopted, the complexity of the business and the degree of court involvement required.

From a practical standpoint, it is useful to distinguish between the negotiation phase and the implementation phase.

The negotiation phase of a pre-pack sale – during which the debtor and the purchaser agree on the commercial terms of the transaction – takes place entirely out of court and may be relatively swift, particularly where the pool of potential buyers is limited or where liquidity constraints require urgent action. Depending on the circumstances, this phase may range from a few weeks to several months and is largely driven by commercial considerations rather than legal constraints.

The implementation phase, by contrast, is subject to procedural timelines that tend to reduce the speed advantages typically associated with pre-pack regimes in other jurisdictions. Where the transaction is embedded in an APE, the overall timeline is influenced by the time required to obtain creditor consents, file the agreement, complete the notice period, resolve any objections and obtain judicial homologation. In practice, this process may take several months, even in relatively straightforward cases.

Where the pre-pack sale requires court authorisation under article 16 of the ABL during a reorganisation proceeding, timelines are similarly uncertain. While courts may act expeditiously in cases involving imminent value destruction, the need to hear the opinion of the court-appointed receiver and, where applicable, the creditors' committee, combined with the possibility of objections or appeals, often extends the timeframe. First-instance decisions may be obtained within a few months, but appellate review can significantly lengthen the process.

As a result, Argentine pre-pack sales do not typically achieve the near-immediate execution seen in jurisdictions with formal pre-pack mechanisms. Instead, they represent an intermediate solution, offering greater speed and flexibility than traditional insolvency asset sales, but falling short of the efficiency associated with fully codified pre-pack regimes.

Notwithstanding these limitations, judicial practice shows that courts are willing to accelerate timelines in exceptional cases where delay would materially erode value, jeopardise employment or render the business non-viable. In such cases, courts have demonstrated a pragmatic approach, prioritising substance over form and authorising transactions within compressed timeframes.

In summary, while pre-pack sales in Argentina can be faster than conventional asset sales conducted during liquidation, they remain subject to procedural uncertainties and judicial discretion. The lack of a predictable and expedited timeline underscores the broader debate on the need for legislative reform to introduce clearer and more efficient pre-pack mechanisms aligned with international best practices.

AUSTRALIA

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

In Australia, there is no specific legal regime governing the purchase of distressed equity. Key regulators, including the Australian Competition and Consumer Commission (ACCC), the Foreign Investment Review Board (FIRB) and the Australian Securities and Investments Commission (ASIC), apply their mandates equally to both distressed and non-distressed equity acquisitions.

For instance, section 50 of the Competition and Consumer Act 2010 (Cth) states that a person must not acquire shares or assets if the acquisition would substantially lessen competition in any market for goods and services in Australia. Additionally, the FIRB serves several key functions under the Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA). These include the examination of proposed investments that fall within the scope of FATA, as well as assessing foreign investment proposals, including those involving distressed assets to ensure alignment with Australia's national interests. Market participants must consider these regulatory constraints when acquiring distressed businesses and assets, outside of formal insolvency processes.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Australia does not have a dedicated legal regime for the purchase of distressed debt or non-performing loans (NPLs). However, general legal and regulatory frameworks apply to such transactions. These include contract law principles, the Personal Property Securities Act 2009 (Cth) (PPSA), and prudential standards enforced by the Australian Prudential Regulation Authority (APRA). Generally, the banking, competition and prudential regulations will apply to regulated entities that are engaged in these transactions and will aim to address considerations such as risk management and proper disclosure principles.

Prudentially regulated entities – such as banks, credit unions, building societies, insurance providers and superannuation funds – must comply with APRA's prudential standards, including those relating to credit risk management. For example, APRA's Prudential Standard APS 220 outlines requirements for managing credit risk, including the treatment of impaired assets and the need for appropriate provisioning. Adherence to these standards assists in regulating risk retention, particularly when the objective of an NPL transaction is to obtain capital relief. There are strict time-based and quantum limitations on representations, warranties, and indemnities associated with the sold assets.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

While only a relatively small percentage of the Australian workforce is unionised, trade unions continue to play a significant role in industrial relations. Under the Fair Work Act 2009 (Cth), unions have rights to represent their members, including during enterprise bargaining and in matters concerning workplace conditions. In the context of distressed investments, unions may engage with restructuring professionals to advocate for employee interests, particularly in industries with a history of successful restructuring, such as manufacturing, mining, construction and airlines.

Additionally, Australia’s federal structure means that regulations exist at both federal and state level. For example, in distressed real estate investments, there is significant regulation at the local government (municipal) level. Investors should be aware of these multi-layered regulatory requirements when engaging in distressed investments.

1.4 What risks exist for an investor of a distressed business?

Australia is generally regarded as a creditor-friendly jurisdiction, with robust institutions and an insolvency law framework that supports investment. However, investing in a distressed business carries specific risks, both within and outside the insolvency context.

1.4.1 *What risks exist for the transaction to be challenged and overturned outside of bankruptcy?*

Outside formal insolvency processes, transactions may still be subject to challenge under general legal principles. For instance, if a transaction:

(1) is not properly authorised;

(2) is not conducted at arm's length; or

(3) breaches third-party contractual restrictions,

it may be vulnerable to legal challenge. Ensuring that transactions are properly documented, authorised through appropriate corporate governance processes, and conducted on commercial terms, can mitigate these risks.

Nevertheless, it is fair to say that identification of the risks of challenge in a distressed investment scenario is more often examined through the lens of post insolvency challenge in the context of a formal insolvency process such as voluntary administration or liquidation.

1.4.2 *What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?*

In Australia, the term "bankruptcy" is largely used only in the personal insolvency context. For consistency, we will generally refer to "insolvency" rather than "bankruptcy" in the remainder of this chapter.

Under Chapter 5.7B of the Corporations Act 2001 (Cth) (Corporations Act), certain transactions entered into within a specified period before liquidation can be voided by a liquidator. These include unfair preferences, uncommercial transactions, unreasonable director-related transactions, insolvent transactions and creditor-defeating dispositions.

Relevant to this is the "relation-back" period, which determines the timeframe during which transactions may be scrutinised. For example, uncommercial transactions may be voidable if entered into within 2 years before the relation-back day, or 4 years if a related entity is involved. Transactions intended to defeat creditors can be voided if entered into within 10 years before the relation-back day. The relation-back day itself varies depending on the circumstances, such as the date of the winding-up application or the appointment of an administrator.

It is therefore imperative for transactions conducted close to insolvency to be meticulously documented, with clear evidence of fair value exchange and consideration of stakeholder rights to withstand later scrutiny should a liquidator be appointed. Failure to do so may result in the transaction being set aside, leading to potential financial loss and reputational damage.

1.4.3 *What risks exist for a new lender investing in a distressed business?*

A new lender to a distressed business assumes the financial risk of the investment, including potential loss of capital or income. Additionally, lenders must be cautious of "shadow director" liability. If a lender exerts significant influence over the company's decisions, they may be deemed a shadow director and be subject to the same duties and liabilities as formally appointed directors, including liability for insolvent trading under section 588G of the Corporations Act. Australian courts have recognised this doctrine, but have emphasised its exceptional nature. Lenders should avoid interfering with the company's management to mitigate this risk.[1]

Directors, including shadow directors, have a duty to prevent the company from trading while insolvent. Insolvent trading occurs when a company incurs debts while insolvent, and directors may be held personally liable if they fail to prevent this. Defences to insolvent trading claims

[1] *Buzzle Operations Pty Ltd (In Liq) v Apple Computer Australia Pty Ltd* [2011] NSWCA 109.

include having reasonable grounds to expect solvency, reliance on competent advice, taking reasonable steps to prevent the debt, and the "safe harbour" defence, which protects directors developing a course of action reasonably likely to lead to a better outcome for the company.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

New shareholders in a distressed business may face similar risks to lenders, particularly if they appoint directors to the company's board. Appointed directors are subject to the same duties and liabilities, including the prohibition against insolvent trading. To mitigate these risks, directors should ensure that they can rely on one or more defences to insolvent trading, such as the safe harbour provisions.

The safe harbour provisions, introduced in 2017, offer protection to directors from civil liability for insolvent trading if they are developing or implementing a course of action reasonably likely to lead to a better outcome for the company than immediate liquidation. To rely on this defence, directors must ensure that:

(1) the course of action is documented and based on reasonable assumptions;

(2) the company continues to pay employee entitlements and comply with tax reporting obligations; and

(3) the debts incurred are in connection with the course of action.

Further, it is to be noted that the safe harbour does not protect directors from other legal obligations, and it does not prevent the appointment of an insolvency practitioner by a third party during the safe harbour period.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Distressed debt and M&A investors in Australia may avail themselves of several enforcement and restructuring mechanisms, including:

(1) *Receivership* – typically initiated by secured creditors under a registered security interest. A receiver is appointed to realise assets and repay the secured debt.

(2) *Voluntary administration* – a formal process where an administrator takes control of the company to assess options for restructuring or winding up.

(3) *Statutory demand* – a formal demand for payment of debt that can lead to court-ordered liquidation if unpaid.

(4) *Share pledge enforcement* – enables the creditor to sell or transfer pledged shares under security arrangements (see paragraph 0 below).

(5) *Court processes* – garnishee orders, writs of possession, and foreclosure actions may be used, though less commonly in corporate recovery scenarios. Public or private sale options are available depending on the nature of the secured asset. For example:

(a) Public sale: this is common for assets like real estate or listed securities. It offers transparency and helps meet the duties under section 420A of the Corporations Act.

(b) *Private sale:* this is permissible where market value can be reliably established by independent valuation or a credible sales process.

Small business restructuring options also exist, but are only available to entities with liabilities below AU $1 million. These options are outside the scope of this paper.

2.2 What involvement does the court have in these processes?

Court involvement varies depending on the process:

(1) Voluntary administration and receivership – typically, these are private processes. Court involvement is optional but available to resolve disputes or validate decisions.

(2) Liquidation – court-ordered liquidations require formal applications and may involve frequent court oversight, particularly for disputes over voidable transactions, asset recovery or creditor claims.

(3) Schemes of arrangement – these require court approval at multiple stages (see paragraph 0 below).

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

In Australia, a share pledge (commonly termed share mortgage or share security) creates a security interest over shares which are classified as personal property under the PPSA. To be enforceable, the security must be registered on the Personal Property Securities Register (PPSR).

The enforcement process includes:

(1) exercising contractual powers such as powers of attorney to effect sale or transfers;

(2) appointing receivers or taking possession of the shares; and

(3) complying with section 420A of the Corporations Act, which imposes a duty to take all reasonable care to sell the property for at least market value or the best price reasonably obtainable having regard to the circumstances when the property is sold (provided there is no market value).

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

Yes. However, the enforcing party must comply with the duties in section 420A of the Corporations Act. This typically involves conducting an open sale process to establish market value, and the creditor may credit bid their debt in lieu of cash.

Alternatives include:

(1) A creditors' scheme of arrangement (Part 5.1 of the Corporations Act) – financially distressed companies are allowed to propose restructuring plans, including debt-for-equity swaps, which requires court approval and creditor support.

(2) A deed of company arrangement (DOCA) – another avenue for distressed companies to arrange with creditors, potentially including debt-for-equity swaps if agreed by creditors during voluntary administration.

(3) Foreclosure – a rarely used but legally possible remedy.

2.3.2 Is a public auction mandatorily required or are private sales possible?

In Australia, enforcement sales can be conducted through either a public auction or a private sale. public auction is not a mandatory requirement, but if the secured asset in question is one which would more typically be sold through public auction in a non-distressed scenario (e.g. many simple real estate assets or listed securities), then a public auction would typically be used to satisfy mortgagee duties. Regardless, it is usual for there to be an open process at the outset, even if truncated and / or leading to a private sale. Private sales are permitted, provided the sale process demonstrates reasonable care in achieving market value (per section 420A of the Corporations Act).

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Generally, no. When debtors pledge shares as collateral for a loan in Australia the secured creditor gains a security interest in those shares and can sell them if the debtor defaults. However, transfer restrictions outlined in constituent documents, such as pre-emptive rights, director approval, tag-along and drag-along rights, lock-up periods, prohibition on encumbrance, and right of refusal, can complicate this process. A secured creditor enforcing over shares will be bound by the same restrictions to which the grantor of the pledge is bound.

Accordingly, it is important to diligence these aspects at the outset and where required seek amendments to any relevant restrictions and / or direct side or tripartite deeds with the other relevant parties as a condition of investing / funding.

2.3.4 Is "market testing" mandatorily required?

Market testing is not mandatory but it is an important consideration for controllers, such as receivers or managers who are tasked with selling property of a corporation with a discernible market value, as required under section 420A of the Corporations Act.

This requirement obligates controllers to ensure that the sale price does not fall below the property's market value, aiming to protect the corporation and its stakeholders from undervalued sales. This duty was exemplified in *Boz One Pty Ltd v McLellan* [2015] VSCA 68, where despite the absence of conventional selling methods like advertising or auctions, the court ruled that the receiver had fulfilled their obligation to sell the property at its market value.[2]

2.3.5 Are valuation reports mandatorily required?

No, but they are routinely obtained in practice. While valuation reports are not always mandatorily required, they play a critical role in upholding transparency and fairness during share transfers and provide some protection to secured creditors and insolvency professionals against breach of duties claims. For example:

(1) Section 420A of the Corporations Act addresses the obligations of controllers of property regarding the sale of secured assets for an amount not less that the market price or otherwise he best price reasonably obtainable in the circumstances. Valuation reports are often commissioned to support decisions to execute a sale.

(2) Section 444GA of the Corporations Act pertains to share transfers in companies under administration, permitting transfers as part of a DOCA. When approving transfers under section 444GA, valuations will be critical.

(3) With schemes of arrangement, ASIC will typically mandate certain conditions providing shareholders with explanatory materials, including an Independent Expert Report (IER) prepared on a non-going concern basis, demonstrating that shareholders have no residual equity in the company based on a liquidation value assessment, and ensuring the independence of the expert preparing the report.

Valuation reports help mitigate liability for breaches of duty and enhance transaction defensibility.

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2 *Boz One Pty Ltd v McLellan* [2015] VSCA 68.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

The most common pre-insolvency process in Australia is a scheme of arrangement under Part 5.1 of the Corporations Act, which is a court-approved statutory agreement between a company and its shareholders and creditors or a class of them. Schemes of arrangement are also utilised in non-distressed public M&A processes as they offer greater flexibility compared to takeover bids and are supervised by both ASIC and the courts. However, schemes are expensive and typically reserved for large, cooperative restructurings.

Other available pre-insolvency options include:

(1) *Informal workouts* – negotiated consensual restructurings outside formal court processes.

(2) *Safe harbour restructuring* – directors can rely on safe harbour protections when developing restructuring plans.

(3) *Refinancing or standstill arrangements* – negotiated debt extensions or capital injections without court involvement.

3.2 What involvement does the court have in these processes?

Court involvement in schemes of arrangement begins at the initial directions hearing to approve the meeting convening process and continues through to the final hearing for scheme approval. The court will scrutinise class formation, disclosure adequacy, procedural fairness and compliance with statutory voting thresholds. The court's role concludes after final orders and any ancillary relief is granted.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The main players include:

(1) company directors and management: initiate the restructuring;

(2) legal and financial advisors: support plan development and disclosure;

(3) pre-insolvency advisors: evaluate a company's viability, conduct root cause analyses and devise turnaround or winding-up strategies if necessary;

(4) valuation experts: assess business and asset values, guiding decisions on asset sales, mergers, or reorganisation based on fair market values and recovery potential;

(5) restructuring specialists: specialise in crisis management and provide strategic guidance on restructuring, financial recovery and operational enhancements to bolster distressed companies; and

(6) insolvency practitioners: may be appointed by the court as scheme administrators or oversee implementation.

The appointment of insolvency practitioners is typically achieved by agreement with the company, though court orders may formalise their role, especially where disputes or objections exist.

3.4 Is there a typical due diligence process followed?

Due diligence is market-standard but not court-imposed. In schemes of arrangement, the target company prepares a scheme booklet with financial and strategic disclosures, reviewed by ASIC and the court. Independent expert reports are often included. Distressed investors are increasingly conducting thorough diligence, particularly where capital structure complexity or regulatory risks exist.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

A scheme of arrangement process typically spans 4 to 6 months. Key steps include:

(1) commercial negotiations and signing of scheme implementation agreement;

(2) drafting scheme booklet and IER;

(3) ASIC review of documents;

(4) first court hearing (directions);

(5) shareholder or creditor meetings (with 75% in value and 50% in number approval);

(6) final court hearing for approval; and

(7) lodgement with ASIC and implementation.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

Not inherently. Asset sales effected under pre-insolvency processes may still be reviewed under voidable transaction provisions if a formal insolvency follows. However, sales implemented under a court-approved scheme of arrangement are generally considered defensible if they occur at fair value.

The "relation-back" period (see paragraph 0 above) determines the look-back period for scrutinising such transactions.

3.7 Are "pre-pack" processes (i.e., pre-packaged restructuring plans) permitted and how do they work?

Yes. Pre-packs can be implemented through:

(1) Schemes of arrangement – pre-agreed between creditors and / or shareholders and then formally approved by court.

(2) DOCAs – entered into post voluntary administration, often negotiated before appointment.

(3) Voting lock-up agreements – may be used, but statutory timelines must still be followed.

4. "Pre-pack" sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Pre-pack sales are permitted but not formally codified. Typically, assets are sold shortly after a voluntary administrator or receiver is appointed. This minimises business disruption and maximises value preservation.

Key structures include:

(1) *Receivership* – appointment by secured creditor to sell charged assets.

(2) *Voluntary administration* – administrator may approve and effect a sale, subject to creditor approval if outside the ordinary course.

Pre-packs require transparency and valuation support to avoid accusations of "phoenixing". Anti-phoenixing laws (e.g. Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 (Cth)) penalise asset transfers without proper consideration.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The key players include:

(1) directors and shareholders – often initiate the pre-pack process;

(2) insolvency practitioners – appointed privately but may later become court officers;

(3) creditors – may approve or challenge the sale; and

(4) regulators – ASIC and the ATO play a monitoring role.

Insolvency practitioners must act independently, even if their appointment was pre-agreed.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Yes, in most cases, insolvency practitioners are privately appointed and their appointment can be influenced by key stakeholders. However, once appointed, they owe duties to all creditors and are subject to statutory and professional obligations.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Yes. Employee entitlements are priority claims under the Corporations Act. Tax authorities (e.g. the ATO) do not have statutory priority but possess powerful recovery tools (e.g. garnishees, Director Penalty Notices).

4.5 Is there a typical due diligence process followed?

Due diligence varies depending on the identity of the buyer. In true third party sales, market testing and valuation are essential. In related-party transactions, diligence may be more limited but still expected to meet minimum transparency and valuation standards.

4.6 Is "market testing" mandatorily required?

No, but it is best practice. If the sale is effected by a controller or administrator, there is a statutory duty to obtain market value. Limited testing or competitive tension should be documented.

4.7 Are valuation reports mandatorily required?

Not legally required, but almost always obtained to support the sale price and mitigate liability risks.

4.8 What is the typical timeline of "pre-pack" sales?

A typical timeline is 2 to 4 months. Steps include:

(1) preparation and negotiation of sale terms;

(2) appointment of voluntary administrator or receiver;

(3) execution of sale;

(4) administrator report to creditors and creditor vote (for DOCAs); and

(5) post-sale compliance and implementation.

Timeframes may vary depending on the asset type, regulatory approvals and whether creditor approval is needed.

BERMUDA

Bermuda's restructuring and insolvency framework is grounded in common law principles and longstanding statutory provisions derived from the British legal system. Although legislative reforms have been introduced within the business sector, most notably in the insurance industry, to strengthen safeguards for investors and policyholders, the broader insolvency regime remains in a phase of progressive development. In response to the accelerating pace of global economic change, Bermuda's legal and professional community continues to engage in active discourse regarding potential enhancements to the existing framework, with a view to expanding the range of restructuring and recovery options available to companies, investors, and creditors.

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

The Companies Act 1981 (Companies Act) sets out regulations which apply to companies in various scenarios, including the purchase of distressed equity. The Companies Act directs parties to comply with the company's bylaws, which might include but are not limited to being compliant with existing shareholders' rights and agreements, and requiring board approval.

The Bermuda Monetary Authority (BMA) also plays an important part in the jurisdiction, regulating businesses such as insurance, reinsurance and funds, and overseeing relevant transactions such as the transfer of business and distressed sales.

As an offshore jurisdiction, Bermuda prides itself in complying with robust legislation to protect its investors, such as anti-money laundering (AML) and counter-terrorist financing (CTF) regulations, which aim to enhance transparency and trust in the jurisdiction.

When the distressed equity is part of a public offering, a prospectus must be prepared and approved by the BMA before being presented to the public in accordance with the Bermuda Prospectus Regulations 2019.

If the purchase of distressed equity leads to a change in control of a public listed company, the Bermuda Takeover Code also applies.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Bermuda does not have a special regime applicable to the purchase of distressed debt or non-performing loans.

As per the purchase of the distressed equity, buyers might have to comply with the Companies Act and the bylaws of the company. Depending on the nature of the business, the BMA might also be involved to overview the transaction(s).

The purchase of debt can occur via a sale and purchase agreement (SPA), an assignment of debt or transfer of the contractual rights.

Insurance and reinsurance companies' debt is quite specialised and it entails, at times, selling, transferring or assigning policies to a third party and capitalising on attractive risk premiums, which need both financial and legal expertise to navigate and understand.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

Bermuda does not have general obligations in the case of distressed investments other than what has already been discussed above.

In terms of Employment Law, section 30 of the Employment Act 2000 clearly sets that every employer has a duty to inform and consult with an employee and their representative (union or otherwise) on a proposed redundancy 14 days prior to giving the employee notice in writing that they are being made redundant.

Under their duties, the employer shall inform the employee and their trade union or other representative of the conditions of redundancy that exist, the reason(s) for the contemplated termination, the number and categories of employees likely to be affected, the period over which the termination is likely to take place and any possible measures they have taken to mitigate the adverse effects on the affected employees.

The conditions of redundancy are listed in section 30(3) of the Employment Act and include:

- the modernisation, mechanisation or automation of part or all of the business;
- the discontinuance of part or all of the business;
- the sale or disposal of the business;
- the reorganisation of the business;
- the reduction in the business as a result of economic conditions, volume of work or sales, reduced demand or surplus inventory; and
- the impossibility or impracticality of carrying on the business at the normal rate.

1.4 What risks exist for an investor of a distressed business?

Investors of businesses in distress may face risks related to reputational damages and intense scrutiny from regulators as to their due diligence processes, which are critical in the circumstances.

It is also important that distressed businesses are market valued by professionals in order to avoid any potential future dispute over the price paid by the investors.

Transactions could later be challenged as fraudulent conveyances and voided or reversed, resulting in financial losses and legal complications. These avoidance actions are based on the principles of the action *pauliana*, which gives creditors or liquidators the power to challenge certain transactions. These matters are discussed further below.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of corporate insolvency proceedings?

Transactions made at an undervalue can be challenged if it can be demonstrated that they were executed with the intent to put assets beyond the reach of creditors or to prefer one creditor over others. These actions do not necessarily require formal insolvency proceedings.

By way of example, certain provisions of the Companies Act (such as section 237) allow for the reversal of transactions outside of liquidation if they are found to be fraudulent or improperly preferential, giving the court power to reverse the transaction.

Furthermore, directors of companies have fiduciary duties to act in the best interests of the company and its creditors, especially when the company is in financial distress. Transactions that breach these duties can be challenged by shareholders or creditors.

Courts can impose a constructive trust on assets transferred in a manner that is unjust or fraudulent. This equitable remedy can be sought by creditors or other stakeholders who have been wronged by such transactions.

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1.4.2 *What risks exist for the transaction to be challenged and overturned in subsequent formal corporate restructuring proceedings?*

When a business cannot trade as a going concern and gets wound up, either voluntarily or by court order, a liquidator (or provisional liquidator, discussed further in the following section) is appointed over the company with limited or full powers.

Liquidators in Bermuda are usually professionals, whose expertise entails identifying potential areas of investigation and setting aside transactions agreed in certain timeframes prior to the winding up.

Some of the common risks associated with transactions that may be challenged and overturned in Bermuda's liquidation proceedings are:

- preference payments, where the intent is to give one creditor an advantage over others;
- fraudulent transfers, where the intent is to defraud creditors. This includes transfers made at undervalued prices or to related parties;
- undervalued transactions, where sales or transfers of assets are for less than their fair market value; and
- lack of proper documentation, where transactions that do not have appropriate documentation or that are not conducted at arm's length may face challenges in liquidation proceedings.

It is therefore important that investors and buyers of distressed assets ensure they get advice throughout the process and have all the backup documents determining and proving the valuation, price and rationale for the transactions.

1.4.3 *What risks exist for a new lender investing in a distressed business?*

Lenders of distressed businesses in Bermuda might have to address, in addition to the risks presented already in this Chapter, specific market requirements.

Bermuda is often referred to as the "island of insurance" due to the many insurance and reinsurance companies running all or part of their operational activities from Bermuda. As a result, the investment products can be specialised and complicated, resulting in an intricate web of contracts transferred and assigned across multiple jurisdictions.

While interest rates match the risk and therefore these can be appealing investments, specialised advice or knowledge of the market and the legal framework are necessary.

1.4.4 *What risks exist for a new shareholder investing in a distressed business?*

If an investor buys the equity of a distressed business and that business subsequently enters liquidation, the distressed investor should be aware of the order of priority of payments in insolvency proceedings, where shareholders are the last to be paid unless they have any additional security.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

2.2 What involvement does the court have in these processes?

Bermuda provides investors with a robust legal framework to enforce an outstanding debt, which is covered in detail below.

- ***Domestic judgments and enforcement***

  Investors may look to obtain a domestic judgment, which will provide for several different options of enforcement. Obtaining a domestic judgment is available through the court following trial, and it includes:

- a judgment ordering a party to take / refrain from taking a specific action; and

- a money judgment ordering the defendant to pay a sum of money within a certain time frame.

In lieu of a judgment, or while this is pending, there are several additional remedies available:

- *interim relief* – this may be granted by the court while the trial is pending. Interim relief may for example put a freeze on assets, a hold on sale proceedings or order the provision of further information;

- *summary judgment* – under Order 14 of the Rules of the Supreme Court, in cases which are not complex in legal nature, the court may make a ruling without the need for trial; and

- *judgment in default* – this can be granted if the defendant has failed to enter a defence within the time prescribed. However, this is open to challenge (at a later date) by the defendant, if it can provide evidence of a just and equitable reason for failing to enter a defence.

Should a final money judgment be granted by the court, the following enforcement actions are available within Bermuda, each of which must be made by application to the court, together with a supporting affidavit:

- *freezing order* – the court may make such an order over all or part of the company's assets in order to prevent disposal or dissipation of the assets;

- *order for committal* – where a judgment debtor refuses or fails to comply with a judgment or order, an applicant can seek an order to send the judgment debtor to prison for non-payment. This type of judgment is typically not easy to obtain and is generally reserved for persistent breaches of the court orders, and after several other remedies have failed; or

- *writ of fieri facias* – this will typically be issued if the time period set out in the court's judgment has expired and has not been complied with. This automatically empowers the Provost Marshal General to take control of the defendants' goods and auction them to satisfy the judgment debt.

▪ ***Appointment of officeholders***

Appointment of a receiver

The court has the power to appoint a receiver over the judgment debtor's assets to assist in collecting funds owed. It is possible, depending on the circumstances, for receivers to be appointed both outside of court and by agreement, and by court order.

The type of security / asset to which the receiver is to be appointed will be determined by differing legislation, including:

- section 35 of the Conveyancing Act 1983;

- Part IV of the Segregated Accounts Companies Act 2000; and

- sections 265 to 272 of the Companies Act.

Appointment of a special manager

A special manager may be appointed in situations where there are concerns about the company's financial stability or management. This is a court ordered process, typically on application from either creditors, investors, shareholders, regulatory authorities or directors of a company.

While not a direct enforcement procedure for individuals to recover their debts in isolation, this provides for an orderly and compliant administration of the assets and conduct of the company and provides protection for the body of creditors.

A special manager takes all instructions from the court and is not required to either realise or distribute assets, but more so to provide security.

Appointment of a provisional liquidator

The appointment of a provisional liquidator is a legal process via court order. It typically occurs in situations where there is concern about the financial stability or solvency of a company and the court determines that the appointment is necessary to protect the interests of stakeholders.

During the provisional liquidation, the company typically continues to operate, but under the supervision of the provisional liquidator as defined by the powers granted by the court.

While the provisional or "soft touch liquidation" is not a direct enforcement action for one creditor, it is an option available for creditors / investors to ensure security of the assets of the company and avoid dissipation or undervalued sales, given that the control of the company will be subject to supervision.

Among other things, the role of provisional liquidators includes:

- taking control of the company's assets and protecting them from dissipation;
- investigating the company's trading history and, if necessary, taking steps to rectify any wrongdoing or dissipation of assets;
- liaising with shareholders, investors, creditors and stakeholders on the status of the provisional liquidation and position of the company;
- managing the ongoing operations and reporting findings to the court; and
- establishing if restructuring may be utilised to save the company as a going concern.

Winding up

In cases where the company is insolvent with no possibility of being rescued in full or in part, the creditor or investor may petition for the company to be wound up and liquidators to be appointed.

This process will ensure that investigations are carried out into the conduct of the company and its affairs, which may result in a higher return to the creditors as a result of overturned transactions and potential recoveries from actions against various parties.

- ***Other forms of enforcement through regulation***

  If a debt is not being met, the creditor / investor may apply to the BMA to increase regulatory control over the company in order to ensure that the company is operating in the best interests of its policy holders and stakeholders. Before commencing the costly and lengthy process of court order enforcement, a creditor may look to liaise with the BMA, in order to ensure the company is compliant and meeting its obligations and protecting their interests.

The BMA's principles of enforcement include, inter alia, the below provisions:

- the BMA will exercise its enforcement powers on a risk-based approach, prioritising conduct that poses the biggest threat to the best interests of consumers or to the reputation of Bermuda; and

- enforcement action will be taken to protect customers from harm.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

A pledge on shares within the jurisdiction of Bermuda involves establishing a security arrangement, wherein the shareholder (pledgor) pledges or offers their shares as collateral to a creditor (pledgee) in order to secure a debt or obligation.

In Bermuda, the enforcement of a pledge on shares of a legal entity typically involves adherence to the laws and regulations governing security interests and the enforcement process. The specifics may vary based on the type of legal entity, as well as the terms outlined in the pledge agreement. Below is a general overview of the process:

- *pledge agreement* – before considering enforcement, it is crucial to review the pledge agreement;

- *registration of pledge* – it is common for security interests, including pledges on shares, to be registered with the Registrar of Companies. This registration provides public notice of the security interest and establishes priority among creditors;

- *enforcement event* – the pledge agreement should specify the events that trigger enforcement rights. This could include default on a loan, failure to meet financial obligations or other agreed-upon conditions;

- *notice to pledgor* – before enforcing the pledge, the pledgee typically provides notice to the pledgor in accordance with the terms of the pledge agreement. This notice may include details of the default and a grace period for the pledgor to cure the default;

- *private sale or public auction* – if the default is not cured within the specified period, the pledgee may proceed with the enforcement of the pledge. The method of enforcement may involve a private sale or a public auction of the pledged shares. The specific process should be outlined in the pledge agreement; and

- *transfer of shares* – following a successful sale, the pledged shares are transferred to the purchaser. The transfer may involve compliance with relevant laws, including any regulatory approvals required for the transfer of shares. This may also include statutory filings with the regulators or Registrar of Companies (dependent on the nature of shares), as well as stamp duty and other tax implications.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

It is possible to implement a debt-for-equity swap as part of a share pledge enforcement in Bermuda, subject to the terms of the pledge agreement and compliance with relevant laws and regulations.

Important considerations include:

- if the company operates in a regulated industry, this will require approval from the regulator. Most frequently due to the nature of business in Bermuda, this is the BMA;

- dependent on the percentage of shares being issued under the agreement, this may require all shareholders agreement and will be governed by the company's bylaws; and

- a fair and agreed valuation method must be used when valuing the shares.

One example of a debt-for-equity swap is in the case of a large Bermuda communications company that, in response to a deadline to pay bondholders, agreed to a swap. In March 2023, the company was due to pay bondholders BMD 925 million. The company and parties involved had initially looked to extend the maturity past its due date of 1 March 2023, but due to deteriorating conditions, the company sought other options and agreed with debt holders to reduce the group's debt by BMD 1.8million and its annual cash interest by BMD 110 million.

2.3.2 Is a public auction mandatorily required or are private sales possible?

Public auction is not mandatory, insofar as parties are in agreement and it can be demonstrated that a sale took place for a fair and equitable price. A public auction more commonly takes place in the case of enforcement being made by the Provost Marshal General following a writ of *fieri facias*.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

In Bermuda, companies typically have the flexibility to include various provisions in their articles of association or other constituent documents regarding the transfer of shares. These provisions may include restrictions on transfers, pre-emption rights, consent requirements and other conditions that govern the transferability of shares.

If the constituent documents of a company contain restrictions on transfers, these may in some cases be able to be set aside, if the pledge documents are more robust in determining the modes of recovery and enforcement action.

When drafting a share pledge agreement, the articles of association, memorandum and other governing documents of the company should be carefully considered and aligned with the terms of the agreement.

In circumstances where there may be ambiguity between the two, the court may be asked to opine on the resolution and this will depend on the specifics of each case.

2.3.4 Is "market testing" mandatorily required?

Bermuda does not have specific legislation that addresses market testing in a broad sense. However, market testing should be considered when assessing the viability, competitiveness or legality of a product, service or business strategy. This would involve obtaining feedback or conducting surveys within the relevant market or consumer base.

When a dispute undergoes arbitration proceedings, the necessity for market testing might be explicitly stated in pre-existing arbitration clauses or integrated as a crucial procedural aspect of the arbitration award. This underscores the significance of valuation reports in confirming the legitimacy of sales, settlements or comparable transactions.

2.3.5 Are valuation reports mandatorily required?

While legislation in Bermuda does not mandate the submission of valuation reports, they can be integral components of legally binding contracts. It is a customary practice for the Supreme Court of Bermuda to mandate valuation reports during judgment enforcement or debt settlement proceedings. These reports serve the purpose of assessing the value of assets subject to enforcement, such as shares or properties. The necessity for a valuation report is contingent on the specifics of each case, the characteristics of the assets involved and the legal arguments put forth.

In disputes handled by the court, there is often a requirement for evidence demonstrating that any asset sale, compromise agreement or transaction was conducted at a fair and equitable market value. It is advisable for both parties, either before a transaction or during a dispute, to seek such evidence to safeguard individual interests. This can be facilitated through the assistance of professionals or with the involvement of legal experts.

In instances where a dispute is subjected to arbitration proceedings, the requirement for valuation reports may either be explicitly outlined in existing arbitration clauses or become a procedural element integral to the arbitration award. This emphasises the importance of valuation reports for substantiating the validity of sales, settlements or similar transactions.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

Before fully winding up a Company, Bermuda's insolvency regime offers few options to save and restructure the business.

As outlined in paragraph 2.1, a secured creditor may exercise their contractual rights to appoint a receiver over charged assets to protect their position while the company's restructuring plans are developed, or to avoid them all together. This mechanism allows investors to protect value without immediately resorting to full insolvency proceedings.

This process also means the investor is in full control of agreeing the costs of a receiver and retains more control over the process when compared to a liquidation.

A soft touch provisional liquidation is a legal proceeding initiated by a creditor, a shareholder or the company itself, according to which a provisional liquidator is appointed by the court with limited powers to safeguard the assets of a company while a restructuring plan is being agreed with the majority of creditors and regulators.

Provisional liquidation provides breathing space for all stakeholders to assess the financial situation and explore potential rescue options, for example a scheme of arrangement.

A scheme of arrangement is a court-sanctioned compromise between a company and its creditors (or any class of them) or its members (or any class of them). In the context of an acquisition, a Bermuda company or any member may apply to the Bermuda court requesting that it order a meeting at which the members (or any class of them) are asked to consider the scheme. If the approval is obtained of a majority in number representing three-quarters in value of members or creditors present and voting either in person or by proxy at the meeting, the court may sanction the scheme. If it does so, the scheme becomes binding (subject to delivery of the requisite order of the court to the registrar of companies) on all the company's members and creditors (or any class of them, as the case may be).

By way of example, on and around February 2025, the court sanctioned a scheme of arrangement in relation to R&Q Re (Bermuda) Ltd, which was designed to protect creditors from the disruption, delays and significant costs associated with an insolvency process.

The scheme of arrangement, under sections 99 and 100 of the Companies Act, provided for a solvent resolution and had the support of all stakeholders, including the BMA.

A merger in Bermuda refers to the process of combining two or more separate entities into one single entity, where the acquiring company absorbs the target company. This can be a great opportunity for a distressed business to avoid full insolvency procedures.

Similarly, amalgamation in Bermuda refers to the process of combining two or more entities into one consolidated entity, which uses the synergies of both companies to create a new stronger formation.

Neither an amalgamation nor a merger requires the approval of the Bermuda courts (unlike a scheme of arrangement) or the approval of the Bermuda company's creditors, but these can be consulted prior to the transaction taking place. The Companies Act requires shareholders' and board approval of the amalgamation or merger agreement. While the Companies Act sets a default shareholder approval threshold of 75%, it does allow for a company's byelaws to set a lower approval threshold.

3.2 What involvement does the court have in these processes?

The Supreme Court of Bermuda plays a significant role in overseeing and approving various pre-insolvency processes to ensure fairness and legal compliance.

For example, the court plays a major role in the approval of any scheme of arrangement and the company seeking the approval must submit an application to the court, which will then be assessed, and the decision made available to creditors. When the court approves the scheme, it becomes binding on all affected parties.

Furthermore, the court may be involved in resolving disputes which arise during pre-insolvency processes – including disagreements between creditors, challenges to the proposed restructuring and any other issues with require judicial intervention.

Unlike the United Kingdom regime, where insolvency practitioners have a lot of independence and freedom and only consult the court for specific, critical and disputed matters, the Bermuda regime relies on courts to ratify the underlying strategy, rationale and decision-making of the process. This proves to be a safe step in the event transactions get challenged at a later date, as discussed above.

The Bermuda regime still provides for some independence, however, unlike the United States regime where courts are more actively involved at every step of any restructuring process.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

In a provisional liquidation and scheme of arrangement, an insolvency practitioner (IP) can be formally appointed to overview the deal or the company's affairs.

At times, these professionals are engaged as advisors but do not act in their official capacity as practitioners.

It is usually recommended to engage advisors at early stages for better chances of rescuing the company and sharing some of the responsibilities of decision making under pressure and distress.

The court can play a central and supervisory role in overseeing the entire process. The court's involvement is crucial in protecting the interests of the company, its creditors and various other stakeholders.

Agents are usually also involved in these processes to evaluate the company's assets and liabilities and recommend the best market price. Relying on this professional advice is especially important in the event of a later dispute.

The roles of directors and shareholders are significantly impacted during any of the pre-insolvency processes, and their involvement may vary depending on the specific circumstances and court orders. Upon the appointment of the IP, the powers of the directors are usually suspended or very limited. However, they are still required to perform their fiduciary duties to the company and stakeholders while also taking into consideration the creditors' interest.

Finally, while the BMA does not have a direct role in the day-to-day proceedings of a pre-insolvency process, its involvement and input is crucial in certain situations. The BMA's concerns are at times the driver for enhanced supervision and preventive measures taken to preserve the business and its assets.

3.4 Is there a typical due diligence process followed?

All buyers are advised to conduct both legal and commercial due diligence. Legal due diligence includes reviewing and obtaining the target's constitutional documents, including bylaws and incorporating acts, material contracts relating to any change of control or obligation to third parties, details of any intellectual property, any ongoing employee matters and any threatened or ongoing legal action.

From recent reports from the BMA and industry leaders, there are many companies that are looking to be proactive when it pertains to ESG reporting. The work done by the Task Force on Climate Related Disclosures (TCFD) has played a big role in this initiative. Over the past years, companies have been encouraged to assess the impact they will have in relation to ESG.

The BMA has been examining the impact of climate change in the Bermuda insurance industry, with the aim of appropriately integrating climate and ESG risks into their regulatory frameworks but has yet to formalise an ESG model.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

Under Bermuda law, there is no specific timeline for acquiring or selling a company. The timing will depend on a variety of factors. The structure of the acquisition and compliance with statutory requirements can be two of the main factors that can cause delays in the sale process.

In private acquisitions of unregulated entities, the sale process can be completed in just a few weeks as there are less compliance and regulatory requirements that must be met to complete the sale, whereas the acquisition of a regulated entity may take months depending on the various requirements that must be met by both the buyer and the purchaser.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

Sales are protected under Bermuda law if the assets are properly valued and sufficient records are kept to evidence this.

There are various ways by which additional security over the assets can be granted, including legal mortgage, equitable mortgage, fixed charge, floating charge, pledge, contractual lien and assignment.

The nature of the security interest, in any case, will be determined by:

- the terms of the parties' agreement, ordinarily set out in the relevant security documents;
- the nature of the property being secured; and
- the nature of the debtor's interest in the property being secured.

3.7 Are pre-pack processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Bermuda has no formal statutory procedure for a "pre-pack" process which is common in other jurisdictions.

In Bermuda, the use of provisional liquidation is prominent, and the principal purpose is to allow a company and its board of directors the time and space to implement and promote among existing stakeholders a restructuring which may return the company to solvency, while giving creditors comfort that management is operating under the supervision of a provisional liquidator and the court.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

As noted, Bermuda has no formal statutory restructuring procedure permitting a pre-packaged sale of all or part of the business of a distressed company.

However, a rough approximation of a pre-packaged sale can be achieved within the context of the liquidation of a company in Bermuda. Thus, a potential liquidator may become privy to and be consulted in connection with negotiations with an investor before being appointed. The liquidator, on appointment, may exercise the power to sell the business of the company by public auction or private contract (which can be done without sanction of the court or a committee of inspection) according to the pre-negotiated sale agreement, pursuant to the powers of the liquidator as set out in section 175(2)(a) of the Companies Act.

However, there are a number of ways in which this process differs from a true pre-packaged sale.

In the first instance, the liquidator's involvement in connection with pre-appointment negotiations must be necessarily limited. Upon appointment, the liquidator must be in a position, and be seen to be in a position, to exercise independent judgment in assessing the advantages and disadvantages of the proposed sale from the point of view of all creditors. While a level of prior familiarity with negotiations is likely to be acceptable, a line needs to be observed between an acceptable level of involvement and a disabling conflict of interest.

In second place, while the power of sale may be exercised by the liquidator without sanction of the court or a committee of inspection, a liquidator is likely to seek the court's blessing of a sale of all or a significant part of the property of the company. This measure is at times a condition of the buyer to complete the sale.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

If the sale is effected post-liquidation, the main player is the liquidator. However, as noted above, there are limits to the extent to which a prospective liquidator can be engaged in formal negotiations pre-appointment.

The liquidator, or at least one of the liquidators in the event that more than one is appointed, must be resident in Bermuda and must have credentials considered acceptable by the court. There are a number of very experienced liquidators in Bermuda working at specialist advisory practices or at the "Big 4" accountancy firms.

With pre-packs not being part of formal legislation in Bermuda, and not a common occurrence, there are no defined rules for the procedure. However, international standards are expected to be followed. Depending on the type of business carried out, the regulatory authority in Bermuda would be consulted.

With regards to the nature of the business in Bermuda, being most commonly insurance and life insurance policies, any sale of business or transfer of insurance would need to be in line with section 25 of the Insurance Act 1978 (Insurance Act), and therefore may require notice to, or consent by, the underlying policyholders. In line with the Insurance Act, the sale or transfer would also need to be advertised in the Gazette, approved by an actuary, on notice to all policyholders and with the approval of the relevant regulatory authorities.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Investors may not able to control who is appointed as officeholder, but they may influence it.

As noted above, the officeholder will typically be a liquidator. The identity of the officeholder is not something investors can control because, among other things, creditors and contributories have the power to affect the decision, subject to the quantum of their claims and ability to command the confidence of the majority of creditors.

4.4 Is there special protection for certain types of creditors in pre-pack sales?

Bermuda does not have ad hoc pre-pack rules. Practitioners achieving a de-facto pre-pack sale should follow all the rules set out earlier in this Chapter for the sale of a distressed business.

4.5 Is there a typical due diligence process followed?

The BMA has several due diligence policies or recommended procedures, in particular for regulated businesses such as insurance and reinsurance companies. This includes but is not limited to guidance in relation to sources of wealth and identity verification.

Independent business reviews may be undertaken as a market standard practice before any large-scale investment or restructuring takes place. This is not imposed by the court but it is common practice.

From recent BMA reports and industry leaders there are many companies that are looking to be proactive when it pertains to ESG reporting. The work done by the TCFD has played a big role in this initiative, encouraging companies to assess the impact they will have in relation to ESG.

4.6 Is "market testing" mandatorily required?

A market test is not a mandatory requirement under our legal framework. However, liquidators tasked with the sale of a business will be mindful of their fiduciary duty when exercising the power to sell assets of the company. While this naturally must be weighed against the risk of destroying value once the marketplace knows a company is in financial distress, some type of market test will typically be attempted to ensure best outcome for all stakeholders.

4.7 Are valuation reports mandatorily required?

Valuation reports are not a mandatory requirement. However, they will generally be sought if a market test is considered impracticable or likely to be value destructive.

4.8 What is a typical timeline of "pre-pack" sales?

There is no typical timeline as a "pre-pack" sale is not part of the legislation in Bermuda specifically.

If the sale or part of business was to be actioned by way of liquidation or provisional liquidation, some guidelines on timelines to be considered are noted below:

- A transfer of business (insurance) subject to section 25 of the Insurance Act may take up to 3 months to become effective. This is on the basis that:

  (i) all policyholders should have notice of the proposed sale / scheme;

  (ii) notice is placed in the Gazette; and

  (iii) an actuary must prepare a report on the adequacy of total long term insurance reserves among other things.

- The process for winding up through the courts is a robust procedure which, when compared to some other jurisdictions, is heavy on counsel and court involvement. For this reason, a timeline in regard to a "pre-pack" sale through a liquidation would take longer to effect than the same procedure within the United Kingdom. A high-level overview is below to give some consideration to the timelines:

(i) filing of a petition, alongside a supporting affidavit with the court for endorsement;

(ii) service of the petition at the Registry;

(iii) notice placed in the Royal Gazette (at least 7 days before the hearing to wind up);

(iv) notice of the petition to be served on the company;

(v) winding up hearing;

(vi) potential for provisional liquidator to be appointed; and

(vii) appointment of liquidator – through a creditors' meeting – typically ordered within 6 months of the winding up order.

BRAZIL

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

Brazil does not have a specific legal regime that applies to selling and purchasing distressed equity. No separate rules apply to the transfer of the shares of a distressed company outside of formal insolvency processes.

Brazilian law recognizes two main types of entities: corporate liability companies (*sociedades limitadas*) and corporations (*sociedades anônimas*), and the latter can be either closely held or publicly traded. Each type of entity has different legal regimes and requirements for the purchase and transfer of equity participations.

Limited liability companies are regulated by the Civil Code (Law No. 10,406/2002) and are formed by partners (*sócios*), who contribute capital and share profits and losses according to their quotas (*quotas*). The quotas represent the partners' equity interests and, unless provided otherwise in the relevant articles of association (*contrato social*), the transfer of the quotas will be allowed except in case of opposition of quota holders representing at least 1/4 of the capital stock of the relevant company. The articles of association may also establish other conditions or restrictions for the transfer of quotas, such as rights of first refusal, pre-emption rights, tag-along rights or drag-along rights. The transfer of quotas must be registered in the board of trade and in the commercial registry to be effective against third parties.

Corporations are regulated by the Corporations Law (Law No. 6,404/1976) and are formed by shareholders (*acionistas*) who subscribe for shares (*ações*) that represent their equity interest and are considered securities. There are no legal requirements with respect to the transfer of shares. However, similar to limited liability companies, the bylaws (*estatuto social*), shareholders' agreement and / or any other agreements among the shareholders in relation to a corporation may establish other conditions or restrictions for the transfer of shares, such as pre-emption rights, tag-along rights and drag-along rights. The transfer of shares must be registered in the company's books or in the securities registry to be effective against third parties.

Listed companies have their shares registered and traded on the stock exchange and are subject to additional rules and regulations by the Brazilian Securities and Exchange Commission (CVM) and the stock exchange. The transfer of shares in listed companies is usually done through the intermediation of brokers or financial institutions and is subject to market conditions, disclosure obligations and trading rules.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Under Brazilian law and outside of formal processes, the sale and purchase of debt and / or a loan may occur through three different mechanisms, which are credit assignment (*cessão de crédito*), debt assumption (*assunção de dívida*) and subrogation (*sub-rogação*).

Credit assignment involves the transfer of the creditor's right to receive a payment or performance from the debtor to a third party, called the assignee. The creditor, or assignor, transfers the credit and all its accessory rights, such as interest, guarantees and privileges, to the assignee, who steps into the creditor's position and can enforce the credit against the debtor. The debtor's consent is not required for the validity of the assignment, unless the contract or the law expressly prohibits it. However, the debtor must be notified of the assignment, either by the assignor or the assignee, to be bound by it and to discharge the obligation by paying or performing to the assignee. The assignor remains liable to the assignee for the existence and legality of the credit, unless the assignment is made for free or with the express waiver of such liability.

Debt assumption is the transfer of the debtor's obligation to pay or perform to a third party, called the new debtor. The debtor, or assignor, transfers the debt and all its accessory obligations, such as interest, guarantees and penalties, to the new debtor, who steps into the debtor's position and becomes liable to the creditor. The creditor's consent is required for the validity of the assumption, and the creditor can either accept or reject the new debtor, depending on the type of assumption and the specific conditions of the loan.

Subrogation is the substitution of the creditor by a third party who pays or performs the obligation on behalf of the debtor, or by the debtor's guarantor who pays or performs the obligation for the debtor. The third party or the guarantor, called the *subrogante*, acquires the creditor's right to receive the payment or performance from the debtor, or from the co-debtors or co-guarantors, if any. The *subrogante* steps into the creditor's position and can enforce the credit and its accessory rights against the debtor and the other parties. The debtor's consent is not required for the validity of the subrogation, unless the debtor has a legitimate interest in preserving the original creditor.

These rules apply to the sale and purchase of a performing loan as well as to a non-performing loan. Please note special rules may apply to the purchase of distressed debt and non-performing loans to consumers and elderly people (Law No. 14,181/2021). In addition, if the creditor has issued proceedings, the debtor's consent is required for the transfer only where the claim has not been crystallised into an enforceable title. In the case of enforcement proceedings (*execução*), the debtor’s consent is not required.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

Other than regulatory requirements for specific industries – such as banking, telecommunications, energy or mining – that may impose additional restrictions or approvals for distressed investments, the general regulatory requirements that need to be considered in the case of distressed investments are mainly related to antitrust, labour and environmental matters.

For example, the acquisition of equity or assets in a distressed company may require the notification or clearance of the antitrust authority – depending on the market share, the turnover and the impact of the transaction on the competition. The acquisition of equity or assets in a distressed company may also trigger the obligation to maintain or transfer the employment contracts, the collective bargaining agreements or the social security contributions of the workers, depending on the type and extent of the transaction. The acquisition of equity or assets in a distressed company may further entail the responsibility to remediate or compensate any environmental damages, violations or liabilities.

The Brazilian National Monetary Council and the Brazilian Central Bank regulate certain terms and conditions of the assignment of credit rights by Brazilian banks. In general, the assignment of credits by Brazilian banks is allowed to other financial institutions or entities outside of the National Financial System (Sistema Financeiro Nacional – SFN) and it may be subject to registration in asset registration and financial settlement systems or to specific commercial conditions that may vary depending on the nature of the credit rights being assigned or the entity that will be the assignee of such rights.

1.4 What risks exist for an investor of a distressed business?

There are two main specific legal risks associated with investing in a distressed business under Brazilian law, which are the risk of the transaction being declared null or void due to the fraudulent conveyance of assets (clawback risk) and the risk of the buyer being held liable for obligations of the debtor (successor liability risk).

- Clawback risk

  Regarding the clawback risk, transactions involving the disposal and transfer of assets owned by companies in financial distress may face legal challenges under the fraudulent conveyance provisions set forth in the Civil Code (Law No. 10,406/2002), the Civil Procedure Code (Law No. 13,105/2005) and the Bankruptcy Law (Law No. 11,101/2005).

The acquirer of an asset is deemed, as a rule, to be acting in good faith and the transaction will be upheld and protected, except for cases where the fraudulent conveyance provisions are applicable. Courts tend to protect bona fide acquirers that did not know or could not have known about the debtor's insolvency.

In general, a transfer of assets is considered fraudulent with respect to the creditors of the transferor where the debtor transfers its property to third parties, worsening its financial situation to the point of becoming insolvent or to the point of jeopardising the fulfilment of its existing obligations to its creditors.

Outside the bankruptcy realm, there are two potential fraudulent conveyance situations: fraud against creditors (*fraude contra credores*) and fraud against an enforcement proceeding (*fraude à execução*).

Fraud against creditors (fraude contra credores)

Articles 158 and 159 of the Brazilian Civil Code provide that certain transactions entered into by a distressed debtor may be held null and void by a court. The purpose of such provisions is to prevent debtors from intentionally subtracting from its creditors the assets that ensure their payment.

In order to make a successful case, the plaintiff must satisfactorily meet a three-pronged test, showing to the courts that:

(i) the transfer of assets by the debtor resulted in a deterioration of its financial and economic situation (*eventus damni*);

(ii) the acquirer of the asset and the debtor engaged in collusion in order to defraud the remaining creditors (*consilium fraudis*); and

(iii) its credit preceded the asset transfer.

Pursuant to article 159 of the Brazilian Civil Code, the requirement of intention to defraud does not need to be proven, if:

(i) the transaction was entered into with no consideration;

(ii) the debtor was notoriously insolvent; or

(iii) there were reasons to conclude that the purchaser should have known about the debtor's financial situation. However, the reduction of the asset pool of the debtor will still need to be proven.

If these requirements are met, the creditor that has been adversely impaired by the asset disposal transaction may request its annulment by taking action in court in the form of a specific remedy (*ação pauliana*). The lawsuit will result in the voidance of the challenged transaction and the disposed assets will return to the debtor's ownership and creditors will be able to attach / seize the assets for use in the payment of their debts.

Fraud against enforcement proceedings (fraude à execução)

Articles 790 and 792 of the Brazilian Civil Procedure Code provide for a similar but more stringent regime of fraudulent conveyance of assets. Article 792, IV provides that the disposal or the encumbrance of assets is considered fraud against an enforcement proceeding if, by the time it was entered or made, there had been lawsuits already filed against the debtor which could result in the debtor's insolvency.

The requirements are: (i) the existence of an enforcement proceeding; and (ii) the seller becoming insolvent as a result of the challenged transaction.

In order to fulfil item (i), the Superior Court of Justice has settled a precedent that the existence of the lawsuit needs to be evidenced by a formal registration of the judicial lien / attachment or the existence of the enforcement proceeding in the title certificate of the disposed property.[1] There is no need to prove collusion of the seller and buyer, except if the registration mentioned above is not available.

In this case, the court's decision on a challenge submitted by a specific creditor, arguing fraud against an enforcement proceeding, will render ineffective the asset transference transaction.

- Successor liability risk

  Regarding successor liability risk, as a general rule, in the case of the transfer of individual assets or properties, the buyer should not be considered a successor of the seller and therefore should not be held liable for the liabilities of the seller. However, any debt or liability inherent to the assets or properties acquired that have a *propter rem* nature is attached to the transferred asset or property, and the buyer shall be responsible for its payment (such as environmental damages or property taxes).

  Other than this general rule, it is important to highlight the specific situation where the transaction involves the transfer of a business (i.e. a significant part or substantially all of the undertaking associated with the business). In those cases, the buyer may be held liable for the debts of the seller existing prior to the transfer. However, there may be specific rules applicable to different types of debt, such as tax, labour and environmental debts.

  Therefore, outside of the formal insolvency proceeding, although an acquisition of equity and / or assets can be freely negotiated, the buyer might not be able to completely mitigate clawback and succession risks if the seller subsequently becomes insolvent. The buyer could pursue evidence that it is a *bona fide* third party acquirer and that such a transaction would not defraud the seller's creditors (e.g. via valuation opinions or important creditors' consent), but Brazilian law and existing relevant precedents do not provide for a safe harbour where clawback and successor liability risks are entirely eliminated in this case. Some precedents, although not dominant, have even suggested that the mere awareness by the buyer that such a transaction could potentially harm creditors could be interpreted as fraudulent in an insolvency scenario.[2] A more robust protection against clawback and successors' liability may be obtained if the purchase is made in a formal bankruptcy liquidation or judicial reorganisation process.

1.4.1 *What risks exist for the transaction to be challenged and overturned outside of bankruptcy?*

The transaction may be challenged and overturned outside of bankruptcy by creditors of the distressed company, based on fraudulent conveyance types of claims, as described above.

1.4.2 *What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?*

Brazilian Bankruptcy Law provides for a specific regime of fraudulent conveyances applicable to certain transactions that have taken place in the period preceding the financial decline of the debtor that ultimately resulted in its bankruptcy liquidation.

There are no such specific claims for a scenario of judicial or out of court reorganisations, as clawback and voidance under the Brazilian Bankruptcy Law are only applicable to situations where the seller of the asset has gone into liquidation. Please note, however, that the claims mentioned above (which exist outside the bankruptcy realm) may be available in the course of judicial or out of court reorganisations, as applicable.

With respect to the fraudulent conveyance regime, article 99, II of the Brazilian Bankruptcy Law

[1] Precedent No. 375 of the Brazilian Superior Court of Justice.
[2] Brazilian Superior Court of Justice, AgInt no REsp 1.294.642/GO.

provides for a look back period, which retroacts up to 90 days from the date of the occurrence of the earlier of the following events:

(i) the date of the filing of the liquidation request;

(ii) the date of the filing of the request for judicial reorganisation (in cases of conversion of the judicial reorganisation into liquidation); and

(iii) the date of the registration with a Public Notary Registry of a defaulted credit instrument.

Article 129 of the Brazilian Bankruptcy Law provides that the following transactions may be voided in case they were entered into during the legal term:

(i) early payment of any debt obligation before its maturity;

(ii) payments made in a form different from the one provided for in the contract (e.g. payment in cash when the agreement provides for the delivery of a certain asset); and

(iii) the granting of mortgages or pledges to secure already existing indebtedness.

In addition, a court may also void:

(a) any agreement entered into or unilateral action taken by the debtor with no consideration during a period of 2 years prior to the liquidation ruling;

(b) any transfer of a business (i.e. a significant part or substantially all of the undertaking associated with the business) without the prior approval of its creditors or if the seller's remaining assets are not sufficient to pay the seller liabilities at the time the seller had transferred such business; and

(c) registration of real estate transfers in the Property Title Public Registry after the liquidation ruling, except in case a registration was made before the liquidation ruling indicating the future transaction.

In respect of item (b), the legal provision is intended to address the situations where creditors are not in agreement with such disposal of assets or the transaction results in the company not being able to pay its debts.

Also, article 130 of the Brazilian Bankruptcy Law provides for a remedy similar to the general fraudulent conveyance claims mentioned above, where an asset that was transferred is "clawed back" to the bankrupt estate in circumstances where the plaintiff can produce evidence that: (i) the parties to the sale contract wilfully entered into the transaction with the purpose of defrauding the creditors; and (ii) transaction resulted in losses to the bankrupt estate.

1.4.3 What risks exist for a new lender investing in a distressed business?

There is no specific legal regime for lenders investing in a distressed business in Brazil. The risks that exist for a new lender investing in a distressed business are mainly related to the priority, the enforceability and the recoverability of the loan.

For instance, the new lender may face the risk of being subordinated to other creditors, such as labour, tax or secured creditors, in the event of a bankruptcy liquidation proceeding, or being subject to a cram down or a haircut in the event of a judicial reorganisation plan.

The new lender may also encounter the risk of being unable to enforce the loan, such as by seizing or foreclosing the collateral, or obtaining a judicial order or an arbitration award, due to the stay of proceedings, the moratorium or the litigation that may arise in the context of a distressed situation. The new lender may further suffer the risk of being unable to recover the loan, such as by receiving a partial or delayed payment, or losing the value or the validity of the loan, due to the insolvency, the default or the restructuring of the debtor.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

There are no specific rules attributing additional or increased liabilities or duties to officers or directors in the context of distressed M&A transactions or when a company nears or becomes insolvent, but scrutiny tends to be more stringent under such circumstances.

As general rule, under Brazilian law, directors and officers owe a duty of loyalty and a duty of care towards the company. As a result, they must exercise the same level of care and diligence that a reasonably active and prudent individual acting in good faith would apply when managing their own affairs. In addition, another important principle is that directors and officers must avoid situations of conflict between their personal interests and the company's best interests.

In terms of civil and commercial obligations, the "disregard of legal entity" theory, also known as "piercing the corporate veil" theory, provides that, under specific circumstances provided for in the law, courts may reach personal assets of shareholders, officers and managers to satisfy obligations and liabilities held by the company.

These requirements are found in article 50 of Brazilian Civil Code, which provides that Brazilian courts can pierce the corporate veil of a company when there is evidence of misuse of the legal entity, characterised by: (i) deviation of the legal entity's corporate purpose; and / or (ii) commingling of assets of the legal entity with the personal assets of shareholders, officers and managers.

The first requirement states that "deviation of purpose" means the use of the legal entity with the intention of harming creditors or committing unlawful acts of any kind. Evidence of the legal entity as an instrument for fraud, for instance, is one of the possible arguments to pursue the disregard of the legal entity (and the most common).

The second requirement states that "commingling of assets" is the absence of real segregation between the corporate and personal assets of the different persons involved – characterised, for example, by:

(i) repetitive payments by a company of obligations of its shareholders or officers or vice-versa;

(ii) transfer of assets or liabilities among entities without proper consideration;

(iii) lack of proper accounting or common staff, or shared resources; and / or

(iv) other acts that may affect the entity's autonomy.

The application of the disregard of corporate entity doctrine is an exceptional measure, which shall only be allowed when there is sufficient evidence that the legal entity is used for illegal purposes.

Apart from the inclusion of this doctrine in the Brazilian Civil Code, the Brazilian Bankruptcy Law also specifically provides – in a bankruptcy context – that shareholders, officers and directors can be held liable for the indebtedness of a bankrupt company by means of the application of the "disregard of corporate entity doctrine". Nonetheless, the mere absence of assets of the company to withstand its liabilities is not an acceptable argument for courts to pierce the corporate veil, unless specific legislation imposes the liability of the shareholder. Additionally, the irregular dissolution of the company or its insolvency are not presumed as misuse of purpose or abuse.

With respect to the application of this theory to insolvency scenarios, the Brazilian Bankruptcy Law does not address specific requirements for veil piercing in judicial reorganisation proceedings, but in practice, creditors and other stakeholders have requested veil piercing or similar remedies to reach shareholders' and officers' assets. As a result, this discussion has already been entertained in a few judicial cases, but it is still a controversial matter and there is no settled interpretation about its requirements and consequences.

In the case of bankruptcy liquidations, if the court finds that the requirements of veil piercing are established (article 50 of Brazilian Civil Code), the result will be that the assets of the involved parties (the applicable shareholders, other companies or management officers) will be pooled and applied to payment of the creditors to the extent necessary. If the assets are not sufficient to repay the creditors, then other shareholders or companies may also go into bankruptcy liquidation.

Please note that such analysis is applicable to usual civil and commercial obligations and the analysis may be different, in case the liabilities are governed by consumer, environmental, anticorruption, tax or labour legislation, among others, where requirements are more relaxed.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Distressed debt investors and M&A investors can enforce their claims or security interests against a debtor or its assets through judicial or extrajudicial processes, depending on the type and nature of the debt, the security and the agreement between the parties.

Enforcement proceedings are regulated by the Code of Civil Procedure, which establishes the rules and procedures for the judicial or extrajudicial enforcement of obligations arising from legal or contractual titles. Enforcement proceedings aim to satisfy the creditor's right by coercing the debtor to perform the obligation or by seizing and selling the debtor's assets to pay the debt.

There are two main types of enforcement proceedings: *execução de título judicial* and *execução de título extrajudicial*.

Execução de título judicial is the enforcement of a judicial title, which is a decision issued by a court or an arbitral tribunal that recognises the creditor's right and the debtor's obligation.

Execução de título extrajudicial is the enforcement of an extrajudicial title, which is a document that meets the legal requirements to prove the existence and enforceability of the obligation, such as a promissory note, a bill of exchange, a contract, a public deed or a certificate of debt.

Both types of enforcement proceedings follow a similar procedure, which consists of the following steps:

- The creditor files a petition for enforcement, attaching the title and indicating the amount and the object of the obligation, the debtor's name and address, and the assets to be seized or the measures to be taken to ensure the enforcement.

- The court issues an order to initiate the enforcement, granting the debtor a term to voluntarily comply with the obligation or to present defences. The term is usually 15 days for *execução de título judicial* and 3 days for *execução de título extrajudicial*. The order may also determine the seizure of the debtor's assets or the adoption of other precautionary measures to secure the enforcement, such as injunctions, attachments or registrations.

- If the debtor does not comply with the obligation or present defences within the term, the creditor may request the court to proceed with the execution / enforcement (*excussão)*, which is the sale of the debtor's assets to satisfy the debt. The *excussão* follows a preferential order of assets, starting with cash / financial deposits, securities, movable property, real estate and finally, the debtor's rights and legal claims. The creditor may also indicate specific assets to be seized, as long as they are not exempt by law or by the title.

- The sale of the debtor's assets is usually done by public auction (*leilão*), which can be judicial or extrajudicial, depending on the title or the court's discretion. The auction is conducted by an official or a private agent, who is responsible for appraising the assets, publishing the notices, receiving the bids and transferring the ownership. The auction can be held in one or two sessions, depending on the minimum price and the number of bidders. The proceeds of the auction are used to pay the debt, the fees and the costs of the enforcement. The surplus, if any, is returned to the debtor.

- As a general rule, under Brazilian law the sale of the secured asset to third parties is mandatory, since a creditor may not receive it as payment of its credit (*pacto comissório*).

- If the debtor presents defences within the term, enforcement may be suspended until the court decides on the merits of the defences. The defences can be either objections (*embargos à execução*) or preliminary motions (*exceções*). Objections are the main form of defence, in which the debtor challenges the validity, the legality or the enforceability of the title or the obligation. Preliminary motions are subsidiary forms of defence, in which the debtor raises procedural issues (such as lack of jurisdiction, competence or representation) or personal matters (such as incapacity, illegitimacy or fraud). The creditor may contest the defences and present evidence to support the enforcement. The court may also order the production of expert or oral evidence if necessary. The court's decision on the defences can be appealed by either party.

- If the enforcement is based on an obligation to do, not to do, or to deliver something, the court may impose coercive measures to compel the debtor to perform the obligation, such as fines, penalties or substitution. If the obligation is impossible, unlawful or impracticable, the court may convert it into an obligation to pay damages.

Another form of enforcement under Brazilian Law is available if the parties agreed on the granting of a security interest, called fiduciary guarantee (*alienação fiduciária* or *cessão fiduciária*). This is a contractual mechanism whereby the debtor transfers the ownership of movable or immovable property to the creditor as a guarantee of the debt, while retaining the possession and the use of the property.

The creditor becomes the fiduciary owner of the property and the debtor becomes the fiduciary possessor. If the debtor pays the debt according to the contract, the creditor transfers the ownership back to the debtor. If the debtor defaults on the debt, the creditor may initiate the enforcement of the fiduciary guarantee, which follows a specific procedure depending on the nature of the property and the contract.

The enforcement of the fiduciary guarantee usually involves the extrajudicial sale of the property by public auction or by direct negotiation, and the application of the proceeds to pay the debt and the costs. The surplus, if any, is returned to the debtor and the deficiency, if any, can be claimed by the creditor in a judicial action. The debtor may also present defences to the enforcement of the fiduciary guarantee, but only in exceptional cases such as illegality, nullity or abuse of the contract or the enforcement.

This type of security interest is considered bankruptcy remote, given that the property itself is transferred as a guarantee of payment. For this reason, it has been used widely in financing and become more common than a pledge or a mortgage.

2.2 What involvement does the court have in these processes?

The court's involvement in the enforcement processes depends on whether they are judicial or extrajudicial. In judicial enforcement processes, the court plays a central role in verifying the legitimacy and enforceability of the claim, ordering and supervising the execution of the debtor's assets and resolving any disputes or objections that may arise during the process.

In extrajudicial enforcement processes, the court's involvement is limited to the recognition and registration of the creditor's title or security, and intervention in the case of judicial review or opposition by the debtor or other parties.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

Pursuant to the Brazilian Civil Code, share pledge agreements must contain:

(i) the amount secured by the pledge, whether the estimated or maximum amount;

(ii) the deadline for payment;

(iii) the interest rate, if any; and

(iv) the asset(s) pledged.

Also, to be enforceable against third parties, the share pledge agreement must be registered before the competent registry office (*cartórios de registro de títulos e documentos*) and, as per the Brazilian Corporation Law (Law No. 6,404/76), the pledge over the shares shall be created upon the annotation of the pledge in the company's share registry book.

Besides the requirements mentioned above, the pledge to be considered an executive title (*título executivo*), it must have been signed by the debtor and, as a formal requirement, by two witnesses. To be considered an executive title, the obligation must be:

(i) certain – i.e. where the quality, quantity and extent of the obligation is clear;

(ii) enforceable – i.e. where there is no lack of consideration or other outstanding obligation of the creditor or other condition precedent required to be fulfilled; and

(iii) liquid, which means that the mathematical amount due is known (quantum) and can be calculated without the need for an evidentiary phase in the proceedings.

If these requirements are met, the creditor can file an *execução de título extrajudicial*, as mentioned in paragraph 2.1 above. Otherwise, the creditor may file an ordinary proceeding (*ação de procediment comum*) for the court to recognise its title and then file an *execução de título judicial* to enforce its pledge.

Please note that if the shares are registered as collateral under a fiduciary guarantee type of security interest, the procedure of extrajudicial enforcement described in paragraph 2.1 above will be applicable.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

Debt-for-equity swaps are not available as a unilateral share pledge enforcement mechanism in Brazil, due to the prohibition of *pacto comissório* (a creditor cannot appropriate the pledged shares as payment). However, Brazilian corporate law does allow capitalisation of credits into equity through duly approved corporate acts, so attempting to embed a debt-for-equity swap in pledge enforcement is likely to be challenged.

2.3.2 Is a public auction mandatorily required or are private sales possible?

A public auction is the default method of selling the pledged shares in a judicial enforcement process, unless the parties agree otherwise. A private sale is possible if the pledge agreement authorises it and the creditor follows the contractual and legal conditions for the sale, such as notifying the debtor, the company and any other interested parties, and respecting the minimum price and the market value of the shares, as mentioned in paragraph 2.1 above.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

It is not possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement in Brazil.

2.3.4 *Is "market testing" mandatorily required?*

Market testing is not mandatorily required under the Brazilian legal framework for the enforcement of a share pledge, but it may be advisable or necessary in some cases. This may occur, for example, when the pledge agreement requires it, when the creditor needs to demonstrate the fairness and reasonableness of the sale, or when the law imposes it for certain types of companies or transactions (such as publicly held companies or regulated sectors).

2.3.5 *Are valuation reports mandatorily required?*

Valuation reports are not mandatorily required under the Brazilian legal framework for the enforcement of a share pledge. However, similar to market testing, they may be useful or necessary in some cases. Given the litigation and claw back risks mentioned above, the parties may take comfort from a valuation report in many cases.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

Under Brazilian law, two pre-insolvency remedies are available to distressed debt and M&A investors before the filing of a judicial reorganisation proceeding. These are the preventive negotiation, and out-of-court reorganisation (*recuperação extrajudicial*).

While both procedures are aimed at preventing the bankruptcy of the debtor and facilitating an outside-of-bankruptcy solution for its debts, there are some considerable differences.

a) ***Preventive negotiation (negociação preventiva)*** – this is a preventive process, in which the debtor and its creditors, with the assistance of a mediator, try to reach a consensual solution for the debtor's financial situation, before the debtor becomes insolvent or files for a judicial reorganisation.

Debtors will have the prerogative to request the suspension of all lawsuits and enforcement proceedings filed against them for 60 days, counted as from the day that the request is granted. This suspension has the same spirit of the stay period – which is to allow the debtor to reorganise with out-of-court and direct negotiations with its creditors while enforcement proceedings are suspended. These negotiations may include mediation efforts.

b) ***Out-of-court reorganisation (recuperação extrajudicial)*** – this is a voluntary and contractual process that allows the debtor to restructure debt held by certain classes of creditors through the negotiation of a "pre-packaged" restructuring plan.

If certain requirements are met, this plan can be "crammed down" on other creditors that were not part of the negotiations, did not voluntarily join in the plan or dissented with the plan. For labour claims, a collective negotiation with the labour union of the respective professional category must occur.

Similar to judicial reorganisation, certain claims cannot be restructured by the out-of-court reorganisation and the relevant restructuring plan will not be binding upon them – such as tax debts and credits arising out of forward foreign exchange agreements (*adiantamentos de contrato de câmbio* – ACCs), financial leases, fiduciary guarantees or transfer of property arrangements. Accordingly, these claims cannot be affected by the restructuring plan.

The debtor's request for confirmation of the restructuring plan will result in the suspension of all rights, actions and enforcement proceedings then pending against the debtor regarding the claims subject to the restructuring plan. That means that creditors excluded from the out-of-court reorganisation can still enforce their rights against the debtor, and the ratification of the plan does not prevent other creditors that are not subject to the proceeding from filing a lawsuit seeking the debtor's liquidation.

The Brazilian Bankruptcy Law provides that, if the restructuring plan is agreed by creditors representing more than half (by credit amount) of each impaired class of creditors (or group of creditors), the debtor can request the court to ratify the restructuring plan. To the extent this ratification is obtained, it becomes binding on all creditors of the same class (or group). This includes creditors that remained silent or opposed the plan.

Furthermore, the debtor may submit the ratification request with the consent of 1/3 of creditors, undertaking to reach the simple majority quorum within 90 days of the filing. During this period, the debtor also benefits from a stay period, suspending actions and enforcements related to the claims impaired by the proceeding filed against the debtor.

3.2 What involvement does the court have in these processes?

The court's involvement in the pre-insolvency processes varies depending on the type and nature of the process. In an out-of-court reorganisation, the court's role is to analyse the legality, ratify and enforce the restructuring plan and resolve any disputes or challenges that may arise during the execution of the plan. In a preventive mediation, the court's role is to authorise and supervise the mediation process and to ratify and enforce the agreement reached by the parties, if any.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The main players in the pre-insolvency processes are the debtor, its creditors and any other parties that may have an interest or a stake in the debtor's business, such as shareholders, employees, suppliers, banks, bondholders, debenture holders, customers, regulators or potential buyers.

There are no court-appointed insolvency practitioners in the pre-insolvency processes, but the parties may choose to hire or consult independent professionals – such as lawyers, accountants, financial advisors or mediators – to assist them in the negotiation, implementation or the supervision of the restructuring plan.

3.4 Is there a typical due diligence process followed?

There is no typical due diligence process that is followed in the pre-insolvency processes, but the parties may conduct their own due diligence according to their needs, objectives and risk appetite, and in accordance with the applicable laws and regulations.

The due diligence process may involve the verification and analysis of the debtor's financial, legal, operational and strategic situation, as well as the identification and the evaluation of the risks and the opportunities in connection with the credit right, legal claim or distressed asset and any aspect of the restructuring or the potential bankruptcy liquidation.

The due diligence process may also involve the verification and the analysis of the target's assets, liabilities, contracts and compliance, in the case of a M&A transaction.

The scope and the depth of the due diligence process may also vary depending on the type and nature of the pre-insolvency process, the availability and the reliability of the information, the complexity and the urgency of the situation and the expectations, risk appetite and preferences of the parties.

Typically, a distressed investor would require at a minimum the same searches and analysis that a purchaser would perform in standard M&A transactions, mainly focused on court certificates on existing lawsuits, tax clearance certificates and other customary certificates (labour debts, protest offices and other matters).

There are other documents and information that, as a rule, may be obtained independently, such as corporate documents filed with the Board of Trades, court records, real estate enrolment certificates issued by the Real Estate Registry Offices and collateral instruments filed with the applicable Registry of Deeds and Documents, among others. Depending on the corporate type of the involved entities, such entities may also be required to publish their financial statements in the newspapers, thus allowing the relevant accounting and financial information to be easily accessed.

3.5 What is the typical timeline of a M&A sale under a pre-insolvency process and how does the process work?

- *Phase 1* – the debtor and its creditors may engage an investment bank or conduct independently the process of identifying and contacting potential buyers and provide them with relevant information and materials regarding the asset itself (such as teasers), the overall terms of the restructuring or the liquidation plan and the overall terms and conditions of the sale.

- *Phase 2* – the potential buyers conduct their due diligence and submit their offers or proposals for the acquisition of the debtor's assets or shares, which may include the assumption of the restructuring of the debtor's debts, the injection of capital or resources or the provision of guarantees or warranties.

- *Phase 3* – the debtor and its creditors evaluate and negotiate the offers or proposals and select the best or the most suitable buyer, based on various criteria such as the price, the payment terms, the closing condition and the feasibility, indemnification and impact of the transaction.

- *Phase 4* – the debtor and the buyer execute the definitive agreements for the sale or the transfer of the debtor's assets or shares and obtain the necessary approvals or consents from the court, creditors, shareholders, regulators (such as antitrust approvals) or any other parties involved.

- *Phase 5* – upon completion of the conditions precedent, the debtor and the buyer complete the closing of the transaction and transfer the ownership and the possession of the debtor's assets or shares, as well as the payment and the settlement of the debts or the obligations.

The duration of each phase may vary depending on the circumstances and the challenges of each case, but an M&A sale under a pre-insolvency process could take from a few weeks to several months, or even longer, to be completed.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

In principle, the pre-insolvency processes in Brazil do not provide formal protection for M&A sales or asset sales in respect of the risk of successor liabilities associated with the target or its assets. Investors considering opportunities with protections similar to a clean sale should look into judicial reorganisation or bankruptcy liquidation scenarios, as explained in paragraph 4 below.

The same contractual protections and other strategies typically used to mitigate diligence gaps in non-distressed M&A transactions, such as representations and warranties and indemnification provisions in general, are used. In distressed scenarios, a seller may not be able to provide all typical contractual assurances, but the documentation usually would include at least fundamental representations and warranties, such as corporate organisation and authority.

In addition, in light of the distressed circumstances, purchasers must seek further protections to ensure they will be indemnified for losses arising from past liabilities. Such additional protections are generally structured as escrow accounts, purchase price retentions (holdback), collateral over sellers' remaining assets and third party guarantees.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

The pre-pack processes are permitted in out-of-court reorganisation, as mentioned in paragraph 3.1 above, and also in judicial reorganisations, discussed in paragraph 4 below.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Pre-pack sales are common under judicial reorganisation proceedings (*recuperação judicial*), given the protections provided for under Brazilian Bankruptcy Law.

The judicial reorganisation proceeding (*recuperação judicial*) is initiated at the debtor's request. Throughout this process, management control remains with the debtor, albeit under the supervision of a judicial administrator appointed by the court to oversee proceedings and the court itself.

One key aspect of judicial reorganisation is its ability to bind pre-filing claims, regardless of whether they are due. However, certain types of claims are exempted from this binding effect, including tax and social security obligations, credits related to forward foreign exchange agreements (*adiantamentos de contrato de câmbio* – ACCs), certain types of financial leases, fiduciary guarantees, and credits resulting from the sale of real estate under irrevocable and irreversible purchase agreements with title retention.

Once the debtor files for judicial reorganisation, and provided that all legal requirements are complied with, the court will issue an order admitting the judicial reorganisation. The order will also trigger a protection period that, in practice, lasts until a plan vote happens, during which time the majority of the lawsuits filed against the debtor (including all enforcement and foreclosure proceedings) will be suspended.

The debtor must present its judicial reorganisation plan, which shall set forth in detail:

(i) the reorganisation measures to be implemented;

(ii) evidence of the economic viability of the plan; and

(iii) an economic-financial report and an appraisal report of the assets of the debtor.

Besides the purchase of assets and shares of the debtor, an alternative structure for M&A transactions under a reorganisation plan that is becoming increasingly usual is the debt-to-equity swap, in particular in the context of more complex cross-border reorganisations.

Under the recent amendments to the Brazilian Bankruptcy Law, creditors were provided with a more stable and predictable system to approve debt-to-equity swap structures, arising from the provision for a safe harbour for creditors – who shall not be held liable or become successors of the debtor by virtue of debt-to-equity swap.

If the judicial reorganisation plan is opposed by any creditor (through a written objection to the plan), the court will convene a creditors' meeting to discuss and vote on the plan. For the purpose of the creditors' meeting, the creditors are classified in four classes, as follows:

(i) class I – labour claims;

(ii) class II – secured creditors (e.g. credits with guarantees in rem, such as a mortgage or pledge);

(iii) class III – unsecured creditors; and

(iv) class IV – creditors classified as "small-sized enterprises" (see below).

For the approval of the judicial reorganisation plan at a creditors' meeting, two requirements must be met:

(i) in the classes of secured and unsecured creditors, the plan must be approved by more than

50% of the creditors attending the meeting, both by the amount of claims and the number of creditors (on a headcount basis); and

(ii) in the classes of labour claims and creditors classified as small-sized enterprises, by more than 50% of creditors attending the meeting (on a headcount basis), regardless of the amount of their claims. Small-sized enterprises are companies with annual gross revenues smaller than R $ 4.8 million (approximately US $0.9 million).

Brazilian Bankruptcy Law also grants the debtor the possibility to request the judge to "cram down" the judicial reorganisation plan in the event the requirements described above are not entirely met. The cram down is possible if:

(i) at least 50% of all creditors attending the creditors' meeting by amount of claims voted favourably for the approval of the plan;

(ii) the plan is approved by three classes of creditors (in case there are four classes in total), two classes of creditors (in case there are three classes in total) or one class of creditors (in case there are only two classes of creditors in total); and

(iii) 1/3 of the creditors attending the creditors' meeting in the rejecting class voted favourably for the approval of the plan (with this 1/3 threshold able to be based on either the amount of claims or the number of creditors, depending on the class).

As noted, amendments to the Brazilian Bankruptcy Law removed one of the main obstacles to pre-pack sales, which was the potential successor liability of acquirers of assets for debtor liabilities. There are some alternatives regarding M&A transactions in the context of judicial reorganisations, as described below.

a) Sale of isolated productive units (UPIs) (unidade produtiva isolada) – this is a legal concept in Brazil that allows a debtor company in judicial reorganisation or bankruptcy liquidation to sell part of its assets or activities, without transferring its liabilities or affecting creditors' rights.

Sales of UPIs are commonly included in the judicial reorganisation plan to be voted on. In accordance with article 60 of the Bankruptcy Law, if the approved judicial reorganisation plan involves the sale of branches or UPIs of the debtor, the court shall order that the sale be performed according to the provisions of article 142 of the Bankruptcy Law.

That article provides that the sale of assets must be carried out by means of an auction on-site or hybrid (on-site and electronic) or a bid.

The auction proceeding is an open sale to the public, at which the asset is sold to the highest offeror. In a bid, the bidders present to the court a closed envelope containing the offer.

Nonetheless, the inclusion of protections to certain buyers that invested and to a certain extent gave support for the completion of the transaction (e.g. stalking horse buyers) have become fairly common in the UPI sale process in Brazil, such as the right to match, the right to top and break-up fees.

In addition, the Bankruptcy Court may also authorise the sale of assets by means other than those set forth by article 142. However, it is not settled whether a sale of a UPI conducted without a competitive process will be considered free of succession risk.[3]

Prior to the plan vote, as a general rule the debtor is not allowed to sell or encumber assets or rights classified as "fixed assets", except upon court authorisation, which may be granted under article 66 of the Brazilian Bankruptcy Law.

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[3] Brazilian Superior Court of Justice, Case Law REsp 1854493/SP, Reporting Judge Moura Ribeiro, 23 August 2022.

b) *Subsidiaries or special purpose vehicles (SPVs)* – assets are commonly contributed to subsidiaries of the seller or SPVs, so that the totality of the shares of such subsidiaries or SPVs are considered the UPIs and sold to the buyer.

c) *DIP financing, or debtor-in-possession financing* – this is also available in Brazil for companies undergoing judicial reorganisation.

   The DIP lenders will have super priority over existing creditors in the event of bankruptcy liquidation. DIP financing can be extended by any third party – including funds, financial institutions, suppliers, existing creditors and related parties (such as shareholders, affiliates or directors).

   The Bankruptcy Law provides that, if the financing is secured by security interests over assets of the debtor, it needs to be reviewed and approved by the Bankruptcy Court. Typically, DIP lenders submit most DIP financing for court approval, regardless of whether it is secured by collateral, as approval affords further protection to DIP lenders.

   If the approval is reversed in appeals, the bona fide DIP lenders that already disbursed funds will not lose their super priority or the security interests negotiated in support of the financing. It is possible that the DIP financing documentation provides for debt-to-equity conversion, which may result in the dilution of current shareholders or even a change of control.

In addition, it is also possible for a bankrupt estate to sell assets or groups of assets free of succession risk in a bankruptcy liquidation scenario, in the same way described above, according to article 142 of the Bankruptcy Law.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

In judicial reorganisation proceedings in Brazil, several key actors play pivotal roles, such as the debtor, creditors – including employees, suppliers, banks, funds, bondholders, debenture holders and shareholders – and the Bankruptcy Court judge.

In a judicial reorganisation, the court appoints a judicial administrator to oversee the proceeding, ensure compliance with legal requirements and safeguard the interests of the debtor, creditors and other stakeholders.

In a bankruptcy liquidation, the judicial administrator assumes a more prominent role and takes over the management of the activities of the debtor. The judicial administrator is responsible for coordinating the effective realisation of the assets and the orderly payment of creditors. Therefore, in a liquidation, any sales of assets or groups of assets will be coordinated by the judicial administrator, and no longer by the debtor.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

The appointment of judicial administrators is made by the court, considering various factors including qualifications, experience, impartiality and the ability to effectively manage the reorganisation process. While creditors may challenge the appointment of a specific insolvency practitioner, a judicial administrator may only be replaced in the case of breach of the law, breach of duties, omission or negligence.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Brazilian law does not provide special protection for certain types of creditors in pre-pack sales.

4.5 Is there a typical due diligence process followed?

There is no typical due diligence process that is followed in Brazil for pre-pack sales, as the scope and the depth of the due diligence may vary depending on the nature and the complexity of the transaction, the availability and the quality of the information, and the level of risk and opportunity involved.

However, some common elements of the due diligence process may include:

(i) the analysis of the legal, financial, tax, labour, environmental and regulatory aspects of the debtor and its business;

(ii) the verification of the validity and the enforceability of the contracts, the licences, the permits and the intellectual property rights of the debtor;

(iii) the identification and assessment of the liabilities, contingencies, litigation and claims of the debtor and its creditors;

(iv) the evaluation of the assets, cash flow, profitability and valuation of the debtor and its business; and

(v) the review of the reorganisation plan, pre-pack sale proposal and court orders and documents related to the judicial reorganisation process.

The due diligence process may be conducted by the potential buyer, its advisors and its financiers and may require the cooperation and the disclosure of the debtor, its management and its advisors.

In the case of UPI sales or sales pursuant to a public auction or other organised competitive process, the acquirer does not succeed on the obligations of the debtor (seller), so that the scope of the due diligence in these cases tends to be narrowed to identify liabilities that are inherent to the assets under negotiation themselves.

4.6 Is "market testing" mandatorily required?

Market testing is not mandatorily required under the legal framework for pre-pack sales in Brazil, as the law does not prescribe a specific procedure or method for the selection of the buyer or the determination of the sale price.

Market testing may involve sounding the market for interest, solicitation of offers, publication of notices or the consultation of experts, among other mechanisms, to ensure the pre-pack sale reflects the best available terms and conditions for the debtor and its creditors. Market testing mitigates the risk of successful challenges by creditors arguing that assets were sold for exceedingly low prices.

As mentioned, in UPI sales, a public auction or other organised competitive process ensures that the acquirer will not bear succession risk.

4.7 Are valuation reports mandatorily required?

Valuation reports are not mandatorily required under the legal framework for pre-pack sales in Brazil, as the law does not impose a specific requirement or standard for the valuation of the debtor or its business.

However, valuation reports may be useful for the pre-pack sale, as they may provide a reliable and objective basis for the negotiation, the approval and the justification of the sale price, as well as the distribution of the proceeds among the creditors.

Similarly to "market testing" or fairness opinions, valuation reports mitigate the risk of successful challenges by creditors arguing that assets were sold for exceedingly low prices.

4.8 What is the typical timeline of "pre-pack" sales?

Regardless of the deal structure, distressed M&A transactions involve the conduct of due diligence on the target company or its assets, the negotiation and execution of a sale and purchase agreement (SPA) and submission of the transaction to antitrust authorities (if applicable) and other relevant public authorities and regulatory agencies, depending on the industry. The timetable for these acts does not differ from a traditional M&A transaction.

For transactions carried out in judicial reorganisation proceedings, the timing for the conclusion of the transaction depends, in addition, on meeting the requirements provided by the Bankruptcy Law.

Pursuant to the Bankruptcy Law, the transfer of non-current assets of the debtor (which usually is the case in M&A transactions) must be submitted for the Bankruptcy Court's approval or, alternatively, be already provided for in the reorganisation plan approved by creditors and confirmed by the Bankruptcy Court.

The timing of the approval by the Bankruptcy Court may vary significantly. An in-court distressed M&A transaction usually provides as a closing condition the non-existence of appeals against the court order. If appeals are filed, a definitive decision on the matter by a Court of Appeals may take 6 to 12 months.

The implementation of a distressed M&A transaction under a reorganisation plan requires the approval of the plan by the general meeting of creditors and then confirmation of the plan by the Bankruptcy Court. If the sale is conducted packaged into an UPI (i.e. free and clear from any liens and liabilities of the debtor), the sale must be provided for in the reorganisation plan and typically preceded by a competitive process, such as a public auction or a private competitive process organised by a professional agent. Public auction processes have typically taken 30 to 90 days from the court confirmation order.

CAYMAN ISLANDS

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

The primary sources which apply to the purchase of equity of companies incorporated and registered in the Cayman Islands are the Companies Act (as revised), the Limited Liability Act (LLC Act) and the common law. More industry-specific regulations and laws may apply depending on whether the target company is listed on the Cayman Islands Stock Exchange (CSX), or the industry in which the target company operates. If the shares that are to be acquired are issued by a Cayman Islands company listed on the CSX, the transacting parties will also need to consider the CSX Code on Takeovers and Mergers and Rules Governing substantial Acquisitions of Shares (CSX Code).

Companies that are subject to the Banks and Trust Companies Act, the Insurance Act or the Mutual Funds Act are regulated by the Cayman Islands Monetary Authority (CIMA) and are subject to change of control provisions which would need to be considered before entering into transactions for the sale and purchase of their issued securities. Entities operating pursuant to the Information and Communications Technology Act are similarly subject to exchange control provisions and regulated by the Information and Communications Technology Authority.

There are no foreign investment restrictions or exchange control legislative provisions in the Cayman Islands and investment is encouraged into the jurisdiction. However, any company that is established and operating within the Islands must comply with local licensing laws with respect to ownership. Any company engaging in business locally is required to be licensed under the Trade and Business Licensing Act. Additionally, the licensed company must be at least 60% beneficially owned and controlled by persons of Caymanian status, or it must hold a licence under the Local Companies Control Act.

Turning to distressed investing, there are no separate rules which generally apply to the transfer of shares in the capital of a distressed company in the Cayman Islands. However, if the securities are to be purchased from a target company that is also subject to a formal restructuring or liquidation process within Part V of the Companies Act, the order appointing the relevant officeholders will generally provide that equity interests in the company are prohibited without the consent of the relevant officeholder. This is discussed below.

1.2 Is there a special legal regime to purchase distressed debt or non- performing loans?

The Cayman Islands does not have specific regimes which apply to the purchase of distressed debt or non-performing loans. However, where a proposed sale / purchase of distressed debt or the assignment of a non-performing loan involves an institution regulated by CIMA, it will be necessary to consider applicable capital adequacy requirements of the acquiring entity. The level of capital which a regulated entity is required to maintain depends on the type and regulatory status of the acquiring entity, for example whether it is a bank, trust or insurance company. The relevant legislation should be consulted in each case.

In the distressed debt space, the assignment of loans and distressed debt is likely to be by and / or between financial institutions. Where the transaction involves a bank incorporated and registered within the Islands, CIMA has adopted the guidelines set by the Basel Committee for Bank Regulation and Supervisory Practices for capital adequacy. The minimum risk asset ratio required by Basel is 8%, and CIMA has applied a minimum of 10% risk asset ratio under applicable law. Banks that are incorporated within the jurisdiction are generally required to maintain a minimum net worth of CI$ 400,000 (or equivalent in other currencies).

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

In the case of a company in distress, the need to obtain additional funding to navigate the period of financial hardship is likely to be a top priority. Distressed investment is often provided by existing investors of the company but may also be provided by new lenders. In each case, lenders who are providing additional capital will need to consider the priority which can be given to the new lending and how it might be secured in the event the debtor company falls into financial distress in the future or enters a winding up process.

With regard to priority, distressed lending will typically be provided with super-senior priority and will rank ahead of debt which existed prior to the restructuring. Under Cayman Islands law, unsecured lending ranks pari passu in a company's insolvency. Given the increased credit risk that is assumed by distressed investors, ranking pari passu is likely to be commercially unattractive. To modify the default position, it is necessary to have an intercreditor agreement in place which alters this default position by contractually subordinating the pre-restructuring / pre-insolvency debts as a matter of contract. Intercreditor agreements which vary the default ranking of priorities are recognised and permitted under the laws of the Cayman Islands. The terms of subordination must include the consent on the part of those stakeholders who are to be subordinated.

Where the super-senior debt is to be secured and there are multiple investing parties, the terms of the intercreditor agreement can also provide for a collateral agent to hold the security interest on trust for the super-senior lenders. Where the distressed investors are being provided with new security interests and the assets which are being used as collateral are located in the Cayman Islands, the security must be perfected within the jurisdiction. How any one of the security interests is perfected will depend on the asset that is being taken as collateral (i.e. there are asset registers for land, ships and aircraft). Where the security takes the form of an assignment of choses in action, that assignment should be perfected by notice given to the relevant counterparties.

1.4 What risks exist for an investor of a distressed business?

Risks for an investor in a distressed business include:

(i) objections and challenges of existing stakeholders;

(ii) challenges to unwind the transaction under the Fraudulent Dispositions Act (1996); and

(iii) failure of the company notwithstanding the additional investment.

- *Stakeholder objections*

  Prospective investment in a distressed company may be challenged prior to its completion by stakeholders who consider their interest in the company to be adversely affected. Equally, some stakeholders may raise objections with a view to obtaining better terms to protect their own position should the company fail notwithstanding the new funding.

  Notably, the Cayman Islands does not currently have an unfair prejudice regime. Where stakeholders wish to block or challenge a course of conduct that is being proposed by management, they are largely limited to seeking relief from the Grand Court of the Cayman Islands having first presented a petition for the company to be wound up. However, rather than prosecuting the petition and seeking the winding up of the company, the aggrieved investors would ask the court to consider either making alternative orders, including regulating the conduct of the company's affairs or requiring the company to refrain from doing or continuing an act complained of, to perform an act the company is not currently doing (section 95 of the Companies Act), or to appoint provisional liquidators to prevent the oppression of the interests of minority shareholders (section104(2)(b)(ii) of the Companies Act). These measures are drastic and can be value destructive. Invoking the Grand Court's jurisdiction in this way would suggest a more fundamental dispute between management and existing investors.

  Where the objections of stakeholders cannot be resolved consensually, the company may need to consider implementing the new investment terms and structure using a scheme of arrangement pursuant to section 86 of the Companies Act. This is a costly and time-consuming process which increases the cost of securing new investment. A discussion of the process and requirements of a scheme of arrangement under the Companies Act falls beyond the scope of this Chapter.

Outside invoking the Grand Court's jurisdiction, the ability of stakeholders to object and prevent the transaction going through will depend on the terms governing the shares, as well as the memorandum and articles of association of the company. While the Cayman Islands does not restrict or prescribe the terms on which shares might be issued, the ability of a company to issue preferred shares to new investors in a distressed situation may require the consent of all or a majority of existing investors. It may also be the case that a company has conferred anti-dilution or pre-emptive rights on certain classes of existing shareholders which may limit the equity interests that may be taken up by a new investor or otherwise require compromise.

- *Void as a fraudulent disposition*

  While the ability to avoid transactions is most frequently associated with actions that may be taken when a company is placed into compulsory (official) liquidation, it is possible for disposition of a company's property to be challenged and avoided outside of a winding up process (discussed below at paragraph 1.4.2).

  This right accrues under the Fraudulent Dispositions Act (as revised) and provides that a creditor may have a disposition of property made at an undervalue and with an intent to defraud set aside. The creditor who purports to be prejudiced by a transaction has the burden of establishing the requisite intent.

- *Valid and enforceable security*

  Aside from the risk that a transaction may be challenged by aggrieved creditors of a company, a distressed investor who is an existing secured lender to the debtor company should consider whether the new lending is capable of falling within an existing security package or whether a new security arrangement is required.

  As addressed in paragraph 1.3 above, this may also require the perfection of any new security arrangements that relate to the super-senior debt to protect the senior-secured lenders' rights in the event it is necessary to enforce the security.

  Notwithstanding the investment that is made into a distressed company, there remains an ever-present risk that the company will fail and subsequently be wound up. The risks to the transaction in the winding up context are discussed below at paragraph 1.4.2.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

As noted above, outside the winding up context a transaction may be challenged either after the event under the Fraudulent Dispositions Act, or prior to its completion if the transaction is being implemented through a scheme of arrangement.

Schemes of arrangement with shareholders of a company can be used to obtain various objectives, including the exchange and purchase of shares, capital organisations and the reduction of capital. A scheme that is proposed to the members of a company (or a class of them) may be objected to by members of that class on the basis that: (i) the class is not correctly composed; or (ii) the terms of the scheme are unfair. For the scheme to pass and the transaction be implemented, it must have the support of at least 75% by value of the relevant shareholding.

Accordingly, a transaction which is to be implemented by a scheme of arrangement can be subject to challenge by minority members. Frequently, a company which is proposing a scheme of arrangement will look to secure the advance approval of key investors so as to limit the likelihood or success of any challenge to the transaction.

A class, for the purpose of a Cayman Islands scheme of arrangement, is a group of creditors or members whose legal rights against the company are sufficiently similar such that they are able to consult together in respect of the proposed scheme. Their rights must not be so dissimilar that they cannot meet and discuss the terms of the scheme based on that common interest. Where there is such a disparity, that will indicate a requirement for an additional class under the scheme. The key aspect to assess whether one or more classes is required by the scheme terms is the similarity of legal rights rather than interests in the company.

The scheme process allows objecting investors to be crammed down where 75% of the shareholders by value are in favour of the proposal. Schemes of arrangement may also be used to compromise the financial obligations of the company with its creditors (or any class thereof). A proposal to the creditors of a company (or a class of those creditors) can bind the minority where 75% in value and 51% in number of the creditor voting approve the arrangement.

Further, if the (proposed) transaction may expose the company to a direct or derivative action by existing shareholders, those shareholders could try to prevent the transaction completing by obtaining a freezing injunction. For such an application to be successful, the court must be satisfied that an applicant has a good arguable case for damages, that there is a real risk of dissipation of assets outside the usual course of business and that it is just and convenient to grant the relief.

To the extent that a distressed investor takes security over the shares in the company, existing shareholders that have concerns about the transfer of shares by way of security without notice are able to file an application for a stop notice with the Grand Court. The notice is then served on the company. The issue of a stop notice is a quick and cost-effective process which enables a shareholder to take any steps it may consider necessary to protect the assets, should it receive notice of a proposed transfer.

The absence of an unfair prejudice action in the Cayman Islands limits actions which shareholders may take to challenge or block courses of conduct that management intend to explore. The actions which remain available are draconian and potentially value destructive, particularly where the prerequisite for invoking an action which could successfully challenge the transaction would first require that a winding up petition be filed against the company.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

If, despite the additional investment, a company enters formal winding up proceedings, transactions that have been entered into prior to the commencement of those proceedings may be vulnerable to being unwound. As a starting point, a company is liable to be wound up in the Cayman Islands where it does not have sufficient cash to meet its current liabilities. This is a cashflow test as opposed to a balance sheet test.

A liquidator may unwind transactions that can be characterised as voidable preferences or transactions at an undervalue under the Companies Act.

- *Voidable preference*

  Pursuant to section 145 of the Companies Act, transactions are voidable at the instance of a liquidator where they:

  - occured in the 6 months immediately preceding the commencement of the winding up;
  - occurred at a time when the company was insolvent in the sense that it was unable to pay its debts;
  - involved a conveyance or transfer of property by the company or a charge thereon, or otherwise involved any payment obligation or judicial proceeding that is taken, made or suffered by the company; and
  - were executed with a view to giving such creditor a preference over the other creditors.

  A transaction is deemed to be preferential within the terms of section 145 where it is made to a related party of the company. This in turn depends on the ability of the recipient party to control or exert significant influence over the financial and operating decisions of the debtor company.

- *Undervalued transactions*

  A liquidator may also clawback assets and property of a company which have been disposed of at an undervalue within the meaning of section 146 of the Companies Act. Transactions that occurred within the prior 6 years are open to challenge by a liquidator. Notably, the look-back period for undervalue claims is determined by the date of the disposition in question and not he commencement of the liquidation.

  The key aspect and often a difficult element to evidence is that the transaction in question was entered into at an undervalue. The question turns on an assessment of the relative value of the consideration flowing to and from the company. This can be a highly contentious issue depending on the subject matter and consideration composition of the transaction. A liquidator is required to prove that there was an intention to defraud creditors (not the dominant or sole intention).

- *Fraudulent trading*

  Sections 145 and 146 are actions which have a restitutionary objective. In contrast, section 147 of the Companies Act provides liquidators with the ability to commence proceedings against “any person” who has “knowingly” participated in the any business of the company that has been carried on with “the intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose”. If a liquidator is successful in bringing an action under section 147, the Grand Court can order that those persons make such contribution to the assets of the company “as the court thinks proper”.

  In the context of a distressed investment, the transactions required to implement the investment generally have a genuine commercial purpose in the context of the company’s financial difficulties. As such, challenges under the provisions outlined above which require a fraudulent intent would not easily be established.

1.4.3 What risks exist for a new lender investing in a distressed business?

There is no specific legal regime for lenders investing in a distressed business in the Cayman Islands. However, the pre and post insolvency risks which are outlined immediately above should be addressed by prospective lenders to prevent debt packages that are negotiated with the company being susceptible to avoidance actions. Furthermore, there remains the overriding risk that the company will fail irrespective of the additional lending.

While the risk that the company fails is one that would be priced into the cost of the loan being advanced in terms of any interest premium and super-priority security, the process of enforcement against any security can be a timely and costly process. In addition, there is always the risk that the security provided is not adequate once the business fails. This may be a factor which can be monitored with regular appraisals and security reviews during the term of the debt.

Distressed lenders frequently negotiate the right to receive financials on the company from the board of directors. Where permitted by the company’s articles of association, a company may issue shares on terms which provide the new lender with certain veto rights. These shares, referred to as “golden shares”, can provide new lenders with comfort that the company’s assets will not be disposed of or transferred away without notice to or consent of that lender. A golden share may also provide a lender with a right to have a nominee attend board meetings and ask questions.

In exercising any of these rights, a new lender should be mindful of being regarded as a shadow or de facto director of the company and coming under a duty of care to the company and its stakeholders as a result. Accordingly, the extent of these rights and the use of them must be drafted clearly and adhered to in practice to ensure the oversight conferred on the new lender does not stray into management and control over the company.

A shadow director is a person in accordance with whose directions or instructions the directors are accustomed to act. While each situation must be approached on its own facts, a shadow director will likely have the same duties and obligations as a formally appointed de jure director. A de facto director is someone who assumes certain roles as a director without being formally appointed as such.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

A lender who invests in the equity of a distressed company which has limited liability should only be liable to the extent it is required to pay the capital for its share interest. Similar to the position of new lenders to a distressed business, new investors typically require terms which provide them with increased levels of control and oversight, which often include a right to appoint a board member or a nominee director. The nominee director continues to owe duties to the company and its general body of stakeholders rather than the appointing shareholder.

Just as a new lender should be vigilant about the potential to be subject to a duty to care to the company and its stakeholders as a result of being regarded as a de facto or shadow director, a new investor is open to the same risk.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

The enforcement remedies that are available to distressed investors are determined primarily by whether the interest in the company is equity or debt, and whether the debt is secured.

2.1.1 Enforcement of equity rights

The rights which accrue to equity stakeholders will be governed by the terms of subscription and the articles of association of the company.

The corporate law regime in the Cayman Islands is flexible and the parties have broad latitude to include commercial terms which are attractive to distressed investors. Distressed investors are likely to obtain preference shares which carry with them rights to be paid dividends during the course of the investment. Those shares may also confer rights to a return on their investment in advance of the common stock in the event the company is liquidated. These preferential interests are realised when the shareholder exercises its right of redemption to exit the company.

2.1.2 Proceedings and interim relief

The breach of rights accruing to shareholders under the applicable constitutional documents of the company may give rise to direct actions against the company or its management. These are personal claims.

In some instances, the company may have suffered wrong at the hands of those who remain in control of its affairs, which may entitle the shareholders to commence a derivative action on behalf of the company. The scope of a derivative action in the Cayman Islands may extend to claims against third parties that were an accessory to or closely associated with the conduct giving rise to the derivative action.

In pursuing either a personal or derivative action, shareholders may seek an injunction or declaratory relief in support of their rights, and / or to prevent harm to the company.

Outside of contractual entitlements that are embedded in the constitutional documents of the company, shareholders of Cayman companies may invoke certain remedies under the Companies Act. These actions predominantly arise in the winding up context and for that fact may be undesirable routes of enforcement for a distressed investor.

2.1.3 *Inspectorship*

Contributories who hold at least 20% of the issued capital of a company (not being a bank) may apply to the Grand Court for the appointment of an inspector pursuant to section 64 of the Companies Act for the purpose of examining the company's affairs and filing a report on the same.

Where the company is a bank, section 64 imposes a higher threshold for the appointment of inspectors, requiring that the application be brought by members representing at least one third of the capital issued at that time. To conduct an examination into the affairs of the company, the inspectors are given the authority to compel the production of all books and records in the power or custody of the company's officers and agents. The inspectors may also examine the officers and agents of the company under oath. The scope and purpose of the examination is a matter to be determined by the court which, in turn, is driven by the underlying facts which gave rise to the need for inspectors to be appointed.

The terms of the Companies Act do not set down a threshold test which an application must meet for the successful appointment of inspectors. Recent decisions of the Grand Court make it clear that the appointment of inspectors is an extraordinary remedy and will only be granted in circumstances where there is cogent evidence that there has been grave misconduct, mismanagement or concealment related to the management of the company.

Indeed, the appointment of inspectors is a serious step which can adversely affect the reputation of the company as well as be an intrusive interruption to the conduct of business. In assessing the application, the court will consider if the remedy which is sought by the applicant members is appropriate and proportionate. Accordingly, where the board is open in its communications in addressing the concerns of investors, the court will be less inclined to be persuaded that it is appropriate or proportionate to appoint an inspector.

Where the court is persuaded that an inspector should be appointed, the terms of the appointment will be narrowly drawn and the scope of examination focused on what the applicant intends to achieve from the examination process.

The Grand Court has permitted the appointment of an inspector for the purpose of assisting a debtor, who was granted shares in a company as part of a settlement, to understand the value of the shares in which they held legal title. It was only through ascertaining the financial status of the company and the value of the shares that the member could assess the extent to which the judgment debt had been satisfied or remained payable.

Once the inspectors have concluded their examination, they will prepare and file a report to the court. This report is not generally accessible unless the court directs, but the report may be used in subsequent legal proceedings that are brought by the members against the company or its management. The information obtained may be used to provide evidence for a just and equitable winding up of the company (discussed below). However, the findings in the report are not necessarily evidence of fact, but of the inspector's opinions as to the matters addressed in the report.

2.1.4 *Just and equitable winding up*

The Cayman Islands company law regime does not include a standalone unfair prejudice remedy for shareholders. Instead, shareholders must first present a petition to wind up the company on the grounds that it is just and equitable to do so pursuant to section 92(5) of the Companies Act. The presentation of a petition on a just and equitable basis entitles the court to consider an alternative order pursuant to section 95(3) of the Companies Act, including an order:

(i) regulating the conduct of the company's affairs in the future;

(ii) requiring the company to refrain from doing or continuing an act complained of by the petitioning shareholder or to do an act which the petitioning shareholder has complained the company has failed to do;

(iii) authorising the petitioner to commence a derivative action on such terms as the court may direct; and / or

(iv) providing for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, a commensurate reduction of the company's capital.

When evaluating whether an alternative order should be granted, the court is principally concerned to grant a remedy which is fair and proportionate in the circumstances.

It is a frequently noted peculiarity of the Cayman Islands regime that for a shareholder to obtain relief in respect of its rights as a shareholder, a liquidation process must first be commenced against the company. Prosecuting a winding up on the basis that it is just and equitable to do so is a remedy of last resort, and highly dependent on the facts of the particular case.

2.1.5 Enforcement of debt obligations

Where debt has been advanced to a distressed company, the enforcement options will be determined by whether the debt is secured (and to what extent) or unsecured. Notably, the security arrangement may be governed by Cayman or foreign law, depending on the commercial drivers of the transaction. One such consideration may be the preference of the lender to whom the security is provided to have remedies that would otherwise not be available under Cayman law.

2.1.6 Secured debt

Security over shares issued by a Cayman company may be taken by a legal charge or an equitable mortgage. The form of a security which is most suited to any one particular case will be driven by various factors including tax, regulatory and accounting implications for the secured party.

When a legal charge is created, the secured party (or its nominee) becomes the registered holder of the relevant asset. The terms of the security documents will usually provide that, upon satisfaction of the security, the chargee will retransfer title in the secured asset to the chargor. Taking security by way of a legal charge provides security to the secured party in the event enforcement becomes necessary, given that the assets are already held in the secured party's name.

In contrast to a legal charge, an equitable mortgage transfers only the beneficial interest in the asset to the secured party, while legal title remains with the chargor. As a result, it is the chargor who retains the right to the benefits which flow from the charged asset. In the case of shares in a Cayman company, this would include the right to receive proceeds on declared dividends and exercise the rights attaching to those assets. These entitlements would be subject only to the limitations and restrictions that are agreed on between the parties in the suite of security documents. However, this structure may be preferrable to an investor having regard to the tax and regulatory consequences which follow from being the legal title holder of the assets being provided as security.

A lender holding security may enforce that security by:

(i) exercising the power of sale. This right arises at common law and under the terms set out in the security documents;

(ii) appointing a receiver over the asset;

(iii) taking possession of the asset; or

(iv) foreclosing on the security

Where the secured assets are shares, it is also possible for a secured investor to file a "stop notice" with the Grand Court. This notice is served on the company whose shares have been charged. A stop notice requires that 14 days' prior written notice be given to the secured party before any dealing with the charged shares may be completed.

2.1.7 Unsecured debt

The means of enforcement of a wholly or partially unsecured debt is firstly determined by whether the debt asserted by the investor is disputed, or whether there is a dispute as to whether there has been an event of default pursuant to the terms of the debt which would permit the creditor to seek repayment of the debt.

Since August 2022, it has been possible to seek the appointment of restructuring officers to a company which is or is likely to become unable to pay its debts as they fall due.

2.2 What involvement does the court have in these processes?

See paragraph 2.1 above.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

It is not possible to create security over shares of a Cayman Islands legal entity by way of a pledge. This is due to the possessory nature of a pledge as a form of security being in conflict with the intangible character of shares issued by a Cayman Islands company. As set out above, the principal means of taking security over shares issued in a Cayman company is by way of an equitable mortgage, or less commonly by way of a legal charge. Enforcement then takes place in the manner set out below.

- *Power of sale*

  In each case, the security can be enforced by the secured creditor selling or arranging for the sale of the shares.

  In exercising a power of sale, the secured party is subject to overriding legal obligations to:

  (i) act in good faith;

  (ii) take reasonable steps to obtain a proper price for the asset;

  (iii) obtain the best price reasonably obtainable;

  (iv) act with reasonable care and skill; and

  (v) act fairly towards the chargor.

  Importantly, the secured creditor is not under an obligation to sell or wait to sell at any particular time.

  When exercising the power of sale, there is no general requirement that the sale be conducted by way of a public auction, or a private sale, and this decision is likely to be driven by prevailing market factors at the time enforcement action is considered.

  It is not necessary to obtain a court order to exercise the power of sale, though it may be preferable to do so in certain circumstances. For example, if the secured party wishes to buy the secured shares or sell them to a third party in a depressed market, a court order authorising that sale may protect the secured party from a claim that it did not receive the best price reasonably obtainable.

  Subject to the terms of the security documentation, a secured investor is at liberty to retain the shares and discharge or reduce the secured debt due from the company. This is effectively a sale by the chargee to itself and brings into focus the question of value of the secured shares. A secured party electing to purchase the secured shares for its own benefit will be required to appoint an independent valuation of the shares to examine if the shares were less than, equal to or greater than the amount of the debt outstanding and costs of enforcement.

If the secured party seeks to enforce by way of a sale to a third party, the overriding duties in exercising the right of sale must be adhered to. The secured investor is generally permitted to sell all shares that are secured irrespective of whether the secured assets exceed the debt due by the company. The proceeds from that sale would then be applied to:

(i) satisfy any prior ranking encumbrances;

(ii) pay expenses of the sale process; and

(iii) discharge the secured indebtedness which led to the sale. Any surplus from the proceeds of sale is held for the account and paid over to the debtor.

In respect of an equitable mortgage, because legal title to the shares remains with the debtor company, the process of enforcement requires the cooperation of the company's directors. When a company is exposed to security enforcement measures, the incumbent directors may not be willing to comply with the reasonable requests of the secured investor. As such, a distressed investor looking to take security over shares in a Cayman company should take steps at the time the security is provided. This will maximise their prospects of successful enforcement.

These measures include ensuring the following documents are provided to the distressed investor:

(i) original share certificates representing the charged shares or a confirmation that share certificates have not been issued;

(ii) signed but undated share transfer form in respect of the charged shares from the chargor;

(iii) certified copy of the register of mortgages and charges of the chargor noting the security interests created by the equitable charge;

(iv) requiring that a note be placed in the register of members that the relevant shares are subject to an equitable mortgage;

(v) irrevocable power of attorney from the chargor in favour of the secured investor;

(vi) irrevocable proxy from the chargor so that the secured party is able to vote the charged shares on behalf of the chargor; and

(vii) letter of resignation from each of the current and future directors of the company whose shares are being charged, together with a signed letter of authority from each such director in favour of the secured party authorising it to date and deliver the letters of resignation upon an event of default

In addition, it would be prudent for the distressed investor to make it a condition of the lending arrangement that the company amend its articles of association to provide for measures that will assist in the enforcement of the equitable mortgage. These could include obliging the directors to effect the transfer of legal title in the shares on enforcement being notified by the secured party and providing for the removal of directors who fail to transfer the shares in accordance with the terms of the security. Directors of the company in which the investment is being made may also be required by the terms of the security to instruct the registered office of the company to act on the instructions of the secured investor / its nominee after receiving notice of an event of default.

- *Receivership*

  A secured party will acquire the right to appoint a receiver as a matter of contract pursuant to the terms the security documents. There is no need for a court order appointing the receiver over the shares. Once a receiver has been appointed by the secured party, it can vote and sell the secured shares, as well as receive any distributions from those shares. Those rights include the ability of the receiver to remove the issuing company's directors and liquidate the company's assets in order to realise the value of the debt due to the secured creditor.

  A receiver who is appointed under the terms of an equitable mortgage is not subject to the supervision of the Grand Court and primarily owes duties to the secured creditor who made the appointment. The function of the receiver is to realise the value of the secured debt and there is no further obligation to the company or its other stakeholders.

- *Taking possession*

  The secured party may also take possession of the secured shares by becoming registered as the legal owner of those shares. The secured lender is able to effect this by dating and completing the share transfer form and presenting it to the company's registered office service provider and requesting that the register be updated. Once updated, the shareholder of record can exercise any rights which are available under the terms of those shares.

- *Rectification of the register of members*

  The registered office of a Cayman company is required to maintain the company's corporate registers, including the register of members. Where the registered office is uncooperative as regards updating the register to reflect the title acquired by the creditor following enforcement of its security over the shares, the secured party may apply to court to rectify the register on the grounds that there has been an unnecessary delay in entering it a shareholder of the company.

- *Foreclosure*

  If the secured party acquires legal title to the secured shares in a company, it also has a right of foreclosure. This remedy extinguishes the security provider's legal and beneficial title to the shares but not its obligation to pay any secured and unpaid sums. Foreclosure involves a time-consuming and costly court process and is not usually exercised in practice given its draconian nature.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

A debt for equity swap is a frequently used tool in the Cayman Islands by companies looking to restructure their debt obligations. Under the laws of the Cayman Islands, it is possible for the consideration of a share enforcement process to include a debt write down or release, and a conversion of part of whole of that debt into equity. The efficacy of this process will turn on the value which can be attributed to the shares at the time the debt is released or written off. Given the potential for the secured creditor to have a clear conflict of interest it would be prudent for the enforcing party to obtain an independent valuation of the shares and have the sale conducted by a third party.

2.3.2 Is a public auction mandatorily required or are private sales possible?

Security over shares may be enforced through a public auction or a private sale, subject to the terms of the security documentation as to how the security should be realised. It is essentially a question of which process is likely to yield the best price reasonably obtainable and whether the sale is sufficiently contentious such that the company could seek to challenge the value of the sale. Discrepancies going to the value of the security may be overcome by obtaining independent valuation reports or conducting a public auction for the shares.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Where the articles and memorandum of association of a company have restrictions on the transfer of shares issued by the company, it would be usual for the relevant resolutions and amendments to be passed at the time the distressed investment in the company is made, rather than when the security is enforced. To the extent that the directors remain cooperative at the time the security is enforced it would be possible for restrictions to be lifted to as to allow the enforcement to be implemented. In the event the directors are not cooperative, a secured lender would need to seek the assistance of the court to realise and enforce that security.

2.3.4 Is "market testing" mandatorily required?

Market testing is not a legal requirement. However, in light of the overriding obligation of a secured lender to obtain the best price reasonably obtainable for the secured assets, there may be a commercial justification to undertake market testing. This is likely to be beneficial if there is a risk that the company will fall into liquidation and the enforcing creditor is concerned about the risk that the transaction is unwound. The ability to clawback dispositions of assets is discussed in paragraph 1.4.2 above.

2.3.5 Are valuation reports mandatorily required?

It is not a legal requirement for the secured creditor to obtain a valuation report when enforcing its security. However, having regard to the common law obligations of a secured creditor to obtain the best price that may be realised for the shares and the risk of clawback the enforcing parties may take comfort from having a valuation report.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

A process that is available prior to an insolvency process being commenced is a scheme of arrangement under section 86 of the Companies Act (as revised). A scheme can be put in place by a company looking to restructure its debt within or prior to there being an insolvency process.

3.2 What involvement does the court have in these processes?

In the Cayman Islands, the Grand Court plays a crucial role in relation to schemes. These are court-supervised processes allowing companies to compromise creditor claims and shareholder rights.

The court is involved in a number of ways through the process. However, it does not facilitate the commercial negotiations between stakeholders. Rather, it ensures the fairness and efficiency of the process. This occurs via:

(i) a convening hearing – the court directs a meeting of creditors of contributories and any classes thereof (as the case may be) which is to be convened to vote on the proposed scheme; and

(ii) a sanction hearing – once the requisite meetings have been held and voting has taken place, the outcome of the votes and issues going to the fairness of the terms of the scheme are presented to the court. It is at this stage, the court considers whether the scheme is fair and reasonable and stakeholders may raise objections to prevent the scheme being sanctioned. Those objections may relate to the conduct of the majority of stakeholders not being bona fide, the statutory requirements of the process not being met, or because the terms of the scheme are unfair to those stakeholders that are dissenting.

The Grand Court has extensive experience in supervising complex schemes of arrangement, providing a robust and efficient process for claims and rights of creditors and shareholders to be compromised.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Outside an insolvency or formal restructuring process, it is not the case that there would be a court-appointed insolvency practitioner coordinating the implementation of a scheme. However, management of the company proposing a scheme would frequently engage insolvency professionals who have prior experience in negotiating and implementing schemes. This can assist in navigating the process and marshalling the various commercial interests of stakeholders, and providing financial modelling for the purpose of demonstrating the viability and fairness of the scheme.

If the scheme is approved, it is often the case that an administrator would be appointed to implement the scheme once it has been sanctioned by the court.

Aside from the company, the main players are legal counsel who advise the various commercial participants and stakeholders during the course of negotiating, drafting and finally implementing the scheme.

3.4 Is there a typical due diligence process followed?

Typically, the due diligence process involves reviewing the company's financial and operational information, assessing stakeholder rights and evaluating the proposed scheme's fairness and reasonableness in those circumstances. This would include taking into account the constitutional documents and financial statements of the company, having particular regard to its liabilities.

Stakeholders to whom a company is proposing a scheme will need to be provided with sufficient information for them to review the terms of the proposed compromise with a view to making an informed decision as to whether to vote in favour of or object to the compromise as proposed.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

Typically, these processes take 4 to 12 months, depending on the complexity of the deal and regulatory approvals that are required. Key considerations include regulatory approvals and measures which CIMA may require, shareholder approval of a sale (generally by special resolution if a scheme is not being invoked) and due diligence. While the Cayman Islands is a tax-neutral jurisdiction, stamp duty requirements may arise as a result of the proposed transaction and must also be considered.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

The statutory framework in the Cayman Islands does not include a specific carve out for asset sales that are conducted pre-insolvency. Each transaction would be looked at on its merits and assessed from the perspective of whether the disposition should be unwound. In most instances, the transaction is not impugned where it was entered into in good faith, without wishing to prejudice the interests of creditors of the company and where the disposition was not at an undervalue.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

See paragraph 4.1 below.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Pre-pack sales are neither expressly authorised nor prohibited under Cayman Islands law.

However, the Grand Court can approve pre-pack sales in appropriate circumstances because of the flexible nature of the Cayman Islands insolvency regime.

These sales will arise in a restructuring scenario and involve the court appointment of a restructuring officer or a light-touch restructuring provisional liquidator (Light-Touch PL). The circumstances of an official liquidation or non-restructuring based provisional liquidation would typically not give rise to a pre-pack sale.

There are no reported or publicly available unreported judgments dealing with pre-packaged sales. However, pre-pack sales may be used independently from and in connection with a scheme of arrangement (i.e. a complete pre-pack restructuring plan).

The powers conferred on a restructuring officer and Light-Touch PL are set out in the appointment order and will be limited to the powers that are necessary in the circumstances (no blanket powers will be granted).

The Companies Act requires liquidators to obtain sanction of the Grand Court to sell any of the company's property by public auction or private contract (including the whole or part of a company's assets) and to dispose of any company property to a person who is or was related to the company. A restructuring officer or Light-Touch PL will, therefore, be required to obtain court sanction for a pre-pack sale if the power is not granted in the first instance in the appointment order.

Since the Cayman Islands does not have a codified pre-pack sales process and because English law and procedures are often considered and followed where there is no local guidance, parties may look to guidance from the English courts and from English regulators (such as the Statement of Insolvency Practice 16: Pre-Packaged Sales in Administrations) for best practices.

Provided a robust pre-filing M&A process is undertaken and that steps have been taken to ensure that a pre-pack sale is in the best interests of the stakeholders, the Grand Court may exercise its discretion to appoint a restructuring officer or Light-Touch PL and grant the full powers to carry out the pre-pack sale in the same appointment order.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Beyond the debtor and the purchaser, the key players in a pre-pack sales process include the court-appointed officer (restructuring officer or Light-Touch PL), creditors, directors (if their powers are not removed by court order), any ad hoc committee and the Grand Court.

The duties and powers of a restructuring officer or Light-Touch PL will be set out in the appointment order. If the directors' powers of a debtor are completely removed, the court appointee will play a key role because they will assume responsibility for the completion of the sale process and seeking Grand Court approval.

To the extent a creditor has security over the assets being sold, the secured creditor effectively has veto power over any sale, as the stay of proceedings (applicable upon petition to appoint a restructuring officer, the making of a winding up order or appointment of a provisional liquidator) does not apply to secured creditors.

In advance of an insolvency court filing, which typically arises out of a company's insolvency, the directors play an important role and will be required to have provided for the interests of the company including all creditors. Both pre- and post-appointment of a restructuring officer or Light-Touch PL (if the directors' powers are not removed by the Grand Court), the directors will have to ensure they are acting in accordance with their general and fiduciary duties.

If an ad hoc (bondholder or other creditor) committee is constituted, the committee will have the ability to influence any restructuring proceedings.

The Grand Court plays a significant role because the sale of any company assets will be subject to court approval (see paragraph 4.1 above).

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

In restructuring proceedings, M&A or debt investors will likely be unable to control who will be appointed as insolvency practitioner.

Under the relevant legislative provisions, the debtor company is the only person who can petition the Grand Court for the appointment of a restructuring officer or Light-Touch PL – see *In the Matter of Kingkey Financial International (Holdings) Ltd* (FSD 56 of 2024 (JAJ) (Unreported, 12 April 2024) for a discussion on the use of the Light-Touch PL regime following the introduction of the restructuring officer regime. Consequently, the debtor company will be in the position to nominate the court-appointed officer.

M&A or debt investors may be able to informally influence the identity of the court-appointed officer as part of the pre-pack negotiation process provided the independence requirements are not compromised.

Other stakeholders (creditors and contributories) may also influence the identity of the court-appointed officer, both pre- and post-appointment.

Under section 91F of the Companies Act, a restructuring officer may be removed from office and replaced upon application by the company, a creditor, a contributory or CIMA (if the company carries on a regulated business).

Companies Winding Up Rule Order 4, rule 5 allows for the variation of an order appointing a provisional liquidation, which may allow for the removal and replacement of a Light-Touch PL.

4.4 Is there special protection for certain types of creditors in "pre- pack" sales?

The protection of certain types of creditors is governed primarily by the Companies Act and is generally limited to the priority ranking of the claims of special classes of creditors.

For example, Schedule 2 of the Companies Act grants preferred creditor status on certain debts due to employees (i.e. salaries / wages, sums due for health insurance premiums and pension fund contributions, severance pay and sums payable for workers compensation), bank depositors and taxes due to the government.

Section 40(1) of the Labour Act (2021 Revision) requires that liability for severance pay shall be paid in priority to all other debts (secured or unsecured) and shall be paid in full unless there are insufficient assets to pay in full.

4.5 Is there a typical due diligence process followed?

There is no defined due diligence process under the Cayman Islands insolvency regime and the due diligence process for pre-pack sales may follow the ordinary due diligence process for distressed M&A transactions.

Court-appointed officeholders are generally reluctant to provide any warranties, guarantees and indemnities, and the purchaser of assets under a Cayman Islands restructuring or insolvency proceeding will acquire the rights and interests which the company had, subject to pre-existing claims against those assets – unless such claims were compromised under a scheme of arrangement. As such, investors may want to carry out a more stringent due diligence process. That said, circumstances of the restructuring or insolvency proceeding may not afford an investor with sufficient time to undertake the due diligence process.

4.6 Is "market testing" mandatorily required?

There are no mandatory market testing requirements. A provisional / official liquidator or a restructuring officer will have to take reasonable care to obtain the best price possible in the circumstances. Accordingly, a court-appointed officer will have to undertake a robust marketing and sales process in order to assess value and obtain the best price possible.

Upon an application to sanction the sale, the Grand Court will scrutinise the sales process undertaken by the officeholder (including the marketing process, bid solicitation and offers received) and generally give weight to the position of those who have a real interest in the assets of the debtor company as well as the views of the court appointee, who may, and normally will, be in the best position to take an informed and objective view.

4.7 Are valuation reports mandatorily required?

There is no mandatory requirement to obtain valuation reports for a pre-pack sale or for the sale of a company's assets generally in an insolvency proceeding. However, it may be prudent to obtain a valuation report, especially in highly contentious proceedings, so that the court-appointed officer can satisfy their obligation of taking reasonable care to obtain the best price possible in the circumstances. That said, the true value of any asset is what a purchaser is willing to pay for it.

4.8 What is the typical timeline of "pre-pack" sales?

The timeline will depend on several factors, including the length of time required for negotiations in advance of any restructuring / insolvency filing, the urgency of the sale, whether the pre-pack sale is done in conjunction with a scheme of arrangement (which ordinarily takes 2 to 3 months from commencement to court sanction), court availability for a sanction hearing, the level of resistance (if any) from other stakeholders, and whether the Grand Court requires a more robust sales process or stakeholder input before sanctioning the pre-pack sale.

FRANCE

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

In France, the sale and purchase of equity is primarily governed by common civil and company law. These rules equally apply to the purchase of distressed equity outside formal processes (e.g. conditions of validity of the deed of transfer and registration). Special provisions in Book VI of the Commercial Code govern the sale and purchase of equity in the context of pre-insolvency and insolvency proceedings, which may encourage investors to acquire equity before the target company's difficulties worsen and insolvency proceedings are initiated.

Pre-insolvency proceedings (i.e. ad hoc mandate and conciliation proceedings) are confidential proceedings in which a court-appointed insolvency practitioner facilitates an agreement between the distressed company and its main creditors (see below). In this context, an investment (i.e. the purchase of equity or capital increase) can be one of the outcomes of an agreement which is negotiated prior to insolvency with the ad hoc representative or the conciliator, and binds the investor.

When purchasing distressed equity in a listed company, investors must adhere to the financial market disclosure rules outlined in European regulation and AMF (*Autorité des marchés financiers*) and MAR (Market Abuse Regulation). In such cases, while it is necessary to inform the market about the listed company's financial difficulties, a delicate balance must be struck between maintaining confidentiality and complying with financial market disclosure rules under the supervision of the French Financial Markets Authority.

The AMF recommends, therefore, that listed companies involved in pre-insolvency proceedings should be particularly vigilant in complying with the obligation to inform the market as soon as possible during the various stages of these procedures (especially at the end of negotiations with creditors).[1] In particular, they must keep the market informed of changes in their level of debt and available cash.[2] Lastly, the AMF must always be informed as soon as a pre-insolvency procedure is initiated, and of its progress.[3]

Title III, Book VI of the French Commercial Code also provides for rules on the transferability of directors' and shareholders' shares, which may encourage investors to purchase distressed equity before rehabilitation proceedings are opened. Directors and shareholders are free to sell their shares in pre-insolvency and in safeguard (*procédure de sauvegarde*) proceedings. However, in rehabilitation proceedings (where the company's situation is worse), article L.631-10 of the French Commercial Code prevents directors from selling their shares from the date of the judgment opening rehabilitation proceedings. Once rehabilitation proceedings have commenced, shares of the directors may only be sold under the conditions determined by the bankruptcy judge. Any transfer made in breach of these provisions is void. If the non-assignment is to end with the adoption of a rehabilitation plan, the court may prohibit directors from selling their shares during the plan's implementation (French Commercial Code, article L.631-19-1, p.2).

When the purchase of distressed equity falls under formal proceedings, the French Commercial Code also provides for two cases. In the event of rehabilitation proceedings, shares held by directors and shareholders may be compulsorily transferred. The court may, at the request of the Judicial Administrator or the Public Prosecutor and under strict conditions:

- order the compulsory transfer of the shares held by shareholders: (i) who refuse to vote in favour of a capital increase; and (ii) who hold a percentage of the share capital giving them a majority of voting rights or a blocking minority (French Commercial Code, article L.631-19-2). This provision is intended to act as a deterrent to blocking behaviour by shareholders. However, as far as we know, it has never been applied in practice; and

1 AMF, "*Guide de l'information permanente et de la gestion de l'information privilégiée*" – DOC-2016-08
2 Idem.
3 Idem.

- order the compulsory transfer of the shares held by directors prior to the adoption of the rehabilitation plan (French Commercial Code, article L.631-19-1, p.2).

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Under French law, there is no special regime for purchasing distressed debt or non-performing loans. These transactions are governed by the rules set out in articles 1321 to 1340 of the Civil Code.

The purchase of debt may take place by way of an assignment of debt (*cession de dette*) (French Civil Code, article 1327 and seq). The assignment of debt must be in writing and creditor consent is required for the assignment to be valid; otherwise, it is void. The creditor may consent to the transaction in advance and, in this case, if the creditor has not intervened in the transaction, the debtor must notify the creditor of the assignment.

The purchase of non-performing loans may be implemented by an assignment of the contracting party's status as a party to the contract to a third party, with the agreement of the co-contracting party (French Civil Code, article 1216 and seq). As with an assignment of debt, the assignment of a contract must be in writing, failing which it is void. The co-contracting party may consent in advance to the assignment of the contract and, in this case, the co-contracting party must be notified of the transaction.

In practice, distressed debt or non-performing loans are purchased as part of a reorganisation plan or to prevent the debtor / borrower from falling into insolvency proceedings. In return for this acquisition, the debtor / borrower is often required to provide a guarantee to the purchaser. However, this guarantee may be challenged and overturned in subsequent insolvency proceedings as a result of claw back actions.

French insolvency law allows the court to challenge an act entered into up to 18 months before the insolvency date (*la date de cessation des paiements*) fixed by the judgment initiating rehabilitation or liquidation proceedings (*les nullités de la période suspecte*), or modified subsequently as part of a claw back action (see paragraph 1.4.2 below).

To prevent the assignment and the provision of a guarantee from being contested, it is generally advisable to carry out the transaction as part of conciliation proceedings. In this case, the purchase of a distressed debt or a non-performing loan is part of the conciliation agreement concluded between the company and its main creditors. If the court approves the conciliation agreement, the insolvency date set in a subsequent insolvency procedure cannot be back-dated prior to the date of the judgment approving the conciliation agreement (*homologation*) (see paragraph 3.1 below), protecting the transaction and the guarantee provided to the purchaser from any claw back actions, except fraud.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

Besides sector-specific regulatory requirements (e.g. investments made in France by foreign investors that relate to public order and security or national defence concerns, and which therefore are subject to prior authorisation by the French Minister of Economy and Finance), there are general regulatory requirements to consider when investing under French law.

However, these requirements are not specific to distressed investments and apply irrespective of whether the target company is experiencing financial difficulties. These provisions broadly concern:

(i) employees;

(ii) listed companies; and

(iii) merger control.

1.3.1 Employees

Under French labour law, companies with at least 11 employees for a continuous 12-month period must establish a work council (*le Comité Social et Économique*). The work council represents the interests of the company's employees and must be informed and consulted on various issues affecting the company.

Its remit depends on the number of employees in the company. In companies with at least 50 employees, the work council is consulted regularly and is required to give its opinion on the company's strategic direction, economic and financial situation, social policy, working conditions and employment. It is also consulted on an occasional basis in relation to:

(i) mergers (French Labour Code, article L.2312-41);

(ii) takeover bids (French Labour Code, article L.2312-42 to L.2312-52); and

(iii) insolvency proceedings (French Labour Code, articles L.2312-53 and L.2312-54).

The work council may therefore be involved in distressed investments, irrespective of whether the distressed investment is part of insolvency proceedings.

Additionally, in small or medium-sized companies (i.e. companies employing fewer than 250 people, with an annual turnover not exceeding 50 million euros or a balance sheet total not exceeding 43 million euros), when a shareholder with 50% of the share capital wishes to sell their shares, employees must be informed of the proposed sale to enable them to buy the shares.

This rule does not apply in the event of conciliation, safeguard, rehabilitation or liquidation proceedings (French Commercial Code, article L. 23-10-6), due to the specific provisions governing these procedures. However, nothing prevents employees (if they are not de jure or de facto directors) from making a bid over shares or assets during the course of such proceedings.

A distressed investment may sometimes be accompanied by redundancies on economic grounds. In the event of redundancies, the company must, under certain conditions (i.e. where an employer makes at least 10 employees redundant over a 30-day period in a company with at least 50 employees), implement a job protection plan (*plan de sauvegarde de l'emploi*). Validation of the plan is subject to authorisation by the French Ministry of Labour (*Directions régionales de l'économie, de l'emploi, du travail et des solidarités*).

1.3.2 Listed companies

When investing in listed companies, whether the investment is distressed or not, several regulatory requirements must be taken into account. For example, French Financial Market Regulator must be informed when certain shareholding thresholds are crossed. A public tender offer must be launched when particular thresholds are reached (e.g. when the shares are credited on a regulated market crossing the 30% shareholding threshold or, if the shareholding is already between 30% and 50% and an increase in the shareholding by more than 1% in less than 1 year occurs). The French Financial Market Regulator also provides rules on market disclosure, especially in the event of the purchase or sale of equity (see paragraph 1.1 above).

1.3.3 Merger control

Investments in large companies are subject to merger control rules. When mergers exceed certain turnover thresholds, they are subject to prior review by the French Competition Authority in France (*autorité de la concurrence*) or the European Commission in the European Union (*Commission européenne*). In this case, prior notification must be sent to the relevant authority in order to obtain its authorisation.

However, when the investment is part of pre-insolvency proceedings or insolvency proceedings, the compatibility of the rules governing these proceedings with the merger control rules raises two problems.

First, it may be difficult to determine whether the thresholds for notifying the Competition Authority have been met. This is because determining the turnover of a target in difficulty may be problematic, particularly if the difficulty arose suddenly after the end of the financial year and does not appear in the annual accounts. Second, as mergers are suspended until authorisation has been obtained, merger control may pose difficulties when investments are subject to time constraints. Investors should therefore plan ahead and apply for a waiver to the suspensive effect of the authorisation application, which can create additional difficulties if the authorisation is not granted.

1.4 What risks exist for an investor of a distressed business?

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

The sale or purchase of equity can be challenged and overturned if the rights of third parties are infringed, although this risk is not specific to investments in distressed businesses and concerns all investments.

As one of the most frequent cases, where a transaction breaches approval or pre-emption clauses in the articles of association of the target company, this may lead to the cancellation of the transaction and, in the case of a transfer of shares, may render the transaction void (French Commercial Code, articles L.227-15 and L.228-23).

Where a transaction breaches approval or pre-emption clauses not stipulated in the articles of association (i.e. in a shareholders' agreement), only the transferring shareholder may be held liable for the breach. The transfer is not void, except in the case of fraud. A sale made in breach of a pre-emption clause may also be annulled if: (i) the purchaser was aware of the existence of the agreement and the beneficiary's intention to take advantage of it; and (ii) the seller and purchaser colluded to make the sale in breach of the pre-emption agreement (French Civil Code, article 1123, paragraph 2).

To avoid the transaction being contested, it is advisable to undertake a thorough audit prior to the sale or purchase, in order to check the articles of association and the shareholders' agreement for interference with third party rights. Such interference may also occur if guarantees have been provided. Although audits should be carried out regardless of whether the target company is encountering financial difficulties, they will be more important in the case of distressed investments, as more guarantees may have been provided and, consequently, more third party rights may be at stake.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

As mentioned above, the investor in a distressed business often requires guarantees in return for its investment. However, the transaction may be challenged under certain circumstances and overturned in subsequent insolvency proceedings if the target company was already insolvent (at the time of the transaction).

Book VI, Title III, Chapter II of the French Commercial Code provides rules enabling the cancellation of an act entered into prior to the opening of rehabilitation or liquidation proceedings. These provisions do not apply in the event of safeguard proceedings (*procédure de sauvegarde*), as the debtor is not insolvent (see the risks mentioned above at paragraph 1.4.1).

Court-appointed insolvency practitioners (i.e. judicial administrators, creditors' representatives and court agents appointed for the execution of the plan), and the Public Prosecutor, may bring a claw back action to declare certain acts passed within 18 months prior to the date of insolvency (*la date de cessation des paiements*) as void (*les nullités de la période suspecte*).

Determining the insolvency date is therefore a key issue. In principle, the insolvency date is often set as the date of the application to open rehabilitation or liquidation proceedings or the date of the judgment opening the proceedings. It is possible for the court to date the insolvency back to an earlier time, up to 18 months before the opening judgment (French Commercial Code, article L.631-8). However, if an insolvency proceeding is opened following a conciliation proceeding ending with the approval of the court (*homologation*), the insolvency date cannot be earlier than the date of the approving judgment of the conciliation agreement (except for fraud). This explains why concluding a distressed investment in the context of a conciliation procedure ending with the approval of the court helps preserve and secure the investment and the guarantees provided (see above).

Only certain acts performed between the insolvency date and the date of the judgment opening the proceedings may be declared void, subject to specific conditions. The French Commercial Code distinguishes between automatic nullities and optional nullities:

- Automatic nullities – article L. 631-1 and seq of the Commercial Code sets out a list of acts that must be declared void if they have been entered into since the insolvency date (e.g. the provision of a security to guarantee a debt previously contracted). The investor of a distressed business must therefore require a parallel guarantee with its investment to prevent the security from being challenged.

- Optional nullities – the court may annul an act under certain circumstances if the creditor knew the debtor was insolvent on the date the act was executed.

1.4.3 What risks exist for a new lender investing in a distressed business?

Outside insolvency proceedings, lenders may be held liable in the event of negligence when granting or terminating credit. Under French law, the lender has a duty to warn the borrower when: (i) credit presents a risk of excessive over-indebtedness; and (ii) the borrower is not in a position to assess the risk itself. Failure to do so can result in lender liability.

French law also provides for specific rules relating to the termination of a loan. These rules apply to loans granted by a credit institution or a finance company to a company (whether a natural or legal person). If the lender wants to terminate the loan, it must give formal written notice of termination and, if the loan is for an indefinite period, must give at least 60 days' notice. If the notice period is not respected, the termination will be void and the lender may be held liable. However, this risk is mitigated in the case of distressed investments, as the lender is not obliged to respect the notice period if it knows that the situation of the company being financed is irremediably compromised or if the borrower has behaved in a seriously reprehensible manner (French Monetary and Financial Code, article L.313-12).

If insolvency proceedings are opened (i.e. safeguard, rehabilitation or liquidation proceedings), lenders cannot, in principle, be held liable for losses suffered as a result of loans granted (French Commercial Code, article L.650-1). However, lenders may lose the benefit of this protection in the case of:

(i) fraud;

(ii) interference in the borrower's business; or

(iii) disproportionate guarantees.

In these circumstances, which may be difficult to establish, lenders will be held liable for losses suffered, provided it can be proved that there was fault in granting the credit, damage and a causal link.

Lenders are at fault if: (i) they practice a ruinous credit policy; or (ii) maintain or provide a loan to a borrower whose situation the lender knows or cannot ignore is irremediably compromised (abusive support).[4] If found liable, lenders must compensate the borrower in full for any loss suffered, and the security provided in exchange for the loan may be reduced or cancelled.

Finally, in the event of liquidation proceedings, lenders may also be held liable for an action for insufficiency of assets. In the case of a shortfall in assets, de jure or de facto directors may be ordered to pay all or part of the shortfall if they have committed a management error that contributed to the insufficiency of assets (French Commercial Code, article L.651-1 and seq). Lenders may[5] be considered as de facto directors where there has been interference in the borrower's business, particularly if they impose strategic orientations on the company as a result of the loan granted.

1.4.4 *What risks exist for a new shareholder investing in a distressed business?*

Outside of insolvency proceedings, a new shareholder investing in a distressed business faces several risks. These include:

(i) shareholding dilution, particularly during subsequent recapitalisations;

(ii) loss of investment if the company's value collapses; and

(iii) inability to recover current account advances.

While these risks are not specific to a distressed investment, they are more likely to occur given the fragile situation of the target company. To mitigate against these risks, new shareholders typically demand that the target company be recapitalised before investing and conduct a thorough audit. However, if letters of intent were executed with an exclusivity period, investors must be cautious not to prolong audits and negotiations without a genuine intention to invest, as this could lead to liability for wrongful termination of negotiations.

In addition, the investment may require authorisation by a Competition Authority under merger control rules (see paragraph 1.3 above). In some cases, the Competition Authority may refuse to authorise the merger, particularly if the target is taken over by its sole or main competitor.

If insolvency proceedings are opened in favour of the target company, one of the main risks for a new shareholder is the extension of insolvency proceedings against them subsequently. French insolvency law allows insolvency proceedings to be extended to another person (natural or legal) in the event of assets confusion (e.g. abnormal financial relations) or fictitious companies (French Commercial Code, article L.621-2, L.631-7 and L.641-1). In such situations, insolvency proceedings may be extended to the new shareholder placed in this situation.

In liquidation proceedings, shareholders, as lenders, may also be held liable for an action for insufficiency of assets (see above). If a shareholder takes part in decisions that fall within the remit of the company's management without holding a mandate, they may be treated as a de facto director and become liable.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Under French law, in addition to personal securities such as security (*caution*) and guarantees on first demand (*garantie à première demande*), distressed debt investors and M&A investors may require various types of security interests over movable or immovable property. These security rights can include mortgages, pledges and pledges over receivables.

When it comes to enforcement proceedings, it is important to distinguish between the rights of secured investors outside of insolvency proceedings and their rights during insolvency

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[4] Commercial Chamber of French Supreme Court, 22 March 2017, n°15-13.290.

[5] According to a case-by-case assessment.

proceedings, as French insolvency law establishes specific rules to limit enforcement in the context of insolvency.

Outside insolvency proceedings, enforcement depends on whether the security relates to personal or immovable property. The principles described below are general, and the nature of the relevant procedure and the method of engaging it must be assessed on a case-by-case basis. Options for enforcement are:

- a court order awarding the secured asset(s) to the secured creditor, following a valuation by a court-appointed expert;
- transfer of title to the pledged assets or rights to the secured creditor by the effect of specific provisions of the security documents (*pacte commissoire*);
- repossession of asset(s); or
- sale of the asset(s) by public auction.

In the event of pre-insolvency proceedings, security rights are preserved and treated normally. Their scope and effect may significantly impact discussions between the parties. If a secured investor may have to realise its security in this context, the ad hoc representative or conciliator may ask the judge for a standstill in order to block the secured creditor's realisation action.

By contrast, the judgment opening insolvency proceedings prohibits any payment of a claim that arose prior to the opening judgment (French Commercial Code, article L.622-7) and halts or prohibits any enforcement proceedings against both movable and immovable property, as well as any distribution process (*procédure de distribution*) that did not have an attributive effect prior to the opening judgment (French Commercial Code, article L.622-21). Thus, secured investors are prevented from enforcing their securities.

Exceptionally, the bankruptcy judge[6] (*le juge-commissaire*) may authorise the debtor to pay claims that pre-date the judgment in order to withdraw a pledge or an asset legitimately withheld, or to obtain the return of assets and rights transferred by way of security to a trust (*fiducie*), where such withdrawal or return is justified by the continuation of the business.

As part of the exception, it may also be possible to implement a *fiducie* (trust), even in the case of insolvency proceedings. Article 2011 and seq. of the French Civil Code defines *fiducie* as a transaction by which one or several grantors transfer their assets, rights or security rights – or a group of assets, rights or security rights – present or future, to one of several fiduciaries who, holding them separately from their own assets, act for a specific purpose for the benefit of one or several beneficiaries.

The *fiducie* can be used for managing assets (*fiducie gestion*) or for securing the liabilities of a debtor (*fiducie sûreté*). Assets or rights can be transferred in full property / ownership to a fiduciary, securing the obligations of a debtor towards its creditors. The assets or rights are returned to the grantor once its obligations are satisfied.

Unlike other security interests, a *fiducie* is effective in the event of the opening of insolvency proceedings where the transfer of ownership has taken place prior to the opening judgment. However, as for any other guarantee, the creation of a *fiducie* will be challenged in rehabilitation or liquidation proceedings if it takes place while the grantor is insolvent and if the transfer was not made as security for a debt contracted at the same time (*les nullités de la période suspecte*) (see paragraph 1.4.2 above).

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[6] A judge, appointed by the court in the judgment opening the insolvency proceedings, that is in charge of monitoring the proceedings

2.2 What involvement does the court have in these processes?

The court may be involved in enforcement depending on the procedure.

The court is involved in the enforcement procedure if the secured creditor applies for the sale of a pledged asset (*vente du bien affecté en garantie*) or its judicial allocation (*attribution judiciaire*). In this case, the court will issue an order authorising the seizure of the asset or its allocation. However, in the case of a forced sale, once authorised by the court, the public auction is conducted by a notary, a bailiff, a judicial commissioner, a judicial auctioneer or a sworn goods broker and is not sold under the aegis of the court.

As mentioned above, in the event of insolvency proceedings, the approval of the bankruptcy judge is required to realise certain security rights (see paragraph 2.1 above).

By contrast, the court will not be directly involved in the enforcement procedure if the secured asset is transferred pursuant to an agreement between the debtor and the secured creditor, provided for in specific provisions of a security document (*pacte commissoire*). The court could decide to appoint an expert to determine the pledged asset's valuation.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

The legal regime of a pledge over shares varies according to the corporate status of the company whose shares are pledged.

For SAs and SASs, shares are evidenced by entries on an account (*compte de titres financiers*)[7] in the books of the company or in the books of a professional intermediary (credit institution). The account (as opposed to the shares themselves) in which the shares are registered can be pledged in favour of a creditor by way of a pledge over a financial securities account, which materialises the pledge over the shares. Such a pledge is made effective by a statement of pledge (*déclaration de gage*) dated and signed by the pledgor. The pledge must be registered in the books of the company whose shares are pledged, and a certificate (*attestation de gage*) is delivered by the company to the pledgee certifying the creation of the pledge.

Pledges over shares issued by other French corporate entities such as SARLs (*société à responsabilité limitée*), SNCs (société en nom collectif), civil companies (*sociétés civiles*) or partnerships with unlimited liability (*groupement d'intérêt économique*) are generally created in the same way as pledges of ordinary receivables, i.e. by an instrument in writing duly registered with the relevant tax authorities.

The legal regime of the enforcement of a pledge on shares or on a financial securities account is set out in the answers below.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

Under French law, a debt-for-equity swap may not be implemented, as such, as part of a share pledge enforcement.

However, the secured creditor may become the owner of the shares if a clause in the pledge deed or a subsequent deed provides that, in the event of non-payment of the secured debt, the pledged shares will become the property of the creditor (*pacte commissoire*) (see paragraph 2.3.2 above). In this case, the enforcement of a share pledge might be equated to a debt-for-equity swap because the secured creditor is being paid by becoming the shares' owner.

2.3.2 Is a public auction mandatorily required or are private sales possible?

Under French law, the legal regime for enforcing a pledge depends on whether the pledge relates to shares or to the account in which the shares are registered (see paragraph 2.3.1 above).

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7 There is no share certificate in France.

In both cases, the sale by public auction to enforce a share pledge is possible but not compulsory. Private sales are also possible.

Options for shares pledge enforcement are:

- the secured creditor may become the owner of the shares if a clause in the pledge deed or a subsequent deed provides that in the event of non-payment of the secured debt, the pledged shares will become the property of the creditor (*pacte commissoire*). The value of the shares is then determined on the date of their transfer by an amicably or judicially appointed expert;

- the secured creditor may apply for a court order that the pledged shares be transferred (*attribution judiciaire des parts sociales*); or

- the secured creditor may obtain a court order for the forced sale of the pledged shares. In principle, the forced sale takes place in accordance with the rules set out in the French Code of Civil Enforcement Procedures (*Code des procedures civiles d'exécution*).

  However, if the share pledge secures a commercial claim (as opposed to a civil claim), the creditor may, 8 days after notifying the debtor (and the pledgor if it is not the debtor), proceed with the sale by public auction by a notary, a bailiff, a judicial commissioner, a judicial auctioneer or a sworn goods broker. Unless the proposed shares pledged have been approved, the other shareholders must approve the secured creditor to whom the shares are assigned, under the same legal or statutory conditions as for a transfer of shares.

The secured creditor may also realise a pledge on a financial securities account 8 days after formal notice has been given to the debtor (or upon the expiry of any other period previously agreed with the account holder).

In the case of French or foreign financial securities traded on a regulated market, the holder of the pledged account or the pledgee may, at its option, sell the shares on the market and appropriate the sale price, or acquire full ownership of them on the basis of the last available closing price on a regulated market.

2.3.3 *Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?*

Whether the transfer restrictions in the articles of association can be set aside when enforcing a share pledge should depend on the form of the company. For example, it seems difficult to exclude them for SAs, whereas this should be possible for SASs, given that the rules applicable to SASs are more flexible.

In practice, the proposed constitution of the pledge will be notified to the company and / or the shareholders, and if the company and / or the shareholders approve it, the secured creditor will automatically be approved in the event of enforcement of the share pledge (French Commercial Code, article L.223-15 for SARL, L.223-26 for stock companies and French Civil Code, article 1867 for civil companies).

2.3.4 *Is "market testing" mandatorily required?*

Under French law, no market testing is required for the enforcement of a pledge on shares or on a financial securities account.

2.3.5 *Are valuation reports mandatorily required?*

In the event of a private sale of shares under an agreement between a debtor and a pledged creditor (*pacte commissoire*), the value of the shares must be determined on the date of their transfer by an amicable or court-appointed expert. A valuation report is then required in this case.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

In France, two pre-insolvency procedures – *mandat ad hoc* and conciliation – offer companies tools to address financial difficulties before formal insolvency.

The *mandat ad hoc*, under article L. 611-3, is initiated solely at the debtor's request. The president of the court appoints a *mandataire ad hoc,* whose role is to facilitate negotiations with creditors, suppliers or potential investors.

The procedure is entirely confidential and offers significant flexibility, as it has no set time limit. Although the Commercial Code does not explicitly forbid using this process when a company is bankrupt (*cessation des paiements*), legal doctrine commonly holds that the debtor should not be in this state when requesting the procedure. The aim is to allow companies to intervene before financial problems worsen, making it a preventive tool. The *mandataire ad hoc* does not hold any management powers, as the debtor remains in control of its business operations.

In contrast, conciliation, governed by article L. 611-4 et seq, is a more structured and time-constrained procedure. The debtor must not have been in cessation of payments for more than 45 days. The conciliation process is limited to 4 months, with a possible 1-month extension. A conciliator is appointed to assist in reaching a solution with the company's key creditors. This process often starts after a *mandat ad hoc* to analyse first the situation at stake and drive negotiations in due course due to the time limit of conciliation. If the conciliation results in an agreement, it can either be simply acknowledged by the President of the court or approved (*homologated*) by the court itself.

Approval of a conciliation agreement confers significant benefits. First, it prevents the court from backdating the cessation of payments prior to the approval (*homologation*) date, thus protecting the debtor from actions voiding transactions during the suspect period.[8] Second, it grants the new money privilege, which gives priority to new financing provided during the conciliation procedure. However, approval has the disadvantage that the agreement is made public (even though the provisions of the agreement are not disclosed), unlike the *mandat ad hoc* and the agreement simply acknowledged by the President of the court, which remain completely confidential throughout the procedure.

In conclusion, while both procedures aim to facilitate a company's recovery before formal insolvency proceedings, the choice between them depends on the specific needs and timing of the company's situation, balancing confidentiality, flexibility and legal protection.

3.2 What involvement does the court have in these processes?

In pre-insolvency proceedings such as *mandat ad hoc* and conciliation, the court's role is relatively limited compared to its extensive authority in insolvency proceedings.

In *mandat ad hoc*, the president of the court appoints the *mandataire ad hoc* at the debtor's request and defines the mission. The court does not intervene in negotiations or oversee the process once the *mandataire ad hoc* is appointed but will require, if needed, intermediary meetings to follow up the ongoing actions. Moreover, the president of the court determines the *mandataire ad hoc's* remuneration, on the basis of the diligence required (C. com., article L. 611-14), with the debtor covering these costs.

In conciliation, the court's involvement is slightly more substantial but still limited. The president of the court opens the process and may order investigations or expert reports to assess the debtor's difficulties, as outlined in article L. 611-6 of the Commercial Code. The president also sets the conciliator's remuneration and will require, if needed, intermediary meetings to follow up the ongoing actions, similar to the *mandat ad hoc*. During conciliation, the court can intervene

[8] Except for fraud.

upon the debtor's request to impose payment delays on creditors, as per article 1343-5 of the Civil Code, if voluntary agreements cannot be reached.

The conciliation process lasts 4 months, extendable by 1 additional month, with the possibility of further extension if the president of the court grants it at the request of the conciliator. If the debtor and creditors reach an agreement, they may either have it formally acknowledged by the president of the court or seek court approval (*homologation*), which provides added legal benefits but sacrifices confidentiality. The latter option involves greater court involvement, as the court must review the agreement's legality and enforceability, ensuring it protects all parties involved.

Should insolvency proceeding be opened during the course of the execution of the conciliation agreement, the agreement will be automatically terminated on the date of the ruling opening the insolvency proceeding.

Thus, while the court's role in these pre-insolvency procedures is foundational, it remains restrained compared to its more active presence in formal insolvency cases, particularly those involving the bankruptcy judge (*juge-commissaire*). The court's limited yet crucial involvement serves to facilitate negotiations and resolutions while maintaining a protective legal framework without overly restricting the debtor's autonomy.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

In the context of pre-insolvency procedures like *mandat ad hoc* and conciliation, several key players emerge, each with distinct but interconnected responsibilities. These procedures maintain a lighter touch in terms of judicial oversight, particularly when compared to formal insolvency proceedings, allowing for a more flexible approach to financial restructuring.

At the centre of both processes is the debtor, who retains control over the business operations. Unlike during formal insolvency, where judicial administrators' involvement is more pronounced, pre-insolvency proceedings allow the debtor to lead negotiations with creditors, supported by professional advisers.

The *mandataire ad hoc* and conciliator, drawn from the practice of France's pool of judicial administrators mainly (or creditor's representatives sometimes), are central figures in both procedures. Although their titles differ depending on the specific process, their functions are similar: they act as facilitators, helping the debtor engage with creditors to prevent financial difficulties from spiralling into insolvency. Their role is advisory, and they are essential in ensuring negotiations are handled discreetly and effectively, often bringing the necessary credibility to achieve a workable solution.

The *mandataire ad hoc*, appointed by the president of the court, acts as an early intervention tool when a debtor is facing financial difficulties but has not yet reached cessation of payments. The president defines the scope of their mission upon the debtor's requests and sets their remuneration.

Similarly, in the conciliation process, the conciliator is appointed within a more structured framework, featuring specific deadlines and the possibility of court approval (*homologation*) of the negotiated agreement. The conciliator's role remains essentially advisory, leaving operational control to the debtor. Additionally, the conciliator may propose measures related to safeguarding the company, ensuring economic continuity and preserving employment. In some cases, the conciliator may even oversee a partial or total sale, preparing the company for a future insolvency procedure such as safeguard, rehabilitation or liquidation.

The president of the court plays a measured but crucial role in both procedures. In *mandat ad hoc*, the president appoints the *mandataire* and defines his or her mission, while in conciliation, the president may, in addition, investigate the debtor's situation and extend the process timeline if necessary. The president may also intervene at critical points, for example, by granting payment delays or suspending the enforceability of claims if negotiations falter.

Finally, the court's direct involvement is limited primarily to approval (*homologation*) in conciliation. The court's role is confined to ensuring the agreement is legally sound and enforceable with an aim to maintain the business and debtor's activity restructured.

In essence, the collaboration between the debtor, the court appointed agents serving as *mandataires ad hoc* or conciliators and the president of the court forms the backbone of France's pre-insolvency procedures. The involvement of these seasoned professionals brings expertise and credibility to negotiations, enhancing the prospects of successful restructuring. By preserving the debtor's operational control and limiting judicial intervention to oversight functions, these processes offer a balance between flexibility and legal assurance.

3.4 Is there a typical due diligence process followed?

Under French Law, there is no typical due diligence process for pre-insolvency proceedings. However, before making an investment, investors tend to closely examine previous indebtedness, security packages, the rights of third parties (see above), the relationship of shareholders with the group, undercapitalisation (if applicable) and any warnings from the statutory auditor regarding the company's ability to continue as a going concern.

In practice, in the case of an M&A sale as part as pre-insolvency proceedings, the investor will generally ask a third-party auditor to carry out an independent business review (IBR) in order to obtain a valuation of the target company and get some forecasts to adjust the sale price or financing needs once acquired to evidence project credibility and business continuity.

If a pre-pack is at stake, a legal notice will have to be published in economic newspaper in order to respect the public nature of the sale, which will take place at a later date in rehabilitation proceedings or liquidation proceedings with continuation of activity.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

Under French law, there are no specific statutory provisions dedicated to organising the sale of shares or equity within the framework of pre-insolvency process, such as *mandat ad hoc* or conciliation. These proceedings primarily serve as mechanisms to enable the debtor to negotiate with creditors to avert formal insolvency, without imposing specific rules on how a M&A sale should unfold.

However, this does not preclude the possibility of structuring a share transfer or equity sale contractually during these processes, often as part of a broader restructuring strategy. When such a transaction occurs, the timeline is dictated largely by the usual contractual framework governing M&A transactions, meaning that the parties retain significant latitude in setting deadlines, negotiation steps and execution phases if the company's cash position permits.

That said, when a share transfer is negotiated during a conciliation process, a more structured timeline emerges due to the statutory limits governing conciliation. Specifically, this process must be completed within 4 months, with the possibility of a 1-month extension (article L. 611-6 of the French Commercial Code). This statutory framework imposes a certain degree of urgency, requiring that any M&A transaction be negotiated and concluded within this relatively compressed timeframe to:

(i) occur before the end of the conciliation process;

(ii) be continued in *mandat ad hoc* and finalise in the second conciliation;[9] or

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[9] With a minimum of 3 months waiting period between the two conciliations.

(iii) be finalised and implemented in subsequent public proceedings (safeguard proceeding if the company is still solvent or rehabilitation proceeding of the company is insolvent).

In contrast, in the context of the *mandat ad hoc*, the timeline is not subject to the same statutory deadlines.

Thus, while there is no legally prescribed timeline for M&A sale under a pre-insolvency process, a conciliation imposes a stricter timeframe due to its limited duration but offers add-on options, whereas *mandat ad hoc* offers more flexibility. The specific timeline for an M&A sale will depend on the contractual process and the context in which the deal is negotiated.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

M&A sales / asset sales in the context of pre-insolvency proceedings may be protected in the event of approval (*homologation*) of the conciliation agreement. Indeed, as mentioned above (see paragraph 1.4.2), certain acts passed since the date of insolvency may be cancelled. However, if insolvency proceedings are opened following conciliation proceedings being homologated, the insolvency date set by court cannot be earlier than the date of the homologation judgment of the conciliation agreement. Thus, M&A sales / assets sales and the possible provision of guarantees are protected in the event of subsequent insolvency proceedings if they are part of the homologated conciliation agreement. In contrast, this protection does not apply in the case of a *mandat ad hoc*.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Under French law, while there is no direct equivalent to the "pre-pack" process found in other jurisdictions, the accelerated safeguard procedure (*sauvegarde accélérée*) offers a similar mechanism. Described by some legal scholars as a "semi-collective" rather than a fully collective process, this tool allows for the rapid adoption of a restructuring plan that has already been negotiated during a pre-insolvency conciliation phase.[10]

The accelerated safeguard procedure is available at the debtor's request, provided the company is already engaged in conciliation and has formulated a restructuring plan aimed at ensuring the company's long-term survival. This plan must demonstrate sufficient support from the affected creditors to make its adoption likely within the statutory deadlines (article L. 628-1 of the French Commercial Code). The existence of a pre-agreed plan that has been negotiated during conciliation is essential for accessing this streamlined process. Here, the conciliator, appointed to facilitate negotiations between the debtor and its creditors, plays a pivotal role in ensuring that a workable solution is reached. The conciliator’s mission, as outlined in article L. 611-7, is to foster an agreement that can safeguard the company’s operations, economic activity and employment.

In practice, conciliation serves as the preparatory phase for the accelerated safeguard. The plan negotiated during conciliation is not intended to result in a conciliation agreement per se, but rather to pave the way for the formal adoption of a restructuring plan in safeguard. As such, the accelerated safeguard process resembles a form of "enhanced homologation," in which the court ratifies the creditor agreements previously obtained during conciliation (T. com. Lyon, 13 April 2022).

Creditors (specifically those involved in the conciliation proceedings) will be divided into classes of affected parties (*classes de parties affectées*). These classes are formed based on objective and verifiable criteria, ensuring that each group represents a sufficiently shared economic interest (*communauté d'intérêt économique suffisante*) (article L.626-30, III of the French Commercial Code).

Each class votes on the safeguard plan and approval requires a two-thirds majority of the voting rights held by members who cast a vote. The voting rights of each affected party are calculated

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[10] V. F. Pérochon et alii, Entreprises en difficulté: LGDJ, 11e éd., 2022, n° 1817.

according to the value of the affected claims or rights, as determined by the debtor and certified either by the debtor's chartered accountant or statutory auditor. Creditors who oppose the plan may have the terms imposed upon them by the court through a cross-class cram-down mechanism (*application forcée interclasses*), provided that the conditions set out in article L.626-32 of the French Commercial Code are met.

A notable strength of the accelerated safeguard is its ability to convert an amicably negotiated plan into a binding court-approved one, offering debtors leverage over uncooperative creditors. The prospect of moving from conciliation, where creditor consent is required, to an accelerated safeguard, where dissenting creditors can be overruled, encourages cooperation during the negotiation phase. Creditors are often more willing to compromise during conciliation, knowing that they risk having a plan imposed on them in safeguard.

Given the complexity and financial scale of accelerated safeguard proceedings, these cases are predominantly handled by specialised commercial courts (*tribunaux de commerce spécialisés)*. Established by Law No. 2015-990 of 6 August 2015, these courts are designed to manage larger companies that meet specific thresholds, such as having 250 or more employees and a turnover of at least €20 million, or alternatively a turnover of €40 million or more (article L. 721-8 of the French Commercial Code). These specialised jurisdictions are also competent to address any potential requests for the extension of proceedings, including matters involving group companies or cross-border entities (Cass. com., 11 March 2020, n°18-22.960).

When filing for accelerated safeguard, the debtor will automatically apply the cross-class cram down regulation, which assists to build a restructuring plan with the possibility to cram down creditors in order to maintain and preserve the business and activity of the debtor.

In conclusion, the accelerated safeguard offers a dynamic restructuring tool under French law, closely mirroring the pre-pack concept through its combination of pre-negotiation and judicial enforcement. It provides a strategic advantage for debtors by allowing them to leverage both amicable negotiations and the potential for court-imposed plans on dissenting creditors. While nothing precludes the use of conciliation followed by judicial reorganisation (*redressement judiciaire*) or traditional safeguard procedures, the accelerated safeguard stands out for its efficiency and speed, making it a preferred option for businesses seeking swift restructuring solutions.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Pre-pack sales are permitted under French law. Pre-pack sales (*pre-pack cessions*) are structured processes through which the sale of a business (or parts of it) is pre-negotiated during preventive procedures, such as conciliation mainly or *mandat ad hoc* sometimes, and then executed within subsequent formal insolvency proceedings. Drawing from established practice, introduced by the Order of 12 March 2014, this mechanism allows the business transfer to be prepared during the debtor's preventive procedure, thereby accelerating formal insolvency proceedings once commenced.

Technically, under article L. 611-7 of the Code de Commerce, the conciliator or the *mandataire ad hoc* can be tasked with organising the sale of the business, which may be either partial or total. The sale is made by each bidder on a cherry picking basis without taking over liabilities.[11] The sale is pre-negotiated during the preventive procedure and is subsequently executed within the framework of a judicial reorganisation (*redressement judiciaire*) or liquidation.

[11] Subject to some exceptions when a security was given as a guarantee of the financing of the debtor's activity. However, each bidder can approach the secured creditor during the bidding process to negotiate a settlement agreement to deal with a reduced amount of debt. The agreement could thus be enforceable if the court rules in favour of such bidder.

The process operates as follows: during conciliation or *mandat ad hoc*, the sale is negotiated confidentially with potential buyers. Offers are reviewed and fine-tuned with the aim of achieving the best possible outcome for the debtor and creditors. The sale can then be swiftly executed once formal insolvency begins. In particular, article L. 642-2 of the Code de Commerce allows the court to dispense with the requirement for new bids once the insolvency proceeding opens, provided the pre-negotiated offers satisfy certain transparency and competitive requirements. Publicity is still required to ensure fairness, but the court can bypass the typical bidding process if the sale prepared in the preventive phase meets the necessary legal conditions.

The primary aim of a pre-pack sale is the preservation of the company's value by pre-emptively organising the sale of its assets, which reduces the time spent in insolvency proceedings and minimises the risk of value deterioration that typically accompanies a prolonged insolvency procedure. It protects employees and maintains creditor confidence, facilitating business continuity. It also reassures potential buyers, as they have had the opportunity to negotiate and assess the business prior to the formal insolvency process, thus maximising the chances of a successful sale. The pre-negotiated nature of the pre-pack sale helps mitigate the uncertainty often associated with judicial sales.

Despite their efficiency, pre-pack sales also face some challenges. French law imposes various statutory obligations that must be respected even when the sale is pre-negotiated. For instance, employee protections and creditor consultation rights must still be observed, and adequate publicity must take place to allow other potential buyers to come forward. These requirements can slow down the process, despite the preparatory work done during the preventive phase.

In practice, pre-pack sales are most commonly used within the framework of judicial reorganisation (*redressement judiciaire*). While partial sales can occur within safeguard proceedings (*sauvegarde*), full business sales (asset sales) are reserved for judicial reorganisation or liquidation, as safeguard proceedings aim to restructure and find new investors in equity / shares rather than fully transfer ownership.

In conclusion, the pre-pack sale is a well-established tool in French insolvency law that allows businesses in financial distress to be sold in an orderly and efficient manner, preserving value and protecting jobs. The court will assess the offers at stake with the same rationales as for a "classic" sale plan but in an accelerated fast track process. As this mechanism continues to evolve, particularly with the potential influence of European legislation, it remains an essential aspect of French insolvency practice, providing a valuable means of mitigating the risks associated with prolonged insolvency proceedings (i.e. cash-consuming and with more uncertainty for the value of the sale and the bidders at stake).

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

In French pre-pack sales, various key players are involved, each with distinct responsibilities outlined by the Code de Commerce. The involvement of these actors depends on whether the process is at the preventive stage or the formal insolvency stage.

At the preventive stage, during conciliation or *mandat ad hoc*, the main actor is the conciliator or *mandataire ad hoc*, appointed by the president of the court. Their role is to organise the sale of the business, either partially or fully, and facilitate negotiations with potential buyers.

Once a formal insolvency procedure begins, the court may appoint an administrator (*administrateur judiciaire*) to carry out the pre-negotiated sale, ensuring compliance with legal standards and creditor protections. In the case of a liquidation with continuation of activity, a judicial liquidator (*liquidateur judiciaire*) is appointed to manage the asset sale, which has been arranged during the preventive phase.

The creditors' representative (*mandataire judiciaire*) is also appointed by the court and represents the interests of creditors during the formal insolvency proceedings, ensuring the sale aligns with their legal rights and overseeing the distribution of proceeds according to legal priorities.

The court also appoints a bankruptcy judge (*juge-commissaire*). Under article L. 642-2 of the French Commercial Code, the judge oversees the judicial phase of the sale, verifying that all legal requirements are met and ensuring that any pre-negotiated sale is transparent and competitive. Bankruptcy judges are responsible for approving the sale and deciding whether to dispense with the need for new bids, provided the pre-arranged sale meets the necessary conditions for fairness and transparency.

In some cases, a creditor controller (*créancier contrôleur*) may be appointed to represent the creditors collectively, ensuring their rights are upheld throughout the insolvency proceedings. This role becomes particularly significant in cases where creditors hold considerable sway in the process.

The employee representative (*représentant des salaries*) appointed at the beginning of the insolvency proceedings will give his or her opinion on the offers at stake.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioner?

As mentioned previously, the president of the court appoints the ad hoc representative or the conciliator when *mandat ad hoc* or conciliation proceedings are opened. The debtor requesting the opening of one of these proceedings may propose a name for the ad hoc representative or the conciliator (French Commercial Code, articles L.611-3 and L.611-6).

However, this option is not available for M&A or debt investors under French law unless they are already shareholders, in which case their opinion is not required. Such investors can only propose to the debtor's director a name or give a recommendation, but will not make such a decision directly.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Under French insolvency law, certain creditors benefit from special protection in the event of the implementation of a pre-pack sale in insolvency proceedings. While there are no specific protections applicable to the preparation of a pre-pack sale, the below rules apply to the sale's implementation.

The work council (discussed above) must be informed and consulted as part of insolvency proceedings in which a pre-pack sale will be implemented. Specifically, the rules governing redundancies for economic reasons set out in articles L.1233-58 and seq of French Labour Code apply if the pre-pack sale involves redundancies. In this case, the opinion of the work council (or, failing that, of the employees' representative appointed as part of the proceedings) will be sought on the redundancies envisaged. By contrast, the company does not have to inform the work council of the opening of *mandat ad hoc* or conciliation proceedings under which the pre-pack sale is being prepared (French Commercial Code, articles L.611-3 and L.611-6).

Preferential creditors also benefit from special protection when a pre-pack sale is implemented as part of insolvency proceedings. The transferee is required to assume the securities guaranteeing repayment of a loan, granted to the debtor to finance the acquisition of an asset to which these securities relate (French Commercial Code, article L.642-12, paragraph 4). Thus, the guarantees of preferential creditors are transferred to the transferee while other creditors are repaid out of the sale price exclusively. However, in practice this automatic transfer of guarantees is negotiated and may be waived by agreement between the transferee and the secured creditors.

4.5 Is there a typical due diligence process followed?

See paragraph 3.4 above.

4.6 Is “market testing” mandatorily required?

Under French insolvency law, market testing is not required in the event of a pre-pack sale except for the publicity of the sale that is required (see paragraph 3.4 above). Where the sale has been prepared as part of pre-insolvency proceedings, the court must ensure, before implementing it as part of subsequent insolvency proceedings, that the offer received complies with the legal requirements and is satisfactory (French Commercial Code, article L.642-2, p. 2). It must also ensure that, given the nature of the business, the steps taken by the ad hoc representative or the conciliator have given sufficient publicity to the preparation of the sale (French Commercial Code, article R.642-40). If these conditions are not met, the court will request a public invitation to tender. Therefore, while a market test is not mandatory for pre-pack sales, the court may require the company to seek potential new buyers if the pre-prepared offers are unsatisfactory.

4.7 Are valuation reports mandatorily required?

Yes, in French law, valuation reports are mandatory in the event of a pre-pack sale. The ad hoc representative or conciliator must submit a report to the President of the court that opened the proceedings at the end of his or her mission.

If a sale was prepared during the pre-insolvency proceedings, the ad hoc representative or conciliator must present it in their report. When the pre-pack sale is implemented in the insolvency proceedings, as part of a disposal plan, the judicial administrator, if there is one, and the creditors' representative must submit a report to the court. The judicial administrator's report (*bilan économique et social*) must set out the main information concerning the debtor and the offers received during the pre-insolvency proceedings and the subsequent insolvency proceedings if the court requires the company to seek potential new buyers (see above, as set out in article L.642-2 of the French Commercial Code).

The report of the creditors' representative must set out the company's liabilities and the opinion of the creditors' representative on the disposal plan. Lastly, the opinion of the work council on the offers received is required in the event of redundancies for economic reasons (see above). The opinion of the bankruptcy judge (*le juge-commissaire*) and the Public Prosecutor on the disposal plan is also required.

4.8 What is the typical timeline of "pre-pack" sales?

There is no fixed deadline for preparing the sale under *mandat ad hoc* or conciliation proceedings, other than the deadline for which the pre-proceedings are opened (see paragraph 3.1 above). However, the aim of a pre-pack sale is to provide the debtor with a rapid rehabilitation solution. The implementation of a pre-pack sale in insolvency proceedings will take varying amounts of time depending on the progress of negotiations in the pre-insolvency proceedings and the quality of the offer(s) received. The court may request a new invitation to tender if the offers received are not satisfactory, which will lengthen the proceedings.

The time taken to implement a pre-pack sale in insolvency proceedings can only be shortened to a certain extent, as certain legal deadlines must be met. For example, the debtor's contracting parties or security holders must be summoned to the hearing to examine the offers, at least 15 days before the date of the hearing, unless waived, particularly in the case of foreign creditors. In addition, the court must seek several opinions, including the opinion of the work council. Care must therefore be taken that the deadlines applicable to redundancy proceedings or the implementation of any job protection plan are respected.

Finally, the deadline for implementing the transfer must be set in accordance with publicity requirements, since the sale of a business must be published. In practice, it is possible to organise pre-packs between 3 weeks to 2 months, but this can be extended depending on various factors.

GERMANY

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

German law does not provide for a specific legal framework for equity transactions involving entities in financial distress. In principle, the sale and acquisition of shares involves the same general rules applicable in non-distressed transactions. However, the distressed context in which the relevant transaction occurs significantly impacts the legal provisions which may either apply directly or must be considered by potential investors.

The most important factors for investors to consider are German insolvency law implications laid out in the German Insolvency Code (*Insolvenzordnung,* or "*InsO*"). Those can become relevant either in case the target itself or the seller may become or is already subject to formal insolvency proceedings.

If the seller and / or the target are insolvent, investors have the option of either purchasing specific assets from the insolvency administrator by way of an asset deal – which allows the investor to "cherry-pick" and leave liabilities behind – or acquire the shares in the target as part of an insolvency plan. The latter enables an in-court restructuring to be implemented before the shares are effectively transferred. Acquisitions out of insolvency typically come along with no or limited guarantees provided by the insolvency administrator.

However, even before the initiation of formal insolvency proceedings with respect to the target or the seller's estate, insolvency law provisions may apply indirectly or may become relevant long after the transaction was closed. This in particular may be relevant with a view to clawback actions by a future insolvency administrator.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

As an act to implement the Credit Servicers Directive (EU) 2021/2167 as a harmonised framework for services in relation to non-performing loans (NPLs), in late 2023 Germany passed the Credit Secondary Markets Act (*Kreditzweitmarktgesetz,* or *KrZwMG*).

This legislation regulates new obligations for credit institutions as sellers of distressed loans, as well as for buyers, including the mandatory engagement of a credit service provider. It also imposes new requirements on providers of credit services to buyers of distressed loans, notably a new licensing obligation and organisational standards. Additionally, the law establishes ongoing supervision of credit service institutes by the Federal Financial Supervisory Authority (BaFin) and includes regulations concerning cross-border transactions, such as access for European providers.

While the provisions of the Credit Secondary Markets Act are regulatory only, the laws applicable to the actual purchase and transfer of distressed debt remain unchanged and do not differ from the purchase and transfer of performing loans.

The Credit Secondary Markets Act is seen as a significant step towards regulating the trade in non-performing loans in Germany. Implementation has proved to be complex, but the legislation offers great potential for market stability and consumer protection. A comprehensive evaluation is still pending but is likely to follow as practical experience continues to grow. The "wave" of NPL deals that has been anticipated by many has not yet arrived in the German market.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

Regardless of the acquisition of the company (respectively the company's assets) via a share or asset deal, employment regulations can be a decisive factor for investors to consider. Especially in the case of strategic investments in distressed business, which lead to mergers of operative units or integration processes, a redundancy of the company's workforce might become relevant. As such, the dismissal protection provisions applicable under German law as well as any applicable co-determination rights of a competent works council, if any - particularly the obligation to negotiate a balance of interest (*Interessenausgleich*) and social plan (*Sozialplan*) - might have to be considered and can affect certain business-related decisions. The additional investment capital and advisory needs required for these measures are an important factor to consider for potential investors. Further, in the case of an asset deal, the asset transfer may trigger the automatic drag-along of the employment contracts to the new owner (*Betriebsübergang*), including the terms of employment and pension entitlements, if any, of active employees. Such automatic transfer results in comprehensive statutory information obligations towards the affected employees.

In summary, employment law in Germany generally provides a high level of protection to employees. Therefore, strategic investors planning to implement restructuring or integration measures must duly familiarise themselves with the relevant laws.

1.4 What risks exist for an investor of distressed business?

Distressed investments are affiliated with a wide array of commercial risks, which may arise from characteristic factors of companies in distress. These include:

- unfavourable metrics and lack of profitability;
- over-leveraging;
- defective operations and / or management structures;
- unresolved shareholder disputes;
- untransparent company structure;
- history of unfavourable strategic acquisitions;
- lingering risks of third party claims and litigation;
- unknown tax liabilities;
- incomplete or low-quality financial data and accounts;
- ineffective employee structure, lack of qualified staff and vast pension liabilities;
- essential investments / CapEx has been postponed;
- breaches of accounting / publication duties or other unlawful behaviour by (former) management;
- incompatibilities with ESG criteria; and
- image impairment / PR issues.

Typical legal risks can be categorised according to the three most common modes of investment:

Equity investments in distressed companies	**Debt investments in distressed companies**	**Purchases of assets from the estate of distressed companies (including purchase of shares in subsidiaries)**
▪ Subordination of shareholder loans and statutory capital in subsequent insolvency ▪ "Infection" of any loans granted to the relevant entity prior to acquisition of equity leads to	▪ Partial or total loss of investment in an insolvency event in subsequent insolvency ▪ Liability risks related to assisting the debtor in delayed	▪ Clawback risks in the event of insolvency ▪ Non-insolvency related clawback risks following disadvantageous transactions at the expense of individual

subordination in subsequent insolvency ▪ Loss of shareholder position through insolvency plans or pre-insolvency restructuring plans (StaRUG) (potentially by way of debt-to-equity swap) ▪ Liability for unpaid statutory capital amounts ▪ Insolvency proceedings initiated by creditors (leads to loss of control by equity holders) ▪ Regulatory risks related to shareholding in distressed assets ▪ Liability risks with respect to de facto directors	insolvency petition ▪ Clawback of new collateral in the event of insolvency ▪ Liability risks with respect to de facto directors ▪ Haircuts in insolvency plans or pre-insolvency restructuring plans (StaRUG) including potential cram-down by other creditor groups ▪ Regulatory risks related to lending to distressed borrowers / NPL quotas	creditors (*Anfechtungsgesetz*) ▪ No representations and warranties when purchasing from insolvency administrator

1.4.1 *What risks exist for the transaction to be challenged and overturned outside of bankruptcy?*

The Avoidance Act (*Anfechtungsgesetz,* or *AnfG*) is a legal statute which projects the principles of insolvency clawback to situations where no formal insolvency proceedings have been commenced. The Avoidance Act stipulates conditions under which contracts, transactions or other legal actions can be contested, typically due to wilfully disadvantaging creditors.

The Avoidance Act provides creditors with a legal remedy in order to access assets of their debtor through enforcement measures even if the debtor has previously transferred these assets to a third party. The creditor can, under certain prerequisites, contest the asset transfer within specific timeframes. Based on the Avoidance Act, creditors entitled to contest certain transactions can, in specific cases, do so for up to 10 years after the transaction was closed. If the contestation is successful, the third party must allow the creditor access to the asset.

1.4.2 *What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?*

German insolvency law includes clawback provisions that allow insolvency administrators to reclaim assets or contest certain transactions made by the debtor – depending on the case – with a look back period of up to 10 years before the initiation of insolvency proceedings. The German clawback regime, similar to the laws in other jurisdictions, aims to ensure the fair distribution of assets among all creditors and prevent the preferential treatment of certain creditors over others.

Transactions subject to clawback include the surrendering of assets without fair and proper compensation, preferential payments made to certain creditors, transactions made to defraud creditors and transactions that unduly disadvantage creditors. The clawback / look back period varies depending on the nature of the transaction. Longer clawback periods typically apply with respect to transactions made between related parties or those involving fraudulent intent to disadvantage creditors.

Investors in distressed businesses can minimise clawback risks by assuring that any assets / shares are priced at fair market value and that the purchase price is paid concurrently with the transfer of the relevant asset. Transactions which include a set-off of the purchase price against prior debt owed to the purchaser are generally prone to trigger clawback risks.

1.4.3 *What risks exist for a new lender investing in a distressed business?*

Lending to a distressed business carries various risks that can impact both the investment and potential liabilities of the relevant investor. In distressed lending scenarios, there is the obvious potential for a partial or total loss of the lender's investment, in particular if the business undergoes insolvency proceedings. Additionally, providing financial assistance in a situation where insolvency is inevitable can lead to significant liability risks. Distressed investors should undertake to comprehensively assess whether or not the borrower is imminently insolvent and whether the new loan is in line with a viable restructuring concept, ideally verified by independent restructuring experts (restructuring opinion or *Sanierungsgutachten*).

Providing additional debt to a distressed business could potentially trigger covenant breaches under existing finance agreements, which may prompt other creditors to invoke default and acceleration clauses. Any collateral provided to secure the new loan may be subject to clawback provisions in insolvency or even outside of insolvency proceedings (based on the *Anfechtungsgesetz*), which puts the investor at risk to lose its collateral and be left with an unsecured claim.

Furthermore, new lenders who exert significant influence or even actively pressure the distressed business's management may face liability risks as de facto directors, potentially held accountable for improper actions or decisions by the company. In insolvency or pre-insolvency restructuring plans, such as StaRUG restructuring plans, significant haircuts may be imposed on new lenders. Even in pre-insolvency restructuring proceedings, opposition from other creditor groups can possibly lead to cram-down situations where certain creditors' votes are overridden.

Lending to distressed borrowers may pose regulatory risks as well. Many regulatory bodies have determined certain thresholds for non-performing loans (NPLs) which trigger certain capital requirements or attract regulatory scrutiny. However, this widely depends on the relevant regulations the specific lender is subject to. Managing these risks effectively requires thorough due diligence, robust legal documentation and proactive risk management strategies to mitigate potential losses and liabilities associated with lending to distressed businesses.

1.4.4 *What risks exist for a new shareholder investing in a distressed business?*

Equity and mezzanine investments in distressed business by default pose higher commercial risks than (senior) debt investments. Statutory capital, equity contributions or (indirect) shareholder loans are generally subordinated, resulting in a lower repayment priority compared to other creditors. This especially applies in insolvency proceedings. However, pre-insolvency restructuring frameworks (such as the German StaRUG) frequently provide instruments to facilitate an overruling of subordinated creditors.

Investors who wish to participate in distressed businesses should be aware that their own investment or any capital brought along with it (e.g. by co-funding debt investors) should be sufficient to ensure the target stays solvent. Otherwise, investors could risk losing their newly acquired shareholder position through insolvency or pre-insolvency restructuring plans, which may involve sales to new investors or debt-to-equity swaps that dilute or eliminate the shareholders' equity stake in favour of other creditors.

Sound due diligence is paramount in order to identify additional legal and commercial risks. New shareholders may face liability for unpaid statutory capital amounts if the former shareholders did not ensure to meet the applicable capital obligations. Regulatory risks associated with shareholding in distressed assets may arise, particularly concerning compliance with regulations governing such investments.

Moreover, shareholders who actively participate in the management and decision-making of the distressed business may face liability risks as de facto directors, establishing potential accountability for any improper actions or decisions taken by the company.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

There are no dedicated enforcement frameworks for distressed debt or M&A investors. The general provisions on the enforcement of claims and realisation of collateral apply to all creditors.

Whether and how a creditor can enforce an outstanding claim depends on many factors such as:

- the legal nature of the claim (monetary debt, surrendering of assets, issuing of approvals or declarations of intent and claims for information);
- whether or not the claim is secured or unsecured;
- the type of collateral provided to secure the claim;
- whether the material and procedural requirements of enforcement are met, including if the relevant collateral can be contested; and
- the existence of grounds for non-enforcement, such as insolvency proceedings or moratoriums.

2.2 What involvement does the court have in these processes?

This again strongly depends on the specific situation. The role of the court in enforcement proceedings varies based on the type of collateral.

Generally, enforcement of collateral requires the secured receivables to be enforceable. Enforceability can be obtained when the debtor has previously submitted itself to immediate enforcement (*Zwangsvollstreckungsunterwerfung*) and thus waived its right to defend itself against the underlying claim in an orderly civil proceeding. However, if the debtor did not agree to such submission, enforceability of the investor's claims against the debtor can only be obtained by court order (i.e. an enforceable judgment).

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

Where a share pledge under German law is provided as collateral for a loan facility, realisation of the share pledge in an event of default generally occurs by way of a public auction. As the creditor and pledgee cannot simply appropriate the pledged shares, unlike for example under the laws of Luxembourg, a debt-to-equity swap is not a typical mode of enforcement under German procedural law. However, the existing shareholders and the investor can, potentially in addition to a traditional share pledge, contractually agree on the terms for a debt-to-equity swap in a predetermined event of default.

Debt-to-equity swaps can also be carried out as part of StaRUG-restructuring plans or through an insolvency plan. This requires for the creditors to vote in favour of the measure, which can be facilitated by payment of the aspiring shareholder in order to increase the return for the remaining creditors. In any case, a debt-to-equity swap requires careful assessment of relevant questions of valuation. As the swap is typically achieved by a capital reduction and a subsequent emission of new shares, whereas the existing debt serves as non-cash contribution, the value of the debt in accordance with the applicable accounting principles plays an important role.

2.3.2 Is a public auction mandatorily required or are private sales possible?

Creditors are frequently bound to adhere to the enforcement processes provided for by the German Code of Civil Procedure (*Zivilprozessordnung,* or *ZPO*). Share pledges, like land charges, require the creditor to apply for a sale by way of public auction. Private sales or appropriation by the relevant creditor is generally not provided for by German law but can be agreed upon.

Therefore, enforcement of pledges over shares in a legal entity, whether it is subject to insolvency proceedings or not, must be conducted via public auction.

In formal insolvency proceedings over a legal entity which has granted a pledge over the shares of a subsidiary, enforcement action by individual creditors with respect to such share pledges is generally not prohibited.

For other types of collateral, the insolvency administrator may realise any collateral and distribute the proceeds to the secured creditor. In return, the insolvency estate participates with a percentage of the proceeds. This principle can be used to avoid public auction for the enforcement of share pledges.

The insolvency administrator can agree to conduct a private sales process with respect to the relevant shares. Pledgees can enter into bilateral realisation agreements with the insolvency administrator, which governs the mode of realisation and the distribution of proceeds. While the insolvency administrator will demand for the debtor's estate to participate in the proceeds, a private sale often produces higher purchase prices over a public auction and therefore can still be a favourable option for creditors.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Any transfer restrictions in the statutes of the relevant legal entity typically apply. Therefore, the share pledge itself often requires the other shareholders' consent. If such consent has been given, it renders transfer restrictions irrelevant in an enforcement event.

2.3.4 Is "market testing" mandatorily required?

As the enforcement of share pledges is conducted via public auction, market testing is not a requirement.

2.3.5 Are valuation reports mandatorily required?

As the enforcement of share pledges is conducted via public auction, valuation reports are not a requirement.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

As of 1 January 2021, Germany implemented the EU Directive on Preventive Restructuring Frameworks (EU) 2019/1023. Under previous German law, there was no legal procedure for restructurings outside the scope of formal insolvency proceedings. Instead, preventive restructurings required a consensual agreement between the company to be restructured and its creditors. The new preventive restructuring proceeding was implemented by way of the Corporate Stabilisation and Restructuring Act (StaRUG).

The StaRUG provides for a variety of instruments at the disposal of companies that face imminent illiquidity (*drohende Zahlungsunfähigkeit*) under section 18 of the German Insolvency Code. These offer alternative restructuring solutions, including the implementation of a restructuring plan. The StaRUG introduces a new Stabilisation and Restructuring Framework (SRF) which companies can use prior to the occurrence of an insolvency event under section 17 of the German Insolvency Code (*Zahlungsunfähigkeit - illiquidity*) or section 19 of the German Insolvency Code (*Überschuldung - over-indebtedness*).

The framework is not an integrated, linear procedure, but rather a modular procedural framework, the elements of which a debtor seeking reorganisation can make use of individually or cumulatively in the form of procedural restructuring assistance.

To make use of the instruments under the SRF, the company needs to file a notice to the restructuring court of its intention to restructure (*Anzeige des Restrukturierungsvorhabens*). The further process (negotiations with creditors, drafting of the restructuring plan and voting on the restructuring plan) can be done either with or without court involvement. The company may also file an application to the restructuring court in order to have the restructuring plan confirmed by the court.

Not all creditors need to be involved in the restructuring plan. The company is free to decide which creditor groups are to be included. However, the selection must be based on appropriate criteria. Claims by employees, as well as claims arising from deliberate tortious acts and fines, cannot be subject to the restructuring plan. Finally, the plan is voted on by the creditor groups.

Further court measures available upon application by the company (and subject to certain requirements) are the introduction of a moratorium and the appointment of a restructuring officer (*Restrukturierungsbeauftragter*) by the court.

The preventive restructuring proceedings are available to any corporate debtor, with the exception of companies in the financial sector (in particular credit institutions and insurance undertakings). They are also open to natural persons who are not engaged in business activities. The process can only be initiated by the debtor.

Creditors as well as potential distressed investors do not have a right to apply for instruments under the StaRUG.

With the notification by the debtor to the court, the restructuring case becomes pending. The StaRUG does not provide for formal opening proceedings. As such, the mere receipt of the notice (including the required information) will be sufficient to commence the process. The measures under the StaRUG are available to companies that are facing imminent illiquidity (*drohende Zahlungsunfähigkeit*) but not yet under the obligation to file for insolvency.

3.2 What involvement does the court have in these processes?

The obligatory involvement of the restructuring court is minimal as the debtor is free to choose whether and which court assistance will be used. In order to make full use of the effects of a restructuring plan (e.g. safe harbour for new financings, clawback protection, cram-downs), the plan must be confirmed by the court after the plan has been adopted by the creditors. The decisions of the restructuring court to confirm a restructuring plan will not be officially published unless the debtor has filed an application for such official publication.

Under certain circumstances, it may be necessary for the restructuring court to terminate the restructuring proceeding or to appoint a restructuring officer ex officio.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

In StaRUG proceedings, the debtor is the central driving force behind the restructuring process. The debtor initiates the procedure voluntarily, provided they are facing imminent financial distress but are not yet insolvent. The debtor drafts and proposes the restructuring plan to its creditors. The debtor also decides which creditors to involve in the StaRUG process and picks procedural tools to use – such as requesting a stay of enforcement or court involvement in plan confirmation. By forming creditor groups and tailoring the plan to gain majority approval, the debtor strategically steers the process toward a successful outcome while maintaining operational control.

Creditors play a critical role as evaluators and co-decision makers in StaRUG proceedings. While they do not initiate the process directly, they can pre-negotiate the restructuring plan with the debtor, which is critical to obtain the majorities required to adopt the plan. Their approval is essential, with a 75% majority required within each creditor group for the plan to pass.

Creditors can also organise themselves into committees to negotiate terms, raise objections and request the appointment of a restructuring officer if needed. Their influence lies in their voting power and their ability to challenge unfair treatment, ensuring the restructuring plan balances the debtor's recovery goals with the protection of creditor rights.

A restructuring officer (*Restrukturierungsbeauftragter*) may be appointed by the restructuring court. The restructuring officer is appointed upon application by the debtor or, in specific cases, ex officio, particularly when the rights of consumers or medium-sized, small and micro-companies are affected, when the restructuring plan provides for the monitoring of the settlement of the creditors' claims, or when the debtor applies for stabilisation measures which will affect essentially all of the creditors.

If the restructuring officer is appointed ex officio, they must notify the court if circumstances are brought to their attention that justify the lifting / termination of the restructuring case, for example when the debtor becomes insolvent.

The restructuring officer will conduct and document any out-of-court voting on the restructuring plan and examine claims including security interests. The restructuring officer may have certain additional competences, depending on the circumstances.

In addition, the debtor can make use of a court-appointed restructuring moderator (*Sanierungsmoderator*). This person will assist the company in negotiating with the creditors and achieving a solution to overcome their economic or financial difficulties. However, the restructuring moderator does not have the powers to cram down dissenting creditors.

3.4 Is there a typical due diligence process followed?

Distressed investors have always put emphasis on sound due diligence, as this is even more important than in fair weather investments. However, there is no standardised process to conduct such due diligence, as this strongly depends on, for example, the desired mode of investment, regulatory requirements and internal risk management standards.

Distressed investors, alongside established financial institutions, often request that companies facing financial challenges provide independent expert opinions, typically issued by auditors specified in restructuring advisory. These opinions, commonly referred to as "restructuring opinions" or "restructuring concepts," exist in various formats and degrees of intricacy. Yet, among these, the IDW S6 Standard has emerged as the prevailing benchmark for such evaluations. This status owes in part to the widespread membership of certified auditors in Germany within the IDW, the authoritative body responsible for formulating and upholding IDW Standards.

The IDW S6 Standard undergoes frequent updates to align with the latest pronouncements of the German Federal Supreme Court regarding the prerequisites for restructuring opinions. For lenders, these opinions serve a dual purpose. They not only provide an independent assessment of the borrower's enterprise, its financial predicament and the potential for a successful restructuring but also serve as a means to mitigate the risk of lender liability.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

Unlike in a regular M&A process, the acquisition of shares or assets through a StaRUG restructuring plan does not follow an established or market standard timeline. The StaRUG is a restructuring framework and not a dedicated M&A oriented proceeding and therefore allows for the implementation of various different restructuring measures, of which the transfer of shares or assets is only one. All steps and phases of the acquisition process are therefore strongly influenced by factors such as:

- the severity of the financial difficulties and if there is acute potential for the imminent illiquidity required to enter into StaRUG proceedings to turn into material insolvency (i.e. illiquidity or over-indebtedness,) which would disqualify the debtor for a StaRUG process;

- if the acquisition of shares or assets by an investor is congruent with the other restructuring measures which the debtor seeks to implement through the StaRUG framework;
- to what extent the potential investor already has conducted its due diligence in relation to the debtor's business and whether there is even enough time to do so;
- if there are potential other parties interested in acquiring shares in the debtor or any of its assets; and
- whether or not the restructuring plan including the envisaged transaction has a chance to reach the necessary voting thresholds.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

Section 90 of the StaRUG provides for comprehensive claw back protection with respect to transactions of shares or assets that have been implemented by way of a StaRUG restructuring plan. However, in order for the claw back protection to apply, the parties must ensure that any creditors who were not included in the restructuring plan are not disadvantaged by the transaction. This means that the compensation paid for the shares or assets must be sufficient for those creditors to not be worse off than without the plan. Whether this condition is fulfilled can be difficult to determine. In general, a fair and market equivalent consideration for assets or shares acquired by an investor, ideally verified by independent market soundings or valuation reports, should create sufficient certainty.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

In an ideal scenario, a StaRUG proceeding is only initiated when the debtor has previously negotiated the terms for the envisaged restructuring measures with a sufficient number of creditors to ensure the restructuring plan is adopted in the voting process. If that is the case, the restructuring plan can be considered a pre-pack plan. However, there are no specific provisions in the StaRUG which constitute the instrument of a pre-pack.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

A pre-pack procedure provides for the negotiation of the sale of a financially distressed entity, as a going concern, prior to the commencement of the insolvency proceedings through which it is executed. German insolvency law allows for a pre-pack sale to be executed by way of a protective shield procedure (*Schutzschirmverfahren*). The protective shield allows for the debtor in possession to pre-negotiate an insolvency plan with its creditors, which outlines restructuring and other measures to be taken to stabilise operations. However, while the insolvency plan may entail a sale of the company or its assets, its ambit can reach far beyond that. In spite of some practitioners marketing the protective shield as a "German pre-pack", its limitations over a true form of the pre-pack concept lie in the requirement to execute a sale by way of a rather lengthy, formalised insolvency plan.

In principle, German law allows for the execution of pre-pack sales outside of an insolvency plan – even without providing a dedicated procedure. The German insolvency proceeding by default entails a two-phased approach, outlined below.

Phase 1

The preliminary insolvency proceedings, which immediately follow the application and entail the appointment of a preliminary insolvency administrator (or preliminary trustee in the case of debtor-in-possession proceedings). The preliminary insolvency administrator assesses the status quo and decides whether to liquidate or restructure the business (or sell it respectively).

Phase 2

The final insolvency proceedings, which sees the appointment of the preliminary insolvency administrator as the final insolvency administrator, who then legally takes over the entity and proceeds to execute the approach decided upon.

Phase 1 is often used for the preparation of a sales process, which is then executed immediately following the opening of the insolvency proceedings.

On 7 December 2022, the European Commission published its proposal for a directive harmonising certain aspects of the insolvency law. The directive, among other aspects, seeks to introduce standalone pre-pack proceedings in all member states. Article 19 of the draft directive obliges member states to include two phases in the pre-pack process:

- *Preparatory phase* – commences with the appointment of a monitor who documents and prepares the sales process. To ensure the process is competitive, fair, transparent and up to market standards, the monitor invites parties to participate in the sales process, enables due diligence by the interested purchasers, obtains offers and recommends an offer which is in the best interest of creditors.

- *Liquidation phase* – commences the approval and execution of the pre-negotiates sale and the distribution of the sales proceeds to the creditors.

Member states may diverge from this approach by implementing a pre-pack sale by way of public auction in a liquidation phase. In this alternative to a privately organised sale, the offer recommended by the monitor is used as a "stalking horse bid." In the event the auction results in a better bid, the "stalking horse bidder," among other inducements, is reimbursed for the expenses incurred or offered a break-up fee. If the sale takes place by way of a public auction, the high standards regarding competitiveness, fairness, transparency and adhesion to market standards are no longer mandatory for the monitor.

The directive is not yet in force and therefore not implemented into national laws of the member states. Until then, pre-pack sales can only be commenced through pre-negotiated insolvency plans as set out above.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Not applicable.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Not applicable.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Not applicable.

4.5 Is there a typical due diligence process followed?

N/A.

4.6 Is "market testing" mandatorily required?

Not applicable.

4.7 Are valuation reports mandatorily required?

Not applicable.

4.8 What is the typical timeline of "pre-pack" sales?

Not applicable.

HONG KONG

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

There are no specific legal requirements for trading in distressed equity prior to the commencement of winding up.

In general, any transfer of shares made after the commencement of winding up (i.e. after the winding up petition has been filed) shall be void unless the court orders otherwise.

In such circumstances, the parties and / or the company whose shares are being traded may apply to the court for a validation order to validate the share transfer pursuant to section 182 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance.

In determining whether to grant an application for the validation of a share transfer, the Hong Kong court will consider whether creditors would be better or worse off in the event a winding up order is made, with the transfer not having been sanctioned. A transfer of fully paid-up shares is generally unobjectionable, as creditors of the company would not be worse off if a validation order is granted.

For equity in distressed listed companies, the Hong Kong Securities Clearing Company Limited issued a circular in 2016 (CD/DNS/CCASSS/332/2016) stating that it may at any time exercise its powers to temporarily suspend its services in respect of the shares of companies subject to a winding up petition. This may include suspension of acceptance of deposits of share certificates into CCASS and suspension of trading.

Trading in equity (whether distressed or not) may also be subject to:

(i) restrictions in the company's constitutional documents (such as transfer restrictions) and / or shareholders' agreements (if any);

(ii) any mandatory laws relating to the transfer of equity in the jurisdiction of incorporation of that company;

(iii) exchange / securities regulations for listed companies; and

(iv) for listed companies, restrictions on trading imposed due to insider trading rules and market manipulation rules.

1.2 Is there a specific legal regime to purchase distressed debt or non-performing loans?

Under Hong Kong law, the sale and purchase of debt and / or a loan may be effected through the assignment or novation of the relevant debt document, provided that any transfer conditions therein are satisfied. Where there are restrictions against assignment or novation in the underlying debt documents, the purchaser of the distressed debt may seek to obtain indirect exposure to the distressed debt through sub-participation agreements or other derivative arrangements (e.g. total return swaps or credit default swaps). There are no foreign ownership restrictions in respect of the purchase of distressed debt or non-performing loans under Hong Kong law.

For the sale and purchase of distressed bonds held through a clearing system and / or listed on an exchange, such bonds are typically traded by way of transfer of the indirect beneficial interests in the bonds in accordance with the trading rules of the Hong Kong Stock Exchange or the relevant exchange (if the bonds are listed on that exchange) and the trading rules of the relevant brokers and the clearing systems which are used to transfer the interests in the bonds.

The aforementioned considerations apply to the sale and purchase of both performing and non-performing loans or bonds, and no special regime applies to the trading of distressed debt. Such transactions primarily rely on contract law principles, including assignment and novation, as well as the specific terms of the debt documents involved. As with purchasing performing loans, parties should also ensure compliance with the Money Lenders Ordinance (Cap. 163) and other applicable laws and regulations relating to money lending in Hong Kong, where relevant.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

There are no general regulatory requirements applicable to distressed investments under Hong Kong law.

1.4 What risks exist for an investor of a distressed business?

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Outside of bankruptcy (which gives rise to potential clawback grounds) and in the absence of fraud, it is generally difficult for transactions to be challenged and overturned.

One practical risk is where the distressed company subsequently challenges the transaction by alleging that the personnel involved in the execution of the transaction do not have authority to bind the distressed company.

This risk is heightened in distressed businesses given the rapid turnaround of personnel and the consequent risk of constant re-assessment by management of the commercial viability of the deal or where a third party (e.g. a receiver or liquidator) subsequently takes control of the distressed company.

It is generally difficult to establish claims of *ultra vires* acts given that: (1) pursuant to the indoor management rule, a third party dealing in good faith with a company is not bound to inquire whether acts of internal management have been regular and is entitled to presume that acts within the company's constitution and powers have been properly and duly performed; and (2) section 117 of the Companies Ordinance provides that, for persons dealing with a company in good faith, the power of the directors to bind the company will be deemed to be free of any limitation under the articles of association, any resolutions of the company or any agreement between members of the company.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

For purchases of assets held by a distressed company, the transaction may be challenged by the liquidator and / or (in the case of a fraudulent conveyance) any person prejudiced by the transfer, on the various clawback grounds set out below.

(i) *Transaction at an undervalue* – liquidators may apply to the court to challenge a transaction entered into within 5 years before the commencement of the winding up if they consider it to be a transaction at undervalue.

A transaction at undervalue includes transactions that result in the company receiving no consideration or receiving consideration that is significantly less than the value it provided. The court will not make an order unwinding a transaction at an undervalue if it is satisfied that: (a) the company entered into the transaction in good faith and for the purpose of carrying on its business; and (b) at the time the company did so, there were reasonable grounds for believing that the transaction would benefit the company.

The liquidator must also prove that, at the time the transaction took place, the company was insolvent or became insolvent as a result thereof. Insolvency is presumed if the transaction is with a person who is "connected with the company".

(ii) *Unfair preference* – a liquidator may apply to the court to challenge an unfair preference transaction. An unfair preference arises when a company takes or permits an action that has the effect of putting a creditor, surety or guarantor in a more favourable position in the event of an insolvent liquidation than they would otherwise have been. The court will only make an order unwinding an unfair preference if the company was influenced by a desire to prefer that particular creditor, surety or guarantor. If the preference was given to a recipient who is "connected with the company" (otherwise than by reason only of being its employee), the desire to prefer will be presumed. The alleged preference must have been given within 6 months (or 2 years where the recipient is "connected" with the company otherwise than by reason only of being its employee) before the commencement of the winding up.

(iii) *Fraudulent conveyance* – a liquidator or any person prejudiced by the transfer may apply to the court to set aside any disposition of property by the company made with the intent to defraud creditors – i.e. with a deliberate intention to place the company's assets outside the reach of creditors. The standard of challenge is high as it requires proof of subjective intention to defraud.

(iv) *Floating charge* – if: (i) a floating charge is created within 12 months (or 2 years if created in favour of a person connected with the company) before commencement of the winding up; and (ii) the company is unable to pay its debts at the time of creation of the floating charge, or becomes unable to pay its debts in consequence of the transaction under which the floating charge is created, the floating charge will be automatically invalid (that is, without the need for an application to be made to the court), except to the extent of the money paid as or after the creation of the charge plus any interest accruing on such sums capped at a rate of 12% per annum.

1.4.3 What risks exist for a new lender investing in a distressed business?

First, new lenders may face clawback challenges in respect of any new security the distressed company provides. The potential clawback grounds have been discussed above.

Secondly, new lenders face the risk of being compromised with other debts in the same class in the event the distressed company proposes a scheme of arrangement to compromise all its debts. It is possible for a distressed company to compromise all its debts which rank *pari passu* with each other, including those incurred while the company is in distress, through a scheme of arrangement sanctioned by the Hong Kong court as long as a majority in number and 75% in value of the scheme creditors who belong to the same class and who attended the scheme meeting voted in favour of the scheme. There is no concept of DIP financing, or any super priority conferred on new lenders providing distressed lending, under Hong Kong law.

Thirdly, new lenders face the risk of being primed by other creditors to the distressed business. Distressed companies often face significant pressure from creditors to provide valuable assets exclusively to such creditors in order to improve their recoveries. For a new lender, if the covenants or amendment thresholds in its debt documents with the company are not drafted sufficiently tightly, there may be room for the distressed company to subsequently: (a) provide exclusive security to other creditors; or (b) insert super-senior tranches in the debt documents or incur structurally senior debts, which would prime the new lender. Although such subsequent lending will be subject to the same clawback risks as described above, in practice, it is often difficult for liquidators to unwind or clawback a debt made to, or security given by, a company in liquidation, and actually make recoveries from the relevant counterparty.

Fourthly, new lenders who acquire the right to and in fact actively participate in the day-to-day management of the business may risk being regarded as a shadow director. A shadow director is a person in accordance with whose directions or instructions the directors or a majority of the directors of the company are accustomed to act. To establish that a person is a shadow director of a company, it is necessary to allege and prove:

(1) who are the de facto or de jure directors of the company;

(2) that the person directed those directors how to act in relation to the company;

(3) that those directors acted in accordance with such directions; and

(4) that they were accustomed so to act.

There must be an established pattern of behaviour in which the board did not exercise any discretion or judgment, but acted in accordance with the directions of the person.

If the new lender is regarded as a shadow or de facto director, then fiduciary duties (including the duty to avoid conflict of interests and the duty to act in the best interests of the company which, in the case of an insolvent company, requires its directors and shadow directors to take into account the interests of the company's creditors as a whole) may attach to the actions of the new lender. This risk is particularly pronounced where the new lender has governance rights in the company (e.g. by having the right to nominate directors).

1.4.4 What risks exist for a new shareholder investing in a distressed business?

First, new shareholders may need to bear the liquidity risks associated with a distressed business. There may not be a market for the shares in the distressed company, and once a winding up petition is filed, validation orders would be required before transfers in the equity of the distressed business can be permitted. If no validation orders are obtained, the transfers would be at risk of being invalidated should a winding up order be made at a later stage.

Secondly, if a distressed company subsequently enters liquidation, payment priority will be given to the company's creditors vis-à-vis its shareholders and the shares will likely be completely out of the money.

Thirdly, new shareholders who actively participate in the day-to-day management of the business may risk being regarded as a shadow director. In that case, the fiduciary duties noted above may attach to the actions of the shareholders. This risk is particularly pronounced where a shareholder engages in actions to actively extract value from a distressed company (e.g. by requiring sales of valuable assets of the distressed company to it or upfront distributions) in return for investing in the company.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Where the relevant distressed assets are subject to security, the normal enforcement process in Hong Kong is to run a receivership sales process for the asset. Although foreclosures are also technically possible, they are rarely used in practice as:

(i) foreclosures require application to the Hong Kong court;

(ii) foreclosure orders lack finality because even after a foreclosure order has been granted, the court may still, upon receiving an application from the mortgagor, reopen the foreclosure order to allow the mortgagor to redeem the security asset; and

(iii) in a foreclosure application, the court has the discretion to order other remedies (e.g. judicial sale) in lieu of foreclosure. There is no appropriation remedy in Hong Kong.

Receivers have a degree of latitude as to the method of sale to be employed to dispose of the asset, subject to the receiver's general duty of care to obtain the best price reasonably obtainable in the circumstances, which will typically require the receiver to properly market the assets in whatever means that are appropriate to the nature of the assets. There is also a prohibition against self-dealing by the receiver – i.e. the receiver cannot sell the assets to itself.

2.2 What involvement does the court have in these processes?

It is possible to appoint out-of-court receivers to enforce Hong Kong-law governed mortgages and charges. This requires no separate court approval. The powers of the out-of-court receivers are set out in the security document. The process is typically formalised through a deed of appointment, which is executed by the lender (or, in some cases, a security trustee acting on behalf of a syndicate of lenders) and by the receiver. The deed of appointment sets out the receiver's powers (which may confirm or supplement the receiver's powers provided for in the security documents), the assets over which they are appointed and the terms of their engagement. Alongside this, it is common practice for the secured party to provide a deed of indemnity in favour of the receiver, indemnifying them against personal liability for actions taken in good faith while performing their duties, except in cases of gross negligence or wilful misconduct. The out-of-court receiver may apply to the court for directions after its appointment, although typically cannot ask the court to "rubber stamp" a sale.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

Enforcement against shares of a Hong Kong company typically takes place by way of the mortgagee or chargee instructing the appointment of a receiver over the shares, which (subject to the security documents providing for the mortgagee's or chargee's powers to appoint a receiver) does not require the approval from the Hong Kong court.

After the mortgagee or chargee instructs an appointment, the receiver (in its capacity as agent of the mortgagor or chargor) will typically use the self-help remedy package (including the letters of authority, undated letters of resignation and undated board resolutions) to replace the directors and company secretaries of the Hong Kong company in order to obtain practical control over the company.

Receivers have the power to sell shares, and would typically commence a market testing before the sale. Receivers are under a duty of care to obtain the best price reasonably obtainable in the circumstances. Although foreclosures are also technically possible, they are rarely used (see paragraph 2.1 above). There is also no appropriation remedy in Hong Kong. Additionally, the secured creditor typically has a power of sale under the security documents (as a self-help remedy) and may exercise all of the voting rights attached to the shares and all the consequential rights flowing from them, including the right to replace the board of directors. The secured creditor may also apply to the Hong Kong court for an order of foreclosure.

Security over listed shares is typically created by way of security over the custodian account in which the listed shares are held. Enforcement against shares of Hong Kong listed shares typically takes place by way of the mortgagee or chargee instructing the appointment of a receiver over the custodian account which holds the equity securities. The process does not require approval from the Hong Kong court. After the mortgagee or chargee instructs the appointment, the receiver (in its capacity as agent of the mortgagor or chargor) will typically assume control over the custodian account and give instructions to the relevant account bank or securities broker and direct the sale of the listed securities. There are also disclosure of interest filing requirements under the Securities and Futures Ordinance (Cap. 571) if the disposal results in the purchaser acquiring a notifiable interest (being holdings of 5% or more of the shares in the listed company), the chargor ceasing to have a notifiable interest as a result of the enforcement sale, or (where either the chargor or purchaser already holds a notifiable interest) changes to the holdings level of the chargor or purchaser's notifiable interest following the enforcement sale.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

It is possible to implement a debt-for-equity swap as part of the share charge enforcement process. In the share security enforcement process, subject to the receiver being satisfied that it is obtaining the best price reasonably obtainable in the circumstances, the enforced shares can be sold to a bidding company held or controlled by the secured lenders which can procure the write-down of all or part of the original debt as consideration for the purchase of the enforced shares (i.e. a credit bid). As noted, there is no remedy of appropriation under Hong Kong law.

2.3.2 Is a public auction mandatorily required or are private sales possible?

A public auction is not mandatorily required and private sales are possible. Receivers have a degree of latitude as to the method of sale to be employed to dispose of the asset, subject to the general duty of care to obtain the best price reasonably obtainable in the circumstances, which will typically require the receiver to properly market the assets in whatever means that are appropriate to the nature of the assets.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

If the security is over shares which is subject to transfer restrictions in the constituent documents, the receiver or mortgagee may be restrained from exercising the rights under the charge in a way which interferes with compliance with those restrictions. A receiver or mortgagee that knowingly breaches the transfer restrictions may expose himself or herself to liability for wrongful interference with contract. There does not appear to be any precedent where the court sets aside transfer restrictions in the constituent documents of a legal entity as part of the share security enforcement process.

2.3.4 Is "market testing" mandatorily required?

Apart from cases where there is a need for an urgent sale (e.g. where the goods are perishable), receivers have a duty of care to obtain the best price reasonably obtainable in the circumstances, which – as noted already – will typically require the receiver to fairly and properly expose the shares to the market to ascertain the best obtainable price. Therefore, "market testing" is typically required under Hong Kong law for share sales.

2.3.5 Are valuation reports mandatorily required?

Although there is no general rule that receivers and mortgagees must obtain a valuation report, in most cases if no proper valuation is obtained, it would be difficult for a receiver or mortgagor to establish that they have discharged their duty of care to obtain the best price reasonably obtainable in the circumstances.

Receivers and mortgagees also have the duty to assess the condition of the property in an appropriate way as a prelude to advertising and to obtain the best price reasonably obtainable in the circumstances.

For the sale of assets of specialist nature, receivers and mortgagees must obtain specialist advice from persons knowledgeable about the relevant industry. Practically, valuation reports may not be required or feasible where: (i) the security asset being enforced against has a clear market price (e.g. listed securities); or (ii) the security assets are perishable such that the preparation of a formal valuation report would take too long and risk diminishing the value of the assets (although, even in such circumstances, the receiver will still have the duty to obtain the best price reasonably obtainable in the circumstances in the absence of a formal valuation report).

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

There is no formal pre-insolvency process (e.g. corporate rescue or standalone moratorium regime) in Hong Kong.

To effectuate the pre-insolvency rescues of companies, companies typically resort to the use of informal workouts (e.g. by private agreements) or (where cram down is required) scheme of arrangement. A scheme of arrangement in Hong Kong, conceptually similar to that in the United Kingdom under Part 26 of the Companies Act 2006, is a court-supervised procedure that enables a company to reach a binding compromise or arrangement with its creditors, often used for restructuring debts. The legal basis for schemes of arrangement is found in Part 13 of the Companies Ordinance (Cap. 622).

3.2 What involvement does the court have in these processes?

For informal workouts, the Hong Kong court is not involved.

For schemes of arrangement, the court will be involved at two different stages. First, before the convening of the scheme meeting(s) – where the scheme creditors vote on the restructuring proposal – an initial application, being the "convening hearing application", will need to be made to the Hong Kong court for approval to convene the scheme meeting.

Secondly, after the scheme creditors have approved the proposal at the scheme meeting(s), a subsequent application, being the "sanction application", will be made to the Hong Kong court, whereby the company asks the court to sanction the scheme.

The court will not automatically sanction a scheme simply because the requisite majority of scheme creditors voted in favour of it. Instead, the court would typically consider, among other things, whether the scheme classes have been properly constituted, whether there has been sufficient disclosure made in the explanatory statement circulated to scheme creditors, whether each class has been fairly represented and has voted bona fide in the genuine interests of the class, whether the scheme proposed is fair and reasonable in the circumstances and whether there are any irregularities at the scheme meeting.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

For informal workouts, the main players are the creditors whose debts are being restructured and the relevant debtors.

For schemes of arrangement, the main players after ad hoc committees or coordinating committees are formed would include:

(a) the distressed company;

(b) creditors whose debts are being compromised under the scheme of arrangement, who would typically be represented by an ad hoc committee or a coordination committee which is advised by financial and legal advisers;

(c) the controlling shareholder / equity sponsor;

(d) the new money investor(s) (if any);

(e) the scheme administrator, who is responsible for the administration of the process of the scheme (e.g. circulation of the explanatory statement, notice of scheme meetings, hosting of scheme meetings and tabulating and recording the votes during the scheme meetings); and

(f) the adjudicator, who is responsible for resolving disputes in respect of the valuation of the scheme claims.

There is no requirement for the company to involve any court-appointed insolvency practitioner to supervise the implementation of the scheme of arrangement.

3.4 Is there a typical due diligence process followed?

For informal workouts, there is no prescribed due diligence process and the degree of due diligence varies on a case-by-case basis.

For schemes of arrangement, distressed companies have a duty to make sufficient disclosure to scheme creditors. As part of this general duty, distressed companies typically engage financial professionals (e.g. accounting firms or consulting firms) to prepare the relevant alternative analysis (usually in the form of a liquidation and recovery analysis) and, in some cases (if requested by the creditors), an independent business review. These documents would typically form part of the due diligence process by the scheme creditors.

There does not appear to be more stringent due diligence carried out by distressed investors in relation to ESG and / or energy transition targets.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

For disposals effected pursuant to schemes of arrangement or informal workouts, the timeline of sale varies depending on the asset being sold, the liquidity position of the distressed company and any creditors' actions pending or threatened against the company. There are no prescribed statutory timelines. Based on experience, the process typically takes several months and up to years depending on the complexity of the transaction, the nature of the assets, the number of stakeholders involved and any relevant court proceedings.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

For informal workouts, any related M&A sales or asset sales would not automatically receive protection.

For M&A sales or asset sales which are effectuated as part of a scheme of arrangement, given that the scheme has to be sanctioned by the Hong Kong court to be effective and that the scheme document typically includes releases of liabilities in respect of the implementation of the restructuring, the risk of such sale transactions being challenged in subsequent insolvency proceedings is thereby mitigated, once the releases contained in the scheme document become fully effective.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

There is no formal pre-pack procedure under Hong Kong law. Although parties involved in a restructuring would typically execute a restructuring support agreement to document the principal terms of the restructuring, the existence of high creditor support would not streamline the formal processes required to implement a scheme of arrangement (including the need to convene scheme meeting(s) and the need to apply to court for the convening of the scheme meeting(s) and the subsequent sanction of the scheme).

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales or parts of the business) permitted and how do they work?

There is no formal pre-pack procedure under Hong Kong law. Informal pre-pack sales are also relatively uncommon in Hong Kong. Creditors may be reluctant to support a pre-packaged sale without the procedural safeguards found in other jurisdictions and there may be concerns about potential challenges from dissenting creditors or stakeholders.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Not applicable.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Not applicable.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Not applicable.

4.5 Is there a typical due diligence process followed?

Not applicable.

4.6 Is "market testing" mandatorily required?

Not applicable.

4.7 Are valuation reports mandatorily required?

Not applicable.

4.8 What is the typical timeline of "pre-pack" sales?

Not applicable.

INDIA

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

The Indian distressed equity market has various participants such as banks, asset reconstruction companies (ARCs), special situation funds (SSFs) and non-banking financial institutions (NBFCs). Each entity operates within its own distinctive framework, subject to specific regulations and restrictions. For instance, ARCs are mandated to restrict their activities to asset reconstruction and securitisation. NBFCs on the other hand have their own set of regulations governing their operations, which may include lending, investment or other financial activities.

Further, the implementation of the Insolvency and Bankruptcy Code 2016 (IBC) has significantly enhanced the appeal of distressed asset investment in India by providing a robust and attractive platform to investors. While there remain other modes of investing in distressed assets, a large part of the Indian distressed debt is resolved under the IBC and therefore the specific restrictions applicable to persons investing through this regime are worth noting.

The IBC, in its original form, did not restrict or bar any person from submitting a resolution plan or participating in the acquisition process of distressed equity of the debtor. However, concerns were highlighted that persons who contributed to the company's default through their misconduct or were otherwise considered undesirable may exploit this lacuna, enabling them to participate in the acquisition process and potentially regain control of the corporate debtor. Consequently, in 2017, section 29A was introduced in the IBC, which outlines the eligibility criteria for individuals or entities to submit a resolution plan for the rehabilitation of the corporate entity in financial distress.

According to section 29A of the IBC, a person shall not be eligible to submit a resolution plan if such a person or any other person acting jointly or in concert with the person:

(1) is an undischarged insolvent;

(2) is a willful defaulter in accordance with the guidelines of the Reserve Bank of India (RBI) issued under the Banking Regulation Act 1949;

(3) has an account which is classified as a non-performing asset (NPA), is a promoter of a corporate debtor whose account has been classified as a NPA, or is in the management or control of a corporate debtor whose account has been classified as a NPA in accordance with guidelines of the RBI or the guidelines of a financial sector regulator issued under any other law for the time being in force, for at least 1 year within the insolvency commencement date. However, if such a person makes payments of all overdue amounts with interest and any associated charges relating to the NPA before submission of a resolution plan, then the person shall regain their eligibility to submit a resolution plan;

(4) has been convicted of any offence punishable by imprisonment for 2 years or more under specified legislation and / or for 7 years or more under any other law in force;

(5) is disqualified to act as a director under the Companies Act 2013 (Companies Act);

(6) is prohibited by the securities market regulator (Securities and Exchange Board of India) from trading in securities or accessing securities markets;

(7) has been a promoter or in the management or control of a corporate debtor in which an avoidance transaction has taken place and in respect of which an order has been made by the Adjudicating Authority; or

(8) has executed an enforceable guarantee in favour of a creditor in respect of a corporate debtor against which an application for insolvency resolution has been admitted under the IBC.

However, the conditions mentioned in points (3) and (8) do not apply to the acquisition of distressed equity in a micro, small or medium enterprise (MSME) under the IBC. A resolution applicant is required to submit an affidavit stating that they are eligible under section 29A along with the resolution plan submitted for the rehabilitation of the corporate debtor.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Distressed debt or non-performing loans can be purchased by various routes, with each route presenting its own set of benefits and challenges.

1.2.1 Purchase of stressed loans from banks by ARCs, bad banks and non-banking financial institutions

The SARFAESI Act was enacted to facilitate the registration and regulation of ARCs by the RBI.

ARCs are specialised financial institutions that typically acquire NPAs from banks and financial institutions through bilateral deals or auctions, often at a discounted price. By doing so, all rights of the bank or the financial institution, as the case may be, are transferred to the ARC. The ARC designs schemes to invite subscriptions to security receipts from qualified institutional buyers (QIBs) through one or more trusts established exclusively for this purpose. Asset-held schemes are used when the size of the acquired NPA is large, while portfolio specific schemes are employed for smaller debt acquisition. In some cases, the ARCs may create a portfolio of debts from various banks and financial institutions. The next stage involves resolution planning, which may extend up to 6 months from the date of asset acquisition from the originator. The resolution methods include change and takeover of the management of the business, sale or lease of the business or parts of the business, rescheduling of payment of debts and enforcement of security interests.

Post-resolution, ARCs start recovery of debts and work on the redemption of the security receipts. Debts can be acquired on a cash only basis, or with a combination of cash and security receipts. To ensure ARCs have a stake in the acquisition process, they are mandated to invest a minimum of 15% of the security receipts on an ongoing basis until the redemption of all security receipts, thus aligning their interests with the resolution and recovery of the NPAs. ARCs are permitted to recover their dues in a period of 5 years, which is extendable up to 8 years, subject to certain approvals. ARCs are also permitted to act as resolution applicants under the IBC.

Further, in 2016, to strengthen banks' ability to resolve stressed assets effectively, the RBI permitted NBFCs (along with other banks and financial institutions) that have the necessary capital and expertise in resolving stressed assets to purchase stressed loans from banks. Subsequently, in 2021, "bad banks" were established as corporate structures that isolate risky assets held by banks into a separate entity. Under this structure, an entity known as the National Asset Reconstruction Company Ltd (NARCL) acquires bad loans from banks by way of cash and government-backed securities, and another entity known as the India Debt Resolution Company Limited (IDRCL) manages and sells the assets to potential investors for eventual value realisation.

1.2.2 Purchase of stressed companies under RBI frameworks

See the response in paragraph 3.1 below.

1.2.3 Special situation funds

Alternative investment funds (AIFs) are funds established or incorporated in India which are privately pooled investment vehicles. They collect funds from sophisticated investors, whether Indian or foreign, for investing in accordance with a defined investment policy for the benefit of investors.

An AIF can be registered in three different categories and sub-categories thereof. In December 2021, the Securities and Exchange Board of India introduced a distinct Category I of AIFs known as special situation funds (SSFs). These funds are for investment in "special situation assets", which includes stressed loans available for acquisition in terms of the RBI (Transfer of Loan Exposures) Directions 2021, or as part of a resolution plan approved under the IBC, security receipts issued by ARCs, securities of investee companies and other specified assets. SSFs were intended to act as a supplementary source of risk capital alongside ARCs in the resolution of stressed loans faced by banks, NBFCs and other institutions.

1.2.4 *Acquisition of assets under the SARFAESI Act*

Investment in distressed assets can also be made through auctions under the SARFAESI Act, which authorises banks to sell secured loans through auctions, tenders and treaties if the borrower defaults on its payment obligations (see further below in paragraph 2.1).

1.2.5 *The IBC*

While there are several avenues for investment in distressed assets outside of the formal framework, the IBC has provided stressed asset resolutions a well-defined legal structure, making the law an attractive investment avenue.

The IBC is a comprehensive piece of legislation that provides for the corporate insolvency resolution process (CIRP) and liquidation for all companies and limited liability partnerships (LLPs), and the insolvency resolution and bankruptcy of individuals and partnership firms.

Provisions of the IBC relating to partnership firms have not yet been notified and those relating to individuals have only been operationalised to include personal guarantors of the corporate debtor. Although the IBC originally excluded financial service providers from its applicability, the government has tailored the provisions of the IBC to apply to non-banking financial institutions with an asset size above INR 500 crores.

An application for initiation of a CIRP against a corporate debtor may be filed by a financial creditor (which has disbursed debt against the time value of money), by an operational creditor (which has provided goods and services to the corporate debtor in exchange for money, including employees and government creditors) or by the corporate debtor itself before the National Company Law Tribunal (NCLT) on a default of a minimum amount of INR1,00,00,000 (approximately USD 120,000) by the corporate debtor.

The CIRP commences on the date the NCLT admits the filed application and operates for a limited period of 180 days. The resolution professional (RP) can file an application before the NCLT to extend the CIRP by a period of 90 days if instructed to do so by a resolution passed at a meeting of the committee of creditors (CoC) by at least 66% of voting shares. The total number of days for the completion of the CIRP may not exceed 330 days, which includes any extensions granted and time taken in legal proceedings. In practice, however, CIRPs have often continued beyond the prescribed 330-day timeline.

When the CIRP commences, the NCLT declares a moratorium, which operates until the completion of the CIRP. Actions against the corporate debtor and its assets are halted and no legal proceedings can be commenced or continued. However, the supply of essential goods and services such as electricity, water, information technology and telecommunication services to the corporate debtor is mandatory. The powers of the board of directors of the corporate debtor are suspended and the management of the corporate debtor vests in the insolvency professional appointed as the interim resolution professional (IRP). The IRP is responsible for protecting and preserving the assets of the corporate debtor and managing the affairs of the corporate debtor as a going concern.

The IRP makes a public announcement of the initiation of the CIRP and calls for the submission of claims by creditors of the corporate debtor. The IRP verifies all claims received and constitutes a CoC comprising all unrelated financial creditors of the corporate debtor. In the first meeting, the CoC resolves to either appoint another insolvency professional as the RP or to retain the IRP as the RP.

The RP, in consultation with the CoC, invites applicants to submit resolution plans to revive the corporate debtor. Certain persons are disqualified from submitting plans, including the incumbent management of the corporate debtor in certain instances.

A resolution plan can propose various measures, including a change in capital structure by way of merger, amalgamation, demerger, debt restructuring, one-time settlement, transfer or sale of the assets of the corporate debtor.

Thereafter, the RP examines the plans received for certain mandatory requirements under the IBC and places all compliant plans before the CoC. If the RP does not receive any resolution plans for resolving the corporate debtor, the RP may, with the approval of the CoC, invite resolution plans for the sale of one or more assets of the corporate debtor. The CoC, by exercising its commercial wisdom, selects a plan for the turnaround of the corporate debtor by a majority vote of 66% in value terms. The plan is then placed before the NCLT for its final approval, after which it binds all stakeholders of the corporate debtor.

A liquidation process can be triggered if:

- the NCLT did not receive or rejected the plan received during the CIRP;
- the corporate debtor contravenes the terms of an approved resolution plan after the CIRP; or
- the CoC by a 66% majority in value resolves to liquidate the corporate debtor during the CIRP.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

There is no requirement to constitute work councils for distressed investments.

1.4 What risks exist for an investor of a distressed business?

While the IBC is a time-bound process, frequent delays in the conclusion of processes often result in uncertainty, causing misalignment between asset acquisition and the timelines proscribed under the IBC. Much of this delay is attributable to the process of approval for a resolution plan.

Since a resolution plan is only approved by the CoC – which comprises unrelated financial creditors of the corporate debtor – other stakeholders, including operational creditors (trade or statutory) or employees of the company, often challenge resolution plans in case their interests are not adequately captured. Further, lawsuits instituted by the erstwhile management of the corporate debtor on the pretext of offering last minute settlement offers (thereby challenging the eligibility of a resolution applicant or the constitution of the CoC) also hinder the process of approval of a resolution plan. These systemic, frequent delays in approving a resolution plan not only contribute to value erosion of the corporate debtor but also negatively impact commercial assessments of resolution applicants.

Furthermore, section 31 of the IBC stipulates a 12-month timeframe after the approval of the resolution plan by the NCLT for obtaining essential approvals from relevant regulators or as mandated by the law to assume control of the corporate debtor. However, this post-facto approval process prescribed by the IBC exposes the resolution applicants to risks and fosters uncertainty regarding gaining timely control of the corporate debtor.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Section 31 of the IBC contains statutory provisions for approval of a resolution plan by the NCLT and its consequences on the stakeholders of the corporate debtor.

Section 31 provides that if the NCLT is satisfied the resolution plan meets the statutory requirements and approves the resolution plan by an order, then the resolution plan is binding on the corporate debtor and all its stakeholders involved in the resolution plan. "Stakeholders" as an encompassing term includes the corporate debtor's employees, members, creditors (including those with Crown dues) and guarantors.

The Supreme Court of India in the case of *Committee of Creditors Essar Steel v Satish Kumar Gupta & Others*[1] propounded the principle of "clean slate", which further explains the consequences of

[1] Civil Appeal No. 8766-76 of 2019.

approval of a resolution plan by the NCLT under section 31 of the IBC.

The Supreme Court in this case held that once a resolution plan is approved by the NCLT, the plan becomes binding on the corporate debtor and all its stakeholders. The legislative intent behind this is to “freeze all the claims” to ensure the resolution applicant starts on a clean slate, free from the burden of the emergence of any new claims. Allowing new claims would disrupt the resolution applicant’s commercial calculations and render the resolution of the corporate debtor unfeasible. Further, any claims not part of the resolution plan would stand extinguished and no person is entitled to initiate or continue any proceedings in respect of any such claim.

Thus, since no new claims can be raised in a resolution plan that has been approved by the NCLT after due consideration of all legal provisions of the IBC, such transactions cannot be overturned outside of bankruptcy.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

The IBC follows a linear process, whereby the CIRP precedes liquidation. In the event the CIRP fails to rescue the corporate debtor, the corporate debtor is liquidated. However, if a resolution plan is approved for the corporate debtor who is admitted into CIRP, formal bankruptcy proceedings are considered closed and final – hence, the question of transactions pursuant to the approval of resolution plans being challenged and overturned in subsequent formal bankruptcy proceedings does not arise. However, there may be instances where a resolution plan, despite its approval, may be overturned in the same insolvency proceedings.

For instance, orders issued by the NCLT, including those approving a resolution plan, can be challenged within the appellate structure established by the IBC. Appeals against the orders of the NCLT must be filed within 30 days from the date of receipt of the order before the National Company Law Appellate Tribunal (NCLAT). Specifically, appeals against orders approving a resolution plan can be made on grounds including contravention of prevailing laws, material irregularities by the RP during the CIRP, failure to provide for debts as owed to operational creditors as specified by the insolvency regulator – i.e. the Insolvency and Bankruptcy Board of India (IBBI) – non-prioritisation of insolvency resolution process costs for repayment or non-compliance with other criteria stipulated by the IBBI.

Appeals against the orders of the NCLAT can be filed before the Supreme Court of India within 45 days from the date of receipt of order. Following these periods of appeals, the order approving the resolution plan attains finality.

However, if the resolution plan is breached by the corporate debtor, any affected person may apply to the Adjudicating Authority for the liquidation of the corporate debtor. If the NCLT confirms the contravention, then it by order liquidates the corporate debtor and nullifies the resolution plan.

1.4.3 What risks exist for a new lender investing in a distressed business?

The IBC contains provisions for interim finance, whereby an existing or new lender may invest in an ongoing insolvency resolution process of a corporate debtor. Interim finance is accorded super priority, when payouts are distributed under a resolution plan or during liquidation. However, the most prominent risks involved in a CIRP currently stem from protracted delays in the conclusion of proceedings primarily attributable to vacancies in the NCLT’s sanctioned strength, compounded by extensive litigation by multiple stakeholders involved in the process. This leads to a lack of repayment visibility, undermining the practice of interim financing. Further, unlike other financial creditors of the corporate debtor, interim finance providers do not have any participation or voting rights in the CIRP and, therefore, they do not have any control over the corporate debtor’s rehabilitation or liquidation.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

Please see the response at the commencement of this paragraph 1.4.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Creditors may either pursue individual recovery or enforcement action or opt for insolvency or other restructuring remedies which involve collective action in respect of their distressed debt. Distressed debt may be secured or unsecured. Security can be created over movable properties, immovable properties and intangible assets. Security over movable assets is generally created in the form of:

- a pledge – i.e. where possession of the movable property is transferred to the creditor with the intention of creating security over such movable property;
- hypothecation – i.e. where possession of the movable property is retained by the borrower, but the creditor has the right to take possession and ownership of the property in case of default; or
- a lien – i.e. where possession of the movable property is handed over to the lender until the discharge of certain obligations without the right to appropriate or sell the goods.

Security over immovable property is generally created by way of a mortgage. The Transfer of Property Act 1882 contemplates six different types of mortgages. The two most common forms of mortgage used in financing transactions are an English mortgage (or a legal mortgage) and mortgage by way of deposit of title deeds (or an equitable mortgage):

- An English mortgage contemplates absolute transfer of the property to the creditor with a right of redemption available to the debtor on repayment of dues on a certain date. An English is recorded in an indenture of mortgage.
- A mortgage by deposit of title deeds involves delivery of title documents to the creditor with an intention to create security on the property. Typically, the act of deposit of title deeds is recorded in a memorandum of entry and is accompanied by a declaration of an authorised officer of the company creating the mortgage.

With respect to intangible assets and intellectual property rights, assignment is the principal form of security. The different enforcement remedies available to creditors of distressed debt have been discussed below.

2.1.1 Individual creditor recovery

- *Civil suits and recovery proceedings*

  Creditors may file civil suits for recovery of debt and enforcement of security with civil courts under the Code of Civil Procedure 1908 (CPC). Alternatively, a commercial dispute under the Commercial Courts Act 2015 may be filed if the cause of action fits within the meaning of "commercial dispute" under section 2(c) of the CPC, which includes ordinary transactions of bankers and financers, agreements relating to immovable property used exclusively in trade or commerce, and subscription and investment agreements pertaining to the services industry, including financial services. A dispute must be over the pecuniary limit specified in law, which may not be lower than INR 3,00,000 (USD 3,600.36). Further, where the security agreement contains an arbitration clause, creditors may pursue arbitration proceedings.

  Certain special laws made for recovery action may also be utilised. Debt Recovery Tribunals (DRTs) were set up by the Government of India as dedicated tribunals under the Recovery of Debt Due to Banks and Financial Institutions Act 1993 (RDDBFI) for expeditious adjudication of debt recovery proceedings for banks and financial institutions. A bank or financial institution can file a suit in the DRT for recovery of its dues. A decree may be passed by the DRT in favour of the applicant bank or financial institution upon hearing the arguments and evidence presented by the parties. The minimum threshold limit of default is INR 20,00,000 (USD 24,002.12) and the total prescribed time for disposing an application for debt recovery is 180 days. However, the conclusion of proceedings often takes longer in practice. Parties may file an appeal from any orders passed by the DRT with the Debt Recovery Appellate Tribunal within 30 days of receiving the order.

- *Enforcement of security*

  The enforcement of security is primarily governed by the terms of the security and certain types of security can be enforced without any intervention of the courts.

  In the case of a pledge, the pledgee may exercise its right to sell the assets by giving the pledgor reasonable notice without any prior court intervention. In case of an English mortgage, the mortgagee may appoint a receiver for the property and sell it without court intervention, subject to certain conditions. A deed of hypothecation usually contains provisions entitling the creditor to sell the hypothecated assets without court intervention. A similar right to sell without court intervention is not available in an equitable mortgage except for the rights available to certain financial institutions and banks under specialised legislation, such as the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI Act).

  The SARFAESI Act provides for, inter alia, mechanisms for the enforcement of security interests by banks and financial institutions. Section 13 of the SARFAESI Act allows secured creditors to enforce their security without any court intervention. As per this provision, where a borrower defaults in repayment of a secured debt and its account is classified as a NPA, the secured creditor may serve a notice to the borrower seeking repayment of the amount owed. The notice served by the secured creditor must contain all the details of the pending amount payable and the details of the secured assets to be taken in possession by the creditor if the borrower fails to repay the creditor.

  The creditor is required to either accept or reject any objections or representations made by the borrower after receipt of the demand notice and communicate the same to the borrower within 15 days. Where the borrower fails to fulfil its liability to the secured creditor after the 60-day notice period has expired, the secured creditor may take any of the following actions to enforce its security interest:

  (1) take possession of the secured asset of the borrower;

  (2) take over the management of the business of the borrower;

  (3) appoint a manager for supervision of the secured assets whose custody has been taken over by the secured creditor; or

  (4) require any person who has acquired any of the secured assets from the borrower, or who owes or will owe the borrower a sum sufficient to pay the secured debt, to pay money to the creditor on behalf of borrower.

  The secured creditor will take over the right to transfer the secured asset or business by way of lease, assignment or sale along with the asset or business respectively. However, the right to transfer the business may only be exercised by the secured creditor if a substantial part of the business of the borrower is held as security for the debt.

  In the case of the financing of a financial asset by more than one secured creditor or joint financing of a financial asset by secured creditors, any of the above-mentioned actions would require the consent of at least 60% in value of the secured creditors. Further, if required, a secured creditor may approach the Chief Metropolitan Magistrate or District Magistrate to assist the creditor in taking possession of the secured asset.

  Although the SARFAESI is intended to allow secured creditors to enforce security without court involvement, it allows the borrower (or any other person) to approach the DRT if it is aggrieved by any of the measures taken by the secured creditor to enforce its security. Further, the borrower has a right of redemption under section 13(8) of the SARFAESI, which provides that the secured creditor shall not enforce its security interest if the borrower repays its dues "at any time before the date of publication of notice for public auction or inviting quotations or tender from public or private treaty for transfer by way of lease, assignment or sale of the secured assets."

The procedure for sale of the security interest is laid down in rule 8 of the Security Interest (Enforcement) Rules 2002, according to which the following methods may be used:

(1) obtaining quotations from the persons dealing with similar secured assets or otherwise interested in buying such assets;

(2) inviting tenders from the public;

(3) holding a public auction; or

(4) private treaty.

Although rule 8 does not clarify which mode of sale needs to be prioritised, courts have required secured creditors to attempt an auction or call public tenders before any private sale is undertaken.[2] Therefore, enforcement action against a secured asset cannot be done by way of sale under a private treaty at the first instance. Various internal circulars and memos of banks and financial institutions also prescribe that sale by private treaty should be resorted to as a last measure, after more transparent methods of obtaining quotations, inviting tenders or holding public auctions have failed. Sale of the secured asset through any of these means does not require approval by the DRT.

2.1.2 Collective action

- *Insolvency and Bankruptcy Code 2016*

  Secured creditors may choose to initiate a CIRP on default by a company if they fall within the meaning of "financial creditors" under the IBC (see paragraph 1.2 above).

- *RBI Framework*

  The RBI periodically issues circulars and notifications for the restructuring of stressed assets outside the IBC (see paragraph 3.1 below).

2.2 What involvement does the court have in these processes?

See paragraph 2.1 above.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

Section 172 of the Indian Contract Act 1872 (Contract Act) defines a pledge as "the bailment of goods as security for payment of a debt or performance of a promise". The term "bailment" is intended to denote that the pledgee may retain the shares until the time of repayment of the loan.

The pledgee's right to sell the shares only accrues when the pledgor defaults in repaying the underlying loan, thereby utilising the pledged shares as a security against the loan.

Section 176 of the Contract Act provides the pledgee with remedies upon default by the pledgor, namely suing the pledgor for the secured debt, retaining the security as collateral or selling the pledged security upon giving the pledgor reasonable notice of sale. However, a right of redemption is provided under section 177 of the Contract Act, whereby the defaulting pledgor has the right to redeem the pledged goods at any time prior to the actual sale of the goods and after the default in payment.

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[2] *Mr Prateek Pradeep Agarwal v Union of India*, 2022 SCC Online Bom 9185.

Where security is created through a pledge of physical (non-electronic) shares, possession of the share certificates is required to be transferred. Where security is created through a pledge of dematerialised (electronic) shares, the Depositories Act 1996 (Depositories Act) applies and the same is to be recorded with the depository. Section 12 of the Depositories Act provides that, subject to applicable regulations and by-laws, a beneficial owner may, with the previous approval of the depository, create a pledge or hypothecation in respect of a security owned by it through a depository.

2.3.1 *Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?*

Typically, a pledge agreement is entered into, with a power of attorney to enforce the pledge also executed by the pledgor upfront. Enforcement of pledged shares is only permissible through:

(1) filing a suit for recovery of debt and retaining the pledged shares; or

(2) selling the pledged shares after giving reasonable notice of sale to the borrower.

The pledgee is entitled to redeem the pledged shares only until the actual sale of the shares and courts have held that the sale of pledged shares to the lender itself is not permitted in law.[3] Any sale of shares by the lender to itself has been held to only amount to conversion and not sale and, therefore, does not extinguish the right of redemption of the pledgor. Thus, the pledge does not come to an end if the shares are only converted to equity of the lender.

2.3.2 *Is a public auction mandatorily required or are private sales possible?*

A methodology for sale is not prescribed in law. A sale may be undertaken through private sale, auction or on the floor.

2.3.3 *Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?*

Pledge agreements often contain clauses that deal with the applicability of share transfer restrictions, contained in the constituent documents (such as articles of association) of a company, on the creditor in the event of invocation of the pledge. Thus, the validity of the sale of shares by the creditor in violation of the constituent documents of the borrower company would depend on the terms of the pledge agreement.

In the absence of provision regarding the same in the pledge agreement, any sale of shares made by a creditor in violation of the constituent documents of the borrower company may be obstructed by the management of the company. The articles of association of private companies in India often grant a discretion to directors to refuse share transfers or restrict share transfers. Private companies may refuse to register the transfer of shares by the creditor by relying on such provisions in the company's articles of association.[4]

Public companies may refuse registration of the transfer of shares in the limited circumstances where there is "sufficient cause" for the refusal, such as where the transfer is in violation of law, is against the best interests of the company or would violate the company's existing contractual obligations.[5] Any such refusal by a private or public company can, however, be challenged before the NCLT.[6]

When determining the validity of the sale of shares by the creditor in such an instance, the NCLT may consider various factors, such as the intention of the parties when entering into the pledge agreement, reasonableness of the restriction in the constituent documents of the company and availability of alternatives for the creditor for the sale of the shares.

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[3] *PTC India Financial Services Limited v. Venkateswarlu Kari & Ors.,* Civil Appeal No. 5443 of 2019 decided on May 12, 2022.

[4] Companies Act, section 58(1).

[5] Idem, section 58(4). See also *Mackintosh Burn Limited v. Sarkar and Chowdhury Enterprises Private Limited* (2018) 5 SCC 575.

[6] Companies Act, sections 58(3) and 58(4).

2.3.4 *Is "market testing" mandatorily required?*

There is no mandate for market testing, but a pledgee has the same duties as a bailee. Accordingly, there is a duty on the pledgee to take as much care of the bailed goods as an ordinary person of prudence would take in the care of their own goods. Hence, so long as the notice of sale has been given, the pledgee is free to sell the asset in a fair manner.

2.3.5 *Are valuation reports mandatorily required?*

There is no mandate for valuations to be undertaken prior to the sale of pledged shares. However, the creditor may appoint valuers to prepare valuation reports if it so chooses. In practice, valuation is often undertaken by creditors to avoid any potential challenge by the pledgor.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

3.1.1 *RBI frameworks*

The RBI introduced a Prudential Framework for Resolution of Stressed Assets in June 2019 (RBI Framework), which provides for a consensual restructuring process between lenders and the debtor. This is an out of court workout available to regulated institutional creditors such as banks and non-banking financial companies.

Under the RBI Framework, lenders classify accounts immediately on default and put in place board-approved policies for the resolution of the stressed asset, including timelines for resolution. Further, lenders undertake a prima facie review of the borrower's account within the first 30 days of default and decide on the resolution strategy (Review Period).

Lenders may also opt to initiate insolvency or recovery proceedings. For the implementation of the plan, the RBI Framework requires lenders to enter intercreditor agreements during the Review Period, which shall provide that decisions of lenders representing 75% by value of outstanding credit facilities and 60% of lenders in number shall be binding on all lenders. The plan must be implemented within 180 days from the end of the Review Period. Failure to adhere to the timelines may lead to additional provisioning requirements.

In June 2023, the RBI released the Framework for Compromise Settlements and Technical Write-Offs (Comprehensive Framework) to provide further impetus to the RBI Framework and to harmonise the instructions provided to all entities regulated by the RBI.

The Comprehensive Framework (which applies to a broader set of entities as compared to the RBI Framework) allows all such regulated entities, in accordance with board-approved policies, to undertake compromise settlements and technical write-offs in respect of borrowers classified as fraudulent or wilful defaulters, without prejudice to the provisions of any other statute in force.

3.1.2 *Schemes of arrangement*

The Companies Act allows for restructuring through a scheme of compromise and arrangement (Scheme). On an application made by a creditor, member or liquidator of a company, the NCLT may order a meeting of creditors or members or classes thereof. A notice of such a meeting, along with details of the Scheme and other requisite documents, is sent to all creditors, members (and classes thereof) and debenture holders of the company. Notice is also sent to the Central Government, income tax authorities and other sectoral regulators and authorities that are likely to be affected by the Scheme to enable them to make adequate representations.

The Scheme is required to be approved by a majority of 75% of those creditors or members in each class who are present and voting. Creditors and members are categorised into different classes, generally based on similar characteristics and common interests, and vote on a Scheme as a class. For example, secured and unsecured creditors usually form different classes.

Consequent to the requisite approval by creditors and members, the NCLT is required to give the final approval to the Scheme for it to bind dissenting and abstaining creditors. The NCLT considers objections of parties to the Scheme while deciding on its approval.

Any person aggrieved by the approval of a Scheme may prefer an appeal to the NCLAT within 45 days of the NCLT order.

3.2 What involvement does the court have in these processes?

No particular court involvement is envisaged in the RBI Framework. For Schemes, see paragraph 3.1 above.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Creditors and members of the distressed company are key players under the RBI Framework and the Scheme process. The NCLT is also one of the key players in the Scheme process. Further, while no insolvency practitioner is appointed in either of these processes, a Scheme may be proposed by a liquidator in cases where the distressed company is undergoing liquidation. In such cases, the liquidator will be a key player in the Scheme, as well as the liquidation process.

3.4 Is there a typical due diligence process followed?

Typically, the scope of due diligence in India includes reviewing several kinds of documents to analyse applicability with the law, such as the corporate records and filings of the company made with the Registrar of Companies, foreign exchange filings (if applicable) made with the RBI, material contracts, ongoing and threatened litigation, labour and employment-related documents, intellectual property registrations, licenses and registrations. In recent years, there has been a heavy focus on ESG-related compliance during the due diligence stage. This includes assessments such as impact on climate, waste management and carbon emissions. Another area of interest in due diligence that has particularly come into focus recently is cybersecurity and data privacy, especially given the enactment of the Digital Personal Data Protection Act 2023.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

For timelines prescribed in law for the RBI Framework and Schemes, see paragraph 3.1 above. In relation to Schemes, however, timelines may often be extended over the prescribed limits in practice.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

Avoidance action provisions under the IBC do not provide an express exemption for pre-insolvency restructuring processes. However, these provisions include an exemption for transactions that “are not undertaken in the ordinary course of business” by the debtor company and pre-insolvency restructuring transactions may fall within this exception.

3.7 Are “pre-pack” processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

The IBC was amended in 2021 to introduce a pre-packaged insolvency resolution process (PPIRP) for companies classified MSMEs under the Micro, Small and Medium Enterprises Act 2006. Only those corporate debtors that have committed default of at least INR 1,00,000 (approximately USD 12,000), or such higher amount as may be notified, and are defined as MSMEs under section 7 of the MSME Development Act are eligible for the PPIRP.

3.7.1 Initiation of a PPIRP

A PPIRP may be initiated by a corporate applicant / corporate debtor as follows:

(1) the unrelated financial creditors of the corporate debtor must propose the name of the insolvency professional to be appointed as RP for conducting the PPIRP, with the approval of 66% in value of the financial debt due to such creditors;

(2) the majority of the directors or partners of the corporate debtor, as the case may be, have made a declaration, stating inter alia:

  (a) that the corporate debtor shall file an application for initiating a PPIRP within a definite time period not exceeding 90 days;

  (b) that the PPIRP is not being initiated to defraud any person; and

  (c) the name of the insolvency professional proposed and approved to be appointed as RP;

(3) the members of the corporate debtor have passed a special resolution (or at least 75% of the total number of partners of the corporate debtor have passed a resolution) approving the filing of an application for initiating the PPIRP;

(4) the corporate debtor has provided its unrelated financial creditors with:

  (a) the declaration referred to in (2);

  (b) the special resolution or resolution referred to in (3);

  (c) a base resolution plan which conforms to the requirements referred to in the law and such other conditions as may be specified; and

  (d) such other information and documents as may be specified; and

(5) 66% in value of the unrelated financial creditors of the corporate debtor, having received all the aforementioned information, have approved the initiation of the PPIRP.

3.7.2 Admission of an application for commencement of a PPIRP

If a corporate applicant who meets all the eligibility criteria submits a complete application before the NCLT, the NCLT must admit or reject the application within 14 days. In making its decision, the NCLT will be supported by the report of the RP confirming that the corporate debtor is eligible for the PPIRP and that the base resolution plan conforms to the specified requirements. Upon admission of the application, the PPIRP operates for a period of 120 days, during which time:

(a) a limited moratorium (applying only sections 14(1) and 14(3) of the IBC) is declared;

(b) the insolvency professional suggested in the application is appointed as the RP if no disciplinary action is pending against him or her; and

(c) a public announcement is made declaring the initiation of the PPIRP.

3.7.3 Timelines and approval of a resolution plan

The PPIRP must be completed within 120 days from the commencement date as per the IBC. However, timelines may often be extended over the prescribed limits in practice. The debtor submits the base resolution plan to the RP within 2 days of the commencement of the PPIRP, who must in turn present it to the CoC.

If a resolution plan does not impair any claims owed by the corporate debtor to the operational creditors – i.e. it provides for full payment of all claims due to the operational creditors – it may be approved by the CoC. Alternatively, where the base plan is not approved by the CoC or it impairs any claims owed by the corporate debtor to the operational creditors, the RP must invite prospective resolution applicants to submit resolution plans.

Both the base resolution plan and invited plans must conform to the requirements of section 30(2) of the IBC (e.g. the plan must provide for payment of process costs in priority and payment for debts of operational creditors and dissenting financial creditors above requisite thresholds).

The CoC must consider the feasibility and viability of the plan and the manner of distribution proposed before approving the resolution plan by a vote of 66% by voting share. Once approved, the plan is to be placed before the NCLT for its approval, after which it becomes binding on all stakeholders.

3.7.4 Conversion into a CIRP

At any time after the commencement of the PPIRP and before the approval of a resolution plan, the CoC may, by a vote of not less than 66% of the total voting shares, resolve to initiate a CIRP with respect to the corporate debtor, as long as the corporate debtor is eligible under Chapter II of the IBC. In such a case, the RP must make an application to the NCLT regarding the decision of the CoC. Within 30 days, the NCLT would then:

(1) terminate the PPIRP and initiate a CIRP;

(2) appoint the RP as the interim RP under the CIRP; and

(3) declare that any PPIRP costs would be included as CIRP costs with respect to the corporate debtor.

Such an order of the NCLT would be deemed to be an order admitting an application under section 7 of the IBC.

3.7.5 Termination of the process

The RP may file an application before the NCLT for termination of the PPIRP where no resolution plan is approved by the CoC, or the timelines of 90 or 120 days have expired. The CoC may also, by a vote of not less than 66% of the voting shares, choose to terminate the PPIRP at any time during the process. In such cases, within 30 days, the NCLT must terminate the process and provide the manner for continuation of avoidance proceedings. The corporate debtor is then liable to bear the costs of the PPIRP. Even where the NCLT rejects a resolution plan approved by the CoC, it must order termination of the PPIRP.

3.7.6 Liquidation

Where the NCLT has already passed an order vesting the management of the corporate debtor with the RP during the PPIRP, liquidation may be ordered if:

(1) no resolution plan is approved by the CoC and the PPIRP would otherwise have to be terminated; or

(2) the resolution plan approved by the CoC does not result in the change in the management or control of the corporate debtor to a person who was not a promoter or in the management or control of the corporate debtor.

Further, liquidation may also be ordered by the NCLT where an approved resolution plan under the PPIRP is contravened by the corporate debtor.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Presently, Indian laws do not provide for the pre-packaged sale of businesses. However, the IBC offers provisions for a PPIRP as detailed above.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The key players in the PPIRP are the corporate debtor as the seller of the business undergoing PPRIP, the CoC as the decision-making body responsible for major determinations throughout the process, the RP functioning as the facilitator of the process and the Adjudicating Authority or the NCLT tasked with the approval of the resolution plan proposed for the corporate debtor or alternatively liquidating the corporate debtor.

The insolvency professional proposed to be appointed as the RP must ultimately receive approval from the NCLT, provided there are no disciplinary proceedings pending against the RP. Consequently, the appointment of the RP is court-sanctioned.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Investors in a corporate debtor undergoing a PPIRP lack control over the appointment of the RP. Unrelated financial creditors representing not less than 66% in value terms hold the authority to propose the appointment of an insolvency professional as the RP before formal admission of the process. If there are no ongoing disciplinary proceedings pending against the RP, the NCLT appoints the professional suggested by the financial creditors. However, if there are disciplinary proceedings pending, the NCLT appoints a RP based on the recommendation of the IBBI. The CoC may at any time during the PPIRP by a vote of 66% of its voting share resolve to replace the RP with another RP, subject to the written consent of the latter.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

The IBC provides that the base resolution plan or the resolution plan approved by the CoC must not impair any claims owed by the corporate debtor to its operational creditors. Further, the subordinate regulations outlined under the IBC in relation to the PPIRP prescribe that the amount payable to the operational creditors and the dissenting financial creditors shall be paid in priority to the financial creditors or the assenting financial creditors respectively.

4.5 Is there a typical due diligence process followed?

In the event the base resolution plan of the corporate debtor is not approved by the CoC or impairs any claims owed by the debtor to the operational creditors, the RP invites third parties or prospective resolution applicants to compete with the base resolution plan. The law requires the RP to prepare an information memorandum, which contains relevant information relating to the corporate debtor required for formulating a resolution plan.

Relevant information includes details such as the financial position of the corporate debtor, information relating to the disputes by or against the corporate debtor, assets and liabilities with descriptions as are necessary for ascertaining their values, the latest annual financial statements, audited financial statements of the corporate debtor for the last 2 years and provisional financial statements for the current financial year, a list of claims along with names of creditors, the amount of the claims and the security interest (if any) in respect of such claims, the number of workers and employees, and liabilities of the corporate debtor towards them.

This information is provided to the resolution applicant in physical and electronic forms, provided the resolution applicant undertakes to maintain confidentiality, to comply with the laws relating to insider trading, and to protect the intellectual property of the corporate debtor. Resolution applicants then commonly conduct their own due diligence.

While the IBC does not compel investors to adhere to specific ESG or energy transition targets, businesses are progressively emphasising sustainable practices, given their impact on financial stability. Further, post-approval of a resolution plan by the NCLT, the applicable laws might require the resolution applicant to secure approvals from environmental protection agencies or similar authorities before assuming control of the corporate debtor.

4.6 Is "market testing" mandatorily required?

The PPIRP framework under the IBC is a debtor-in-possession model, and thus first allows the corporate debtor an opportunity to submit a base resolution plan to the CoC for the company's rescue. In the event the base resolution plan is not approved by the CoC, or it impairs the claims owed by the corporate debtor to its operational creditors, the RP then invites prospective resolution applicants to submit resolution plans to compete with the base resolution plan. The resolution applicants submitting resolution plans must adhere to the criteria established by the RP with the approval of the CoC concerning the complexity and scale of the corporate debtor's operations, along with other specified conditions.

The RP presents the legally compliant resolution plans to the CoC, and the CoC evaluates and selects a resolution plan to compete with the base resolution plan.

If the selected resolution plan is significantly better than the base resolution plan, it is selected for approval. However, if no resolution plan is significantly better than the base resolution plan, the scores of the compliant resolution plans and the base resolution plan are disclosed to the submitters and they are given the option to improve their plans.

This process of improvement is completed within a time window of 48 hours. The resolution plan having the highest score on completion of the process of improvement is considered for approval.

4.7 Are valuation reports mandatorily required?

Accurate valuation of the corporate debtor is a fundamental aspect under the IBC and is essential for achieving the objective of value maximisation of the corporate debtor. Valuation reports determine the worth of the company's assets, enabling informed decision making by the CoC. This facilitates a comparison of options, allowing them to either approve a resolution plan for the rescue of the corporate debtor or opt for its liquidation.

In a PPIRP, the RP, within 3 days of his or her appointment by the NCLT, is required to appoint two registered valuers to determine the fair value and the liquidation value of the corporate debtor. The estimation of the fair value and the liquidation value of the corporate debtor is computed in accordance with internationally accepted valuation standards, after physical verification of the inventory and fixed assets of the corporate debtor. The average of the value determined by the two registered valuers shall be considered the fair value or the liquidation value, as required.

The RP provides the fair value and the liquidation value to each member of the CoC in electronic form after receipt of the resolution plans in accordance with the IBC and the subordinate regulations. The members of the CoC provide an undertaking to the RP that they shall maintain confidentiality of the values and shall not use them to cause any undue gain or loss to itself or any other person.

4.8 What is the typical timeline of "pre-pack" sales?

The PPIRP must be completed within 120 days from the commencement date as per the IBC. However, as noted, these timelines may often be extended over the prescribed limits in practice.

The RP must submit the resolution plan, as approved by the committee of creditors, to the NCLT within a period of 90 days from the PPIRP commencement date. The NCLT must approve a plan within 30 days of the receipt of the resolution plan.

If no resolution plan is approved by the CoC or NCLT within these periods, the RP shall, on the day after the expiry of such time period, file an application with the NCLT for termination of the PPIRP.

INDONESIA

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

The Indonesian Civil Code Book III (Code) establishes a legal foundation governing contract. It encompasses requirements for agreements to be binding and legally enforceable,[1] as well as specific provisions applicable to sale and purchase transactions.[2]

The Indonesian Company Law (Law No. 40 of 2007) outlines the standard process for the sale and purchase of shares in an Indonesian limited liability company. The process of share transfers requires a formal deed of transfer documenting the transaction, which needs to be registered in the company's official shareholder register.[3]

The articles of association of the company might also impose additional requirements, such as pre-emptive rights for existing shareholders, prior approval from the company's governing body (i.e. board of directors, board of commissioner and / or general meetings of shareholders) within 90 days of the approval request and authorisation from pertinent regulatory agencies as applicable.[4] However, distressed equity situations might require deviations due to factors such as creditor claims or court orders.

The sale of shares in public limited companies is overseen by the Financial Services Authority.[5] While the core transfer process shares similarities, public companies face additional regulatory requirements such as market access (issuance and trading of shares in the primary and secondary market), enhanced disclosures, pre-emptive rights and tender offer regulations. Distressed equity acquisitions might necessitate further regulations regarding public disclosures and potential trading suspensions during periods of financial hardship.

While there is no special legal regime on the purchase of distressed equity, additional legal requirements often arise. When the distressed equity originates from a debt restructuring process (PKPU / suspension of debt payments or out-of-court), the terms of the restructuring plan and / or any court approvals can influence the transfer of ownership.

If the company is declared bankrupt, a specific legal framework governs the sale of assets, including equity. Compliance with the Indonesian Insolvency Law (Law No. 37 of 2004) becomes essential for purchasing distressed equity in such scenarios.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Indonesia does not have a special legal regime specifically designed for purchasing distressed debt or non-performing loans. However, the general framework of debt transfers is governed by the Code.

The most common mechanism is assignment (*cessie*).[6] It requires a formal deed (notarial or private) between the original creditor (assignor) and the new creditor (assignee). While notification to the debtor is deemed sufficient under the Code, obtaining written approval or acknowledgement from the debtor will strengthen the creditor's legal position and avoid potential disputes.

The other mechanisms are subrogation[7] and novation.[8] Subrogation applies when a third party settles a debtor's obligation to the original creditor. The third party then assumes the creditor's position and rights regarding the debt, essentially replacing the original debt agreement with a new one between the new creditor and the debtor. Novation involves an agreement between the original

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1 Code, article 1320.
2 Idem, Chapter V, articles 1457-1540.
3 Indonesian Company Law, article 56.
4 Idem, articles 57-59.
5 Financial Services Authority Regulation No.22/POJK.04/2019 on Securities Transactions.
6 Code, article 613.
7 Idem, article 1382.
8 Idem, article 1413.

creditor and debtor to extinguish the existing debt and replace it with a new one. In a distressed situation, the terms of the new agreement can be adjusted to reflect the nature of the debt.

While the Code provides a foundation, distressed debt purchases often introduce complexities and additional legal considerations might apply.

If the debt is secured by assets, having a formal deed documenting the debt transfer and collateral details will provide more certainty. If there are multiple creditors with secured claims against the debtor, the ranking of those claims determines priority in case of asset liquidation. If the debtor is going through debt restructuring process, the restructuring plan may influence terms of the debt transfer and if the debtor is undergoing bankruptcy proceeding, compliance with the Indonesian Insolvency Law becomes crucial.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

Distressed investments in Indonesia are not governed by a single, overarching legal framework. Nevertheless, investors must navigate through various general regulatory requirements in addition to any industry-specific regulations.

Compliance with Indonesian labour law[9] is crucial and this is particularly relevant when the investment requires workforce reductions. In such scenarios, strict adherence to employee termination procedures outlined in the relevant regulations is essential. Additionally, depending on the presence and activity level of labour unions within the distressed company, negotiations with these unions might be required. Furthermore, if the investment strategy involves acquiring a distressed company's assets with the intention of continuing its operations, regulations governing the Transfer of Business Undertakings (TOBU) might become applicable.[10] These regulations prioritise the protection of employee rights during such business transfers.

Potential tax liabilities of the distressed company become the investor's responsibility upon acquisition. Thorough due diligence is crucial to assess tax exposures and potential transaction-related tax implications and ensure compliance with Indonesian tax laws.

Environmental regulations must also be addressed. Due diligence should identify and address any outstanding environmental liabilities. Competition law, particularly regarding mergers and acquisitions, needs to be considered. Investors should also verify the validity and enforceability of the distressed company's intellectual property (IP) through due diligence. Compliance with foreign investment rules, including ownership limitations, is necessary. Data privacy regulations must be adhered to, depending on the nature of the investment and data involved.

The nature of the investment might trigger specific disclosure requirements to the Indonesian Stock Exchange (IDX) or other authorities regarding the financial situation, restructuring plans and potential stakeholder impacts. Additionally, regulations prioritise protecting minority shareholder rights. Actions impacting their rights or interests during the investment process might require adherence to specific procedures and potential approvals.

Thorough due diligence and legal guidance from qualified professionals are therefore essential to navigate these requirements, ensuring compliance and mitigating risks throughout the distressed investment process in Indonesia.

1.4 What risks exist for an investor of a distressed business?

Investing in a distressed Indonesian business carries specific legal risks related to avoidance actions (*actio pauliana*) and insolvency proceedings. These can significantly disrupt operations and impact the investor's ability to recover debt or equity investments.

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9 Law No. 13 of 2003 on Labor/ Manpower, as amended by Law No. 11 of 2020 (Omnibus Law on Job Creation) and Government Regulation No. 2 of 2022.

10 Constitutional Court Decision on Case No. 27/ PUU-IX/2011.

Creditors can potentially challenge past transactions by the distressed company through *actio pauliana*. This allows courts to nullify transactions deemed detrimental to creditors' interests, potentially including those made before the investor's involvement. The Code and the Insolvency Law govern *actio pauliana*[11] respectively.

If the distressed company enters PKPU (suspension of debt payments) or bankruptcy proceedings, the investor's ability to control or recover their investment can be significantly impacted. Notably, PKPU proceedings require court approval for any sale of assets or shares outside the ordinary course of business[12] (see paragraph 3.6 below).

1.4.1 *What risks exist for the transaction to be challenged and overturned outside of bankruptcy?*

Outside of bankruptcy, the transaction can be challenged on various legal grounds rooted in the Code. These challenges primarily focus on the validity, breach and good faith aspects of the transaction.

If the transaction fails to adhere to essential legal principles of a contract regarding mutual consent and the capacity of parties to enter into an agreement,[13] as outlined by the Code, it might be subject to nullification. Similarly, if the transaction violates core conditions for a valid contract under the Code which could involve issues on the subject matter of the contract or objects that cannot be part of a contract or prohibited clauses,[14] the transaction might be declared null and void from the outset.

In addition, the Code also regulates the legal consequences for non-performance of contractual obligations. Breach of contract might lead the affected party to institute legal proceedings. The affected party can request to nullify the transaction or can alternatively claim the continuance of the transaction and payment for the loss.

The Code emphasises good faith in business transactions.[15] This principle extends to debt investments. A debt investment transaction can be challenged if any party acted in bad faith, causing demonstrable harm or losses to creditors. The key element in such challenges is proving that, at the time of the transaction, the debtor and the other involved party were aware the transaction would cause creditor losses.[16]

1.4.2 *What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?*

In Indonesian bankruptcy proceedings, *actio pauliana* can be utilised to challenge transactions made by the debtor before the bankruptcy declaration. This mechanism aims to recover assets that have been removed from the debtor's bankruptcy estate (*boedel pailit*) and protect creditors' interests.

Following a bankruptcy declaration, the creditor or receiver (bankruptcy trustee) can initiate *actio pauliana* proceedings against the debtor in the court. The application of *actio pauliana* in Indonesian bankruptcy proceedings requires the petitioner to provide:[17] (i) that, at the time of the transaction, the debtor and the counterparty of the transaction knew or should have known the transaction would cause potential losses to creditors; and (ii) the challenged transaction occurred before the bankruptcy declaration, the debtor is not legally obligated to carry it out and it demonstrably harms the creditor's interests.

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[11] Code, article 1341.

[12] In PKPU cases of property industry, transfer of asset title to the customer also requires the court's approval despite being an ordinary course of business (in most cases, transfer of asset title cannot be done during PKPU period).

[13] Code, articles 1320(1) and 1320(2).

[14] Idem, articles 1320(3) and 1320(4).

[15] Idem, article 1340.

[16] Idem, article 1341.

[17] Indonesian Insolvency Law, articles 41-42.

However, demonstrating the debtor's knowledge of impending insolvency and potential harm to creditors can be difficult. This is because knowledge inherently relates to the debtor's subjective state of mind. The case of *PT HEI*[18] in Indonesia highlights the limitations in providing evidence for this "knowing" element. While confessions from any party in the challenged transaction hold significant weight, acquiring other evidence can be challenging.[19]

1.4.3 What risks exist for a new lender investing in a distressed business?

The absence of a dedicated legal framework for distressed business investments amplifies the inherent risks associated with the debtor's financial struggles. Default risk is heightened due to potential misconduct by the debtor and undisclosed debts or liens undetected during due diligence, unforeseen economic downturns or mismanagement that can significantly affect their ability to repay the loan.

Furthermore, recovery risk arises when the collateral's valuation does not reflect its true realisable value, making it difficult for the lender to recoup their investment in the case of default. Incomplete security documentation or legal challenges from the debtor can also create collateral enforcement risk, hindering the lender's ability to enforce their rights over the assets pledged as security. The risk of insolvency proceedings initiated by existing creditors looms high, potentially disrupting the business and impacting the validity or classification of the new lender's loan.

Finally, even in situations where a PKPU proceeding leads to a settlement plan, there is a risk of the plan being cancelled due to non-implementation, potentially pushing the company into bankruptcy.

A thorough legal and financial due diligence, as well as careful structuring of the loan agreement and collateral documents, are crucial to mitigate these inherent risks.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

Beyond the inherent risks associated with any equity investment, distressed businesses present a magnified set of challenges for new shareholders. Distressed businesses are also more likely to be embroiled in litigation or regulatory investigations due to past misconduct.

While new shareholders might install their own management team, a subsequent PKPU process could expose these directors to lawsuits from previous creditors. Indonesian law limits director liability to company losses caused by their own errors or negligence. To mitigate this risk, the new directors should ensure the homologation decision (approved restructuring plan) clearly addresses any potential issues, such as unfulfilled obligations by the prior debtor, unclear permits or other outstanding matters that could lead to future liability for the new investors. The investors should also negotiate clear terms to address these issues in the share purchase agreement.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Indonesian law offers distressed debt investors a range of enforcement mechanisms to recover their investments or acquire assets in the event of default. For secured creditors, Indonesia recognises "*parate executie*," a streamlined process allowing them to directly enforce their security interest through public auction without prior court approval.[20] This expedites the recovery process compared to jurisdictions requiring court orders. However, if a security agreement is

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[18] Commercial Court decision No. 07/PDT.SUS-ACTIO PAULIANA/2015/PN.NIAGA.MDN.

[19] In the case of PT HEI, the evidence submitted included: (i) overlap board membership (same director and commissioner) between PT HEI and the counterparty in the challenged transaction; (ii) asset sale transaction documents and a confession from an individual involved in the transaction, which bolstered the case against PT HEI; and (iii) a transfer of funds from PT HEI to a shareholder supposedly for a loan repayment, though the shareholder was not listed as verified creditor.

[20] Based on article 20 of Law No. 4/1996 on Mortgage Rights over Land and Objects Related to Land.

breached and "*parate executie*" is unsuccessful, creditors can still initiate legal proceedings to obtain a court order for enforcement, typically involving a public auction.[21]

Both creditors and debtors can also explore consensual sales of secured assets as an alternative to public auctions.[22]

During PKPU proceedings, dissenting secured creditors who reject the restructuring plan have specific rights. They are entitled to receive compensation equal to the lesser of the collateral's value and the outstanding loan.[23] This ensures their execution rights are not automatically extinguished even if the PKPU is successful. However, Indonesian insolvency law lacks specific provisions on the form and term of the "compensation" payable. This often necessitates renegotiation between the creditors and the debtor to determine the appropriate compensation and payment timeframe.

If the PKPU fails and the debtor enters bankruptcy, enforcement of security interests generally requires a public auction. However, with the supervisory judge's approval, a consensual sale can occur if the initial auction is unsuccessful.[24]

While the focus has been on distressed debt investors, M&A investors can also leverage legal options in case of a breach of contract by the seller. They might pursue remedies such as damages or, potentially, the return of their investment through legal proceedings. Public auctions would not typically be involved in such claims.

2.2 What involvement does the court have in these processes?

As discussed in paragraph 2.1 above, the extent of court involvement in enforcing mortgages and pledges in Indonesia hinges on whether the process occurs within or outside of bankruptcy proceedings. Generally, the court plays a more active role in bankruptcy proceedings. Outside of court processes, holders of security rights benefit from *parate executie*, enabling them to enforce mortgages and pledges without prior court approval, or conduct a consensual sale. However, if peaceful enforcement attempts are unsuccessful, creditors can seek a court order for execution, typically involving a public auction.

Outside court-supervised enforcement, debtors may take defensive actions to challenge enforcement, including disputing the validity of security interests or objecting to enforcement procedures.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

The Indonesian Company Law allows shares in a legal entity to be pledged as collateral, subject to any restrictions outlined in the company's articles of association.[25] In the event of a default by the debtor (shareholder), the creditor (pledgee) has the right to sell the pledged shares to recover the debt.

The Code allows for efficient enforcement through a public auction,[26] or for publicly traded shares, a sale on the Indonesia Stock Exchange (IDX) facilitated by brokers.

The pledge agreement can also grant the creditor an irrevocable power of attorney to sell the shares, further expediting the process without court involvement. However, if a power of attorney is unavailable or the creditor prefers it, the Code provides an alternative. The creditor can petition

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21 Article 29 (1) of Law No. 42/1999 on Fiducia Security.

22 Diana Afifah, Konsep Parate Executie dan Fiat Executie dalam Pelaksanaan Lelang Pasal 6 UU Hak Tanggungan di KPKNL (Ministry of Finance of Indonesia, https://www.djkn.kemenkeu.go.id/kpknl-lampung/baca-artikel/14751/Konsep-Parate-Executie-dan-Fiat-Executie-dalam-Pelaksanaan-Lelang-Pasal-6-UU-Hak-Tanggungan-di-KPKNL.html, February 2022).

23 Indonesian Insolvency Law, article 281(2).

24 Idem, article 185.

25 Indonesian Company Law, article 60(2).

26 Code, article 1155.

the court for an order to either sell the pledged shares or retain them in their possession to cover the outstanding debt.[27]

2.3.1 *Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?*

While Indonesia does not regulate debt-for-equity swaps within share pledge enforcement, these swaps remain a possibility under certain conditions. The enforcement mechanism of share pledge, as discussed above, is for the shares to be sold to repay the outstanding loans, not a direct swap.

In practice, a successful debt-for-equity swap hinges on a negotiated agreement between the creditor (pledgee) and the debtor (shareholder). They must agree on the conversion ratio (debt converted to equity) and other swap terms.

However, legal hurdles might exist. The Indonesian Company Law and the company's articles of association might restrict debt-for-equity swaps, particularly regarding new share issuance (i.e. pre-emptive rights with a restriction on converting the interest portion into shares).[28] Addressing these potential limitations is crucial.

Additionally, the swap could dilute existing minority shareholder ownership, requiring consideration of their rights under Indonesian law. Both the creditor and debtor might face tax consequences due to the swap, so it is crucial to understand potential tax liabilities from the swap.

2.3.2 *Is a public auction mandatorily required or are private sales possible?*

As discussed in the previous paragraphs, public auction is a standard method of security enforcement in Indonesia. Public auctions can be conducted either through state or private auction houses.

However, private sales are also an option with the debtor's consent and often are a preferred method of share pledge enforcement. Such options are often documented in the security documents, with process as agreed with the debtor.

2.3.3 *Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?*

Indonesian law generally respects the freedom of contract principle, allowing parties to agree on various terms within a share pledge agreement unless it is in contradiction with the prevailing law. If such transfer restrictions are in accordance with Indonesian Company Law, they will remain in effect and cannot be avoided.

It is to be noted that the Indonesian Company Law provides for limitations when it comes to transfer restrictions in the context of share pledge enforcement. Transfer restrictions established in a share pledge agreement cannot override existing restrictions outlined in the company's articles of association. The law recognises the importance of protecting minority shareholders and transfer restrictions in the articles can be a mechanism to safeguard their interests. Therefore, the more formal document (company articles) takes precedence over a private contract (pledge agreement).

2.3.4 *Is "market testing" mandatorily required?*

While Indonesian law does not require formal "market testing" for enforcing security interests such as share pledges, it emphasises good faith efforts by creditors to recover debts. Public auction houses require an updated independent valuation report for both court-ordered and out-of-court enforcement. This valuation report is to be issued by a licensed independent valuer (*Kantor Jasa Penilai Publik* or *KJPP*) and details both market and liquidation values of the asset. Independent valuations are also mandatory in other situations, such as asset sales or purchases by public limited liability companies.

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[27] Idem, article 1156.

[28] Indonesian Company Law, article 35 (2).

2.3.5 Are valuation reports mandatorily required?

Valuation reports are practically mandatory for share pledges enforcement (as mentioned in paragraph 2.3.4 above), to determine market value in the enforcement process. Independent valuation reports are not mandatory under a PKPU process. However, it is becoming market practice to provide such reports during negotiations and settlement discussions.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

Companies or individuals facing financial difficulties In Indonesia can explore several formal legal processes before resorting to full insolvency proceedings.[29] These options allow for negotiation with creditors to potentially avoid bankruptcy.

1. Out-of-court restructuring

Negotiated settlements and informal restructuring agreements, without court involvement, can be explored. These agreements, while not formally court-supervised, can outline a restructuring plan and provide temporary relief to the debtor.

2. Suspension of debt payments (Penundaan Kewajiban Pembayaran Utang or PKPU)

This court-supervised process is centred on the development of a composition plan (restructuring plan) which is presented by the management of the debtor and is voted on by those creditors who have gone through a formal proof of claim process. Throughout this process, the debtor retains control of the company, subject to oversight by court-appointed administrators. PKPU provides a temporary suspension of debt collection activities and a moratorium against creditors' legal actions while the debtor negotiates a restructuring agreement with them. The aim is to provide breathing room for the debtor to stabilise finances and find solutions. The debtor has a maximum of 270 days from the date of the approval of the PKPU petition to present and secure creditors' approval for the composition plan.[30] Following creditors' approval, the court will formally sanction (or homologate) the composition plan and the debtor's PKPU status will be lifted.

3. Debt settlement process within a bankruptcy proceeding (bankruptcy settlement, or "Perdamaian dalam kepailitan")

An insolvent debtor[31] may initiate debt settlement negotiations by submitting a proposal to the court-appointed receiver (or bankruptcy trustee). The discussion and creditors voting on the proposal must occur immediately following claim verification, but can be postponed for up to 21 days with the agreement of relevant creditors. However, secured and preferred creditors generally cannot vote on the settlement proposal unless they relinquish their security interests. Upon the court's final approval of the settlement agreement, the bankruptcy status and proceedings will be terminated.

Secured creditors who choose to relinquish their rights but then do not submit their vote (abstain) will have their abstention counted as a vote against the agreement.[32]

Secured or preferred creditors who never relinquished their security interest, and therefore did not vote in favour of the settlement proposal, are considered a dissenting voice to the settlement proposal. These creditors are then not legally bound by the court-ratified settlement agreement and remain unaffected by it.

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29 Essentially refers to a liquidation proceeding.
30 Indonesian Insolvency Law, article 228.
31 In the event the debtor files for bankruptcy or a petition is presented against it (*kepailitan*).
32 Indonesian Insolvency Law, article 151.

3.2 What involvement does the court have in these processes?

Indonesian Insolvency Law positions the court as a central figure in overseeing and facilitating financial distress resolutions through PKPU and bankruptcy settlement proceedings. The court fulfils several crucial functions throughout these processes, including legal oversight, compliance, process management by appointing an administrator or receiver (bankruptcy trustee) and sanctioning agreements. This includes providing a legal moratorium (temporary suspension) against creditor lawsuits for claim receivables during a PKPU process.

Secondly, the court is heavily involved in managing the overall process. The court is responsible for reviewing and approving petitions for PKPU or bankruptcy (*kepailitan*). The court, jointly with the administrator, is also responsible for determining and agreeing creditors' claims, classifying creditors based on their claim types (secured, unsecured, etc) and establishing timeframes for each process to ensure its efficient completion. Lastly, following creditor approval of the composition plan in PKPU or the settlement agreement in bankruptcy, the court formally homologates (sanctions) the agreement, making it binding on all involved parties.

Practically, the PKPU and bankruptcy settlement processes are entirely court-led, with each process outlined as follows:

1. PKPU

Upon receiving a PKPU filing, the court first assesses the debtor's eligibility. If eligible, the court appoints a supervisory judge to oversee the proceedings and grants a temporary PKPU order, typically lasting 45 days.[33] If this period proves insufficient to develop a composition plan (restructuring proposal), it can be extended to a permanent PKPU (PKPU tetap) with a maximum total duration of 270 days from the initial PKPU grant.

The court appoints administrators to manage the overall process. This includes the evaluation of the debtor's financial health, the receipt and verification of claims and the monitoring of the development of the composition plan. In some cases, additional experts may be appointed by the court to assess creditors' financial health or assist with plan development and negotiation.

Creditor meetings are held, considering creditor classifications, to discuss and vote on the proposed composition plan. If a majority of creditors approve the plan as defined by law[34] and it is subsequently sanctioned by the court, it becomes binding, including against dissenting unsecured creditors.

2. Bankruptcy settlement

While bankruptcy settlement shares similarities with PKPU, some key differences exist. Unlike a PKPU, a bankruptcy process does not have a pre-defined maximum timeframe. The duration varies depending on the case's complexity. However, the court retains the authority to set time limits. These processes involve the court appointing a supervisory judge upon receiving the petition (in this case, bankruptcy (*kepailitan*) petition). The court also facilitates communication by scheduling creditor meetings for discussion and voting on the proposed settlement plan. Similar to a PKPU, if the plan receives the required majority creditor approval as defined by law[35] and is sanctioned by the court, the settlement agreement becomes binding on all creditors, including dissenting creditors.

The treatment of secured creditors in a bankruptcy settlement differs significantly. If a secured creditor does not vote on the debtor's proposed settlement agreement, their conduct is automatically deemed a rejection.[36] By being deemed to have rejected the agreement, the

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33 Idem, article 225.

34 The minimum approval requirement in a PKPU is 2/3 by value and 1/2 by headcount of registered creditors present in the creditors meeting, applicable to each secured and unsecured creditor class.

35 The minimum approval requirement in bankruptcy settlement is 2/3 by value and 1/2 by headcount of registered creditors present in the creditors meeting, applicable to each unsecured creditor class.

36 Indonesian Insolvency Law, article 151.

secured creditor is essentially not legally bound by the court-ratified settlement agreement.[37] Consequently, their security rights remain attached to the collateral and are not affected by the settlement agreement. This ensures secured creditors retain the ability to enforce their security rights separately, even after the settlement is ratified for the unsecured creditors.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Indonesia's framework for PKPU and bankruptcy settlement relies on the collaboration of several key players.

- ***Court-appointed insolvency practitioners***

  a. *Administrators (PKPU)* – overseeing and managing the PKPU process, including recognition of creditor claims, oversight of the management of the debtor and management of creditor meetings and voting. They are accountable to the court and creditors.

  b. *Receivers (bankruptcy)* – manage assets and liabilities in bankruptcy proceedings, acting under the court's supervision.

- ***Court***

  As discussed in paragraph 3.2 above, playing a central role, the court appoints supervisory judges and insolvency practitioners, oversees the processes and ensures legal compliance, and sanctions approved restructuring / settlement agreements.

- ***Court appointed expert witnesses (optional)***

  When necessary, the court may appoint auditors, financial advisors or independent valuers (KJPP) to contribute specialised knowledge.

- ***Legal advisors***

  Lawyers who provide legal expertise to various stakeholders, including the debtor, creditors or others involved in the process.

- ***Financial advisors***

  Financial experts (representing either debtor or creditor side) are often involved in the overall process, particularly in the development of the restructuring or settlement plan and negotiations with the debtor / creditors.

3.4 Is there a typical due diligence process followed?

While there are no specific regulations dictating due diligence procedures in PKPU and bankruptcy situations, the court may require parties involved to conduct thorough investigations to ensure transparency and compliance with applicable laws. Additionally, it is standard market practice in larger situations for the conduct of detailed due diligence, including business review and planning, security valuations, financial modelling and risk assessments.

The market standard due diligence procedures carried out by distressed investors can vary significantly from that of investors in the pre-investment stage. Key areas of focus are realisable value of security, enforcement mechanisms and strategy, documentation completeness and fairness of financial statements. Currently, ESG or energy transition due diligence is not common in the distressed market.

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[37] Idem, article 286.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

While Indonesia lacks a distinct pre-insolvency process with specific regulations, companies facing financial distress can explore options through the PKPU process. The timeline for any M&A transaction must work within the timelines and extensions specified in accordance with the law.

The PKPU process has a defined timeframe. There is an initial supervisory period of no more than 45 days with the potential for multiple extensions thereafter, subject to creditor voting, for a cumulative time of no more than 270 days.

A company can be declared insolvent in the following circumstances: (i) rejection of the proposed composition plan in a PKPU process; or (ii) a bankruptcy petition that leads to a bankruptcy decision.

If the insolvency is driven by the court's approval of the bankruptcy petition, the decision must be pronounced no later than 60 days after the date the application for bankruptcy declaration is filed.[38] Although bankruptcy proceedings allow for a composition plan, the duration of bankruptcy proceedings can vary significantly depending on the case's complexity. Their primary focus is on asset management and settlement by a court-appointed receiver. M&A transactions are not practical within bankruptcy due to the emphasis on asset liquidation and distribution to creditors.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

M&A sales or asset sales conducted as a result of the PKPU process may benefit from protection against clawback actions (avoidance actions) in subsequent bankruptcy proceedings. This protection hinges on the specific circumstances.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Indonesia does not have specific regulations or formalised procedures for "pre-pack" processes similar to those found in some other jurisdictions. Distressed companies can explore synthetic mechanisms such as a voluntary restructuring followed by a PKPU process to formalise the agreement and cram down uncooperative unsecured creditors. However, this strategy always runs the risk of aggressive pre-empting the planned PKPU with a petition of their own.

4. "Pre-pack" sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Indonesia does not have "pre-pack" sales (see paragraph 3.7 above).

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Not applicable.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Not applicable.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Not applicable.

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[38] Idem, article 8(5).

4.5 Is there a typical due diligence process followed?

Not applicable.

4.6 Is “market testing” mandatorily required?

Not applicable.

4.7 Are valuation reports mandatorily required?

Not applicable.

4.8 What is the typical timeline of “pre-pack” sales?

Not applicable.

ITALY

The Italian Crisis and Insolvency Code (CCII) was adopted by Legislative Decree No. 14/2019. The CCII replaced and overhauled the former Italian bankruptcy law. After having been amended to comply with the European Insolvency Directive 2019/1023, the CCII finally entered into force in July 2022.

It should be noted that Italian law does not provide for "pre-insolvency" proceedings per se, with most procedures contained in the CCII available in both crisis and insolvency situations. For the sake of clarity, this chapter will refer to "pre-insolvency proceedings", in contrast with judicial liquidation (formerly called *fallimento*, i.e. bankruptcy), which will be referred to as an insolvency proceeding considering that it is only applicable to insolvent debtors.

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

General rules applicable to equity transfers also apply to distressed equity purchases in Italy.

Article 2468 of the Italian Civil Code enshrines the principle according to which quotas in private limited liability companies (*S.r.l.*) – which are the most common type of company in Italy, especially for SMEs – are freely transferable unless otherwise provided in the bylaws or in a shareholder agreement.

The transfer agreement, in order to produce its effects in respect of the company and third parties, must be published in the Register of Commerce and certified by a notary – either as an authentic deed or as a notarised private agreement. The principle of free transferability also applies to public limited liability companies (*S.p.A.*), in which the transfer of shares may be completed through two techniques: *transfert* or *girata*.

The first technique, governed by articles 2355 and 2022 of the Italian Civil Code, involves recording the name of the buyer on the share certificate (if any) or issuing a new share certificate in the name of the buyer. If the change is requested by the seller, it will have to prove its identity through a certificate issued by a notary. If requested by the purchaser, the latter will have to produce the authentic deed of purchase.

In accordance with article 2023 of the Civil Code, the transfer of shares may also be completed through an endorsement (*girata*), which must be dated and signed by the seller, certified by a notary and mention the buyer's name. In any event, both methods require the company to record the purchaser's name on the company's register. *S.p.a.* may also issue dematerialised shares, for which transfer may only be carried out through authorised intermediaries as per article 83-*ter* of the Consolidated Finance Law (TUF).

In some sensitive and strategically important sectors such as defence, national security, energy, transportation and communications – and regardless of whether the company is public or private – the State may veto the transfer of shares or impose additional conditions (golden power), as provided for under Law No.56/2012. In addition, particular attention should be paid to general rules on merger control (e.g. antitrust issues).

The same rules apply to the transfer of distressed equity and Italy does not have a specific legal regime in this regard.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Non-performing loans (NPL) may be acquired: (i) by banks or other regulated financial intermediaries registered in accordance with article 106 of the Consolidated Banking Act (TUB); or (ii) since the transposition in Italy of Directive (EU) No. 2021/2167, by other natural or legal persons acquiring NPLs as part of their professional activity, provided the management of the NPLs is entrusted to an authorised "credit servicer".

Such credit servicers must be authorised by the Bank of Italy, subject to compliance with certain requirements established in article 5 of the Directive, including criteria relating to reputation (particularly in light of past business conduct), governance, the experience of the management or administrative body and adequate anti-money laundering procedures.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

According to article 2112 of the Italian Civil Code, the purchaser of a company's business or business units (as part of an asset deal) must maintain employment relationships and workers' rights. In addition, the purchaser has, under article 47 of Law No.428/1990, an obligation to inform the respective trade unions and work councils (which may be established in business units with over 15 workers) at least 25 days before the completion of the transaction.

The information must include:

(i) the date or proposed date of the transaction;

(ii) the reasons for the transaction;

(iii) its legal, economic and social consequences for workers; and

(iv) any measures envisaged in respect of workers.

1.4 What risks exist for an investor of distressed business?

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Outside of bankruptcy, the transaction runs the risk of being overturned through an ordinary clawback action (*azione revocatoria ordinaria*) under article 2901 of Italian Civil Code.

This provision enables creditors to challenge the transaction – including a transfer of shares – completed by the debtor if it is prejudicial to their interests. Ordinary clawback actions are subjected to two conditions: (i) the debtor was aware of the adverse effect of the transaction on the creditor's claim, or, if the claim arose after the conclusion of the transaction, it was maliciously concluded for the purpose of endangering the satisfaction of the creditor; and (ii) in the case of a deed for consideration, the third party was also aware of its adverse effect or – if concluded prior to the arising of the claim – it participated in the malicious conclusion of the transaction.

Thus, the third party purchaser acting in good faith is safe from clawback actions except in the case of a gratuitous deed.

A successful clawback action, filed within 5 years from the deed of transfer, will not render the transaction null and void, but only ineffective against the creditor who brought the action. This means that the transfer of shares / assets is still valid, but the creditor will be able to bring an enforcement proceeding against the third party purchaser, as the new owner of the shares / assets. Therefore, it is crucial, when investing in a distressed business outside of pre-insolvency proceedings, to preliminarily conduct a careful assessment of the debtor's financial situation. Indeed, if the debtor's financial situation is good enough to satisfy possible creditors' claims, the risk of clawback actions becomes less significant.

However, pursuant to article 166 of the CCII, there are protections against ordinary clawback actions for any act or payment made, or any security granted on the debtor's property as part of the implementation of a certified recovery plan, debt restructuring agreement, composition with creditors or restructuring plan subject to homologation (see further below in paragraph 3.1).

1.4.2 *What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?*

First of all, in the case of a judicial liquidation (which is the Italian bankruptcy equivalent), the trustee may bring ordinary clawback actions against third party purchasers in accordance with the above-mentioned rules. In addition, article 166 of the CCII governs bankruptcy clawback actions (*azione revocatoria fallimentare*), which apply to a series of transactions concluded after the filing of the application which led to the judicial liquidation or in the previous year (or 6 months for judicial mortgages) when the third party purchaser was aware of the debtor's state of insolvency. Such awareness of the purchaser is presumed. The transactions subject to a bankruptcy clawback action are the following:

(i) deeds for consideration in which the services performed or obligations assumed by the bankrupt exceed by more than one quarter what is given or promised;

(ii) acts extinguishing due and payable pecuniary debts but not made with money or other normal means of payment; and

(iii) pledges and judicial or voluntary mortgages.

Moreover, provided the trustee proves the third party purchaser was aware of the debtor's state of insolvency, the following are also subject to bankruptcy clawback actions if completed after the filing of the application which led to the judicial liquidation or in the previous 6 months:

(i) payments of payable debts of a fixed amount;

(ii) deeds for consideration; and

(iii) transactions creating preferential rights (i.e. the right to be satisfied in priority over other creditors).

If successful, bankruptcy clawback actions carry the same consequences as ordinary clawback actions.

Nevertheless, it is worth mentioning that some acts concluded as part of a negotiated settlement procedure (see paragraph 3.1 below) are protected from bankruptcy clawback actions. Moreover, as is the case for ordinary clawback actions, any act, payment or security made / granted as part of a certified recovery plan, debt restructuring agreement, composition with creditors or restructuring plan subject to homologation cannot be subject to bankruptcy clawback actions.

1.4.3 *What risks exist for a new lender investing in a distressed business?*

Naturally, the most obvious risk when investing in a distressed business is to never be refunded if it goes bankrupt. However, under certain conditions, lenders investing as part of a pre-insolvency proceeding may benefit from what is called *prededuzione,* i.e. a special protection aimed at their full repayment. Indeed, in the case of a subsequent judicial liquidation, such lenders will be satisfied before any other creditor, even before those enjoying a pledge or a mortgage (see further at paragraph 2.1 below).

This is particularly the case for the composition with creditors and debt restructuring agreements as per articles 99 and 101 of the CCII. According to these provisions, funding in any form (including a request for issuance of a security) granted to ensure business continuity either: (i) before the homologation of the plan or agreement; or (ii) for the purpose of implementing a homologated plan / agreement, is given priority in case of a subsequent judicial liquidation – subject to prior authorisation from the court in the case of a composition with creditors, and provided that such funding is expressly mentioned in the restructuring agreement.

However, new funding is not protected if the application for the court's authorisation or the plan / agreement itself contains incorrect information or leaves out relevant information and the investor was aware of it.

1.4.4 *What risks exist for a new shareholder investing in a distressed business?*

In an asset deal (i.e. purchase of a business or business units), the buyer may be exposed to the same liabilities as the seller, pursuant to article 2560 of the Italian Civil Code.

In a share deal, while the purchaser enjoys limited liability, it might be, under certain conditions, held liable as a de facto director in the case of subsequent bankruptcy and, as such, incur the same liabilities (criminal and civil) as a de jure director. Italian case law has laid down the following criteria to identify a de facto director:

(i) lack of effective appointment as a director;

(ii) performance of directors' typical powers;

(iii) participation in significant management activities in a continuous way (i.e. not merely occasionally);

(iv) absence of a subordinate relationship; and

(v) being recognised by third parties as an effective representative of the company.

In addition, article 2497 of the Civil Code provides that companies carrying out direction and coordination activities of subsidiaries may be held liable for the prejudice caused to their profitability or the damage caused to the integrity of their corporate assets.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Like any other creditor, distressed debt investors and M&A investors may try to recover their claims by seizing the debtor's property through an enforcement procedure. The Italian Code of Civil Procedure provides for three ordinary enforcement procedures:

(i) attachment of the debtor's movable property (against the debtor);

(ii) attachment of the debtor's movable property or receivables that are in possession of third parties (against third parties); and

(iii) attachment of the debtor's immovable property (against the debtor).

Regardless of the procedure, the prerequisite to initiate enforcement proceedings is to have a valid enforceable title (*titolo esecutivo*). Pursuant to article 474 of the Italian Code of Civil Procedure, the enforceable title must relate to a right that is certain (i.e. there is no doubt about its existence), fixed (i.e. the amount is determined or determinable) and due (i.e. the suspensive conditions, if any, have already been fulfilled and the deadline has expired).

Enforceable title may be either judicial or extrajudicial. A judicial enforceable title may consist of either: (i) a final judgment (which has the force of *res judicata*); or (ii) any other measure / decision to which the law grants the same enforceable effects (the most common example being a court order to pay not opposed by the defaulting party within the following 40 days).

Among extrajudicial enforceable titles, there are:

(i) certified private agreements regarding obligations as to the sum of money stated therein (acknowledgement of debt for instance);

(ii) promissory notes or other negotiable instruments and documents to which the law grants the same effects; and

(iii) documents drawn up by a notary or other public servant.

Once in possession of an enforceable title, the creditor must serve it on the debtor, together with a writ of execution (*precetto*). The writ of execution is a formal notice to comply within 10 days, with the warning that failure to do so will entitle the creditor to trigger the enforcement procedure. Following the debtor's failure to comply, the creditor may initiate the enforcement procedure, no later than 90 days after the notification of the writ, by handing over a certified copy of the writ and the enforceable title to the competent court's offices.

Pursuant to article 491 of the Code of Civil Procedure, the judicial officer then issues a seizure order (*pignoramento*) aimed at making ineffective against the creditor any act by which the debtor intends to dispose of the assets subject to attachment.

After the issuance of the seizure order, the creditor must petition the competent court to proceed with: (i) the sale of the attached property to third parties; or (ii) the assignment of such property to the creditor – assignment being the only option when the attached property is money.

Considering that forced sale aims at achieving the highest price, it is therefore necessarily carried out through an auction, guided by the principle of competitiveness (see paragraph 2.3.2 below).

The last stage of the enforcement procedure, once the sale is completed, lies in the distribution and division of the sale proceeds. On the one hand, if only one creditor is involved in the procedure, the court will order the payment of the sum due to it. In the case of assignment of an asset the value of which exceeds what is due to the creditor, the latter will have to deposit the exceeding part for the debtor's benefit. On the other hand, if other creditors also participated in the procedure and the sale proceeds are not enough to satisfy all of them, the court must treat them equally – in accordance with the principle of *par condicio creditorium* enshrined in article 2741 of the Italian Civil Code.

In any event, distressed debt investors and M&A investors should always consider obtaining security to facilitate the enforcement procedure and be granted preferential rights.

Italian law provides for two main types of securities: mortgages (*ipoteca*) and pledges (*pegno*).

A right of mortgage may be created over immovable property or registered movable such as vehicles, vessels or aircraft.

Conversely, pledges consist of a contract between the debtor and the creditor in respect of receivables or unregistered movable property, which must be handed over to the creditor as security for the payment. If not voluntarily satisfied by the debtor upon expiry of the relevant period, creditors benefiting from a pledge or a mortgage on movable property will be able to trigger the ordinary enforcement procedure as outlined above, without having to obtain a seizure order (they must however be in possession of an enforceable title).

In this case, article 502 of the Italian Code of Civil Procedure provides that the term to petition the competent court in view of the forced sale or assignment will run from the notification of the writ of execution. Alternatively, creditors may resort to a special procedure (private enforcement) that does not require the possession of an enforceable title and may therefore directly proceed with the forced sale through an authorised entity. In addition, creditors enjoying a pledge or mortgage (or other privilege) are given priority over other creditors – both in and out of pre-insolvency proceedings – as a derogation from the principle of *par condicio creditorium*.

It should be noted that the creditor of a distressed company might be prevented from enforcing its claim during a pre-insolvency procedure. Indeed, the debtor may ask – pursuant to article 54 and 55 of the CCII and article 18 for the negotiation settlement procedure – for protective measures to protect its assets from creditors' enforcement actions.

Unlike the Bankruptcy Law previously in force, the new CCII does not provide for automatic protection of the debtor's assets (i.e. an automatic stay) upon submission of an application for a pre-insolvency procedure. Now, protective measures may only be granted if the debtor so requests before the competent court:

(i) during the negotiations;

(ii) when filing the application for the pre-insolvency procedure; or

(iii) after the application.

Protective measures become effective from the publication of the request in the Register of Commerce, subject to subsequent confirmation of the judge.

These measures not only prevent creditors from starting or continuing enforcement action, but will also hinder the opening of a judicial liquidation and the establishment of the debtor's state of insolvency. The court, after hearing the parties, either confirms or revokes the protective measures.

Protective measures are meant to be temporary and thus cannot exceed 12 months (article 8 of the CCII). The court may at any time – upon request of the debtor, the judicial commissioner or the Public Prosecutor – amend or revoke these measures. Under no circumstances can protective measures affect workers' rights. The only crisis management tool that does not allow protective measures is the certified recovery plan.

2.2 What involvement does the court have in these processes?

All ordinary enforcement procedures necessarily begin and end with a court's order, which gives judges an essential role. However, this role is significantly reduced when it comes to the implementation of the forced sale, which is most of the time entrusted to other experts.

Ordinary enforcement procedures are initiated with the issuance of a seizure order by the competent court, i.e. the enforcement court. As explained in paragraph 2.1, even when a seizure order is not required – in the case of a pledge or a mortgage granted over movable property – the sale or assignment of the attached property must still be filed before a court.

To put it in a nutshell – and with slight differences depending on the nature of the attached property – the judge sets the main terms of the auction (including the base price) and entrusts another professional to implement and supervise the sales operations. The judge's role is also reduced when it comes to immovable property or registered movable property, as the sale must mandatorily, since 2015, be delegated to a professional. During the sales operations, the judge only intervenes when difficulties arise – upon request of the delegated professional – and supervises the whole process. Lastly, the sale is finalised by the court's decree of transfer of the property.

The court is, however, excluded from the private enforcement available to creditors enjoying a pledge or a mortgage on movable property. If it chooses such special procedure, the creditor will directly resort to an authorised entity to proceed with the sale. In a special procedure, the court's intervention is merely conditional on the debtor's opposition or on the creditor's request for the assignment of the attached property to its benefit (pursuant to article 2797 of the Civil Code). Otherwise, the forced sale can proceed without any authorisation from the enforcement judge.

The sale of the company's assets in the context of insolvency proceedings (i.e. judicial liquidation) is mainly carried out by the trustee (helped by an estimator), who:

(i) draws up a liquidation program;

(ii) ensures the publication on the public sales portal of the relevant information at least 30 days before the sale; and

(iii) supervises the sales process.

However, under article 217 of the CCII, the bankruptcy judge is not completely excluded from this procedure: he or she reviews the trustee's liquidation program and authorises its submission to the approval of creditors. The court may also intervene during the sale to suspend it or to prevent its completion, upon request from the debtor, creditors or any other interested party in the case of serious reasons or if the offered price is significantly lower than the price considered reasonable.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

Under Italian law, a pledge may be created on movable property, claims and "other rights relating to movable property". The possibility to pledge shares (of *S.p.a.*) has long been recognised and is governed by article 2352 of the Civil Code. According to the prevailing doctrine, shares fall within the scope of movable property, which implies that a pledge on shares: (i) must be made in writing; and (ii) must be "handed over" to the creditor so that the debtor cannot dispose of the share without the creditor's cooperation (articles 2786 and 2787 of the Italian Civil Code).

Royal Decree No. 239 of 1942 also requires that the pledge be recorded in the company's register. The possibility to pledge a quota (particularly of *S.r.l.*) has initially been admitted by the Italian Court of Cassation[1] and then by the legislator in article 2471 *bis* of the Civil Code, as part of the 2003 Corporate Law Reform.[2]

In contrast with shares, the legal nature of quotas in *S.r.l.* has always been the subject of debate. In a 2019 ruling, the Italian Court of Cassation[3] defined quota as a "contractual position" (recalling that quotas are a form of "intangible movable property, not capable of possession")[4] and enclosed quotas within the category of "other rights". Conversely, more recent rulings and doctrine have classified quotas as either intangible movable property, or even as registered movable property. In any event, regardless of a quota's legal nature, it seems safe to affirm that the deed of pledge must enter in the Register of Commerce to produce its effects towards the company and third parties.

Quota pledges and share pledges are subject to the same rules – contemplated in article 2352 of the Civil Code – when it comes to the exercise of shareholders' rights. While the right to vote is transferred to the pledgee, the pledgor remains, alone, entitled to its option rights. However, in the event of a capital increase in which the newly issued shares / quotas are gratuitously assigned to shareholders, the pledge will extend to the shares / quotas freely assigned to the pledgor. The entitlement of any other shareholder right will be vested in both the pledgee and the pledgor.

To avoid the aforementioned rules and retain alone its shareholders rights, the debtor may prefer to resort to a "non-possessory pledge" (similar to the concept of a floating charge at common law), as introduced by the Decree Law No. 59 of 2016 (converted into Law No. 119/2016). This innovative tool is available to businessmen wanting to secure claims related to their business by granting a pledge on unregistered movable property (including intangible) or claims intended for / related to the exercise of such business activity.

The exclusion of registered movable property from the scope of non-possessory pledge has raised the issue of whether such a tool should also be available for quotas, sometimes defined as registered movable property. In spite of the debates around a quota's legal nature, the recent Interministerial Decree No. 114/2021 seems to have admitted this possibility by referring to the registration of a non-possessory pledge on "shares" or "quotas". As opposed to an ordinary pledge – the key feature of which is the pledgor's dispossession – a non-possessory pledge allows the pledgor to continue the business activity using the pledged assets. Indeed, the latter maintains its power of disposal on the pledged assets and is therefore able to transform or dispose of the assets. Should this be the case, the pledge is automatically transferred to the product resulting from the transformation, the sale proceeds, or the assets purchased with said proceeds.

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1 Italian Court of Cassation, 7 November 2002, No. 15605.
2 Legislative Decree 6/2003.
3 Italian Court of Cassation, 27 November 2019, No. 31051.
4 Italian Court of Cassation, 17 August 2017, No. 20170.

To be validly created, the agreement of non-possessory pledge must be in writing and include:

(i) the personal details of the creditor, debtor and the third party pledgor, if any;

(ii) the description of the pledged assets and of the claim secured; and

(iii) the maximum amount secured.

To take effect against third parties, the deed of non-possessory pledge must then be entered in the appropriate register (Register of Non-Possessory Pledges) managed by the Italian Tax Administration.

Again, when it comes to enforcing the pledge, the creditor may choose the ordinary procedure before the enforcement judge or – if not in possession of an enforceable title – special "private enforcement" through an authorised entity under article 2795 et seq. of the Civil Code.

Private enforcement must be preceded by a formal notice to comply (similar to a writ of execution), with the warning that failure to do so will entitle the creditor to sell the pledged property. If the debtor has not complied with nor has challenged the notice within the following 5 days, the creditor will be able to proceed with the sale in accordance with the terms agreed upon in the pledge agreement or – if not explicitly set forth in the pledge agreement – pursuant to article 1515 et seq. of the Italian Civil Code (i.e. through an authorised entity).

Private enforcement necessarily implies that the pledgee is in possession of the pledged property, which means that it will be available to a creditor enjoying a non-possessory pledge only if, upon notice to do so, the debtor hands over the property. In this case, the creditor will be entitled to, up to the amount secured:

(i) sell the pledged property and retain the sale proceeds in satisfaction of the claim;

(ii) enforce or assign the pledged receivable;

(iii) if provided for in the agreement, lease the pledged property and retain the rents; or

(iv) if provided for in the agreement, be transferred the pledged property.

Otherwise, should the debtor fail to hand over the property, the creditor enjoying a non-possessory pledge will have to resort to a judicial officer.

2.3.1 *Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?*

The non-possessory share (or quota) pledge enforcement may consist of a conversion of debt into equity. This is contemplated under article 1, paragraph 7(d) of Law No. 119/2016: the share, object of the pledge, may be transferred to the pledgee, if it wishes, in satisfaction of its claim, up to the amount secured.

The creditor will therefore receive shares worth exactly the same amount as its security (1:1 swap ratio). The non-possessory pledge agreement must expressly provide for this possibility and must set the criteria and methods for assessing the value of the pledged shares and the claim secured.

A debt for equity swap also seems perfectly conceivable as part of an ordinary share pledge. Indeed, even though forced sale is described as the default method for the pledgee's satisfaction, the latter may, alternatively, apply to court to be assigned the pledged assets up to the amount secured (see article 2798 of the Civil Code for movable property).

In any event, the assignment of the pledged share or quota is subject to: (i) an estimate made by an expert appraisal or based on the current price of the share; and (ii) reimbursement of the exceeding part if the share's value exceeds what is due to the pledgee. In that regard, article 2744 of the Italian Civil Code expressly forbids the agreement according to which the pledgor's failure to pay within the stipulated period automatically transfers the asset's ownership to the pledgee. By way of derogation, article 2 of Law No. 119/2016 allows such an agreement as long as it provides for the payment to the pledgor of the difference between the amount of the claim and any greater value of the pledged property, as ascertained by an appraisal of a third party (*patto marciano*).

2.3.2 Is a public auction mandatorily required or are private sales possible?

Public auction, commonly known as "sale *con incanto*" – i.e. a public contest in which the bidders have 3 minutes to make a higher offer than the previous one and the adjudication is made to the last highest bidder – is only used on a residual basis in Italian ordinary enforcement procedures (and rarely used in practice).

Indeed, pursuant to article 503 of the Code of Civil Procedure, the court may decide that the forced sale should be carried out through a public auction only if it considers that this method is likely to ensure the attached property is sold at a price higher than half of its value. If not, the default method in ordinary enforcement is an auction, which is open to anyone but is carried out by individual bids through sealed envelopes on an electronic platform (sale *senza incanto*). This kind of auction takes place over several days starting from the court's sales order and the offers are irrevocable. In public auctions, the first bid must not be lower than the price set by the judge, while an offer made through sealed envelope may only be accepted if not lower than the base price by more than 1/4 and if accompanied by a security of at least 1/10 of the price offered.

Even as part of the judicial liquidation, the sale of the company's assets must be carried out through a competitive process open to the public in order to find the best offer and thus ensure the maximum satisfaction of creditors (see article 216 of the CCII et seq.). The same applies to the sale of assets subject to non-possessory pledge pursuant to article 1, paragraph 7(a) of Law No. 119/2016, which expressly refers to a competitive procedure.

However, as part of a private enforcement of a pledge, private sales are admitted if provided for in the pledge agreement. Otherwise, the pledged share / quota will be sold: (i) at the current market price through the intervention of a commissioner; or (ii) in the absence of a market price, through a public auction.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

As mentioned in paragraph 1.1, the company's bylaws may restrict the free transferability of shares (in *S.p.A.*) and quotas (in *S.r.l.*). In this case, article 2471 paragraph 3 of the Italian Civil Code indicates the path to follow to enforce a quota pledge in front of such a restriction, striking a balance between the creditor's needs and those of the company.

In particular, it provides the possibility for the creditor, the debtor and the company to first reach an agreement on the method of sale of the quota. Failing such agreement, the sale must be carried out through public auction. Within 10 days following the adjudication, the company may present another buyer offering the same price as the winning bidder, thus making the sale through auction ineffective.

As for the enforcement of a pledge on shares, the possibility to set aside transfer statutory restrictions is debated and has not been object of attention by doctrine or case law.

In addition, it should be noted that the company's bylaws may also validity prohibit the creation of a pledge on shares or quota.

As opposed to bylaw clauses, restrictions contained in shareholders' agreements are only binding on the contracting parties (i.e. the shareholders) and not on the third party pledgee.

2.3.4 Is "market testing" mandatorily required?

Unless otherwise provided for in the pledge agreement, the most common enforcement procedures provide for a competitive sale based on appraisals, whereas market testing without a proper appraisal is residual.

2.3.5 Are valuation reports mandatorily required?

As part of ordinary enforcement proceedings, the judge will necessarily rely on experts' appraisals in order to set the base price for the auction. Similarly, article 1, paragraph 7(a) of Law No. 119/2016 expressly requires, for the sale of property subjected to a non-possessory pledge, the competitive procedure to be based on appraisals. Even though not formally required, private enforcement also relies on appraisals in practice, except if the property already has a market price.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

First, it should be recalled that Italian law does not provide for "pre-insolvency" proceedings strictly speaking, given that most procedures are available not only to debtors in situation of crisis – which shall be understood as a shortfall in assets to meet financial obligations for the coming year – but also to insolvent debtors, "insolvency" being defined as the debtor's inability to meet its financial obligations (article 2 of the CCII).

These procedures – which will be referred to as "pre-insolvency proceedings" for the sake of clarity – are in contrast to judicial liquidation (formerly called "*fallimento*", which may be translated as bankruptcy or insolvency proceeding), applicable when the debtor is actually insolvent, and no longer in a mere distressed situation.

The CCII provides for the following six pre-insolvency procedures, all of them being aimed at restructuring the debt of a distressed company and preserving, where possible, business continuity as a going concern:

(a) negotiated settlement procedure (*composizione negoziata*);

(b) simplified composition (*concordato semplificato*);

(c) certified recovery plan (*piano attestato di risanamento*);

(d) debt restructuring agreement (*accordo di ristrutturazione dei debiti,* also known as Adr);

(e) composition with creditors (*concordato preventivo*); and

(f) restructuring plan subject to homologation (*piano di ristrutturazione soggetto a omologazione,* also called PRO).

3.1.1 Negotiated settlement procedure

The negotiated settlement, governed by article 12 of CCII and introduced in 2021, is the only procedure that does not require a situation of crisis or insolvency per se, but merely an asset or an economic and financial imbalance likely to lead to such crisis or insolvency. It is indeed aimed at the early management of a distressed situation that can be overcome by negotiating with creditors.

To facilitate these negotiations, an expert is appointed by an independent commission via a national online platform. If successful, negotiations lead to the drafting of:

(i) an agreement with one or more creditors;

(ii) a standstill agreement to suspend payment deadlines, and / or waive or suspend legal actions; or

(iii) a recovery plan signed by the debtor, its creditors and the expert.

The negotiated settlement procedure has some advantages for the debtor given that creditors have, under article 16 paragraphs 5 and 6, a duty to actively collaborate with the debtor during the negotiations as well as a confidentiality obligation. This helps to mitigate adverse reactions from the debtor's clients, suppliers and banks, which might jeopardise the company's recovery. However, the distressed situation becomes public when the debtor applies to the court for protective measures, which are then published in the Register of Companies as per article 17 of the CCII.

Should the parties fail to reach an agreement, the debtor may still apply for other procedures, and particularly for the simplified composition.

3.1.2 Simplified composition

Pursuant to article 25 *sexies* of the CCII, debtors who have unsuccessfully gone through a negotiated settlement composition procedure may file a petition for a simplified composition within 60 days following the receipt of the expert's final report. This procedure is only available to companies that have first applied to the negotiated settlement procedure, when the expert's report shows that negotiations were conducted in good faith but have failed or have led to solutions that were not viable.

In this case, the debtor may submit to the court a proposal for a simplified composition, consisting of a liquidation plan and any proposed transfer of assets.

Unlike judicial liquidation, the simplified composition does not require a creditors' vote on the plan, hence the promptness of the procedure. Creditors are only granted the right to object to the homologation at least 10 days before the homologation hearing. Afterwards, upon assessment of the feasibility of the liquidation plan and verification that it is not detrimental to the creditors compared to a judicial liquidation scenario, the court homologates the simplified composition and nominates a liquidator who will be in charge of selling the company's assets and distributing the profit between creditors, depending on their priority status.

3.1.3 Certified recovery plan

According to article 56 of the CCII, the debtor in a situation of crisis or of reversible insolvency can negotiate with the relevant stakeholders to draft a recovery plan aimed at ensuring business continuity as a going concern and rebalancing the company's economic and financial situation. The going concern plan must describe:

(i) the company's economic and financial situation;

(ii) the main causes of the crisis;

(iii) the strategies and deadlines necessary for overcoming the crisis;

(iv) a list of all creditors (both those who signed the plan and those who did not), as well as the amount of claims that have been renegotiated, the status of current negotiations and the resources earmarked for repayment of non-signatory creditors;

(v) any new sources of financing;

(vi) a provisional timetable; and

(vii) a business plan.

The recovery plan must then be certified by an independent professional (*attestatore*), upon verification of the accuracy of the business data and of the economic viability of the plan. The certification of the plan by an independent professional allows any transaction set out in the plan to be saved from clawback actions.

Entirely left to the debtor's contractual freedom, the procedure is confidential, which avoids alarming the company's clients and suppliers. However, the debtor may choose to publish the certified recovery plan in the Register of Companies to enjoy tax advantages.

3.1.4 Debt restructuring agreements

Debt restructuring agreements, regulated under articles 57 to 61 of the CCII, aim at implementing an economic and financial plan (similar to a certified recovery plan) and must be reached between the debtor in a state of crisis or insolvency and creditors representing at least 60% of the overall claims.

This percentage is reduced to only 30% as part of a "facilitated restructuring agreement", available when the debtor: (i) does not propose standstill agreements to dissenting (non-signatory) creditors; and (ii) does not apply for temporary protective measures. In practice, such a facilitated agreement is only available to debtors facing a crisis at an embryonic stage. Indeed, it implies that the debtor has enough liquidity to immediately satisfy the claims of non-signatory creditors (given that it cannot resort to a standstill agreement allowing it to suspend the deadline of payments) and has not yet faced enforcement procedures.

In both cases, the agreement – standard or facilitated – may aim at ensuring business continuity as a going concern or at liquidating the company. Its content may include, among other things, debt relief, conversion of claims into shares of the company, lodging of a security or granting of new finances. Creditors have every interest in collaborating with the debtor and eventually signing the agreement in order to prevent the latter from becoming insolvent, and therefore being unable to pay its debts.

As with a certified recovery plan, an independent professional (*attestatore*) must attest the accuracy of the business data and the economic viability of the agreement. In addition, the professional must also assess whether the agreement enables the company to fully satisfy the claims of non-signatory creditors. Then, after verifying the compatibility of the agreement with mandatory legal provisions, the court homologates it.

As a contract, the debt restructuring agreement should produce its effects only between the contracting parties, i.e. the debtor and the creditors who signed it. However, in accordance with the ordinary rule provided for under article 1239 of the Italian Civil Code and article 59 of the CCII, any debt relief granted to the debtor by a signatory creditor also releases certain types of guarantors (*fideiussori*).

Another derogation from the principle of relativity of contracts is contemplated in article 61 of the CCII, with the possibility to forcibly extend the terms of the restructuring agreement to non-signatory creditors under two scenarios. It should first be pointed out that in both cases creditors must be grouped into categories, depending on their respective economic interests and legal status.

Without prejudice to the above-mentioned conditions (agreement that must be signed by creditors representing at least 60% or 30% of the overall claims), the cram down is subject to two additional conditions: (i) the restructuring agreements are part of a going concern plan (and thus exclude any liquidation option); and (ii) creditors representing at least 75% of a category's overall amount of claims have agreed to it. If so, the effects of the agreement may be extended to the dissenting creditors belonging to the same category (and who represent therefore 25% or less of the overall claims of such category). Should the debt restructuring agreement result from the negative outcome of a negotiated settlement procedure, the required percentage of 75% is reduced to 60%.

Cram down is also available regardless of the scope of the agreement (business continuity or liquidation) when debts towards banks and financial intermediaries represent at least half of the overall claim, all categories combined. In this case, the agreement may be forcibly extended to dissenting banks or financial intermediaries belonging to a category in which signatory creditors represent at least 75% of the category's overall amount of claims. In any event, cram down is only possible if it entitles non-signatory creditors to a greater amount than what they would have received in a judicial liquidation.

3.1.5 Composition with creditors

The debtor in a situation of crisis or insolvency can also resort to the composition with creditors (article 84 of the CCII et seq.) by proposing a plan to ensure that creditors are not "worse off" than under a judicial liquidation process.

This pre-insolvency procedure aims at avoiding a declaration of bankruptcy. In a nutshell, just like the debt restructuring agreement, the composition with creditors plan may be aimed either at the liquidation of the company or at its continuity as a going concern and requires in most cases the division of creditors into different categories.

On the one hand, the going concern plan – which might also be indirect through, for instance, the sale of the company (see paragraph 4 below) – should focus on protecting creditors' interests and, where possible, preserving jobs. It may also provide for a standstill period for the payment of secured creditors (article 88 of the CCII).

On the other hand, a liquidation plan is possible as part of composition with creditors only if the debtor brings additional external contribution to produce a 10% increase in corporate assets, to be used to repay at least 20% of unsecured creditors' claims.

The composition plan must contemplate the following elements: the reasons behind the distressed situation, an overview of the financial and economic corporate situation, the restructuring strategies (with possible steps to take in case of deviation from the original plan), expected timing necessary to implement them, any new sources of financing, possible clawback actions and liability action against directors that might be filed, a list of the creditors and the amount of each claim, the effects of the reorganisation on workers, as well as – in case of a going concern plan – a business plan and an analytical description of the expected costs and revenues, among other things.

Once assessed and approved by court, the plan must also obtain a favorable vote from creditors who are allowed to vote – relatives, in-laws, companies belonging to the group or creditors in conflict of interest being excluded from the vote in accordance with article 109 of the CCII.

The liquidation plan must be approved by creditors representing at least the majority of claims, whereas the going concern plan must obtain either: (i) the majority of votes in each category; or (ii) 2/3 of the votes in each category if the voting creditors represent at least half of the category's overall claims.

This vote takes place online under the supervision of a judicial commissioner and must comply with the adversarial principle, meaning that creditors are entitled to formulate observations and objections. Dissenting creditors may then still challenge the proposal when the court reviews it for homologation. In any case, the court will homologate the composition plan if it finds that such dissenting creditors are not "worse off" than under a judicial liquidation.

Composition with creditors is an important tool to cram down dissenting creditors, considering that once the threshold of votes is reached and the plan is homologated by the court, it becomes binding for all creditors, and not only for those who agreed to it. Article 88 paragraph 2 bis CCII contemplates particularly the possibility to cram down the tax administration and social security institutions when their vote is decisive and their satisfaction under the proposed plan is not worse than in a judicial liquidation scenario.

3.1.6 Restructuring plan subject to homologation (PRO)

Half-way between the debt restructuring agreement and the composition with creditors, the PRO is a brand new tool introduced in 2022 and governed by article 64 *bis* and *ter* of the CCII. In short, the debtor in a state of crisis or insolvency may submit to a court a restructuring plan certified by an independent professional and aimed at satisfying creditors with the aggregate value generated by the plan. If approved by creditors and homologated by the court, the plan may derogate from articles 2740 and 2741 of the Italian Civil Code – according to which all creditors shall be treated equally, with priority given to secured creditors – when repaying creditors, as long as workers are fully paid within 30 days from homologation.

Upon assessment of the conditions entitling the debtor to apply for a PRO and verification of the correctness of the criteria applied to form the categories of creditors, the court sets the date for creditors to vote on the plan, in line with the provisions set down for the composition with creditors. To be homologated as a PRO, the plan must be approved by all categories of creditors. If not, article 64 *quarter* of the CCII enables the debtor to transform the PRO into a composition with creditors at any time.

3.2 What involvement does the court have in these processes?

The procedures outlined above are traditionally divided into two main categories: negotiation tools and *procedure concorsuali*.

On the one hand, the negotiated settlement procedure and the certified recovery plan fall within the scope of negotiation tools. Through these out-of-court procedures, the legislator intended to entrust the resolution of the distressed situation to the stakeholders' negotiation and contractual freedom. As a result, the court only plays a marginal role if not non-existent: while the court is completely excluded from the certified recovery plan, it might only intervene in the negotiated settlement procedure to grant protective measures, if requested by the debtor. Under no circumstances, even indirectly, may the court decide whether there are actual possibilities of recovery. Indeed, the experts involved in those negotiation procedures are completely independent and do not operate under judicial supervision.

The remaining procedures fall, on the other hand, into the other category and are, as such, in-court processes. Articles 40 et seq. of the CCII set uniform rules that govern the application for such procedures, most of them being also common to judicial liquidation. The debtor initiates the judicial phase though its lawyer by submitting to the competent court its proposal (for a simplified composition, debt restructuring agreement, composition with creditors or restructuring agreement as part of the PRO).

The court may also intervene before the submission of the proposal to grant the debtor, at its request, protective measures.

The application is published in the Register of Companies. During the procedure, the debtor is subject to court supervision through the appointment of a judicial commissioner and may need the court's authorisation to perform acts of extraordinary administration (this is particularly the case for the composition with creditors, the simplified composition and the PRO). Depending on the procedure chosen, the court sets the date by which the creditors' vote must be taken, and homologates the proposal, subject to prior verification of the judicial feasibility of the plan – i.e. compatibility of the plan with mandatory legal provisions.

As part of a composition with creditors or a restructuring plan subject to homologation (PRO), the court's role also extends to the supervision – by a judicial commissioner – of the implementation of the plan / agreement (see article 118 of the CCII). In-court processes ensure an additional layer of protection and yet at the same time, as a disclosed procedure, may trigger adverse reactions from the debtor's clients and suppliers.

The legal nature of the debt restructuring agreements – which includes both a negotiation and a judicial phase – has long been discussed. With a series of rulings, the Italian Court of Cassation has put an end to the debate in 2018:[5] debt restructuring agreements belong to in-court procedures. This classification is also in line with Regulation (UE) 2015/848.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

It should be noted that, as opposed to the judicial liquidation which can be initiated either by the debtor, the company's supervisory body, or even creditors, application to pre-insolvency procedures referred to in this section may, as a general principle, be filed only by the debtor itself (article 37 of the CCII).

Therefore, it is safe to say that the debtor is among the most important stakeholders if not the most important one. Then, as explained above, most procedures depend on the outcome of negotiations with creditors and / or on their favourable vote, which gives them an equally important role.

But two other players also come into the picture to verify the corporate data, to assess the adequacy and feasibility of the chosen restructuring strategies and / or to facilitate negotiations.

- ***Independent professional***

  The independent professional (*attestatore*) is a key figure in the new CCII and plays a crucial role in most pre-insolvency procedures, both in and out of court – with the exception of the negotiated settlement procedure and the possible subsequent simplified composition.

  The independent professional must first and foremost be independent – i.e. not bound by a professional or personal relationship to the parties involved in the procedure (including creditors), under penalty of nullity of the appointment.

  In particular, pursuant to article 2, paragraph 1(d) of the CCII, the professional and the individuals with whom the professional may be united in a professional association must not have engaged in employed or self-employed activities for the benefit of the debtor during the last 5 years, nor must they have been a member of the company's administrative or supervisory bodies or held shares / quotas in the distressed company.

  The professional must also comply with the requirements of article 2382 of the Italian Civil Code, which reinforce the independence condition (for instance, the professional must not be related to the companies controlled by the distressed company or to the companies controlling it). In addition, the independent professional is required to appear on the register for statutory auditors and the register for business crisis managers.

  The independent professional is nominated by the debtor and has the twofold task of verifying the accuracy of the business data which underpins the turnaround plan and the economic viability of the plan. On the one hand, the professional must certify that the data used in the plan is reliable and consistent with the data accounts. On the other hand, the professional must explain why he or she believes the plan has real prospects for success, assessing the adequacy and feasibility of the measures envisaged.

  The independent professional may bear both civil liability (contractual liability towards the company in case of wilful misconduct or gross negligence, or tort liability towards the shareholders and third parties) and criminal liability (article 342 of the CCII).

- ***Expert***

  Within the scope of the negotiated settlement procedure, the independent expert's primary role is to facilitate negotiations between the debtor and creditors and other relevant

[5] Cass. civ., Sez. I, 18 January 2018, n.1182; Cass. civ., Sez. I, 25 January 2018, n.1896 and n.1895; Cass. civ., Sez. I, 12 April 2018, n.9087; Cass. civ., 24 May 2018, Sez. I, n.12965. However, some district courts still resist (for instance: Tribunale Milano, 20 December 2018; Tribunale Roma, 27 February 2019, ord. 27)

stakeholders. He or she is appointed for a maximum of 180 days (renewable once at the parties' request) by an independent commission through a national online platform and must fulfil the same independency conditions as those required for the independent professional.

Following appointment, the expert meets with the debtor to assess the prospects of recovery. If he or she does not discern any prospect of recovery, the expert may ask the Chamber of Commerce to dismiss the debtor's application.

During the negotiations, the expert, who must be made aware of any act of extraordinary administration, offers advice but does not make the decisions. He or she is also invited by the court to give an opinion on the appropriateness of protective measures (when requested by the debtor) and may ask the court to revoke such measures.

After having collected and analysed corporate data, the expert eventually drafts a final report outlining the outcome of the negotiations. Such a report also serves as the starting point for applying to another procedure, and particularly to a simplified composition (which is available within 60 days of the expert's final report and only if it results from the report that negotiations were conducted in good faith).

3.4 Is there a typical due diligence process followed?

Even though most transactions implemented as part of pre-insolvency proceedings are protected from clawback actions (see paragraphs 1.4.1 and 1.4.2 above), it is always advisable in practice to perform due diligence verifications.

3.5 What is the typical timeline of a M&A sale under a pre-insolvency process and how does the process work?

The practice has shown a great variability of timelines, depending on the kind of procedure, the territorially competent court, and whether there is a challenge. It is difficult to provide a "typical" timeline.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

As explained in paragraphs 1.4.1 and 1.4.2, M&A transactions made as part of the implementation of a pre-insolvency proceeding – except for the simplified composition – are protected against clawback actions and cannot therefore be declared null and void in a subsequent judicial liquidation.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

As a preliminary remark, it is worth noting that the Italian legislator favours, as a general rule, the sale of the entire business (rather than only parts of it) for the sake of the going concern. This is evidenced in article 214 of the CCII regarding judicial liquidation, which states:

> *"The liquidation of individual assets … shall be ordered when it is foreseeable that the sale of the entire business, its branches, assets or legal relationships identifiable as a whole will not allow for greater satisfaction of creditors."*

The CCII includes tools similar to "pre-pack" options. Indeed, the negotiated settlement procedure, the simplified composition and the composition with creditors appear to allow pre-pack packages as defined by the European Commission in the Proposed Directive of 7 December 2022 – i.e. the sale of the debtor's business (or parts thereof) as a going concern negotiated before the formal opening of the insolvency proceedings and promptly completed thereafter.

On the one hand, article 12 of the CCII states that the negotiated settlement aims at finding a solution to the company's economic and financial imbalance, including through the transfer of the business or business units. In that regard, article 22 of the CCII allows, through a court's authorisation, to sell the business as a going concern while exempting the buyer from the company's existing debts (in derogation to article 2560 of the Civil Code).

Similarly, following the possible failure to find an agreement as part of the negotiated settlement, the simplified composition plan submitted to the court may also include a proposal for the transfer of assets as provided for under article 25-*septies* of the CCII, subject to court homologation. The company or one or more branches thereof may be transferred to a pre-identified buyer before or after the court homologated the simplified composition plan, upon judicial verification of the absence of a better solution on the market.

On the other hand, pursuant to article 84 paragraph 9 of the CCII, the composition plan may include an irrevocable offer from an identified potential buyer for the purchase (or lease) of the business or business units. Such a transfer may be concluded before or after the plan's homologation, subject to the respect of a competitive process, as explained below in paragraph 4.6.

In particular, the irrevocable offer must be published in order to allow competing offers (article 84 paragraph 9 and article 91 of the CCII). The last paragraph of article 118 of the CCII also provides for an exemption from the liabilities set under article 2560 of the Civil Code.

A combined reading of article 84 paragraph 8 and article 91 of the CCII, which are both referenced in article 64-bis paragraph 9, implies that pre-pack sales are also admissible in a PRO procedure.

Most of the time (regardless of which of the four procedures is used), the business is leased (*affitto di azienda*) to the pre-identified buyer, with the procedural bodies retaining the option to terminate the lease if the competitive process results in the selection of another buyer (other than the lessee) who offers a better price.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The sale of the distressed company's business or business unit(s) as a "pre-pack" implies an essential negotiation stage and therefore mainly involves the debtor and the proposed buyer. Within the negotiated settlement, they are assisted by an independent expert, whose role has already been outlined above.

In principle, the contract transferring the business or its branches does not, as part of the negotiated settlement, require any judicial approval to be fully effective and valid. However, by not resorting to the court, the purchaser of the distressed company will remain liable – jointly and severally with the debtor – for the debts of the transferred business recorded in the mandatory accounting books as per article 2560 of the Italian Civil Code. To release the purchaser from such existing debts (except for workers' claims), the debtor may ask for the court's authorisation, in accordance with article 22 of the CCII. Therefore, the court might also play a role.

The court is however a decisive player for the outcome and the implementation of the business transfer as part of a simplified composition or a composition with creditors, given that in both procedures it necessarily: (i) verifies the competitiveness of the sale procedure; and (ii) eventually decides to homologate or not the proposed plan containing the purchase offer.

Moreover, it should be recalled that creditors also have a say in the composition with creditors, the plan (and thus the sale) being subject to their vote.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

All pre-insolvency practitioners (expert for the negotiated settlement, judicial commissioner for the simplified and ordinary compositions) or insolvency practitioners (liquidator) intervening in "pre-pack" sales are appointed by the court, or by an independent commission for the negotiation expert. The investor is thus unable to choose who will be appointed.

The only professional whose appointment depends on the debtor's choice (and where the purchaser may therefore be able to exercise control) is the independent professional attesting the accuracy of business data and the feasibility of the plan as part of the composition with creditors.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Protection of creditors and of their best satisfaction is at the heart of all pre-insolvency proceedings (pre-pack or not), but there is no additional special protection for certain creditors.

4.5 Is there a typical due diligence process followed?

See paragraph 3.4 above.

4.6 Is "market testing" mandatorily required?

To maximise the satisfaction of the creditors' claims while avoiding to compromise the promptness of the sale, the regulation of "pre-pack" sales procedures mainly requires the offer made by a pre-identified purchaser to be competitive in the market.

For instance, as already mentioned in paragraph 4.2 above regarding the simplified composition plan, the court verifies the absence of a better solution on the market.

As for a purchase within the framework of a negotiated settlement, article 22 of the CCII lays down that, if the debtor applies for an exemption from article 2560 of the Italian Civil Code, the court will verify that the selection of the purchaser complies with the principle of competitiveness and will "order the measures deemed appropriate".

Even though the wording is vague, commentators mostly consider that it refers to the implementation of a competitive procedure. In the absence of the court's intervention (i.e. if the debtor does not ask for the exemption), although not expressly required by law, the best practice recommends selecting the buyer through a contest between bidders in order to maximise the proceeds in the interests of creditors.

In that regard, article 12 of the implementing Decree issued on 21 March 2023 provides that the expert must make the debtor aware of the usefulness and advisability of competitive procedures.

Finally, the use of a competitive procedure is more obvious and detailed as part of the composition with creditors. Indeed, pursuant to article 91 of the CCII, the court orders that the intent to sell the business or business units is made public in order to acquire possible competing offers. Should someone express their intent to make an offer, the court opens a competitive procedure and establishes its main terms (requirements for the bidders to participate, access to information, time and place of the submission of bids, minimum increase of bids and advertising on the public sales portal, among other matters).

The procedure is concluded with the award to the highest bidder, at least 20 days before the creditors' vote on the plan. In the absence of any competing bid (or any best offer), the sale will be held in accordance with the conditions laid out in the original irrevocable offer – as outlined in the composition with creditors plan – the court being unable to amend such terms (for instance it cannot fix a higher price or require a one-time payment).

4.7 Are valuation reports mandatorily required?

Even when not expressly mandated by law, appraisals are in practice required in order to obtain the court's authorisation / homologation.

4.8 What is the typical timeline of "pre-pack" sales?

See paragraph 3.5 above. In any event, the above-mentioned pre-pack tools provide for an accelerated sale of the business compared to the judicial liquidation.

JAPAN

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

The sale and purchase of equity, typically shares, is primarily regulated by the Companies Act of Japan (Act No. 86 of 2005, as amended). The most common types of limited liability companies are *kabushiki kaisha* (KK) and *godo kaisha* (GK).

Under Japanese law, the transfer of shares (*kabushiki*) in a KK or units (*mochibun*) in a GK generally is effected by an agreement of such transfer between the seller and the purchaser. Additionally, depending on the type of company, the following additional requirements may apply to perfect or ensure effectiveness of the transfer of shares or units, as applicable:

No.	Type of company	Additional requirement for transfer
(i)	A KK where shares are deposited on a book-entry system (*furikae kabushiki*)	The transfer has to be registered on the book-entry system
(ii)	A KK where share certificates are issued pursuant to the company's articles of incorporation	The share certificate has to be delivered to the purchaser, and the transfer has to be registered on the shareholders' register (*kabunushi meibo*) of the company
(iii)	A KK where share certificates are not issued	The transfer has to be registered on the shareholders' register (*kabunushi meibo*) of the company
(iv)	A GK	Generally construed so that a consent from the company is required together with a certified date stamp of the notary public (*kakutei hizuke*) affixed on it

Assuming the company does not become involved in any insolvency proceedings, no separate or specific rules are applicable to the sale and purchase of distressed equity.

For the purpose of this Chapter, we focus only on the sale and purchase of shares in a KK where: (i) no share certificates are issued; and (ii) the shares are not listed.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

In Japan, the general rule is that the transfer of loan receivables is effected by an agreement of the transfer between the seller (i.e. existing lender) and the purchaser (i.e. successor lender). If this general rule applies, consent is not required from the borrower for the purpose of validating the transfer. However, this general principle may not apply if the underlying loan agreement prohibits the transfer of loan receivables. In such a case, the borrower's consent will be required.

In addition to the above, perfection of the transfer is required for the purchaser to legally establish its claim and rights to a receivable against any third party that subsequently acquires the same receivable. While there are various methods of establishing such perfection of transfer, the most common method, in the context of loan receivables, is to obtain written consent from the borrower. When a certified date is attached to such written consent by a Japanese notary public, the transfer is perfected against the borrower and all third parties.

The same rules apply to the sale and purchase of performing loans and non-performing loans.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements?

There are no additional regulatory requirements.

1.4 What risks exist for an investor of a distressed business?

Other than those risks not specific to Japan, one notable risk for an investor (or buyer) of distressed businesses is the right of avoidance (*hinin ken*). This right is typically exercised under court-supervised insolvency proceedings but could also be exercised outside of such proceedings. If exercised, the relevant transaction or action may be voided, annulled, cancelled or overturned.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Under the Civil Code of Japan (Act No. 89 of 1896, as amended), each creditor is granted an analogous right to the right of avoidance that exists under court-supervised insolvency proceedings – i.e. bankruptcy, civil rehabilitation and corporate reorganisation proceedings (see paragraph 1.4.2 for further details).

Namely, acts carried out by the debtor with the intention to prefer one creditor over other creditors or to harm other creditors may be invalidated by a creditor (Challenging Creditor) through court proceedings, unless the counterparty to, and beneficiary of, the challenged act (Counterparty) can successfully prove that it had no knowledge that as a consequence of such act, the other creditors of the debtor would be harmed.

If the challenged act is a payment to the Counterparty and is invalidated, the Counterparty will be obliged to pay an amount equal to the payment that it received from the debtor to the Challenging Creditor. In principle, the amount that is received by the Challenging Creditor from the Counterparty should be returned to the debtor and distributed among all creditors. However, arguably it is possible that the Challenging Creditor sets off from the amount that it returns to the debtor the amount of its own claim against the debtor.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

The trustee (*kanzainin*) or the company itself (if no trustee is appointed) has the right of avoidance (*hinin ken*), whereby they may avoid or set aside a contract, a disposition of assets (including the granting of a guarantee or the creation of a security interest) or payment of a debt made by the company, which has the effect of harming creditors or preferencing one creditor above another creditor.

In general, there are two types of avoidance available to the trustee, namely: (i) the avoidance of acts which harm creditors; and (ii) the avoidance of acts which prioritise one creditor over another creditor. While the detailed requirements set out in the relevant Japanese insolvency law should be referred to, the outline of the general (or standard) requirements is as follows:

(i) an act which harms other creditors carried out by the company (whether or not insolvent at the time of the act) with the intention to harm other creditors may be avoided or set aside by the trustee, unless the Counterparty to such an act can successfully prove that it had no knowledge that, as a consequence of the act, other creditors of the debtor would be harmed; and

(ii) if the company takes any action relating to the creation of security for pre-existing debts or to discharge pre-existing debts (in this paragraph, a "discharging act") after the occurrence of a critical event being: (a) the company's inability to pay; or (b) an application for insolvency proceedings, such act may be avoided or set aside by the trustee if the trustee successfully proves that the Counterparty of the act had knowledge of: (A) in the case of (a) above, the company's suspension of payments generally or its inability to pay; or (B) in the case of (b) above, an application for insolvency proceedings having been made against the company at the time of such act, as the case may be.

Additionally, if the discharging act had been made by the company in a situation where the company is not obliged to do so under law or any other pre-existing contract, within 30 days prior to the occurrence of the company's inability to pay, such act may be avoided or set aside by the trustee, unless the Counterparty can successfully prove that it did not know at the time of such act that as a consequence of such act the other creditors of the company would be harmed.

1.4.3 What risks exist for a new lender investing in a distressed business?

If a new lender extends a new loan to a distressed business and that business subsequently enters an insolvency proceeding, there is a risk that such loan may not be paid in priority unless the loan is made under the framework of turnaround ADR (discussed further below).

While there have been discussions regarding a lender's liability based on general principles of law, e.g. tort liabilities, there is no statutory rule or established theory of law for lenders' liability.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

Generally, the directors or officers of a company who breach their fiduciary duty to act as "good managers" of the company would be liable for any losses incurred by the company. As such, if the new shareholder appoints any of its employees to act as directors or officers of the company and the company subsequently enters an insolvency proceeding, thereby incurring a loss, then there is a risk that such directors or officers may be liable for such loss.

Nonetheless, if the new shareholder is purely an investor in the distressed business, it is unlikely that any directors or officers appointed by the shareholder would become liable for any losses unless they actively prioritise the new shareholder's interests by sacrificing other shareholders' interests (if any).

Having said that, the paragraph mentioned above focuses on the liability of directors or officers, and a new shareholder *per se* is not directly liable in investing in a distressed business even if it turns into insolvency proceedings. Shareholders may generally enjoy a limited liability meaning that they are only liable to the extent of their paid-in capital contributions.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Any monetary claim can generally be secured by security (*tanpo ken*) in the forms of, among others, mortgage (*teito ken*), pledge (*shichi ken*) and / or security assignment (*joto tanpo ken*) over a collateralised asset, unless the asset is prohibited from being subject to a security.

If no insolvency proceeding has been initiated against a company which prohibits secured creditors from enforcing their security to some extent, enforcement is, in principle, to be made through a court-supervised auction (or payment in kind supervised by a court if the secured assets are movables and there are justifiable grounds for doing so) under Japanese law, although the parties may separately agree to enforcement by certain other method(s) without any court involvement. Considering the cost and timing of an enforcement action and the pricing of the secured asset(s), it is generally optimal for enforcement to take place without court involvement.

There are two main types of enforcement actions which do not involve a court: (i) a "forfeiture" (*kizoku seisan*), i.e. the secured creditor acquires the title to the collateral; and (ii) a "private sale" (*shobun seisan*), i.e. a third party acquires the collateral and applies the purchase proceeds to the secured obligations to the extent agreed between the parties. A private sale is generally preferred when the collateral has a market price.

The secured creditor will be given priority when it comes to distributing the proceeds of enforcement up to the amount of the secured obligations. If the collateral is receivables, enforcement may also be made through collection of the proceeds directly from the obligor of the receivables.

For unsecured liabilities, such liabilities may be enforced by attachment on the debtor's assets. An unsecured creditor is required to have an "execution title" (*saimu meigi*) for the compulsory execution of an unsecured right, whereas a secured creditor is not required to have such title insofar as his or her security interest is fully perfected.

An execution title is an instrument in the prescribed form certifying the existence and substance of a right enforceable through the compulsory execution procedure. The types of execution title are specified in the Civil Execution Act of Japan (Act No. 4 of 1979, as amended).

A simple example of an execution title is an irrevocable final court judgment. If a general creditor with an irrevocable final judgment in its favour commences compulsory execution proceedings against the judgment debtor and attaches its property, this attachment operates as a prohibition on the debtor's disposition of the attached property – i.e. a judgment lien is created for the benefit of the judgment creditor. If a third party has a security interest in the attached property, a conflict occurs between the security holder and the attachment creditor and priority of the security and the attachment is determined by reference to the timing of when perfection of their respective interests took place.

2.2 What involvement does the court have in these processes?

Please refer to paragraph 2.1 above.

In respect of a security enforcement, the court is involved in the context of court-supervised auction processes.

In relation to enforcement of unsecured obligations, a final court judgment as execution title would normally be required and attachment is made through a court process.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

Under Japanese law, a pledge (*shichi ken*) may be created over the shares in a KK.

The Civil Code of Japan (Act No. 89 of 1896, as amended) provides that enforcement of a pledge should be made through a court supervised auction However, the Commercial Code of Japan (Act No. 48 of 1899, as amended) also provides that for a pledge given by one commercial enterprise to another, the involved parties may also agree to enforcement by certain method(s) without court involvement. Considering the cost and timing of an enforcement action and the value of the secured asset(s), it is generally optimal for enforcement to take place without court involvement.

As mentioned in paragraph 2.1 above, there are two main types of enforcement action which do not involve a court: (i) a "forfeiture" (*kizoku seisan*), i.e. the secured creditor acquires the title to the collateral; and (ii) a "private sale" (*shobun seisan*), i.e. a third party acquires the collateral and applies the purchase proceeds to the secured obligations to the extent agreed between the parties. A private sale is generally preferred when the collateral has a market price and the creditor is seeking to apply the sale proceeds towards repaying the secured obligation(s).

To enforce the share pledge by way of forfeiture, the pledgee should send an enforcement notice to the pledgor and thereupon, the pledgee will be entitled to acquire the title to the shares in the company. There is no prescribed form for such enforcement notice. Upon enforcement by way of forfeiture, the pledgee should notify the company of the enforcement and request the company to record the name and address of the pledgee and the number of shares acquired in the shareholders' register (*kabunushi meibo*) kept by the company. This is because the pledgee needs to be recorded as a new shareholder in order for the pledgee to assert its right as a shareholder, in respect of its newly acquired shares, against the company and any third parties. The pledgee can also acquire the title to the shares following delivery of an enforcement notice.

If there are no physical share certificates, ownership of the shares is governed by any relevant agreements between the pledgee and the company’s parent and the shareholders' register (*kabunushi meibo*) kept by the company. The shareholders' register (*kabunushi meibo*) is not a public register but merely a private document kept by the company. However, if no physical share certificates are issued, there is no requirement under Japanese law other than recording shareholders in the register to perfect a shareholder's ownership against the company and third parties (i.e. to claim ownership of the shares against the company and third parties).

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

As mentioned above, ultimately this would result in the same outcome as a debt-for-equity swap, whereby the debt investor would enforce its share pledge over the shares in the company by way of a forfeiture and apply such proceeds to the loan.

2.3.2 Is a public auction mandatorily required or are private sales possible?

Please refer to paragraph 2.3 above.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Other than listed companies, it is not unusual for a transfer of shares under the articles of incorporation of a KK to be subject to the approval of the board of directors in order for such shares to be validly transferred.

Unless the articles of incorporation are amended at the time of creating a share pledge, it is generally not possible to set aside transfer restrictions in the constitutional documents of a legal entity as part of a share pledge enforcement in Japan, and this would cause an issue when the shares are transferred to a secured party, and also when the same secured party transfers the shares to a third party.

While a board approval is not necessary when a share pledge is created as title to the shares is not transferred at that point in time, a board approval would be necessary when the pledge is enforced and the shares are transferred accordingly.

A pledgee customarily receives a power of attorney from the security grantor which allows it to request the board to approve a share transfer, should it be necessary to do so following enforcement of the security.

If the board refuses to give its approval to the proposed share transfer, it has to designate a third party to whom the shares can be transferred. The share price for such a transfer would ultimately be decided by the court unless the transferor and the transferee can mutually agree to a price.

A pledgor may be asked to provide, in advance, a board approval to a transfer of shares on enforcement, and this is quite prevalent in practice. One problem with this approach is that such an approval may have to identify a transferee (a general approval may not be valid). There is also some doubt as to the validity of such an approval for any extended period of time, therefore the security grantor may also be obliged to renew that approval on a regular basis (e.g. once a year).

The pledgor and the company may also be asked to procure that the articles of incorporation of the company in which it holds shares be changed to remove the requirement that a board approval be given for a share transfer.

If the company does not have the board of directors (which is relatively usual for a Japanese SPC), each reference to board approval in this paragraph 2.3.3 should be replaced with the reference to approval by shareholders meeting.

2.3.4 Is "market testing" mandatorily required?

If the enforcement occurs via a forfeiture or private sale, there is no market testing or private auction mandatorily required. However, the pricing and valuation of the shares may be challenged by the pledgor and market testing would be relevant evidence to prove that the pricing and valuation are on an arm's length basis and not arbitrarily determined.

Indeed, if the enforcement is made via a forfeiture or even a private sale, it is recommended that a certain type of market testing should be performed so that the process can be considered fair and the pricing can be justified. In the case of a private sale, a private auction would be sought.

2.3.5 Are valuation reports mandatorily required?

No. As is the case for paragraph 2.3.4, valuation reports would be relevant evidence to prove that the pricing and valuation of the shares are appropriate. Indeed, if the enforcement is made via a forfeiture, it is recommended that valuation reports should be sought so that the pricing can be justified.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

In addition to a purely consensual out-of-court restructuring process, there are multiple rule-based pre-insolvency procedures available. One notable and most widely used method is the turnaround alternative dispute resolution process (*jigyou saisei*, or ADR).

The turnaround ADR was introduced in November 2008. As this is not a court-supervised procedure, and basically a private restructuring arrangement, it is different from other court-supervised proceedings. Since its introduction, the turnaround ADR process has been frequently used.

When the turnaround ADR was first introduced, the Japanese Association of Turnaround Professionals (*jigyou saisei jitsumuka kyokai*) (JATP) was established to govern and regulate turnaround ADR procedures. Japanese qualified lawyers (*bengoshi*) and accountants specialising in the area of business rehabilitation are registered with the JATP to coordinate turnaround ADR procedures.

The turnaround ADR procedures are not judicial insolvency proceedings, but non-judicial restructuring proceedings. The court does not supervise the turnaround ADR proceedings or the JATP. While the relevant creditors can be selected by the debtor of the proceedings, successful completion of the turnaround ADR proceedings requires the unanimous consent of all the creditors which are selected for and involved in the proceedings (Involved Creditors) to successfully restructure debts. The debtor has to negotiate with the Involved Creditors to obtain their unanimous consent and to establish a restructuring plan (*jigyou saisei keikaku*) under the supervision of the JATP.

One of the characteristics of the turnaround ADR procedure is that the process is supervised by a fair and neutral organisation, the JATP. The JATP is licensed by the Japanese authorities under relevant statutes. It is expected that the JATP should enable turnaround ADR procedures to be fair and reasonable, which would benefit judicial rehabilitation proceedings by decreasing the number of such proceedings and provide relief to creditors by providing them with access to a flexible and practical restructuring plan.

3.2 What involvement does the court have in these processes?

The court is not involved in turnaround ADR proceedings.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The distressed company and the JATP are the main players to lead a turnaround ADR process.

The other main players are the Involved Creditors. The Involved Creditors are chosen by the JATP and the company from:

(i) financial institutions;

(ii) non-banks (money lenders);

(iii) servicers acting for (i) and / or (ii); and

(iv) any other creditors who should be involved for the purpose of rehabilitating a company's business.

Although trade creditors (such as vendors of goods and services necessary for the company's business) can theoretically be involved in turnaround ADR proceedings as in (iv), it can be difficult for a company to continue its business if trade creditors are involved, and as such, they are rarely involved in turnaround ADR procedures. Bondholders are also not involved in such processes as it is generally extremely difficult to obtain the unanimous consent of bondholders which is required in turnaround ADR proceedings.

3.4 Is there a typical due diligence process followed?

If a potential sponsor is involved, that sponsor would require due diligence, but that due diligence would be conducted outside of a turnaround ADR proceeding.

As turnaround ADR proceedings are designed to be completed within a relatively short timeframe, there is unlikely to be much room for the Involved Creditors to conduct due diligence. Therefore, as an alternative, all the Involved Creditors are generally expected to attend the first meeting and, among other things, to receive a description of the company's assets and debts and a draft of the restructuring plan. As the Involved Creditors should have a chance to ask questions or express views on or before the first meeting, this may serve as a replacement for the due diligence process.

3.5 What is the typical timeline of a M&A sale under a pre-insolvency process and how does the process work?

While there is no hard deadline to completing a turnaround ADR proceeding, there is a restriction that meetings should not be held more than 3 times. Due to this restriction, turnaround ADR proceedings would usually take 3 to 6 months to complete after the JATP formally accepts an application for the proceeding to take place.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

Turnaround ADR proceedings are designed to have a mechanism to suspend payments to some extent. The JATP formally accepts an application for turnaround ADR proceedings when a provisional coordinator (*tetsuzuki jisshisha no yoteisha*) appointed by the JATP believes that rehabilitation of a debtor is feasible after examination of: (i) the debtor's business and financial position; and (ii) a draft of the restructuring plan provided by the debtor.

Once the JATP formally accepts the application, the JATP and the debtor jointly send a stop notice (*ichiji teishi no tsuuchi*) (Stop Notice) to the Involved Creditors. In the Stop Notice, the debtor would request the Involved Creditors not to:

(i) collect their debts;

(ii) take further security; or

(iii) petition for a judicial insolvency proceeding.

The Stop Notice does not bind Involved Creditors at this stage. However, if Involved Creditors approve the Stop Notice in the first creditors' meeting, the Stop Notice would bind the Involved Creditors.

The suspension of payments above does not provide any protection for M&A sales or asset sales per se. However, if the M&A sales or assets sales are implemented in the course of a turnaround ADR proceeding, the suspension of payments may provide the purchaser with some comfort in a sense that the company's asset is not overly lost.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Given the limited amount of time, a restructuring plan would usually be prepared and discussed with the JATP before a turnaround ADR proceeding is filed. Having said that, once it is known to creditors that the company is intending to undergo a restructuring, it may deteriorate the company's credit and business of the company. Therefore, negotiation of the restructuring plan with creditors tends to be a sensitive topic. Discussion and negotiation with major creditors on the restructuring plan would likely begin once a Stop Notice is served.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Pre-pack sales are neither expressly permitted nor prohibited under Japanese law. While pre-pack sales are not statutorily stipulated, in practice pre-pack sales would usually indicate that a sponsor has been appointed in advance (whether this has been approved by major creditors or not) and that the company would then apply for a court-supervised insolvency proceeding, in particular, a civil rehabilitation proceeding as they are basically a debtor-in-possession (DIP) type process. In most cases, the sponsor would seek to purchase shares in the distressed company, though it could also take other approaches, such as a business or asset sale.

Generally, pre-pack sales are considered beneficial as it would accelerate the sale process and the credit risk of the company may be minimised due to knowledge of there being a potential sponsor. However, at the same time, given that pre-pack sales are not legislated, the process may not be sufficiently controlled by major creditors and / or the court. As such, the fairness of such process may not necessarily be guaranteed.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The main players in these processes are the company, its management and the sponsor.

The company would usually coordinate with its financial advisor and legal advisor to select a suitable sponsor amongst multiple candidates. Before the company enters into an insolvency proceeding, usually during the sponsor selection process, it is important for the company to communicate with the court (and potentially a prospective supervisor (lawyer) to be appointed by the court). This is because, after the company enters into the insolvency proceeding, the sponsor agreement would need to be approved by the court and the company's major creditors as the restructuring plan will have to ultimately be approved in the creditors' meeting. The court and the prospective supervisor could therefore also be seen as main players of these processes.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

As mentioned in paragraph 4.2, at the time of selecting a sponsor, an insolvency proceeding has not yet been filed. This means that a supervisor would therefore not have been appointed, as a supervisor is appointed by the court after commencement of an insolvency proceeding. However, in practice, the company and their counsel would start communicating with the court and related parties informally in advance of officially filing for an insolvency proceeding.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

There is no special protection for certain types of creditors in pre-pack sales per se, but if an insolvency proceeding follows, all the general protection package available under the relevant insolvency proceeding would be applicable – e.g. a payment waterfall.

4.5 Is there a typical due diligence process followed?

The due diligence process in the context of a pre-pack sale process does not necessarily differ from that of other types of distressed process outside of a pre-pack process.

4.6 Is "market testing" mandatorily required?

As the pre-pack process is not statutorily stipulated, there is no requirement for market testing. However, as mentioned in paragraph 4.1, it has been argued that given a fair, equal and due process is not always guaranteed, market testing should be sought as a matter of good practice. Additionally, given that a sponsor agreement needs to be approved by the court and the restructuring plan would also need to be approved in a creditors' meeting, a reasonable and fair sponsor agreement and market testing would assist in achieving this outcome.

4.7 Are valuation reports mandatorily required?

Please see paragraph 4.6 above. Valuation reports are not statutorily required but would definitely assist with convincing the court and the major creditors that the sponsor agreement and restructuring plan should be approved.

4.8 What is the typical timeline of "pre-pack" sales?

As the pre-pack sale process is not statutorily stipulated, there is no stipulated timeline.

MEXICO

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

In Mexico, there are no specific legal requirements applicable for purchasing distressed equity.

There are different types of companies according to the General Law of Commercial Companies (*Ley General de Sociedades Mercantiles*). There is the limited liability company (*Sociedad de Responsabilidad Limitada*) and there is the limited corporation (*Sociedad Anónima*).

That said, in general terms, equity is transferred through the conveyance of equity interests in limited liability companies (*sociedad de responsabilidad limitada, S. de R.L.*), or through the endorsement of shares in the case of corporations (*sociedad anónima S.A.*).

For corporations, there are special rights or preferred rights of actual owners of shares in regard to a buy / sell operation of any other shares of the company.

In the Mexicana Airlines case, the judge ruled that said preferred rights were not valid if in an insolvency proceeding (*concurso mercantil*).

The transfer is effective between the parties as of the moment it is agreed between them; however, it is effective as against third parties, including the target S. de R.L., as of the date of the registration of the transfer and details of the new shareholder in the company's shareholders' ledger kept by the S. de R.L.

The transfer of shares that represent the capital stock of an S.A. is effective as of the date the certificates that represent the shares are endorsed and the purchaser physically receives them. The transfer is effective as against third parties, including the S.A., as of the date the transfer is registered in the company's shareholders' ledger and in the public Commercial Registry.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

No, there is no special legal regime in Mexico regarding the sale and purchase of distressed debt or non-performing loans.

That said, in general terms, under the Federal Commerce Code the transfer of collection rights should be perfected through an assignment agreement that will become effective:

(i) between the parties as of the date of the assignment agreement;

(ii) against third parties, if the shares were part of a pledge, as of the date the assignment is registered with the Sole Registry of Moveable Collateral (*Registro Único de Garantías Mobiliarias*); and / or as of the date the transaction was registered in the entities deed and in the Public Registry of Commerce; and

(iii) against the debtor, as of the date the debtor is notified of the assignment before two witnesses.

If the debtor is not notified of the assignment, it will be released from the payment obligation under the collection right by paying the assignor, notwithstanding the assignment between the creditor and the assignee.

If the distressed asset has collateral or warranties, the formality of the assignment will vary, as it will have to be done before a notary public in the case of a mortgage and sometimes a pledge.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

To the extent a distressed investment takes place outside a Mexican Insolvency process (*concurso mercantil*), there are no specific requirements to be considered in the case of distressed investments.

1.4 What risks exist for an investor of distressed business?

There are specific legal risks associated with investing in distressed businesses under Mexican law.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Outside of bankruptcy proceedings (*concurso mercantil*), individual creditors, under the Federal Civil Code that supplements the Commerce Code, have the right to seek the annulment of legal acts by the debtor, if:

(i) the debtor became insolvent as a result of those acts;

(ii) the acts resulted in detriment to the creditor;

(iii) the challenged acts took place after the date of the creditor's collection rights; and

(iv) in the event the acts were for consideration, they were undertaken in bad faith from both parties.

Note that the acts may be annulled only if all requirements mentioned above are met. Otherwise, the challenged acts will continue to be valid and effective.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

Under the Mexican Bankruptcy Law (*Ley de Concursos Mercantiles*), the competent court may review the acts undertaken by the debtor that took place during the clawback period of 270 calendar days before the date of the sentence declaring the state of bankruptcy thereof. The clawback period may be increased under certain circumstances, such as when there are subordinate lenders or when the restructuring officer, the trustee or any creditor requests it, on the understanding that the clawback period may not exceed a period of 3 years.

Based on the above, the debtor's acts in fraud of its creditors that took place during the clawback period may be declared null and void. The Mexican Bankruptcy Law defines acts in fraud of creditors as those acts that took place before the declaration of bankruptcy, knowingly defrauding creditors, if the third party that participated in those acts was aware of such fraud, unless the act is gratuitous in which case the third party's knowledge is not required.

The Mexican Bankruptcy Law further considers certain acts as fraudulent when taking place during the clawback period, such as

(i) gratuitous acts;

(ii) acquisitions of assets by the debtor for a price that notoriously exceeds its value or a conveyance for a price far below its value;

(iii) transactions under terms that significantly differ from market standards and practices;

(iv) waiver of payments by the debtor, and

(v) the payment of debts that are not yet due and payable.

Other acts are presumed fraudulent under the Mexican Bankruptcy Law, requiring proof to the contrary by the debtor, such as: (i) granting of collateral or the increase thereof when the original obligation did not require such collateral or increase; and (ii) the payment in kind of debt, when the original obligation required a different type of payment.

1.4.3 What risks exist for a new lender investing in a distressed business?

There is a provision in the Mexican Bankruptcy Law that refers to new loans (article 224, section ii). Under this provision, loans given to a company declared *in concurso* will be paid before any others, except wages and labour debt.

Notwithstanding this, if the loan takes place during the clawback period described in paragraph 1.4.2 above, it is possible that the terms of the loan and collateral might be reviewed and possibly challenged by a creditor – noting that the loan, collateral and other terms thereunder should prevail to the extent it is evidenced that the transaction was not undertaken to defraud the debtor's creditors.

The recommendation is to have a ruling by the *concurso* judge authorising the loan. That way, the investor is a secured creditor that will be paid first.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

Under the Mexican Bankruptcy Law, shareholders are subordinate creditors of the debtor. Consequently, in the event of bankruptcy and possible liquidation, a shareholder will receive any remaining funds after most other debts have been paid, including labour and tax obligations, secured obligations and non-secured creditors.

Therefore, regardless of the date when the investment is made by the shareholder, there is a risk that it might not recover any of its investment in the case of bankruptcy.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

According to the Mexican Bankruptcy Law, a loan to the distressed company after it was declared *in concurso* or bankruptcy, approved by the judge, will give the loan a secured place such that it will have to be paid first and above all other creditors.

Under Mexican law, any debt can be secured with the common three warranties that the Civil Code recognises and establishes:

(i) mortgage (*hipoteca*);

(ii) pledge (*prenda*); or

(iii) surety bond (*fianza*), depending on the type of asset that is going to serve as collateral.

There is also the possibility to secure a specific debt with an escrow / guarantee trust (*fideicomiso*), in which the debtor transfers the property rights of specific real estate assets or other assets and instructs the escrow agent or trustee to sell or transfer the assets if there is a default notice by the creditor that the debt has not been paid on the dates agreed upon.

- ***Mortgage***

  A mortgage must be created before a notary public and registered in the Public Registry of Property of the city or town where the asset (land) is located. If the debt is unpaid and the debtor is in default, the creditor must start a civil mortgage special action before a civil court.

In Mexico, mortgage foreclosure follows a specific legal procedure that is regulated by Civil Procedural Codes which are almost identical in all states. The following is a general description of the process:

a) *Debtor default* – the foreclosure process generally begins when the borrower defaults on the mortgage loan. This may be due to non-payment of one or more monthly installments, depending on what is stipulated in the loan agreement.

b) *Notification to the debtor* – once the default occurs, the creditor that holds the right over the mortgage notifies the debtor about their delinquency situation and lets them know that the process of foreclosure is starting.

c) *Beginning of the judicial process* – if the debtor is in default, the creditor that holds the right over the mortgage can initiate a judicial process to foreclose the mortgage. This involves filing a lawsuit before the competent courts requesting the foreclosure of the mortgage and the forced sale of the mortgaged property to satisfy the outstanding debt.

d) *Hearing* – once the lawsuit is filed, the debtor as defendant is served with the claim and a hearing is scheduled in which the debtor has the opportunity to present arguments and offer proof of its arguments.

e) *Judicial ruling* – after the hearing, the court issues a ruling that can order the foreclosure of the mortgage and the sale of the property, as well as the payment of legal costs and expenses associated with the process.

f) *Property auction* – once the court ruling is issued and the ruling is made final, the mortgaged property is forced to be sold through a public auction.

It is important to note that this process may vary slightly depending on the jurisdiction and the specific circumstances of the case. Additionally, it is recommended to seek specialised legal advice from local attorneys if you find yourself in a foreclosure situation.

- ***Pledge***

When a pledge is being generated, the notary public or the parties with an interest must register it before the Public Registry of Warranties (*Registro Unico de Garantías- RUG*).

If the pledgor or the mortgagor is in default in respect of the obligations secured by the security right, the pledgee can start the process to enforce its security right. The legal process is very much the same as for a mortgage.

However, in the case of a pledge, if the debtor remains in possession of the assets that were pledged and does not comply with a notice to hand back the pledged assets, a criminal action can be started for breach of trust.

- ***Security bond***

If the debt was secured with a bond, there is a specific process that must be followed by the creditor. First, the default must be demonstrated and verified. If the bond company does not pay, then a special civil claim must be filed before the courts.

- ***Guarantee trust***

In Mexico, the establishment of a guarantee trust involves several steps and legal requirements. The following is a general description of the process:

a) *Choice of trustor and trustee* – the trustor is the person or entity who transfers the assets to the trust, while the trustee is the entity in charge of managing the assets according to the instructions of the trustor and for the benefit of the beneficiary (generally, the creditor).

b) *Planning of the trust agreement* – the trustor and the trustee must enter into a trust agreement that establishes the terms and conditions of the trust, including the identification of the parties, the description of the trust assets, the rights and obligations of the trustee and the rights of the beneficiary.

c) *Trust registration* – the trust contract must be registered in the corresponding Public Registry of Property and Commerce, according to the location of the trust assets.

d) *Trust before a notary public* - it is common for the establishment or constitution of the trust to be recorded in a public deed before a notary public to give it greater legal certainty and legal validity.

e) *Delivery of assets to the trust* - the trustor transfers the property of the assets that will serve as collateral to the trust, generally through an assignment of rights.

f) *Asset administration* - once the trust is established, the trustee has the responsibility of managing the assets in accordance with the provisions established in the trust contract. This may include the sale of the goods in the event of default by the debtor or the performance of other actions provided for in the contract.

g) *Fulfilment of the purpose of the trust* – the main purpose of the guarantee trust is to ensure compliance with an obligation, generally a loan or an issue of securities. Once the secured obligation is satisfied, the trust assets can be released and transferred back to the settlor.

It is important to note that the constitution of a guarantee trust is subject to the legal and regulatory provisions applicable in Mexico, as well as the specific terms agreed between the parties involved. It is recommended that you consult lawyers specialised in trusts and commercial law for detailed advice on this process.

2.2 What involvement does the court have in these processes?

In Mexico, if the obligation is warrantied through mortgage, pledge and sometimes in the case of bonds, the process to execute them must occur before civil or commercial courts.

If a warranty trust is involved, then in the majority of the cases the execution will take place before a notary public and is fairly quick.

When the court is involved, a final ruling will result in an order for the relevant warranties to be sold by public auction.

The creditor would receive the monies recovered from the judicial auction. The creditor cannot keep the secured asset.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

A share pledge contract is a legal agreement in which one party (the pledgor) grants another party (the pledgee) a security over a certain number of shares as security for the fulfilment of a specific obligation. Some of the elements you might find in a share pledge contract include:

a) *Parties involved* – the parties participating in the contract are identified as the pledgor and the pledgee.

b) *Description of shares* - details which specific shares are being used as collateral, including the quantity, type of shares and any other relevant information. If the title of the shares is not transmitted to the pledgee, then the contract must be registered at the Public Registry of Pledges (*Registro Unico de Garantías RUG*).

c) *Delivery and registration* – it is customary that the pledgor delivers the titles of the shares to the pledgee and registers the pledge agreement in the books of the company.

d) *Obligations of the pledgor* – the obligations and responsibilities of the debtor are established, such as maintaining the value of the shares, paying dividends and any other provision related to the shares.

e) *Conditions of default* - describes the circumstances under which the debtor would be considered to have breached the contract and bein default, which could allow the creditor to take steps to enforce the collateral.

f) *Procedures in case of default* - the steps that the creditor can take in the event of default by the debtor are detailed, such as the sale of shares to cover the debt.

g) *Duration of the contract* – the duration of the contract is established – i.e. how long the shares will remain as collateral and when they will be released once the obligation is fulfilled.

h) *Additional provisions* – whatever other provisions the parties consider necessary, such as applicable law and dispute resolution.

Under Mexican law, a right of pledge may be created over the shares in a company. As stated in paragraph 0 above, the default position by law is that the enforcement of such a pledge occurs by a claim presented in court.

Transfer restrictions may apply in the articles of incorporation of the association that govern the company whose shares are pledged.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

There is no specific provision in Mexican law. There is a possibility to agree upon a swap of shares and include this in the pledge agreement.

2.3.2 Is a public auction mandatorily required or are private sales possible?

A public auction is the ordinary method of enforcement sales under Mexican procedural law if the warranties are a mortgage, pledge or bond, but if the warranty is a trust then the sale can be done through a private auction before a notary public.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Under Mexican law, the articles of association will always be applicable to any pledge of the shares and any restriction that appears in them must be waived expressly by all owners of the shares.

The transfer restrictions may be set aside by a federal bankruptcy court, but courts will not grant the request to set aside transfer restrictions easily.

2.3.4 Is "market testing" mandatorily required?

This does not apply in Mexico.

2.3.5 Are valuation reports mandatorily required?

In the event of enforcement of a right of pledge over shares through a public auction with court approval, a valuation report of the value of the shares is mandatorily required to be submitted to the court under the court's procedural regulations.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

There are no pre-insolvency processes available under Mexico law. The *concurso* process has two different stages, the first called conciliation – in which for a period of 185 days (that can be extended twice for 90 days each) the company tries to reach an agreement with creditors.

If the period ends, the *concurso* enters a liquidation stage that is called bankruptcy and the assets are sold to pay creditors in the manner established by the Mexican Bankruptcy Law.

The Mexican Bankruptcy Law also provides that an agreement or restructuring plan can be reached in the bankruptcy stage of any *concurso* process.

3.2 What involvement does the court have in these processes?

The *concurso* process must be filed in federal bankruptcy courts. The involvement of the court is mandatorily required for the sanctioning of any restructuring plan presented in the conciliation stage.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The *concurso* process has two stages in which the Federal Office for Concursos Mercantiles (*Instituto Federal de Concursos Mercantiles – IFECOM*) appoints the trustee who will be responsible for the restructure plan to be negotiated and signed, and also will be in charge and become the administrator if the process goes into the bankruptcy stage (*quiebra*), at which point the administrator will be responsible for the sale of assets and distribution between creditors.

3.4 Is there a typical due diligence process followed?

This does not apply in Mexico.

3.5 What is the typical timeline of a M&A sale under a pre-insolvency process and how does the process work?

There is no timeline as the Mexican Bankruptcy Law does not regulate a distressed M&A sale or transaction. Assuming the relevant M&A transaction is part of the overall restructuring proceeding under the agreement sanctioned by the bankruptcy judge, the timeline for a distressed M&A sale may vary as it is necessary that the agreement sanctioned by the court becomes final (so that it cannot be further disputed or appealed). This can take more than 12 months.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

The Mexican Bankruptcy Law does not provide any form of protection for M&A sales or asset sales in the pre-insolvency process, but if a sale is part of the restructuring plan sanctioned by the bankruptcy court, this may provide the parties with some comfort, as the sale will be final if the judgment becomes final.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Pre-packaged restructuring plans are permitted under the Mexican Bankruptcy Law. Articles 339 through 342 provide that a request be must signed by the debtor as well as the holders of debt by a simple majority (50.01%) of the total amount owed by the debtor.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Pre-pack sales are not permitted or foreseen in the Mexican Bankruptcy Law. Under Mexican legislation, a debtor may file for bankruptcy (*concurso mercantil*), including a pre-packaged restructuring plan signed by the debtor and at least the simple majority of all creditors based on the total amount of the debt.

Assuming that the bankruptcy application is accepted by the competent court, the court must issue the corresponding ruling declaring the state of bankruptcy or *concurso mercantil* with a pre-packaged restructuring plan, provided that the full, ordinary bankruptcy process as provided in law will take place. This means that, even though there might be a pre-packaged restructuring plan, it might not be the final approved plan after the bankruptcy process is concluded, and it is authorised and adopted by the acknowledged creditors.

The main benefit of filing a bankruptcy petition with a pre-packaged restructuring plan is that, under the Mexican Bankruptcy Law, the debtor will not have to go through the pre-bankruptcy process whereby an officer, called a visitor (*visitador*), appointed by the Federal Institute of Bankruptcy Specialists (*Instituto Federal de Especialistas de Concursos Mercantiles*) must confirm that the debtor is insolvent in terms of the Mexican Bankruptcy Law, and suggest any injunctive or restraining orders (TROs) or relief to protect the assets of the debtor.

The pre-packaged restructuring plan could include the sale of assets of the debtor. However, the approval of such a sale will be subject to the terms of the bankruptcy process and the approval of the restructuring officer (*conciliador*), appointed by the Federal Institute of Bankruptcy Specialists as ordered under the corresponding sentence declaring the state of bankruptcy or *concurso mercantil*.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

As mentioned in paragraph 4.1, pre-pack sales are not permitted or foreseen under the Mexican Bankruptcy Law.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

As mentioned in section 4.1, pre-pack sales are not permitted or foreseen under the Mexican Bankruptcy Law.

If a bankruptcy claim is admitted with a pre-packaged restructuring plan, the debtor and creditors will still have to go through the ordinary bankruptcy process and the restructuring officer appointed by the Federal Institute of Bankruptcy Specialists would have to authorise the sale of any assets in the ordinary terms of the bankruptcy process.

According to the Mexican Bankruptcy Law (article 147), the simple majority of creditors can also intervene and choose and appoint the trustee or restructuring officer.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Not applicable.

4.4 Is there a typical due diligence process followed?

Not applicable.

4.5 Is "market testing" mandatorily required?

Not applicable.

4.6 Are valuation reports mandatorily required?

Not applicable.

4.7 What is the typical timeline of "pre-pack" sales?

As mentioned in paragraph 4.1, pre-pack sales are not permitted or foreseen under the Mexican Bankruptcy Law, and any sale under a pre-packaged restructuring plan would be subject to the same timeline as an ordinary bankruptcy process in Mexico.

As of the date of the last publication of the sentence declaring the bankruptcy or *concurso mercantil* of the debtor in the Federal Official Gazette (*Diario Oficial de la Federación*), the restructuring process may not take more than 185 calendar days, provided this term may be extended per the request of the restructuring officer (*conciliador*), the creditors and the debtor, noting that the restructuring phase of the process may not exceed 365 calendar days in any case.

NIGERIA

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

There is no single piece of legislation regulating the purchase of distressed equity in Nigeria.

However, there are still various incidental regulations (mostly industry specific or based on the scale of the purchase) to be considered when purchasing distressed equity.

1.1.1 SEC rules and regulations

In Nigeria, the Securities and Exchange Commission (SEC) is the key regulator when it comes to the purchase of distressed equity, where the target company is publicly traded. The guiding framework is found in the Investment and Securities Act 2025 (ISA) and the SEC's own rules.

The ISA gives the SEC wide powers to supervise transactions such as mergers, acquisitions and takeovers. This means that, where an investor is trying to buy into a struggling company – whether through a direct equity purchase, a merger or a takeover – SEC approval may be needed before the deal can go through. For example, if an investor acquires a large enough stake in a listed company, SEC rules may require that a public takeover offer be made to all shareholders to ensure fairness.

The ISA also prevents insider trading, which means an investor cannot buy distressed equity using confidential, price-sensitive information that is not yet available to the public. This is to ensure a level playing field and protect existing shareholders.

Another important area is disclosure. The law requires that investors must be given all relevant information about the company's financial health, risks and operations before making a purchase decision. Similarly, fund managers or intermediaries are required to act in the best interests of their investors, avoid conflicts of interest and be transparent about their own financial position and interests.

In essence, the SEC's oversight under the ISA is built around three core principles:

- approval and regulation of mergers, acquisitions and takeovers;
- fair dealing and prohibition of insider trading to protect the market; and
- disclosure and transparency requirements to make sure investors are fully informed before acquiring distressed equity.

It should be emphasised, however, that the SEC rules and the ISA only apply to the purchase of distressed equity in publicly traded companies.

1.1.2 The Companies and Allied Matters Act 2020 (CAMA)

CAMA governs the establishment, operation, and dissolution of companies in Nigeria.

CAMA essentially sets out the process for transferring ownership interests in companies. An investor in distressed equity needs to comply with the relevant provisions of CAMA and carry out relevant due diligence at the Corporate Affairs Commission (CAC) to ensure compliance.

1.1.3 Foreign investment regulations

Where a foreign entity or individual seeks to purchase distressed equity, the investor will need to comply with foreign investment regulations and commissions such as those imposed by the Nigerian Investment Promotion Commission (NIPC) pertaining to approval for the transactions involving a prescribed level of foreign ownership. This is especially applicable when the distressed investment is in sectors such as the oil and gas sector.

1.1.4 *The Federal Competition and Consumer Protection Act 2018 (FCCP Act)*

In cases when an entity or individual intends to acquire distressed equity, they must obtain approval for the transaction and comply with restrictions under competition law. The FCCP regulates this, and provides for, among other things:

(a) merger control – certain mergers, acquisitions and combinations that meet specified thresholds require pre-merger notification to the Federal Competition and Consumer Protection Commission (FCCPC) for approval. Additionally, distressed investments resulting in a change of control or significant market consolidation may trigger obligations under merger control regulations; and

(b) public interest considerations – the FCCP Act seeks to evaluate public interest considerations such as employment, the wellbeing of small and medium-sized enterprises (SMEs) and national security. Consequently, purchasers in distressed investments must take into account these public interest considerations.

1.1.5 *The Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act 1994*

This Act was introduced during Nigeria's banking crisis of the 1990s to address widespread bank failures. It empowers special tribunals to recover debts owed to failed banks and to punish fraudulent or reckless practices by bank managers and directors. For a distressed equity investor, this law is important because it provides a mechanism for recovering debts from insolvent banks and imposes liability on those responsible for mismanaging financial institutions. If the target distressed company is a bank (or has dealings with a failed bank), investors need to be aware of ongoing debt recovery proceedings and potential legal risks.

1.1.6 *The Central Bank of Nigeria Act 2007 (CBN Act)*

The CBN Act establishes the Central Bank as the regulator of Nigeria's financial system. It gives the Central Bank powers over monetary policy, currency management and the licensing and supervision of banks and other financial institutions. For investors buying into distressed equity, the Central Bank's role is particularly relevant where the distressed company is in the financial sector. The Central Bank may impose conditions, revoke licences or intervene in management where it deems it necessary to protect depositors or ensure systemic stability. Any acquisition of distressed equity in a regulated financial institution must therefore consider Central Bank oversight.

1.1.7 *The Nigerian Deposit Insurance Commission Act 2023 (NDIC Act)*

The NDIC Act complements the CBN Act by protecting depositors in the event of bank failure. The Nigerian Deposit Insurance Commission (NDIC) insures bank deposits and has powers to act as liquidator of failed banks. For distressed equity investors, this law matters because if the target company is a distressed bank, NDIC involvement is unavoidable. The NDIC may already be managing the resolution process, and investors must negotiate within that framework.

1.1.8 *Nigerian Insurance Industry Reform Act 2025 (NIIRA)*

The NIIRA regulates insurance companies in Nigeria, requiring proper licensing, solvency margins and adherence to prudential guidelines. When an insurance company becomes distressed, an investor cannot simply acquire equity without satisfying the regulatory requirements under the NIIRA. The legislation ensures that policyholders are protected and that only financially sound investors are allowed to step in. It effectively places conditions on acquisitions in the insurance sector.

1.1.9 *The Finance Act 2020*

The Finance Act amended various tax and fiscal provisions in Nigeria to improve revenue collection and align with modern business realities. For distressed equity acquisitions, the relevance lies in its impact on corporate taxation, capital gains tax, stamp duties and value added tax (VAT). An investor taking over distressed equity must account for the tax consequences of restructuring, mergers or asset transfers under the Finance Act. The legislation therefore directly affects deal structuring and the cost of acquisition.

1.1.10 The Federal High Court (Civil Procedure) Rules 2019 (Rules)

The Constitution of the Federal Republic of Nigeria (as amended) in section 251 confers exclusive jurisdiction on the Federal High Court on matters relating to companies as provided for under CAMA. By virtue of this, matters relating to the acquisition of distressed companies and corporate entities fall within the scope of regulation of the rules of court. The Rules set out how cases are conducted before the court. For distressed equity transactions, the Rules are relevant because disputes that may arise around mergers, acquisitions, debt recovery and insolvency are likely to be litigated in the Federal High Court. Understanding the Rules ensures investors can anticipate timelines and legal processes in the case of disputes.

1.1.11 Other regulations

Other general laws and regulations to be considered by an investor in a distressed investment include those touching on anti-money laundering (AML) and anti-corruption. The Economic and Financial Crimes Commission Act and the Independent Corrupt Practices and Other Related Offences Commission Act may be relevant, along with provisions touching on environmental law, labour law, foreign exchange regulations, taxation and intellectual property (among others).

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

In respect of the purchase of distressed debt, currently Nigeria has no singular legal regime which codifies the requirements for the purchase of distressed debt or non-performing loans (NPLs). Nonetheless, there are various sector-specific legal regimes that touch on the purchase of distressed debt or NPLs.

1.2.1 The Asset Management Corporation of Nigeria Act 2019 (AMCON Act)

The AMCON Act is specialised legislation which essentially regulates the acquisition, management and disposal of NPLs within the banking sectors. The AMCON Act created the Asset Management Corporation of Nigeria (AMCON), a body charged with the duty of efficiently resolving NPL loans and distressed assets in Nigeria. AMCON also has a practice direction (AMCON Practice Direction 2013).

The AMCON Act outlines AMCON's mandate to acquire eligible bank assets, encompassing NPLs, distressed assets and other assets identified by the Central Bank as eligible, from eligible financial institutions in Nigeria.

Eligibility is mainly determined by the nature and quality of the asset. The AMCON Act focuses on assets that are either non-performing or distressed, meaning they are not yielding the expected returns and are putting the stability of the financial system at risk.

The AMCON Act establishes the procedures, terms and conditions governing the transfer of eligible bank assets to AMCON.

AMCON is given the authority to conduct valuations of eligible bank assets to ascertain their fair market value for acquisition purposes, ensuring transparency in the acquisition process.

The AMCON Act empowers AMCON to manage and dispose of the assets it acquires, including the authority to take possession, manage, sell, lease, assign or otherwise deal with these assets. AMCON is also given enforcement powers, including enforcing security interests, foreclosing on assets and pursuing other legal actions against defaulting debtors.

Section 6 empowers AMCON to issue bonds and other debt instruments to pay for NPLs or other eligible assets it acquires from banks. It may also borrow money, raise capital or secure its borrowings with its assets, either with or without the guarantee of the Central Bank. AMCON can hold and manage a wide range of investments, including equities, fixed-income securities and real estate, and is authorised to provide or take equity stakes where it considers such investments necessary for asset recovery or restructuring.

AMCON can enforce or restructure debts, engage in reorganisations or compromises of debtor businesses, and use derivatives and foreign currency instruments to hedge financial risks. It has the power to guarantee obligations of other entities, enforce or release securities and guarantees, and even compromise or forgive debts, although such forgiveness requires the approval of the Minister of Finance where it might prevent full recovery of AMCON's investment.

The AMCON Act further permits AMCON to establish subsidiaries or joint ventures, enter into partnerships, maintain bank accounts (local or foreign) and dispose of its assets or investments as necessary. These powers may be exercised either directly, through agents or in collaboration with other entities, both within and outside Nigeria.

1.2.2 Banks and Other Financial Institutions Act 2020 (BOFIA)

This is applicable in the banking and financial industry. BOFIA contains provisions indirectly related to the purchase of distressed debt, loan recovery and management of NPLs. Some key provisions in this regard pertain to prudential guidelines, risk management, capital adequacy, asset classification and provisioning, and restructuring and recovery.

1.2.3 Prudential Guidelines

These are rules issued by the Central Bank, which banks must follow to ensure they operate safely and soundly.

The Prudential Guidelines cover issues such as how loans are given, how bad loans are recognised and how much risk banks can take on. For distressed debt, the Prudential Guidelines matter because they set the standards for when a loan should be classified as non-performing and how it should be managed.

For example, the Central Bank's Prudential Guidelines 2010 define the standards for asset classification. A loan or credit facility is classified as non-performing when interest or principal is overdue for more than 90 days.

The Central Bank is also authorised to regulate banking activities, including how banks deal with distressed debts and NPLs. The Central Bank can equally issue guidelines and directives to banks in this regard.

1.2.4 The Secured Transactions in Movable Assets Act 2017 (STMA)

The STMA establishes a regulatory framework for enforcing security interests in Nigeria. It includes provisions on the creation, perfection and enforcement of security interests in movable assets, which serve as collateral for loans. Therefore, if a distressed debt involves movable assets used as collateral, the enforcement mechanisms outlined in the STMA may apply.

1.2.5 The Nigeria Deposit Insurance Corporation Act 2023 (NDICA)

This NDICA deals with the operations of the Nigeria Deposit Insurance Corporation (NDIC), which is responsible for the protection of depositors and the resolution of distressed financial institutions.

The NDIC provides insurance coverage for deposits placed in licensed banks and financial institutions. This means that, if a bank fails, depositors can still recover part (or all) of their money, up to the insured limit. The NDICA specifies how much is covered and ensures banks contribute to the insurance fund through premiums.

The NDIC has powers to supervise and examine the books of banks alongside the Central Bank. This is to detect early signs of financial distress and ensure banks comply with prudential standards.

If a bank becomes distressed, the NDIC plays a frontline role in resolving the crisis. The NDICA empowers the NDIC to recover debts owed to failed banks and manage their assets during liquidation. This means the NDIC can sell loans, foreclose on collateral or restructure assets to maximise recovery.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

General regulatory requirements often differ based on the specific circumstances of each distressed investment opportunity (see paragraph 1.1 above).

1.4 What risks exist for an investor of a distressed business?

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Transactions conducted by a company facing financial distress can be contested in the court. Injunctive relief could be brought against investors by distressed parties and criminal proceedings could also be brought where fraud is involved.

Additionally, failure to comply with relevant statutory requirements may expose the transactions to being overturned or invalidated by the court.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

An investor in a distressed business in Nigeria may be exposed to various claims under CAMA.

- *Claim for fraudulent conveyance – section 658 CAMA*

  Section 658 deals with fraudulent preferences – that is, actions by a company that unfairly favour certain creditors or parties over others when the company is facing financial difficulty.

  If a company transfers property, makes payments or takes any action within a defined period before insolvency that gives an undue advantage to one creditor or guarantor, the relevant transaction can be declared invalid.

  The law assumes that if the favoured party is connected to the company (e.g. a related party), the company likely acted with the intent to prefer them, unless proven otherwise. Even if the action followed a court order, that does not automatically protect it from being treated as a preference.

- *Undervaluation or inadequate consideration – section 659 CAMA*

  Section 659 focuses on transactions made at an undervalue – meaning the company gave away assets for little or no value when it was in financial distress.

  If a company entering administration or liquidation is found to have gifted assets, or sold assets for significantly less than their true value, then the liquidator or administrator can ask the court to reverse or adjust the transaction. The goal is to restore the situation as if the undervalued transaction never happened.

  This ensures that a company's assets are not improperly depleted before insolvency, protecting creditors and maintaining fairness in the distribution of the company's remaining value.

- *Substantial property transactions involving directors and related parties – sections 310 and 312 CAMA*

  Sections 310–312 regulate transactions between a company and its directors or controlling members, particularly those involving significant company assets.

  If a company enters into a substantial property transaction without following the proper approval process set out in CAMA, that transaction is voidable, meaning the company or the court can cancel it.

  However, there are exceptions. The transaction may stand if it is no longer possible to return the assets but the company has been compensated, or otherwise if innocent third parties who bought in good faith would be unfairly affected, or if the transaction is properly ratified within a reasonable time.

  The aim of these provisions is to prevent self-dealing and abuse of power by insiders (such as directors) and to protect the interests of shareholders and creditors. These provisions collectively aim to protect creditors, shareholders and the integrity of the insolvency process by ensuring that asset transfers are fair, transparent and subject to proper oversight.

  Apart from the obligations under CAMA, there are also other important risks to consider, as outlined below.

- *Breach of contract*

  When an investor acquires equity in a distressed company, they are stepping into a business that already has legal obligations and binding contracts with third parties (such as lenders, suppliers, employees, landlords, regulators and customers). If the investment transaction itself breaches those existing obligations, several risks arise.

  For example, many distressed businesses already owe money to banks or other creditors. Loan agreements often contain covenants (conditions) that restrict changes in ownership, control or capital structure without lender consent. If an investor acquires the business without complying with these covenants, the loan could be called in immediately, worsening the financial crisis.

- *Misrepresentation or non-disclosure*

  If significant information was misrepresented or omitted during the negotiation or execution of the transaction, stakeholders may contest it based on allegations of fraud, misrepresentation or non-disclosure.

- *Violation of contractual obligations*

  If the transaction breaches contractual agreements or obligations with third parties, such as lenders, suppliers or customers, those parties may challenge the transaction and seek remedies under contract law.

- *Public policy considerations*

  Transactions that violate public policy or are contrary to the public interest may be subject to challenge by regulatory authorities or other stakeholders, particularly in highly regulated industries or sensitive sectors.

1.4.3 What risks exist for a new lender investing in a distressed business?

The risks include lack of transparency and full disclosure by directors and officers of the distressed business. The new lender also faces the risk of existing lenders not agreeing to share security or refusing to give the new lender a priority over the existing lenders.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

Financial difficulties may increase the likelihood of creditors pursuing shareholders for unpaid debts. Shareholders may incur liability where amounts remain unpaid on the shares.

Other risks include litigation risk and dilution of the ownership structure in the case of restructuring, which could impact on their shareholding and therefore reduce their control and potential return on investment.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Firstly, a distressed investor should explore the procedures for enforcement set out in the agreement governing the transaction. Under Nigerian law, security documents typically outline the circumstances under which the security interest can be enforced.

That aside, there are several enforcement routes available to distressed debt investors and M&A investors in Nigeria.

2.1.1 Traditional court route

Investors can file claims in the Federal High Court, which has jurisdiction over matters such as company law, securities, banking and insolvency. Through litigation, investors can seek remedies such as a simple debt action / fast track procedure, breach of contract, a winding up petition or action for the enforcement of collateral.

2.1.2 Pre-emptive remedies

This entails seeking injunctive relief from the court to protect creditors' interest. There are different types of injunctions, including an *ex parte* interim injunction, an interlocutory injunction, a perpetual injunction, a Mareva injunction (freezing order) and an Anton Pillar injunction (search and seizure order).

2.1.3 Insolvency route

These options consist of liquidation, receivership or administration.

Liquidation of a company is a process whereby the affairs of a company are wound up and its assets or properties are sold and administered for the benefit of its creditors and members. By this process, the life of the company is brought to an end. Chapters 20-24 of CAMA regulate liquidations.

Receivership is more of a rescue procedure because the administrative receiver has powers similar to those of an administrator in an administration. The receiver has the power to continue to operate the business. Chapter 19 of CAMA provides for this, while the Eleventh Schedule sets out receivers' duties.

Administration is regulated under Chapter 18 of CAMA. An administrator may be appointed over a company where the company is or is likely to become unable to pay its debts. Section 444(2) of CAMA provides that the rescue of the company is the primary objective of the administrator. The exception is where the administrator is of the opinion that it is not reasonably practicable, or a better result can be achieved for the company's creditors by pursuing another course.

2.1.4 AMCON receivership

As noted above, the AMCON Act gives AMCON enhanced enforcement powers when dealing with NPLs and distressed assets. One of its most powerful tools is the right to appoint a receiver or receiver / manager over a debtor's assets.

2.1.5 *Alternative dispute resolution*

Many investment agreements contain arbitration clauses, allowing disputes to be resolved outside court. Arbitration is usually faster and confidential, which is attractive in M&A disputes.

Mediation and negotiation are also common, especially where preserving the business relationship is important.

2.1.6 *Law enforcement agencies*

This entails lodging a criminal petition for Illegal Diversion of Funds among others. The Economic and Financial Crime Commission (EFCC) has also been invoked in this regard. This method has, however, been challenged as an inappropriate mode of recovery as it could easily lead to violation of human rights.

2.1.7 *Adverse publicity and reputational risk*

This is one of the less "legal" but very real risks and enforcement considerations in distressed investments. It does not come from a statute or contract clause, but rather from how the market, regulators, media and the public perceive the transaction.

If an investor acquires a distressed company, especially in banking, oil and gas or manufacturing, there may be public suspicion that the investor benefited unfairly or exploited loopholes.

Accusations of "asset stripping," insider dealing or taking over companies "on the cheap" can damage the investor's brand.

2.1.8 *Regulatory scrutiny*

In Nigeria, regulators such as the Central Bank, SEC, EFCC and ICPC may become more inquisitive if an investment is portrayed negatively in the press.

Adverse media can even trigger investigations into compliance with anti-money laundering laws, taxation or foreign exchange rules.

2.2 What involvement does the court have in these processes?

The legal mortgage holder possesses the right to assume control of the mortgaged property in order to safeguard it from any potential deterioration. This right is immediate and not contingent upon the mortgagor defaulting on payment of the loan amount.

A legal mortgagee is a lender who holds a legal interest in the mortgaged property. This arises when the mortgage is created in full compliance with statutory requirements.

An equitable mortgagee is a lender who holds only an equitable interest in the property because the mortgage is not perfected into a legal one.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

Section 191 of CAMA empowers a company to create a charge / pledge on its uncalled capital or any part thereof, or issue debenture stock and other securities as a security for debt.

The enforcement process is often outlined in the pledge agreement and may involve obtaining a court order for judicial foreclosure or private sale. Furthermore, various industry-specific legislation sets out the modes for enforcement of a pledge on shares.

For example, the BOFIA provides, in section 20(2), for the requirement for the Central Bank to approve a bank's attempt to enforce security created over shares other than those held in the bank's subsidiary, holding company, associate or other related party.

By way of further example, section 86(5) of the Investments and Securities Act 2025 prohibits the sale of securities of publicly quoted companies without the prior consent of the SEC.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

Yes, it is possible to implement a debt-for-equity swap as part of a share pledge enforcement in Nigeria. Chapter 27 of CAMA provides for this.

Under this Chapter, a company has the authority to engage in a compromise or arrangement with its creditors or shareholders – whereby the rights and liabilities of members, debenture holders or creditors are regulated by CAMA or through the unanimous consent of all involved parties. However, this procedure requires endorsement from the Federal High Court in Nigeria, following confirmation from the SEC that it deems the proposed compromise or arrangement fair.

2.3.2 Is a public auction mandatorily required or are private sales possible?

No, public auctions are generally not mandatorily required. The Eleventh Schedule of CAMA specifically gives a receiver the prerogative to decide whether to organise a public auction or private sale / treaty.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Yes, it is possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement in Nigeria. However, this typically requires obtaining the requisite consent of parties, disclosure and transparency to shareholders. The code of corporate governance and laws governing securities should, however, be taken into consideration in this regard.

2.3.4 Is "market testing" mandatorily required?

Generally, market testing, used interchangeably with competitive tendering or competitive bidding, is not mandatorily required under the legal framework of Nigeria in all situations.

Nonetheless, it is required in transactions involving certain industries (such as those involving telecommunications, the oil and gas sector or the energy sector) and generally in transactions involving government agencies (this is to ensure fairness and transparency).

2.3.5 Are valuation reports mandatorily required?

Generally, valuation reports are not mandatorily required under the legal framework of Nigeria. However, valuation reports are desirable to prevent the violation of regulations touching on various areas such as undervalued sales. Some instances where valuation reports are necessary include:

(a) asset sales and disposals – valuation reports may be used to determine the fair market value of assets being sold or disposed of by companies, to avoid disposal of asset at an undervalue and therefore face the risk of being upturned in accordance with section 659 of CAMA; and

(b) financial reporting – CAMA requires companies to prepare financial statements and file the same at the Corporate Affairs Commission (CAC). Valuation reports are therefore needed in this instance to accurately capture the value of assets for inclusion in the financial statement.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

Distressed debt and M&A investors could adopt several pre-insolvency processes to address distressed business situations towards facilitating debt recovery, restructuring and turnaround before the initiation of formal insolvency proceedings

3.1.1 Informal workouts

Informal workouts are common, especially in the context of loan restructuring that avoids changes to the debtor's corporate framework. Regulatory bodies sometimes endorse these informal workouts, typically by encouraging existing creditors to agree to a pause and the injection of new funds. The main benefit is to provide the debtor with flexibility to continue its operations, aiming ultimately to repay its debts and avoid bankruptcy or liquidation.

3.1.2 Debt restructuring

Distressed debt investors and creditors have the option to negotiate agreements with borrowers to restructure debts, adjust repayment terms or convert debt into equity. Chapter 27 of CAMA provides for this type of process, such as an arrangement or compromise.

Importantly, section 715 of CAMA also introduced a statutory 6-month moratorium under schemes of arrangement, during which no creditor can initiate winding up petitions or enforcement actions against the company. This can help to promote a debt restructuring and creditor negotiations.

3.1.3 Company voluntary arrangement (CVA)

This is provided for in Chapter 17 of CAMA. A CVA enables a company, represented by its director, liquidator or administrator, to propose and implement a binding agreement with all unsecured creditors. This agreement addresses debt restructuring and repayment to prevent liquidation. A CVA allows distressed entities to manage cash flow insolvency efficiently without extensive court or regulatory involvement, overseen instead by an insolvency practitioner, except in cases where legal challenges to the CVA proposal arise.

3.1.4 Administration

Administration was introduced by CAMA. Under this process, an insolvency practitioner is appointed to serve as administrator for a distressed company, tasked with managing its business operations, affairs and assets. The primary objective is to rescue the company wholly or partially as a viable entity. If rescue is not feasible, the administrator focuses on achieving a better outcome for the company's creditors, including secured and preferential creditors, through the sale of assets.

Administration provides a shield for the company against creditor actions to enforce debts. It serves as an effective mechanism for business rescue because once an administrator is appointed, no actions can be taken to enforce security over the company's assets, nor can legal proceedings be initiated or continued against the company or its assets, except with court permission or the administrator's consent (section 480 of CAMA). This allows the administrator to concentrate on implementing rescue efforts without the distraction of impending insolvency claims from creditors.

Despite its advantages, certain companies are ineligible to utilise administration under sections 447(4) and 447(5) of CAMA. These include commercial banks, insurance companies (without approval from the National Insurance Commission) and non-authorised deposit takers as defined by banking laws and regulations.

3.1.5 BOFIA mechanisms

BOFIA introduced further business rescue measures, including the asset separation tool outlined in section 41. This tool facilitates the segregation of a bank's distressed assets into an asset management vehicle, allowing for an orderly wind-down if immediate liquidation is not warranted under prevailing market conditions. Additionally, BOFIA introduced the sale of business tool as per section 42, empowering the Central Bank to sell all or part of a failing bank's securities or assets to a third party, even without the consent of the bank's shareholders.

3.1.6 Distressed M&A

This represents another approach taken prior to insolvency, aimed at rescuing a distressed entity by means of various forms of business combinations or transfers. This process acts as a business rescue mechanism while also presenting an appealing business opportunity for investors. A distressed M&A transaction can take the form of:

(a) an asset deal, where the distressed company sells off its non-core assets. Also, a financial investor may acquire assets not burdened by legacy debt; or

(b) a share deal, where the investor purchases the distressed company at a price below market value due to its liabilities, or acquires it for a nominal sum, potentially avoiding capital gains tax obligations while assuming responsibility for existing liabilities.

3.1.7 Other options

Standstill agreements, which give the borrower time to restructure its liabilities, allow distressed debt investors and creditors to temporarily abstain from exercising their rights or pursuing legal actions against borrowers.

Various ADR procedures could equally be adopted by distressed business as a pre-insolvency rescue option.

Finally, turnaround professionals such as members of the Business and Rescue Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN) could also be consulted to assist distressed businesses improve, restructure and stabilise the health of the company to prevent insolvency situations.

3.2 What involvement does the court have in these processes?

Court involvement will generally be dependent on the pre-insolvency processes adopted by the distressed investor. It is generally not a court-led process, although in some instances the court is involved.

For instance, section 480 (2) of CAMA states that where a company is in administration, no step shall be taken to enforce security over the company's property except with the consent of the administrator or leave of the court.

Also, in the case of a CVA, the CVA is overseen by a nominee who is appointed by the court to ensure that the agreement is properly implemented. Furthermore, the CVA proposal is to be filed in court (regulation 2.09(3) of the Insolvency Regulation 2022 and section 435(2) of CAMA) and amendments to the proposal require court permission.

For an arrangement and compromise, court approval is required for the company to modify the rights of its members and creditors and an application must be filed with the Federal High Court to convene a meeting of creditors and members under section 717 of CAMA.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The main players include a nominee or supervisor of a CVA, as well as administrators, administrative receivers and receivers and managers depending on the pre-insolvency procedure being utilised.

3.4 Is there a typical due diligence process followed?

ESG and energy transition targets are getting more attention in Nigeria especially with climate change regulations now in place. Listed companies are encouraged by the Nigerian Stock Exchange (NSE) to voluntarily disclose ESG-related information in their annual reports.

Additionally, companies operating in Nigeria and other jurisdictions and seeking to attract investors (distressed or otherwise) are embracing international best practices regarding ESG and energy transitions and are complying with relevant policies. Investors from countries with strong requirements / policies relating to ESG and energy transition tend to be more stringent on ESG and energy transition targets.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

The duration of an M&A sale within a pre-insolvency context in Nigeria may fluctuate based on factors including transaction complexity, negotiation dynamics, regulatory compliance and the stakeholders engaged. However, it usually takes between 6 months and 12 months.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

In Nigeria, M&A transactions or asset sales made before a company becomes insolvent are not automatically shielded from challenge in future insolvency proceedings. Instead, whether a transaction can be reversed (clawed back) is determined case by case, depending on fairness, good faith and compliance with legal requirements.

Reference should be made to the avoidance actions outlined in paragraph 1.4.2 above for the statutory clawback protections that exist under CAMA.

Because there is no absolute immunity from clawback for M&A or asset sales made before insolvency, investors should conduct robust due diligence, ensuring the transaction is well-documented, fair and transparent. Deals should be made at fair value and without insider advantages to reduce the risk of future legal challenges. Bona fide purchasers who buy assets in good faith and without notice of irregularities generally enjoy a higher level of protection.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

There are no provisions for a pre-packaged sale under either CAMA or the Companies Winding Up Rules. Nonetheless, it is possible to carry out an informal pre-pack sale of assets. This will involve creditors' negotiations, amongst other processes.

Parties must be careful in doing this in order not to contravene the provisions against fraudulent preferences under CAMA.

This is discussed in further detail below.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

As noted above, it is possible to carry out a pre-pack sale of assets on an informal basis in Nigeria (in contrast to the formal frameworks available in some jurisdictions).

In Nigeria, pre-packs are regarded as an informal corporate rescue mechanism, involving the pre-arranged sale of an insolvent company's business and assets while it remains under the control of its management.

Informal corporate rescue procedures focus on restructuring engagements conducted outside formal statutory insolvency proceedings. They provide debtor companies with a flexible opportunity to resolve financial distress without the rigidity, delay and expense often associated with formal insolvency processes.

In a pre-pack sale, negotiations take place before formal insolvency proceedings begin, with a prospective purchaser for the company's business already identified. The assets to be sold are agreed upon in advance and the purchase price is usually determined based on an independent valuation. The transaction aims to preserve the business as a going concern and maximise value for creditors.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The key participants in Nigerian pre-pack or distressed business sales include:

- the company (debtor) or its directors;
- secured creditors, typically banks or financial institutions;
- an insolvency practitioner (acting as receiver / manager or administrator); and
- potential investors or buyers, often M&A or private equity firms.

While courts have the power to appoint administrators or liquidators under sections 448 and 585 of CAMA, many appointments, especially receiverships, are made contractually by secured creditors under a debenture or security deed, without court intervention.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Generally secured creditors, not investors, determine the insolvency practitioner where a receiver / manager is appointed under a fixed or floating charge.

An insolvency practitioner may be appointed by the court or out of court. Only secured creditors can appoint a receiver / manager under the authority granted by a security instrument (fixed or floating charge). Therefore, a creditor who wishes to make such an appointment without going to court must ensure that the power to appoint a receiver / manager is expressly included in the security agreement.

If this express power is absent, the creditor must apply to the court for the appointment. The receiver / manager's role is primarily to preserve and realise the secured assets for the benefit of the appointing creditor.

However, in a pre-pack arrangement where investors provide funding or drive the restructuring, they may influence the choice of insolvency practitioner through negotiations with the secured creditor or debtor company. Nonetheless, they do not have statutory authority to make the appointment directly.

When the court makes the appointment (for example, in administration or winding up), it retains the discretion to select a qualified insolvency practitioner, although the parties may suggest candidates.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Nigerian law does not grant special protection to specific creditors, such as employees, in pre-pack sales beyond the provisions of CAMA. Employees are typically unsecured creditors and their claims are treated alongside other unsecured debts. Secured creditors generally have priority.

However, under section 657(2) of CAMA, employee wages and entitlements are classified as preferential debts, ranking ahead of unsecured creditors but below secured creditors.

These obligations survive a pre-pack sale and, depending on the structure of the transaction, the purchaser may inherit employment and tax liabilities.

4.5 Is there a typical due diligence process followed?

Due diligence in Nigerian pre-pack or distressed sales typically focuses on:

- title to assets and existing encumbrances;
- regulatory compliance (CAC filings, FCCPC merger approvals, tax status);
- employment obligations;
- environmental and community liabilities (especially for oil, gas or manufacturing assets); and
- pending litigation or contingent liabilities.

4.6 Is "market testing" mandatorily required?

Nigerian insolvency law does not require market testing before a pre-pack sale. However, where a court-appointed administrator is involved, principles of fairness and transparency may oblige the administrator to demonstrate that the sale price was commercially reasonable and aimed at maximising returns for creditors.

In practice, some administrators voluntarily conduct limited market testing to establish fair value and reduce the risk of challenges from unsecured creditors.

4.7 Are valuation reports mandatorily required?

Not expressly. Nigerian insolvency and accounting best practice recommends obtaining an independent valuation of the business or assets before executing a pre-pack sale. This ensures that the transaction reflects fair market value and helps prevent allegations of fraudulent preference or undervaluation under sections 658 to 662 of CAMA.

4.8 What is the typical timeline of "pre-pack" sales?

Timelines vary depending on the complexity of the transaction and the regulatory approvals required. However, because key negotiations and valuations occur before formal insolvency proceedings begin, pre-pack sales are generally faster than traditional insolvency sales.

PEOPLE'S REPUBLIC OF CHINA

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

The rules that govern the sales and purchase of the equity of non-distressed company also apply to the sales and purchase of the equity of distressed company under the laws of the People's Republic of China (PRC).

In general, the sale and purchase of equity under PRC law is primarily governed by the relevant provisions of the Civil Code of the People's Republic of China (Civil Code) and the Company Law of the People's Republic of China.

Shareholders of limited liability companies can transfer all or part of their equity to each other, subject to the articles of association. When a shareholder transfers equity to a third party, the other shareholders have the right of first refusal, subject to the articles of association.

Shareholders of joint stock companies can transfer all or part of their equity to each other or a third party, subject to the articles of association.

1.2 Is there a special legal regime to purchase distressed debt or non- performing loans?

There is no special legal regime in the PRC that applies specifically to the purchase of distressed debt or non-performing loans. The rules that govern the transfer of creditors' claims generally apply.

In general, pursuant to the Civil Code, a creditor can transfer part or all of its claim to a third party, unless such a claim cannot be transferred by its nature, according to the agreement or the law. The transfer of the claim will become effective on the debtor once the debtor is notified of the transfer.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

Subject to the target company's articles of association, equity transactions may require approval from the shareholders' meeting or the board of directors. Special regulations may apply to the investment of state-owned enterprises and listed companies, which may require review, approval or filing from the relevant regulatory authorities.

1.4 What risks exist for an investor of a distressed business?

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Outside of bankruptcy, a creditor may request the court to revoke the transaction if a debtor disposes of its property rights and interests for no consideration by waiving creditors' rights, waiving guarantees or transferring property for no consideration, or if the debtor maliciously extends the performance period of its due debts, thereby affecting the realisation of creditors' rights.

In addition, a creditor may request the court to revoke the transaction of a debtor if the debtor, to the detriment of the creditor's rights realisation, engages in the significantly unreasonable sale of assets at a low price, the significantly unreasonable purchase of others' assets at a high price, or the provision of guarantees for others' debts, and the debtor's counterparties are aware of or should be aware of such circumstances.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

In the bankruptcy proceedings, the risks mentioned in paragraph 1.4.1 above also apply *mutatis mutandis*.

In addition, if a company enters bankruptcy:

(a) transactions by the company of concealing or removing assets for the purpose of avoiding debts, or fabricating debts or acknowledging untrue debts, will be declared void regardless of when they occur;

(b) the administrator may petition the court to set aside any of the following transactions, if they occur within 1 year before the court's acceptance of the bankruptcy application:

(i) gratuitous transfer of assets;

(ii) transaction at an obviously unreasonable price;

(iii) creation of security for an otherwise unsecured debt;

(iv) advance payment of a debt that is not due; or

(v) waiver of the company's rights as a creditor; and

(c) the administrator may also petition the court to set aside selective payments by the company to some but not all of its creditor(s), if such payment is made within 6 months before the court's acceptance of the bankruptcy application and the company is insolvent at the time of the payment, unless a selective payment benefits the company's assets as a whole.

1.4.3 What risks exist for a new lender investing in a distressed business?

There is no specific legal framework for the liability of lenders investing in distressed businesses in the PRC. The primary risks for a new lender typically revolve around the potential non-performance of the debtor.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

A shareholder is liable to the company to the extent of his subscription to the registered capital of the company, and third-party creditors generally have no recourse to the shareholder, except:

(a) if the shareholder has provided a guarantee or security for a debt of the company, it obviously will be liable to the third party creditor pursuant to the terms of such guarantee or security document;

(b) if the shareholder has not paid up its subscription to the registered capital of the company, and if there are insufficient assets to repay all creditors, the shareholder will be jointly liable to the extent of its unpaid registered capital; and

(c) if the shareholder is in default of performing its obligations (e.g. obligations to appoint or nominate directors and senior management members to fill any vacancy in the management), resulting in the loss of material assets, books and important documents, and making it impossible to wind up the company, then the shareholder may be held jointly liable towards third party creditors for the company's debts.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Once an event of default occurs or the conditions triggering the investor's assertion of rights against the debtor are met, the investor with a secured interest may negotiate with the debtor regarding the exercise of its security interest, including disposing of the collateral to repay the investor's claim. If the parties fail to reach consensus, or if the collateral has already been attached by another creditor, rendering disposal impossible, the investor can initiate a special procedure for realising its security rights or file a lawsuit or arbitration against the debtor.

The special procedure for realising security rights is an expedited judicial process, which applies where there is no material dispute over the underlying debt. If, after certain examination, the court deems that the application is valid, it will issue an order granting auction or sale of the collateral. The applicant may then apply for mandatory enforcement of this order. Alternatively, the investor may initiate a lawsuit or arbitration, just as unsecured creditors. In such cases, the court or arbitral tribunal will conduct a comprehensive review of all contested issues, extending beyond the scope of the security interest.

With respect to the unsecured debt, the investor can file a lawsuit or arbitration against the debtor. After obtaining an effective judgment or arbitral award, the investor can apply to the court for mandatory enforcement of the judgment or award.

During the enforcement process, the court can take enforcement actions against the debtor's assets, such as public auction and public sales. Public auction should be prioritised unless otherwise specified by law or judicial interpretations. That said, with the consent of both the investor and the debtor, the court may, instead of public auction or sale, directly compensate the investor with the valued property of the debtor to settle the debt, provided that this will not compromise the legitimate rights and interests of other creditors or public interests.

2.2 What involvement does the court have in these processes?

As mentioned in paragraph 2.1 above, a secured investor will need to obtain either an order from the court for realising its security interest or a judgment from the court (or an arbitral award if the parties have an arbitration agreement). After that, the investor may initiate mandatory enforcement proceedings to enforce its security right.

With respect to unsecured claims, the investor needs to obtain a judgment from the court (or an arbitral award if the parties have an arbitration agreement). After that, the investor may initiate mandatory enforcement proceedings to enforce its security right.

It is the enforcement court that takes enforcement action, such as organising judicial evaluations and public auctions.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

The pledgee may negotiate with the pledgor regarding the exercise of its pledge rights, including the disposal of the pledged shares to satisfy the secured claim.

If the parties fail to reach consensus, or if the pledged share has already been attached by another creditor, rendering disposal impossible, the investor can initiate a special procedure for realising its pledge or file a lawsuit or arbitration against the debtor as mentioned in paragraph 2.1 above. After obtaining an order from the court for realising its pledge or a judgment or arbitral award, the investor can initiate mandatory enforcement proceedings to enforce the pledged shares.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

It is possible to implement the debt-for equity swap in the enforcement process under PRC law.

On the one hand, if the public auction or public sale fails, with the consent of the creditor and without prejudice to the legitimate rights and interests of other creditors or public interests, the court may implement a debt-for-equity swap so that the creditor can acquire the equity without consideration. On the other hand, as mentioned in paragraph 2.1 above, the court may, instead of public auction or sale, directly implement a debt-for-equity swap, with the consent of both the creditor and the debtors, provided that this will not compromise the legitimate rights and interests of other creditors or public interests.

2.3.2 Is a public auction mandatorily required or are private sales possible?

As mentioned in paragraph 2.1 above, public auction should be prioritised unless otherwise specified by law or judicial interpretations.

Private sales are only available if the debtor cooperates and its assets have not been frozen by other creditors, in which case the creditor does not need to resort to the court for mandatory enforcement.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

It is possible to set aside transfer restrictions in the constituent documents of the debtor during the enforcement process. Under PRC law, if the debtor's articles of association or shareholders' agreement impose restrictions on the transfer of shares, and the debtor requests that a compulsory auction not be held on this basis, the court shall not support such a request.

2.3.4 Is "market testing" mandatorily required?

Under Chinese law, the term "market testing" may not have a direct legal counterpart or explicit recognition. Market testing is not a legal requirement for determining the value of the pledged shares under Chinese law.

The court may determine the price of pledged shares through various methods, including negotiation between the parties, targeted inquiry, online inquiry or commissioned valuation. The agreed-upon price mutually submitted by the parties after negotiation can be the reference price.

If the negotiation is unsuccessful, and the property has a tax assessment base price, government-set price or government-guided price, the court shall initiate a targeted inquiry with the relevant authorities. In case the targeted inquiry also fails, and the property neither requires on-site inspection by professionals nor falls outside the scope of online inquiry conditions, the court shall proceed with an online inquiry via the judicial online inquiry platform. In most cases, the court shall commission an appraisal institution to conduct a formal valuation as the reference of assets' market value.

2.3.5 Are valuation reports mandatorily required?

There are generally four methods for the court to determine the reference price for auction:

(i) negotiation by the parties;

(ii) targeted inquiry with relevant government authorities;

(iii) judicial online inquiry; and

(iv) valuation.

If the reference price cannot be determined through the former three methods or the parties request a valuation, the court shall entrust a valuation institution to conduct evaluation before the auction.

For assets such as stocks of listed companies, valuation reports are usually not necessary. The value of stocks is usually assessed based on the average closing price over a certain period before the assessment.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

The main pre-insolvency processes under PRC law are out-of-court restructuring and pre-packaged reorganisation.

There are no mandatory rules regarding out-of-court restructuring in the PRC. Instead, debtors typically take the lead in negotiating with primary creditors, particularly financial institutions. These negotiations often revolve around various measures aimed at alleviating financial burdens, such as reducing interest rates, granting debt waivers or temporarily suspending enforcement actio. Judicial intervention is typically not required in this process.

The China Banking and Insurance Regulatory Commission, the National Development and Reform Commission, the People's Bank of China and the China Securities Regulatory Commission jointly issued the Working Rules of the Committee of Creditors of Financial Institutions (Working Rules) in December 2020, providing some guidance on how a committee of creditors of financial institutions should work.

According to the Working Rules, the chairman, the vice chairman and the member institutions can voluntarily enter into a creditors' agreement with binding force to stipulate, inter alia, how the committee should decide / vote on relevant matters. The Working Rules further provide that a restructuring plan should in principle be adopted by member institutions representing 2/3 or more in value of the total financial claims and 1/2 or more of all the member institutions in number, and they should represent 1/2 or more in value of the total unsecured financial claims, unless otherwise stipulated in the creditors' agreement.

After the restructuring plan is adopted by the majority member institutions as stipulated in the creditors' agreement, the debtor may pursue execution of a restructuring agreement with all the member institutions in the committee. However, those who do not sign the creditors' agreement are not bound by the restructuring plan. The debtor will then voluntarily perform the agreement, and there is no administrative or judicial process to ensure a successful implementation. For instance, if some of the debtor's assets that should be disposed of according to the restructuring plan were frozen by a creditor, the debtor would need to separately negotiate with this creditor for releasing the frozen assets.

Pre-packaged reorganisation will be discussed in paragraph 3.7 below.

3.2 What involvement does the court have in these processes?

Judicial intervention is typically not required in an out-of-court restructuring.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

In an out-of-court restructuring process, the key players are the debtor and creditors. In significant corporate debt restructuring cases, a creditors' committee comprising financial institutions may form.

3.4 Is there a typical due diligence process followed?

During out-of-court restructuring, there typically is not a court-imposed or market standard due diligence process. Debtors often seek settlements and debt waivers from creditors without involvement of a new investor. If a new investor is involved, the investor may conduct due diligence process resembling that of normal circumstances. The extent of due diligence varies based on asset nature and transaction timelines.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

In a pre-insolvency M&A sale process, the timeline can vary widely due to factors such as transaction complexity, negotiations, regulatory approvals and market conditions. Companies in financial distress typically face tight deadlines due to urgent financial needs and insolvency risks. Consequently, the entire transaction process for distressed firms may be compressed and accelerated compared to normal M&A deals.

Urgency arises from addressing immediate liquidity concerns, stabilising operations and averting bankruptcy. Key M&A stages such as due diligence, negotiation and regulatory approvals may therefore be expedited to meet tight deadlines. Furthermore, distressed M&A transactions often involve added complexities, such as obtaining creditor consent and addressing potential legal hurdles. Balancing these factors is crucial for successful outcomes amidst challenging circumstances.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

There are no specific rules protecting M&A sales / asset sales in an out-of-court restructuring. Rules regarding pre-packaged reorganisation will be discussed in paragraph 3.7 below.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

The PRC Enterprise Bankruptcy Law itself does not contain the concept of pre-packaged reorganisation.

The Minutes of the National Court Work Conference on Bankruptcy Trials issued by the Supreme People's Court encourages courts to explore different approaches to pre-packaged reorganisation and confirms that the reorganisation plans can be prepared based on out-of-court agreements reached by the debtors, creditors and other stakeholders.

The Minutes of the National Working Conference on the Trial of Civil and Commercial Cases by Courts further emphasise the transition from pre-packaged reorganisation to reorganisation proceedings.

If the out-of-court agreement reached by the debtor and some of the creditors before the court accepts that the reorganisation application is consistent with the reorganisation plan formulated in the reorganisation proceedings, the consent of the creditors on the out-of-court agreements should be deemed as their consent on voting for the reorganisation plan.

However, if the reorganisation plan revises the out-of-court agreement and has adverse impacts on the relevant creditors, or is related to the relevant creditors' major interests, the affected creditors may have another vote on the reorganisation plan. The creditors will be divided into several groups for voting, typically including the group of secured claims, the group of unsecured claims, the group of employees and the group of tax claims. The reorganisation plan shall be approved by creditors representing 2/3 or more in value of the total claims and 1/2 or more of all the creditors in number for each voting group.

In practice, there are two forms of pre-packaged reorganisations:

(a) in one form, governed by certain local court pilot rules, an interim administrator appointed by the court investigates the debtor's business and assets, reviews proof of claims and formulates a draft restructuring plan. This process is primarily led by the interim administrator, who reports to the court and seeks guidance on major matters. Formal bankruptcy proceedings follow, during which the plan can swiftly pass and be confirmed, subject to court decision; and

(b) in the other form, the debtor negotiates an out-of-court restructuring agreement with a majority of creditors, followed by commencement of formal bankruptcy reorganisation. This approach is led by the debtor with minimal court involvement. It therefore resembles out-of-court restructuring.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all parts of the business) permitted and how do they work?

Under PRC law, there are no specific rules for pre-pack sales. The rules regarding pre-packaged reorganisation will generally apply. Please refer to paragraph 3.7 above.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

In pre-packaged reorganisation, the main players include the interim administrator, the court, the debtor and creditors. Unlike formal bankruptcy proceedings, the debtor can take a more proactive role in the pre-pack reorganisation process.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

In pre-pack reorganisations, the interim administrator is appointed by the court. The methods for appointing administrators vary and can include:

(a) *random selection* – administrators are randomly chosen from a roster via a lottery system;

(b) *competitive selection* – administrators are selected through a bidding process;

(c) *recommendation* – entities are recommended for appointment as the administrator; and

(d) *direct appointment* – administrators are appointed directly without any selection process.

Generally, entities with the right to recommend the administrator to the court include the debtor, major creditors, and shareholders of the debtor. It is uncommon for investors to recommend or appoint administrators due to potential conflicts of interest. Administrators need to initiate investor recruitment and selection processes from a neutral perspective to ensure fairness. As such, the approach of being recommended by investors is rare in both practice and regional regulations.

4.4 Is there special protection for certain types of creditors in "pre- pack" sales?

In pre-packaged reorganisation in China, there is not specific protection for certain types of creditors. However, as the pre-packaged reorganisation often transitions into formal bankruptcy proceedings, the claims of employees, tax authorities and other priority creditors can be prioritised for payment.

4.5 Is there a typical due diligence process followed?

In pre-pack reorganisations, similar to formal reorganisation procedures, the interim administrator may initiate the investor recruitment and bidding process. Investors can usually conduct due diligence investigation and then submit the reorganisation investment proposals.

During pre-pack reorganisations, due diligence timelines may be more condensed, with a heightened focus on the company's asset deficiencies and debt scale.

4.6 Is "market testing" mandatorily required?

Under Chinese law, the term "market testing" may not have a direct legal counterpart or explicit recognition. Please refer to paragraph 2.3.4 above.

4.7 Are valuation reports mandatorily required?

During pre-packaged reorganisation, it is common for a valuation report of the debtor's assets to be required. This report helps determine the value of assets, enabling the formulation of investment quotations for investors and relevant debt repayment plans.

4.8 What is the typical timeline of "pre-pack" sales?

The timeline of pre-packaged reorganisation varies from place to place. It usually takes 3 to 9 months.

POLAND

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

The sale and purchase of equity in Poland is governed predominantly by the rules set out in the Commercial Companies Code (*Kodeks Spółek Handlowych,* KSH). The transfer of shares in the capital of a private company with limited liability (*spółka z ograniczoną odpowiedzialnością, sp. z o. o.*) requires notarised signatures. The transfer will, subsequently, be registered in the shareholders' register of the company.

Comparable rules apply to the transfer of shares in the capital of a public limited liability company (*spółka akcyjna, S.A.*). In addition, separate rules apply to the trade of shares in a listed company. However, for the purpose of this Chapter, we will focus only on the sale and purchase of shares in the capital of a limited liability company that is not listed on a stock exchange.

Turning to distressed mergers and acquisitions (M&A), no separate rules apply to the transfer of shares in the capital of a distressed company in Poland. The rules are the same for both distressed and non-distressed entities.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Claims trading in Poland is subject to general rules set forth in article 509 et. seq. of the Polish Civil Code,[1] provided that legal regulations governing the protection of banking secrecy may also constitute an impediment to claims trading.

To address banking secrecy as well as certain other regulatory issues, market players have, since 2004, mostly chosen acquisitions and servicing through entities regulated under the Investments Fund Law[2] of 27 May 2004 (such as standardised and non-standardised investment funds, i.e. securitisation funds).

Securitisation funds are frequently used for NPLs (non-performing loans) transactions in Poland. The assignment of claims also involves the acquisition of any collateral security rights accompanying the claim.

In the case of registered pledges, the transfer of a registered pledge to the assignee requires the re-registration of the relevant pledge in the registry of pledges.

In the case of mortgage loans, the re-registration of a mortgage in the name of the assignee in the land and mortgage registry is a condition precedent to not only the acquisition of collateral security, but also for the valid assignment of a mortgage claim. This is a practical hurdle for trading in mortgage claims because re-registration takes on average 1-3 months.

Finally, special rules may apply to the purchase of distressed debt and non-performing loans to consumers.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

Under Polish law,[3] certain companies are required to install a works council if certain conditions are met (e.g. if the company has more than 50 employees). The works council is a corporate body that represents the interest of the employees of the company.

The works council needs to be consulted for advice on certain important decisions that the company takes. For example, large M&A deals may require an opinion of the works council. A

[1] The Polish Civil Code, unified text of 2 August 2023 (Dz. U.2023 item 1610).
[2] The Investments Fund Law (Dz. U. 2004 No. 146 item 1546).
[3] The Law on Information Requirements Towards Employees and Conducting Consultations of 7 April 2006 (Dz.U.2006 No. 79 item 550).

company's works council may also be required to render its advice if there is a change of control (whether direct or indirect) concerning the governance of the company. As a result, distressed M&A transactions may be subject to works council advice.

The sale and transfer of distressed debt does not require separate works council advice. However, if the distressed investor is pursuing a loan-to-own strategy with the purchase of the distressed debt, the subsequent acquisition of the shares may be subject to works council advice, in case the economic situation of the employer changes or the level of organisation of employment changes.

In that event, the relevant company should ensure the works council is adequately enabled to render its advice in respect of the proposed transaction. This means that the works council is required to be involved with a transaction at a moment in time where it can still influence the proposed transaction.

Notwithstanding the above, works councils are fairly rare in Poland, and their advice is not binding on employers.

1.4 What risks exist for an investor of a distressed business?

There are specific legal risks associated with investing in distressed businesses under Polish law. The most prominent risks relate to avoidance actions (*actio pauliana*).

The *actio pauliana* is comparable to, but is not identical to, the legal concept of fraudulent conveyance and preferred transactions in other jurisdictions. The *actio pauliana* may lead to the annulment of transactions. Polish law provides for *actio pauliana* both outside and in a bankruptcy scenario. In a bankruptcy proceeding, only the bankruptcy trustee (*syndyk*) may initiate an action, with the right switching though to a creditor if the bankruptcy trustee does not remain active in the case.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Outside a bankruptcy, individual creditors have the right to annul voluntary legal acts by a debtor if the debtor entered into a transaction that renders fully or partially impossible the satisfaction of its claim in the circumstances when the parties knew about the creditor's claim, or the transaction has been entered gratuitously. There is a 1-year deadline to file a request to set aside the transaction.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

In a bankruptcy, individual creditors can only use their right to invoke the *action pauliana* after an insolvency administrator has exhausted the right. In bankruptcy proceedings in Poland, the bankruptcy trustee has the exclusive right to avoid legal transactions entered into by the debtor prior to its bankruptcy.

Legal transactions of the debtor may be declared ineffective towards the bankruptcy estate if made within 1 year prior to the filing of a bankruptcy motion. This can occur where the debtor disposed of its property, regardless of whether the relevant transactions were made gratuitously or non-gratuitously, in circumstances where the value of the property grossly exceeded the relevant performance received in return.

This means that even a paid legal transaction will be declared ineffective unless it is proved there was no detriment to creditors.

The above regulation also applies to legal transactions between affiliates and where the insolvent is a dominant company for the other party or vice versa.

Additionally, the assignment of a claim that comes into existence after the declaration of bankruptcy becomes ineffective against the bankruptcy estate, unless an assignment agreement has been entered into not later than 6 months prior to a bankruptcy filing and with a certified date.

An insolvency administrator may also request that the judge-commissioner should set aside an encumbrance on the insolvent's assets in the form of a mortgage, pledge, registered pledge or maritime mortgage in the case where the insolvent was not a personal debtor of the secured creditor, the encumbrance was established within 1 year before the filing for insolvency, and the insolvent did not receive any performance (or the performance was inadequately low) in return for providing the security.

Further, regardless of the value of performance received by the insolvent, the judge-commissioner will set aside the relevant encumbrance where it is provided in favour of a family member or related corporate parties, unless the secured party proves there was no harm to the creditors.

The above rules are further supplemented by general *actio pauliana* under the Polish Civil Code.

1.4.3 *What risks exist for a new lender investing in a distressed business?*

Under Poland's Restructuring Law of 2015,[4] a new lender supporting a restructuring can benefit from a restructuring process in various ways, including:

(i) the loan and security can be officially voted through among the terms of arrangement and then approved by the court; and

(ii) if the lender is also a creditor, it can be awarded terms of restructuring more beneficial than those of the other creditors in return for the financing of the arrangement. However, as opposed to liquidating bankruptcies (including pre-pack cases), acquisitions within liquidating arrangements do not offer protection in the form of the acquisition of the debtor's business free and clear of encumbrances regardless of court approval of the arrangement.

Needless to say, lending outside a restructuring process could potentially expose the lender to the risks described in paragraph 1.4.1 above.

1.4.4 *What risks exist for a new shareholder investing in a distressed business?*

If an investor buys the equity of a distressed business and that business subsequently enters bankruptcy, the distressed investor only bears a personal risk if the investor is also a director and fails to meet its statutory duties of timely filing for insolvency notwithstanding other duties of care under the Commercial Companies Code.

Where a distressed investor provided distressed equity, whether existing or new, and the underlying business enters into bankruptcy, the investor's loss is limited to the capital invested.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Under Polish law, a claim for an amount of money can be secured by a security right in the form of a right of mortgage (*hipoteka*), maritime mortgage (hipoteka morska), a right of civil pledge (*prawo zastawu cywilnego*), a right of registered pledge (*zastaw rejestrowy*), as well as transfers of movables for security (*przewłaszczenie na zabezpieczenie*) and assignments of rights for security (*cesja praw na zabezpieczenie*), provided the relevant asset is not restricted from being made subject to a security right.

A right of mortgage may be created over real estate, or claims secured by mortgage, while a right of pledge may be created over all other types of assets. A maritime mortgage can be created over registered vessels.

If the debtor defaults on the secured claim, the creditor cannot rely on its security without obtaining an enforcement title from the court. This can be obtained by way of regular litigation,

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[4] Restructuring Law of 15 May 2015 (Dz.U.2015 unified text of 16 September 2022 Dz.U.2022, item 2309).

but litigation is, as a rule, skipped by obtaining a debtor's up-front notarial submission to enforcement – based on which the creditor can instruct the bailiff to start enforcement process mostly by way of an auction. While enforcement against certain categories of assets may be quick and easy (such as against bank accounts or work pay), enforcement against real estate is much more cumbersome. In particular, valuations of assets ahead of auctions would be mandatory, and the valuations could also be appealed.

As regards registered pledge and maritime mortgage laws, they both envisage routes for private sales and private enforcement upon a default, to which a debtor can consent up front when entering into the secured transaction. In those scenarios, the lender-creditor can take over ownership of the collateral setting off the value, appropriated against the value of the unpaid debt, as well as initiate a sale by a bailiff or notary public.

While maritime mortgage financings and disputes are relatively rare, registered pledge clauses anticipating a takeover or private sale of the debtor's assets without court enforcement are very common and often used in secured transactions. However, it seems an ample scope of debtor tools to protract creditors' efforts to take over the debtor's assets has prevented out of court enforcement from becoming an efficient enforcement instrument.

2.2 What involvement does the court have in these processes?

The court's involvement is more limited, to the extent the bailiff conducts enforcement against moveables or rights, unless there are numerous parties challenging the action or knockdown granted to a particular party. However, when enforcement is conducted against real estate, the court's involvement is quite broad at each and every stage of the process, from the valuation through the adjudication of ownership and entry of the new owners into the land and mortgage registers

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2.3 How does the enforcement of a pledge on the shares of a legal entity work?

Under Polish law, a right of civil pledge or registered pledge may be created over the shares in a company. Enforcement of a civil pledge happens by way of court enforcement as described in paragraph 2.1 above. Private sales or takeovers are possible if agreed upon in the registered pledge of shares. However, none of the above routes are often resorted to for two practical reasons: the debtor's capability to obstruct the process, and a looming (distressed) status of the underlying entities, whereby taking over corporate / management control (subsequent to a takeover of shares) may become meaningless or even dangerous for the acquirer.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

A debt-for-equity swap as a part of share pledge enforcement would not work, but it is conceivable that a debt-for-equity swap would be effectuated as part of debt repayment or arrangement among creditors.

2.3.2 Is a public auction mandatorily required or are private sales possible?

As set out in the previous paragraphs, a public auction is the default method of enforcement sales under Polish law. A private sale of shares encumbered by registered pledge by the bailiff or a notary public is possible, but too rarely used as a matter of practice.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

Under Polish law, four formalised restructuring processes could in theory be resorted to by distressed debt and M&A investors. These are proceedings for:

(i) the adoption of an arrangement;

(ii) an expedited arrangement proceeding;

(iii) an arrangement proceeding; and

(iv) a deep reform restructuring proceeding.

However, in reality only the proceeding for the adoption of an arrangement could be relevant from the perspective of an investor, given the prospects of rescuing the debtor at an early stage and the time frame that is fixed by law. Interestingly, this proceeding was promising but not very useful when introduced with the advent of the Restructuring Law in 2015 and only got real teeth during the time of COVID-19.

A particular feature of this proceeding is the debtor's ability to set an arrangement date – and for all debts which came into existence prior to the arrangement date capable of being crammed down pursuant to an arrangement vote. A debtor enters into an agreement with an arrangement supervisor, who assists with the preparation of arrangement proposals, the collection of creditors' votes and filing of the motion for the approval of the arrangement with the court.

While the usefulness of this proceeding before COVID-19 was questionable, during the pandemic the Restructuring Law was amended to the effect that, following the preparation of a list of claims, a list of contentious claims and an initial restructuring plan, the arrangement supervisor can announce the fixation of arrangement date. This announcement, if not struck down by the court, has benefits for the debtor comparable to court restructuring proceedings, including that:

(i) the arrangement supervisor becomes the court supervisor for the duration of proceedings;

(ii) the debtor remains the debtor-in-possession (DIP);

(iii) the debtor enjoys protection from enforcements and attachments against its assets and suspensions of already pending enforcements; and

(iv) the debtor or court supervisor may also petition that already existing attachments should be lifted.

The arrangement covers personal claims that come into existence before the arrangement date. It does not cover employees' claims or claims secured on the debtor's assets by mortgage, pledge, registered pledge, fiscal pledge or maritime pledge to the degree covered by the value of collateral, unless the secured creditor consented to the coverage of its claim by the arrangement.

Consent is not required where the debtor has presented to the creditor arrangement proposals, envisaging full satisfaction of creditors' claims by the deadlines specified in the arrangement or envisaging a satisfaction of creditors' claims to a degree not lesser than it may expect when seeking enforcement, including any ancillary claims from the collateral.

Arrangement proposals specify one or more manners of restructuring of a debtor's debts, including:

(i) deferment of payment;

(ii) setting into instalments;

(iii) reduction of payments;

(iv) debt-for-equity swap; and

(v) change, conversion or annulment of an instrument securing certain claim.

Arrangement proposals may envisage the satisfaction of creditors through the liquidation of the debtor's assets, which in theory sounds attractive to distressed investors. However, a sale made in implementation of an arrangement which envisages a liquidation of the debtor's assets does not occur free and clear of claims and encumbrances. Hence, an investor would need to use more traditional ways to achieve comfort, such as its own due diligence, third party guarantees or insurance.

Arrangement proposals may – and if there are secured creditors among the debtor's creditors must – envisage a division of creditors into groups covering their relative categories of interests, in particular:

(i) creditors who have employment claims and who have consented to being covered by the arrangement;

(ii) farmers who have claims under agreements for the delivery of products from their own farms;

(iii) secured creditors, secured in various ways, who have consented to being covered by the arrangement; and

(iv) creditors that are shareholders or stockholders of a debtor, being an equity company holding at least 5% of votes at the shareholders' meeting or stockholders' meeting (regardless of any holding of the claims specified in (i)-(iii) above at the same time).

When it comes to a creditors' vote, a resolution of the creditors on the approval of an arrangement is deemed adopted if it is supported by the majority of voting creditors who validly vote holding at least 2/3 of the total amount of debt belonging to voting creditors.

In case an arrangement vote is held in groups, the arrangement is deemed adopted if it is supported in each group by the majority of voting creditors who hold at least 2/3 of votes belonging to the creditors of that group.

The arrangement is deemed adopted even though it has not reached a required majority in some of the creditors' groups, if:

(i) the arrangement was voted for by a majority of voting groups of creditors, including at least one of the secured creditors' groups and / or groups of creditors who are senior to the ordinary unsecured creditors in insolvency proceedings; or

(ii) failing that, at least one of the voting groups of creditors who, upon a valuation of the debtor as a going concern, would receive any payment or keep any interest in the course of potential insolvency proceedings, voted for the arrangement;

    in either case, provided that:

    A. the creditors holding at least 1/2 of the amount of debt belonging to voting creditors voted for the adoption of arrangement; and

    B. further, in case the lower ranking creditors in potential insolvency proceedings were to receive any satisfaction by way of implementation of an arrangement, the groups of higher-ranking creditors in potential insolvency proceedings who voted against the arrangement receive full satisfaction of their claims by way of arrangement within the deadlines specified in the arrangement.

The conditions for the approval of arrangement mentioned in (i) – (ii) and (A)-(B) above are a result of the implementation of the cross-class cram down provisions of the European Preventive Restructuring Directive by Poland. It is also worthy of note that:

(i) along with a restructuring plan, a new document – a satisfaction plan – will mandatorily be prepared at the outset of restructuring proceedings. This is intended to provide a simulation of satisfaction of creditors by way of the implementation of an arrangement compared to their satisfaction in a liquidating bankruptcy scenario, and letting creditors make an informed decision when voting on an arrangement; and

(ii) the court will be obliged to disapprove of a voted through arrangement if at least one creditor raises that it would receive a higher satisfaction of its claims in a liquidating bankruptcy or enforcement proceedings and the complaint is substantiated.

Hence, the recent changes to the Restructuring Law may paradoxically reduce a number of court restructuring proceedings. From the perspective of a distressed investor, it will need to make a more in-depth analysis of acquisition routes where in-court restructuring will not necessarily be on the top of the agenda.

The debtor has 4 months to file with the restructuring court a motion for the approval of the adopted arrangement. Otherwise, the beneficial effect for the debtor resulting from the public announcement about the arrangement date expires by operation of law. In case the debtor's motion for the approval of an arrangement is rejected or the proceeding concerning the review of its motion terminated, the debtor can file a simplified motion for the announcement of deep reform restructuring proceedings or insolvency proceedings.

3.2 What involvement does the court have in these processes?

During the proceeding for the adoption of an arrangement until the filing for the approval of the adopted creditors' vote, the involvement is in principle nil, with a few exceptions as follows:

(i) if the debtor files a complaint with a restructuring court against a refusal of the arrangement supervisor to make a public announcement about the arrangement date; or

(ii) if the restructuring court sets aside the effects of the public announcement of the arrangement date upon a motion of a creditor, debtor or the arrangement supervisor in the circumstances specified in the Restructuring Law (including harm to creditors).

Once a motion for the approval of the arrangement voted through by the creditors has been filed with the court, the restructuring court becomes fully involved in the process.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

As the proceeding for the adoption of an arrangement is characterised as a debtor driven, the debtor plays a crucial role during the procedure. It remains a debtor-in-possession process, and the debtor controls the business. Creditors play an equally important role, given that it is within their discretion whether to accept the restructuring plan.

The arrangement supervisor is also very important as he / she is responsible for the formal part of the proceedings, including arrangement proposals. Most importantly, the arrangement supervisor makes a public announcement of the arrangement date, which triggers a protection of the debtor from enforcement and attachment.

3.4 Is there a typical due diligence process followed?

The due diligence carried out by a distressed debt and / or equity investor in Polish pre-insolvency procedures does not materially differ in the proceeding for the adoption of an arrangement compared to consensual restructurings outside a formal restructuring process. However, distressed debt and / or equity investors should be aware of the proceeding for the approval of an arrangement, as it may give them an additional tool for their post-investment restructuring.

3.5 What is the typical timeline of a M&A sale under a pre-insolvency process and how does the process work?

As already mentioned, there is a 4-month deadline under the Restructuring Law when the debtor protection expires if a motion for the approval of the adopted arrangement is not filed with the restructuring court. That is the practical time limit for such a transaction.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

In principle, the proceeding for adoption of an arrangement does not provide any form of protection for M&A sales or asset sales. However, if a sale is effectuated pursuant to a restructuring plan sanctioned by a court within the arrangement, this may provide the relevant parties with some comfort in that the court will refuse to approve the arrangement if it violates the law or its terms are grossly harmful for the creditors who voted against the arrangement and raised objections. M&A sales / asset sales do not have effects of enforcement sales and therefore all existing encumbrances such as mortgages pledges and registered pledges remain on the assets.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Pre-packaged restructuring plans are unknown to Polish restructuring law and could only be pursued as part of purely consensual restructurings.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

A pre-pack sales procedure is expressly permitted under Polish insolvency law.[5] It consists of the steps outlined below.

In a pending proceeding for the declaration of bankruptcy, a participant in the proceeding may request that the bankruptcy court should approve the terms of sale of the debtor's business or viable parts of its business for the benefit of the purchaser.

The petitioner attaches to the motion for the approval of the terms of sale evidence of payment of 10% of the proposed purchase price by the purchaser, failing which the motion will not be considered. The terms of sale may be specified in the draft agreement. Also attached to the motion shall be an appraisal of the debtor's assets targeted by the motion prepared by an appraiser entered on the list of court appraisers. The motion may envisage the delivery of the debtor's business to the purchaser on the date of declaration of the debtor's bankruptcy. In such a case, evidence of payment of the full price into the court's deposit account shall be attached to the motion.

Filing of a motion for the approval of terms of sale shall be publicly announced. Once the motion has been filed, the bankruptcy court appoints a temporary court supervisor or compulsory administrator. The bankruptcy court approves the motion if the price is higher than the amount that could be recovered in a general liquidating bankruptcy, reduced by the costs of proceedings and other liabilities of the bankruptcy estate that would need to be covered in the course of a liquidation.

Where there are more motions for the approval of terms of sale, an auction among the potential purchasers is organised in order to find the best offer. The auction is conducted by the temporary court supervisor or compulsory administrator, supervised by the bankruptcy court acting through one judge.

If it approves the motion, the court approves the terms of sale in the court decision declaring the bankruptcy. It may also refer to the terms of sale agreement appended to the motion. The bankruptcy trustee (*syndyk*) enters into the sale agreement with the purchaser not later than 30 days following the bankruptcy decision having become final and binding.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The key players in a Polish pre-pack are the debtor (as the offeror of the business) and the buyer of the business. They need to agree on the commercial and legal terms of the distressed M&A transaction.

[5] Insolvency Law of 28 February 2023 (unified text, Dz.U.2022, item 1520).

The temporary court supervisor (or potentially compulsory administrator) is also an important player in this process as he / she needs to enter eventually into the transaction with the buyer in the capacity of the bankruptcy trustee.

While creditors are important players in any restructuring, their role will not necessarily be proactive in a pre-pack process. An exception to the rule is a registered pledgee who holds a registered pledge on the assets subject to a pre-pack sale. A sale will not happen without his / her consent.

The bankruptcy court will appoint a temporary court supervisor (or compulsory administrator), who will become bankruptcy trustee upon the declaration of bankruptcy.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

No, there is no such control.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Certain creditors, such as employees, enjoy better treatment in the bankruptcy waterfall.

4.5 Is there a typical due diligence process followed?

Unfortunately, there are no clear standards, and it is fair to say the quality of data rooms prepared by bankruptcy officers differs. On the other hand, given the distressed state of the target (group), investors should be mindful that warranties and indemnities will generally not be provided by a selling bankruptcy trustee. Hence, due diligence should by no means be neglected.

4.6 Is "market testing" mandatorily required?

No.

4.7 Are valuation reports mandatorily required?

Yes, an appraisal by the court appraiser needs to be prepared and attached to the motion for the approval of the terms of sale.

4.8 What is the typical timeline of "pre-pack" sales?

The negotiations on the pre-pack sale are not bound by any timeline, but the practical issues prompting the negotiations are enforcements and attachments by creditors, and a debtor's liability for timely filing for insolvency.

The parties involved will take the time needed, but in our experience, there is much time pressure on the process. Depending on how much time parties have, this may take place any time from several weeks to several months.

However, once the commercial discussions have taken place, the debtor will file a motion for the approval of terms of sale indicating the purchaser. It will likely take at least 2 months from that moment in time until a sale agreement is entered into by the purchaser and bankruptcy trustee. It may still be protracted if a court decision approving the terms of sale is appealed.

SINGAPORE

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

There are no specific legal requirements applicable in Singapore for the purchase of distressed equity.

Note, however, that if the target company is already subject to winding up proceedings, any transfer of the shares of the target company must be approved by an order of the court, or will otherwise be void pursuant to section 130 of the Insolvency, Restructuring and Dissolution Act 2018 (IRDA).

In practice, investors may prefer to purchase the business and assets of the distressed target company, as opposed to the shares of the company if it is in liquidation.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Singapore does not have a special legal regime for purchases of distressed debt or non-performing loans.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in case of distressed investments (e.g. work council requirements)?

Singapore does not have general regulatory requirements applicable to distressed investments.

Where the distressed investment involves a company transferring the whole or a part of its undertaking to another person, section 18A of the Employment Act 1968 will apply to regulate the effect of the transfer of undertaking on the contracts of service of the transferor company's employees.

The contract of service is not considered to be terminated and instead continues to be effective after the transfer as if it were originally made between the employee and the transferee. Further, as soon as it is reasonable and before a transfer of undertaking takes place, the transferor is required to notify the affected employees and the trade union of affected employees (if any) of the details and implications of the transfer, as well as the measures (if any) that the transferor and the transferee envisage that they will each respectively take in relation to the affected employees.

1.4 What risks exist for an investor of distressed business?

Apart from the financial and default risks associated with distressed investing, the specific legal risks include the possibility for avoidance and clawback of certain pre-insolvency transactions, as discussed in more detail below.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Outside of bankruptcy, a transaction can be challenged and set aside under contractual doctrines such as undue influence, fraud, misrepresentation and illegality.

A transaction entered into by a Singapore company will not be considered invalid on the ground that the company did not have the capacity or power to enter into that transaction. However, a transaction may not be binding on the company if the person dealing with the company had notice that the person entering the transaction on behalf of the company was doing so without authority or in breach of directors' duties owed to the company.

1.4.2 *What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?*

Depending on the type of formal corporate insolvency proceedings that are commenced, a liquidator may be appointed where the company is to be wound up and dissolved, whereas a judicial manager may be appointed where the goal is to rehabilitate the company or achieve a better return for creditors than in a liquidation. The liquidators or judicial managers of a company have the power to apply to the court for orders to set aside transactions at an undervalue, transactions constituting an unfair preference and extortionate credit transactions.

Transactions entered into at an undervalue by the debtor company within 3 years before the commencement of winding up are liable to be set aside by way of an order of court.

An undervalued transaction refers to: (a) making a gift or otherwise entering into a transaction that provides for the company to receive no consideration; or (b) entering into a transaction for consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company.

However, the court will not order the transaction to be set aside where: (a) the company entered into the transaction in good faith and for the purpose of carrying on its business; and (b) at the time the company entered into the transaction, there were reasonable grounds for believing that the transaction would benefit the company.

Any unfair preferences given by the company within 1 year before the commencement of winding up (or 2 years before the commencement of winding up, in the case of an unfair preference given to a person who is connected with the company) are liable to be set aside by way of an order of court.

A company gives an unfair preference to a person where: (a) that person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities; and (b) the company does anything or suffers anything to be done which has the effect of putting that person into a position which, in the event of the company's winding up, will be better than the position that person would have been in if that thing had not been done. It must further be shown that, in deciding to give the unfair preference, the company was influenced by a desire to produce the effect of putting that person in a better position than that person would, in the event of the company's winding up, have been in if that thing had not been done.

Transactions for or involving the provision of credit to the company within 3 years before the commencement of winding up are liable to be set aside by way of an order of court.

Certain floating charges created on the company's property may be invalidated, depending on the time at which the charge was created and the value of the consideration given for the creation of the charge.

1.4.3 *What risks exist for a new lender investing in a distressed business?*

There are no specific legal risks applicable to lenders investing in a distressed business in Singapore.

However, if the new lender lends or invests on an unsecured basis, it will stand in line with other creditors should the company fail. Taking security over assets may also pose some risk if it is held to be an antecedent transaction. There are provisions in the IRDA granting new lenders super priority status if the investment or lending is undertaken together with a scheme of arrangement.

1.4.4 *What risks exist for a new shareholder investing in a distressed business?*

There are no specific legal risks applicable to shareholders investing in a distressed business in Singapore other than the usual risks of investing in equity.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Distressed debt and M&A investors would often have taken security over valuable assets or rights of the debtor company, whether in the form of mortgages, fixed or floating charges, pledges or assignment of rights. Investors will typically be able to enforce their security without court involvement. The terms of the security instrument will usually set out when and how the security can be enforced.

For instance, the instrument may provide for a right of possession or a power of sale in the event of default. The sale of secured assets can be conducted by way of public auction or private sale. The creditor must act in good faith and take reasonable care to obtain the true market value of the property at the time of sale. Additionally, the creditor must act with reasonable care and skill and act fairly in exercising its power of sale. A public auction is a commonly accepted method to ensure that the creditor properly fulfils its obligations.

The security instrument may also entitle the creditor to appoint a receiver over the underlying asset. The appointment of a receiver serves to place the asset out of the hands of the company and into a receiver appointed by the creditor.

If there is no security, the investor can apply for judgment on the unsecured debt and then enforce the money judgment by way of a writ of seizure and sale, a garnishee order and / or an order for the appointment of a receiver by equitable execution.

A writ of seizure and sale allows the creditor to have particular immovable or movable property of the judgment debtor seized and sold in satisfaction of the judgment debt. In garnishee proceedings, the creditor applies to the court for an order that a person indebted to the judgment debtor makes payment of the amount owed to the judgment debtor to the creditor instead. Yet another option is to have the court appoint a receiver by way of equitable execution over the assets of the judgment debtor.

However, investors' ability to pursue enforcement processes or proceedings may be restricted where the debtor enters a formal restructuring or insolvency processes. For instance, if the debtor company proposes or intends to propose a scheme of arrangement, the debtor can apply for moratoria relief to restrain the commencement of legal or enforcement proceedings against the company, or the taking of any step to enforce security over the company's property, unless court approval is obtained. Additionally, where a debtor enters a formal restructuring process, its subsidiary or holding company can also apply for a moratorium to restrict enforcement over their respective assets if these companies are integral to the restructuring of the debtor. Moratoria on enforcement processes will also take effect when the company applies for judicial management or is placed under judicial management.

2.2 What involvement does the court have in these processes?

Generally, the investor can enforce its security without the need for judicial involvement. However, where the company is protected by moratoria relief, investors have to apply to the court for permission to enforce their security. The court is entitled to impose such terms on the enforcement process as it deems appropriate.

Unsecured debts can be enforced by court processes such as a writ of seizure and sale, garnishee orders or an order for the appointment of receivers.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

In Singapore, security over the shares of a legal entity usually takes the form of a charge or mortgage.

By way of background, security over assets can be given and taken under Singapore law in different forms, including possessory security interests such as pledges and liens, and non-possessory security interests such as charges and mortgages. A pledge involves a transfer of possession (but not ownership) of the asset from the pledgor to the pledgee, who will be entitled in the event of default to sell the asset in satisfaction of the debt. A lien gives the lienee the right to retain possession of the asset until the debt has been repaid. In a charge, the debtor does not transfer ownership or possession to the creditor, but instead confers a right for the lender to seize the charged assets in the event of default and to sell them in satisfaction of the debt. In a mortgage, the debtor transfers ownership to the creditor, subject to the debtor's right of redemption to have the assets transferred back to it upon full repayment of the debt.

In the case of shares, what is ultimately of value is not the physical share certificate but the intangible rights attaching to the share. A common practice for a debtor to give security over the shares of a private company is to deliver possession of the share certificates with blank transfer forms over to the creditor. Although there is a transfer of possession of the share certificates, the case law has generally decided that, at least in most cases, a delivery of share certificates with blank transfer forms ultimately creates an equitable mortgage (or a charge), as opposed to any possessory security such as a pledge.[1] Accordingly, it is more common in Singapore to have security interests over shares to take the form of a charge or mortgage or an assignment.

The type and manner of creating a security interest over shares may be subject to applicable regulations. As mentioned above, security may be given over the shares of a private company by delivering the share certificates with the creditor, often with executed blank transfer forms in order to enable the creditor to enforce and realise its security without seeking the cooperation of the debtor. Charges and equitable mortgages are more common than legal mortgages, as a legal mortgage would deprive the debtor of legal title and therefore the ability to exercise the voting and other rights attached to the shares.

Unlike the shares of a private company, the shares of a public company listed on the Singapore Exchange (SGX) operate on a scripless system – i.e. no share certificates are issued and the ownership and transfer of shares are recorded instead by electronic book entries using the Central Depository System (CDP). Security over such shares can only be created by way of assignment or charge, pursuant to section 81SS of the Securities and Futures Act 2001 (SFA).

The mode of enforcement of a charge or mortgage on shares in the event of default is typically governed by the rights and powers granted under the terms of the security instrument. An equitable mortgagee is entitled to the self-help remedies of sale, possession or the appointment of a receiver. These self-help remedies are not intrinsic to a charge, but nevertheless they are often provided for in charge instruments.[2] The sale of the shares may be conducted through public auction or public sale, depending on the terms of the security instrument. These enforcement processes have been described in paragraph 2.1 above.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

It is possible for the security interest to provide that the share charge or mortgage (as the case may be) can be enforced by way of an issuance or transfer of shares in the company to the secured lender, provided the issuance or transfer of shares in such a manner is not prohibited by the constitution of the company. This can include a transfer of shares in exchange for a debt write-off, though the company may need to lodge certain documents with ACRA pursuant to section 63B of the Companies Act, such as a copy of the contract pursuant to which the shares were transferred in exchange for the debt write-off.

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[1] *State Bank of India Singapore v Rainforest Trading Ltd* [2011] 4 SLR 699; *Pacrim Investments Pte Ltd v Tan Mui Keow Claire* [2005] 1 SLR(R) 141; *Chase Manhattan Bank NA v Wong Tui Sun* [1992] 3 SLR(R) 436.

[2] *Kong Swee Eng v Rolles Rudolf Jurgen August* [2011] 1 SLR 873.

2.3.2 Is a public auction mandatorily required or are private sales possible?

Public auction is not a mandatory requirement under Singapore law for the realisation of security by way of a sale of shares. The terms of the security instrument may set out the applicable process for the sale of shares.

Even if the security is realised by way of private sale rather than public auction, the creditor has an obligation to act in good faith and exercise reasonable care to ensure that the shares are sold at their true market value. The creditor must also demonstrate reasonable care, skill and fairness when exercising its power to sell the shares.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Any applicable share transfer restrictions in the constituent documents of the target entity can be set aside by making the necessary amendments to those constituent documents.

Share transfer restrictions in the corporate constitution and / or the shareholders' agreement typically only apply to a transfer of legal title in the shares and not a transfer of equitable title (i.e. where legal title is held for the benefit of another person).

2.3.4 Is "market testing" mandatorily required?

Market testing is not a mandatory requirement under Singapore law for the enforcement of a security interest on the shares of a Singapore entity. However, the creditor has an obligation to ensure the shares are sold at a reasonable market price at the time of the sale. From this perspective, market testing may be a useful method of ensuring that the pledged shares are sold at a fair market value.

2.3.5 Are valuation reports mandatorily required?

Valuation reports are not a mandatory requirement under Singapore law for the enforcement of a security interest on the shares of a Singapore entity. However, the creditor has an obligation to ensure that the shares are sold at a reasonable market price at the time of the sale. From this perspective, valuation reports may be a useful method of ensuring that the pledged shares are sold at a fair market value.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

There are two types of pre-insolvency processes available under Singapore for distressed debt and M&A investors: (a) the scheme of arrangement; and (b) judicial management.

A scheme of arrangement is a compromise or an arrangement between a company and its creditors or a class of its creditors, which will bind all affected parties and creditors so long as the court gives its approval to the scheme. The scheme of arrangement can be used by companies as a form of debtor-in-possession (DIP) restructuring because the debtor company remains in control of the management and assets of the company and puts together a restructuring plan with its creditors.

A proposed scheme of arrangement must receive the approval of a majority in number, representing at least 3/4 in value, of the creditors presenting and voting at the meeting. Further, the scheme must be approved by the court.

Judicial management is a formal restructuring process which is ordered and supervised by the court via the appointment of a judicial manager to take control and perform the functions of the company. There are three distinct purposes of judicial management:

(a) to ensure the survival of the company, or the whole or part of its undertaking, as a going concern;

(b) to obtain the court's approval of a proposed scheme of arrangement; and

(c) to achieve a more advantageous realisation of the company's assets or property than on a winding up.

A company will only be placed under judicial management where it is insolvent or likely to become insolvent and there is a reasonable probability of achieving one or more of the purposes of judicial management.

A particular unique feature of Singapore's scheme of arrangement and judicial management regimes is the ability to seek the court's approval under section 67 of the IRDA to confer super-priority status for rescue financing. Rescue financing is defined as any financing that: (a) is necessary for the survival of the company (or of the whole or part of that company's undertaking) as a going concern; and / or (b) is necessary to achieve a more advantageous realisation of the assets of a company that obtains the financing than on a winding up of that company.

This enables the investor to enjoy, in respect of the rescue financing debt, higher priority than what it would have had during an insolvency scenario.

For instance, the rescue debt may be treated as though it were part of the costs and expenses of liquidation, or it may be treated to have priority over all preferential debts and all other unsecured debts of the company.

It is also possible to have the rescue debt be secured by a security interest on the company's encumbered or unencumbered property. The security can also be given in priority to existing security interests. In these cases, the company has to justify the superpriority status by showing that it would not have been able to obtain the rescue financing unless the rescue debt was secured in such manner and there is adequate protection for the existing secured creditor.

Further, it is possible to seek super-priority status for roll-up rescue financing (i.e. where an existing lender of the company extends rescue financing partly to pay off existing debt owed to it and partly to inject new capital into the company), so long as the roll-up financing ultimately creates some new value for the company.

3.2 What involvement does the court have in these processes?

The court is closely involved in both types of processes – i.e. schemes of arrangement and judicial management.

In order to implement a scheme of arrangement, the debtor company must obtain the court's approval in at least two distinct stages of the process.

First, the debtor company may apply to the court under section 210(1) of the Companies Act for an order that a meeting of the creditors of the company (or such other persons who will be affected by the proposed compromise or arrangement) be summoned for the purpose of putting the proposal to implement a compromise or arrangement to those affected creditors (or other persons).

Assuming the proposed scheme receives the requisite approval at the creditors' meeting, the debtor company must apply to the court under section 210(3) of the Companies Act for an order to approve the proposed compromise or arrangement. In this regard, the court retains its discretion to decide if it wishes to approve the proposed scheme or grant its approval subject to such alterations or conditions as it thinks just. This serves to ensure that the interests of minority creditors, who may not necessarily have voted in favour of the proposed scheme, are sufficiently protected and taken into account.

There is also the simplified scheme of arrangement process under section 71 of the IRDA under which the company need only show that the requisite majority would have been obtained had a scheme meeting been held (this will be described in more detail below). Here, the court will also need to approve the scheme of arrangement subject to such alterations or conditions as it thinks just.

There are other specific types of matters for which the company must seek the approval of the court. One example, as mentioned in paragraph 3.1 above, is an application to confer super priority status for rescue financing. Other examples include an application for a scheme moratorium (see paragraph 3.6 below), an application for the company to convene a creditors' meeting to re-vote on a proposed scheme, and an application for a cross-class cram down on minority dissenting creditor classes.

A debtor company will only be placed under judicial management by way of a formal court order. An application for a judicial management order can be made by the debtor company or its creditors. The court must be satisfied that the company is, or is likely to become, unable to pay its debts and that there is a reasonable probability of achieving one of the three purposes of judicial management.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The main players in schemes of arrangement and judicial management will most often be the creditors of the debtor company. In the case of schemes of arrangement, the debtor company is often the one who puts together and presents a scheme to its creditors, although it is also not infrequent that the scheme may be pushed ahead by one of the larger and / or secured creditors or other interested party.

Ultimately, however, the proposed scheme of arrangement must receive the support of the requisite statutory majority of creditors. Judicial management likewise often depends significantly on the creditors, who may wish to replace the existing management of the debtor company with a court-appointed insolvency practitioner, in the hope of standing a better chance of achieving a rehabilitation of the company, the preservation of its business as a going concern, or a more advantageous realisation of the company's assets or property than on a winding up.

Debtor-led schemes of arrangement do not require the involvement of court-appointed insolvency practitioners, Although, in practice, there is usually a financial advisor appointed by the debtor to assist in formulating the scheme. Of course, schemes of arrangement can also be implemented in situations where the debtor company is being managed by a court-appointed insolvency practitioner, such as a judicial manager.

In judicial management, the judicial manager is an insolvency practitioner who is appointed by order of the court. The judicial manager is considered to be an officer of the court.

The party applying for a judicial management order (e.g. a creditor of the debtor company, or the company itself) does have some degree of influence over the appointment of the judicial manager, since the applicant is required to nominate a licensed insolvency practitioner to act as a judicial manager. However, the decision ultimately lies with the court, and the court is entitled to reject the applicant's nominee and appoint another insolvency practitioner if it so chooses.

3.4 Is there a typical due diligence process followed?

The due diligence process for distressed M&As is generally similar to other M&As, although distressed sellers or buyers may decide to focus on specific key areas for due diligence purposes or simplify the due diligence process in order to meet the additional time pressures brought on by the distressed conditions. Obtaining expert evidence, including valuation reports and cash flow projections, will be important to work on the mechanics and terms of the investment.

3.5 What is the typical timeline of a M&A sale under a pre-insolvency process and how does the process work?

The expected timeline for an M&A sale under a pre-insolvency process will vary depending on many different factors such as the size and complexity of the deal, as well as market conditions.

Where the M&A sale is structured as a scheme of arrangement under section 210(1) of the Companies Act, a meeting of the creditors must be held to vote on the scheme of arrangement. Alternatively, the company can apply for a court order under section 71 of the IRDA to approve a "pre-packaged" scheme of arrangement without having to hold a meeting of the creditors. This is further elaborated on in paragraph 3.7 below.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

Certain protections and reliefs are available under the scheme of arrangement and judicial management regimes to help buy time for the structuring, negotiation and closing of the sale and purchase transaction.

Where a debtor company proposes or intends to propose a scheme of arrangement, the company can apply to court under section 64(1) of the IRDA for various moratoria relief, for example: (a) to restrain the passing of a resolution for winding-up of the company; or (b) to restrain the commencement or continuations of any proceedings against the company except with permission of the court.

Once a section 64(1) application is made, the company will benefit from an automatic 30-day moratorium, which affords some immediate breathing room pending the court's hearing and determination of the application. Moratoria relief can also be sought in respect of a subsidiary or holding company of the debtor company under section 65(1) of the IRDA.

In the case of judicial management, the filing of an application for a judicial management order can trigger certain limited restrictions on the acts of the company pending the hearing of the judicial management application. Once a company has been placed into judicial management, the company benefits from various protections, for example:

(a) against any winding up application or resolution;

(b) against the commencement or continuation of proceedings against the company except with the consent of the judicial manager or the permission of court; and

(c) against the appointment of receivers or managers over the company's property or undertaking.

Nevertheless, M&A sales and asset sales may still be challenged in subsequent insolvency proceedings under the avoidance and clawback mechanisms described in paragraph 1.4.2 above.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Singapore law expressly provides for a formal procedure to obtain the court's approval for "pre-packaged" schemes of arrangement.

Under section 71 of the IRDA, the company may apply to the court to make an order to approve the proposed compromise or arrangement between the company and its creditor (or a class of its creditors), even though no meeting of the creditors or class of creditors has been ordered or held. Put simply, the advantage of such "pre-pack" schemes of arrangement is an expeditious and procedurally simple mechanism to obtain the necessary sanction for a restructuring plan whilst avoiding the process of holding actual meetings.

There are four procedural and substantive requirements for a section 71 application for the court's sanction of a "pre-pack" scheme of arrangement. These are set out in section 71(3) of the IRDA.

First, the company must provide each creditor meant to be bound by the compromise or arrangement with a statement which sets out certain prescribed information and explain the effect of the compromise or arrangement. The prescribed information which must be included in the statement is:

(i) information concerning the company's property, assets, business activities, financial condition and prospects;

(ii) information on the manner in which the terms of the compromise or arrangement will, if it takes effect, affect the rights of the creditor; and

(iii) such other information as is necessary to enable the creditor to make an informed decision whether to agree to the compromise or arrangement.

In relation to the effect of the compromise or arrangement, the statement should explain in particular any material interests of the directors of the company, as well as the effect that the compromise or arrangement has on those interests, insofar as that effect is different from the effect that the compromise or arrangement has on the like interests of other persons. If the compromise or arrangement affects the rights of debenture holders, the statement must additionally provide an explanation to the trustees for the debenture holders.

Second, the company must publish a notice of the section 71 application in the Gazette and in at least one English local daily newspaper. A copy of the notice should also be sent to the Registrar of Companies.

Third, the company must also send the above-mentioned notice to each creditor meant to be bound by the compromise or arrangement.

Fourth, the company must satisfy the court that, had a meeting of the creditors or class of creditors been held, the requisite majority of the creditors or class of creditors would have agreed to the proposed compromise or arrangement anyway. In practical terms, the company can use ballot forms or lock-up agreements for the creditors to indicate their support (or otherwise) to the proposed compromise or arrangement. This is then submitted to the court as evidence to establish that the requisite majority of creditors would have agreed to the proposed compromise or arrangement had a meeting of the creditors been held.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Singapore law does not prohibit a debtor company from entering into a "pre-pack" sale of its business (or a part of its business). The applicable risks and requirements may vary depending on whether the debtor company is in a pre-insolvency or an insolvency scenario.

In the pre-insolvency scenario, the debtor company should ensure that the "pre-pack" sale does not contravene the clawback provisions under the IRDA for unfair preference transactions and undervalued transactions. The rules against unfair preference transactions become particularly pertinent where the "pre-pack" sale involves the debtor company's sale of its business to a connected party. Therefore, the debtor company should ideally take steps to ensure that the valuation and terms of the sale and purchase transaction are sufficiently justifiable.

In a liquidation scenario, the court's approval is required for any disposition of the property of the debtor company.

Although there are no formal mechanisms for "pre-pack" sales in Singapore, such transactions could be achieved by way of a court-sanctioned "pre-pack" scheme of arrangement or a sale by the appointed judicial manager. Please refer to paragraph 3.7 above for the advantages and legal requirements for "pre-pack" schemes of arrangement.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The key players in Singapore-based pre-pack sales are the debtor company which is selling the business or a part of the business, and the purchasing entity. The debtor company may appoint corporate finance advisors and valuation experts to plan and structure the pre-pack sale by way of a scheme of arrangement. Other important players are the court and the creditors of the debtor company, especially since a "pre-pack" scheme of arrangement requires the court's formal approval and at least the tacit approval of a majority of the creditors.

"Pre-pack" sales do not necessarily require a special court-appointed insolvency practitioner, but they can also be carried out by a judicial manager or liquidator which provide certain protections to the buyer.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

In Singapore, there is usually some degree of control over who will be appointed as insolvency practitioner if the applicant(s) applying for the appointment of an insolvency practitioner is funding the fees of the insolvency practitioner.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Singapore law has some protections for employees in the event of a transfer of employment as a result of a sale or transfer of undertaking. Pursuant to section 18A of the Employment Act 1968, the transfer of an undertaking (or part thereof) does not operate to terminate the contract of service of the transferor's employees.

The contract of service continues effect after the transfer as if it were originally made between the employee and the transferee. Further, as soon as it is reasonable and before a transfer of undertaking takes place, the transferor is required to notify the affected employees and the trade union of affected employees (if any) of the details and implications of the transfer, as well as the measures (if any) that the transferor and the transferee envisage that they will each respectively take in relation to the affected employees.

4.5 Is there a typical due diligence process followed?

The due diligence process for "pre-pack" sales is generally similar as with other asset or M&A sales, although distressed sellers or buyers may decide to focus on specific key areas for due diligence purposes in order to meet the additional time pressures brought on by the distressed conditions. Obtaining expert evidence, including valuation reports and cash flow projections, will be important to work on the mechanics and terms of the pre-pack sale.

4.6 Is "market testing" mandatorily required?

Market testing is not a mandatory requirement under Singapore law, whether for "pre-pack" sales or for "pre-pack" schemes of arrangement more generally. Nevertheless, market testing will often be helpful to persuade the court (not to mention the creditors themselves) that the proposed sale is in the interests of the creditors and should be sanctioned.

4.7 Are valuation reports mandatorily required?

Valuation reports are not a mandatory requirement under Singapore law, whether for "pre-pack" sales or for "pre-pack" schemes of arrangement more generally. Nevertheless, valuation reports will often be helpful to persuade the court (not to mention the creditors themselves) that the proposed sale is in the interests of the creditors and should be sanctioned.

4.8 What is the typical timeline of “pre-pack” sales?

There are no fixed timelines for the structuring and negotiation of “pre-pack” sales. The timeline required will depend on the relevant parties and stakeholders and can range from between a few weeks to a few months.

As for section 71 applications for “pre-pack” schemes of arrangement, it is possible to obtain the court’s approval for the “pre-pack” scheme within about two months from the date of application.

SOUTH AFRICA

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

The Companies Act[1] regulates the transfer of equity in South Africa, whether through sale and purchase or otherwise. Outside of formal processes relating to financially distressed or insolvent entities such as liquidation and business rescue, which will be dealt with below, there are not *per se* specific legal requirements that apply in South Africa when purchasing distressed equity.

A share issued by a profit company is movable property[2] and may therefore be sold and transferred in any manner recognised by the Companies Act or other legislation.[3] For a share to be transferred as a result of a sale, the transfer must be recorded in the company's securities register after a valid instrument of transfer (which would be the sale agreement) has been delivered to the company.[4]

In the instances where a distressed company forms part of an amalgamation or merger of two or more companies, an important requirement is that, upon implementation of the amalgamation or merger, each amalgamated or merged company must satisfy the solvency and liquidity test,[5] which, in short, requires that the company is factually and commercially solvent.[6] In other words, its assets exceed its liabilities and it can pay its debts as they become due in the ordinary course of business for the 12 months after the date on which the test is considered.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

The general principles relating to the transfer debts applies to distressed debt and non-performing loans.

In South African law, the transfer of a debt occurs through "cession", which denotes the transfer of a right, while "assignment" typically refers to the transfer of both rights and obligations.[7] The cession of a right by agreement does not require the debtor's consent, nor even notice to the debtor.[8] Where a right is transmitted by cession, it is transmitted in its entirety with all its benefits, incidents, defects and disadvantages.[9]

These general principles apply to the transfer of any debt, whether distressed or otherwise. In the context where distressed debt is being transferred, this means that any restrictions or limitations attached to the debt and binding on the cedent (the original creditor) automatically bind the cessionary (the party who has taken transfer of the debt). In the context of consumer loans, which are not the focus of this book, the debtor's rights under the National Credit Act 34 of 2005 would apply.

Legislation that specifically applies to the purchase of distressed debt or non-performing loans is the Debt Collectors Act,[10] which requires that any entity which conducts a business whereby it takes over debts in order to collect them for their gain must be registered as a debt collector.[11] This Act applies specifically to bad or doubtful debts and does not apply to factoring arrangements, where a financier takes transfer of debts that are not bad or doubtful at the time they are sold or offered as security.[12]

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1 Act 71 of 2008.
2 Section 35(1) of the Companies Act deals with the legal nature of companies' shares.
3 Companies Act, section 35(1).
4 Idem, section 51(6)(a). This section deals with certificated shares (i.e. shares evidenced by a physical certificate). Where a company has uncertificated shares, the transfer is recorded through the central securities depository, as provided in section 53.
5 Idem, section 113(1).
6 Section 4 of the Companies Act contains the solvency and liquidity test.
7 *Simon NO v Air Operations of Europe AB and Others* 1999 (1) SA 217 (SCA) 228H.
8 Although not a legal requirement, for a cession to be effective against the debtor, notice needs to be given. See *Lynn & Main Incorporated v Brits Community Sandworks CC* 2009 (1) SA 308 (SCA).
9 *Cession,* LAWSA Volume 3, Third Edition, para 176.
10 Act 144 of 1998.
11 Definition of "debt collector" in section 1 read with section 8 of the Debt Collectors Act 114 of 1998.
12 Definition of "factoring arrangement in section 1 of Act 114 of 1998.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

South Africa does not have specific requirements relating to work councils, although there are certain other regulatory requirements that need to be considered in the context of distressed M&A. We will briefly consider three important regulatory requirements, being:

(i) automatic transfers of employment under the Labour Relations Act[13] (LRA);

(ii) the Takeover Regulation Panel (Panel); and

(iii) the Competition Commission.

1.3.1 Automatic transfers of employment under the LRA

The LRA protects employees by providing that, where a business or part of a business is transferred as a going concern from one party to another, the associated employment contracts automatically transfer to the acquiring party.[14] Often, in the acquisition of a business under financial distress, a restructuring of the business's labour force may be required, so it is essential to be cognisant of these provisions, and furthermore to be aware that a dismissal that relates to a transfer of a business is deemed to be automatically unfair.[15]

A dismissal that is causally related to the transfer of a business can, however, be distinguished from a situation where a new business owner dismisses employees due to operational reasons (i.e. retrenchment).[16] In the latter case, such a dismissal is permitted where the correct procedure is followed and the substantive requirements for a dismissal due to operational reasons are met.

1.3.2 Panel

The Panel was established in terms of section 196 of the Companies Act as an independent and impartial institution that must exercise its functions in line with constitutional values of accountability, responsiveness and openness.[17] The Panel is mandated to oversee "affected transactions"[18] – including mergers, schemes of arrangements and the disposal of all or a greater part of a company's assets – in accordance with Parts B and C of Chapter 5 of the Companies Act and the Takeover Regulations[19] (Takeover Provisions).

The Panel's core functions include regulating affected transactions and offers, monitoring compliance with the Takeover Provisions, investigating complaints and, where appropriate, applying to court for a winding up order against offending companies.[20]

The Takeover Provisions apply to "regulated companies",[21] which include public companies, state-owned companies, and private companies if at least 10% of their shares have been transferred among non-related parties within 2 years prior to a proposed transaction, or if the private company's memorandum of incorporation[22] provides that the company is subject to the Takeover Provisions. Any equity investment into a financially distressed regulated company is therefore subject to the Takeover Provisions.

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13 Act 66 of 1995.
14 LRA, section 197.
15 Idem, section 187(1)(g).
16 *Van der Velde v Business & Design Software (Pty) Ltd* [2006] 10 BLLR 1004 (LC). In this case the court established the objective two-stage causation test for determining whether a dismissal is automatically unfair by reason of being causally related to a transfer of a business.
17 Section 196(2)(d) provides that the Panel must exercise its functions in accordance with the values and principles mentioned in section 195.
18 As defined in section 117(c) of the Companies Act.
19 Chapter 5, Companies Regulations, (regs 81-122).
20 Companies Act, section 201(1).
21 Section 117(1)(i) read with section 118(1) of the Companies Act.
22 In South African company law, the memorandum of incorporation is the constitutional document of a company.

To promote fairness and transparency, the Panel requires adequate disclosure and sufficient time for shareholder decision-making, and prevents actions that could impede legitimate offers.[23] In particular, the Takeover Provisions specify several regulated transactions. For example, a mandatory offer must be made to all remaining shareholders when an acquirer gains control of more than 35% of a company's voting rights,[24] while compulsory acquisitions or squeeze-outs allow a shareholder that acquires at least 90% of the shares to compel the acquisition of the remaining shares in particular circumstances.[25] Other regulated transactions include comparable and partial offers,[26] restrictions on frustrating action by a target board once an offer has been made or is imminent[27] and rules prohibiting dealings in securities during an offer period.[28] Together, these mechanisms aim to uphold integrity, fairness and transparency in change-of-control situations, balancing the rights of controlling and minority shareholders.

The Takeover Special Committee (TSC) may hear and decide matters referred to it by the Panel and is empowered to review compliance notices issued by the Executive Director of the Panel, functioning as the Panel's internal appeal body. Two recent rulings of the TSC, both related to one takeover attempt, illustrate the application of the above principles in practice.

In *Aton GmbH v Murray & Roberts Holdings Limited*,[29] the TSC overturned a decision by the Panel that had permitted Murray & Roberts to proceed with its proposed merger with Aveng, both large construction groups in South Africa. The dispute arose after Aton had entered into a forward sale agreement which, together with its existing shareholding, pushed its stake in M&R above the 35% threshold. In a prior decision,[30] the TSC had held that Aton's attempt to combine a voluntary offer with forward sales could not be used to avoid the mandatory offer rule,[31] and compelled Aton to make a mandatory offer to all shareholders.

Against this backdrop, M&R sought to proceed with a proposed merger with Aveng, which both parties accepted constituted "frustrating action" under section 126 of the Companies Act.

Although M&R obtained shareholder approval, the TSC emphasised that Panel approval is not a formality. Rather, it must weigh broader statutory purposes, including fairness to all stakeholders, market integrity, proper disclosure, overlaps in shareholder interests and the impact on an existing mandatory offer. The TSC concluded that there was no legal imperative for the Aveng deal to proceed during the offer period and that it risked undermining Aton's bid. The TSC therefore refused approval of the merger.

Although the case did not arise in a rescue setting, no rulings have directly addressed business rescue. Nevertheless, the Takeover Provisions apply in distressed contexts. Any attempt to acquire control or inject equity into a regulated company must navigate the Takeover Provisions even though they may restrict the flexibility often needed in corporate rescues.

1.3.3 Competition Commission

The Competition Commission is a statutory body established in terms of the Competition Act[32] to investigate, control and evaluate restrictive practices, abuse of dominant position and mergers,[33] to ultimately assist in promoting competition in South Africa's economy.[34]

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[23] Companies Act, section 119(1).
[24] Idem, section 123.
[25] Idem, section 124.
[26] Idem, section 125.
[27] Idem, section 126.
[28] Idem, section 127.
[29] *Aton GmbH and the Independent Board of Murray & Roberts Holdings Ltd*. Ruling of the Takeover Special Committee (31 July 2022).
[30] *The Independent Board of Murray & Roberts Holdings Ltd and Others*. Ruling of the Takeover Special Committee (25 May 2022).
[31] As provided for in section 123 of the Companies Act.
[32] Act 89 of 1998.
[33] Preamble of the Competition Act.
[34] Idem, section 2.

Any distressed investment or merger[35] in South Africa is subject to the jurisdiction of the Competition Commission.[36] Generally, the Competition Commission does not need to be notified of a "small merger"[37] where the value of the proposed merger is less than R600 million – calculated by combining the annual turnover of both firms or the combined value of their assets – or if the annual turnover or asset value of the transferred / target firm is less than R100 million.[38]

Where neither of these circumstances apply, the merger is classified either as an "intermediate merger" or "large merger" and it is then a requirement that the Competition Commission be notified of the merger.[39] Any intermediate or large merger is subject to approval by the Competition Commission, which considers the merger to determine whether or not it is likely to substantially prevent or lessen competition.[40]

Importantly, in the context of distressed mergers, a factor to be considered in determining whether a merger is likely to substantially prevent or lessen competition is whether the business or part of the business of a party to the merger has failed or is likely to fail.[41] This so-called "failing firm defence" can be relied upon to justify what may otherwise be considered an anti-competitive merger.[42]

To rely on the failing firm defence, a substantive four-part test would need to be satisfied, being that:

(i) but for the merger, the assets would exit the market;

(ii) the firm is a failing firm;

(iii) the reorganisation of the failing firm is not a realistic option; and

(iv) a less anticompetitive outcome than the proposed transaction is absent.[43]

1.4 What risks exist for an investor of a distressed business?

This section will consider the legal risks that ought to be considered when investing in a distressed business in South Africa.

The *actio pauliana* is a common law action available to creditors that have been prejudiced by a disposition by the debtor made with the intention to avoid the disposed asset being available to the debtor's creditors.[44] The action may be brought before or during insolvency proceedings by the defrauded creditor(s) or the trustee / liquidator[45] of an insolvent estate.[46]

From the perspective of a distressed investor, a transaction may only be set aside based on the *actiopPauliana* if the distressed investor, who may have acquired an asset or business from a debtor, knew of the intention to defraud creditors, or had not given value for the acquired the

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35 A "merger" for the purposes of the Competition Act is defined in section 12(1)(a) as occurring "when one or more directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm."
36 Section 3 of the Competition Act provides that the Act applies to all economic activity within, or having an effect within, South Africa with certain exceptions.
37 Competition Act, section 13(1)(a).
38 Thresholds as published in Government Gazette No.41124 in terms of section 11 of the Competition Act.
39 Competition Act, section 13A(1).
40 Section 12A of the Competition Act sets out the factors to be considered by the Competition Commission when it is required to consider the approval of a merger.
41 Competition Act, section 12A(1)(2)(g).
42 For a more complete consideration of the "failing firm defence", see Ranenyeni, K, Poswa, T (2021), *Failing Firms, Business Rescue and Reorganisation in Antitrust*.
43 This test is laid out by Ranenyeni and Poswa after considering various decisions of the Competition Tribunal.
44 *Nedcor Bank Ltd v ABSA Bank and Another* 1995 (4) SA 727 (W) 729G-H.
45 A trustee is responsible for the sequestration of an insolvent natural person or trust while a liquidator is tasked with the winding-up (liquidation) of an insolvent company or close corporation.
46 *Fenhalls v Ebrahim and Others* 1956 (4) SA 723 (D).

asset or business. The *actio pauliana* is therefore not a material risk to an investor acquiring a business or assets in good faith.

An important consideration for an investor in a distressed business is section 34 of the Insolvency Act,[47] which applies in the context of the transfer of a business or part of a business by a trader.[48] This section requires that the trader transferring of the business publishes a notice in the Government Gazette and in newspapers in the district in which the business is carried on at least 30 days, but not more than 60 days, prior to the transfer. Should the trader fail to do so, the transfer will be void against the trader's creditors for a period of 6 months after the transfer, or if the trader's estate is sequestrated or liquidated (i.e. enters formal insolvency proceedings) within the 6-month period.[49]

As soon as the notice is published in terms of this section, every liquidated liability of the trader in connection with the business which will become due in future becomes due immediately should the relevant creditor demand payment of the liability. This section is an important consideration for an acquirer of a business under financial distress, but outside of formal insolvency or restructuring proceedings.

Where immovable property forms part of the subject matter of a transaction, it is important to note that in terms of section 35 of the Insolvency Act, where there is an uncompleted acquisition of immovable property in which the property was not transferred prior to the commencement of the insolvency proceedings, the trustee / liquidator may elect to enforce or abandon the contract providing for the transfer of the immovable property.[50]

An investor in a distressed business ought also to be aware of the risk of a pending winding up application against the company which, if later granted, will have the effect of voiding all dispositions of property by the company and transfers of its shares that took place subsequent to the issuing of the winding up application.[51]

Where an investor lends to a company that forms part of a group of companies, and certain of the companies in the group are guarantors of sureties for the obligations of the borrower, it is important to be aware of the provisions relating to the provision of financial assistance to related or interrelated companies.[52] The board of the company providing financial assistance to a related company in the form of a guarantee or surety must, when authorising the provision of the financial assistance, be satisfied that the company satisfies the solvency and liquidity test[53] (see paragraph 1.1 above) immediately after the provision of the financial assistance, failing which guarantee / surety may be declared to be void by a court.[54]

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

As mentioned above, the *actio pauliana* may be used to set aside certain dispositions by a debtor both in and outside of formal insolvency proceedings.

Section 34(1) of the Insolvency Act may also be relied upon both during and outside of insolvency proceedings. Creditors of a trader that had disposed of a business without giving the required notice[55] may apply to a court to have the disposal declared void as against creditors in order for

47 Act 24 of 1936.
48 The definition of "trader" in the Insolvency Act includes any person carrying on a trade, business, industry or undertaking where property is sold, bought, exchanged or manufactured and also includes, among other things, building operations and public entertainment but specifically excludes farming.
49 Insolvency Act, section 34(1).
50 Idem, section 35.
51 Sections 341(1) and 341(2) of the Companies Act 61 of 1973.
52 Companies Act, section 45.
53 Idem, section 4.
54 As occurred in the highly-publicised restructuring of Steinhoff International in the case of *Trevo Capital Ltd and Others v Steinhoff International Holdings (Pty) Ltd and Others* 2021 (6) SA 230 (WCC).
55 As discussed above, section 34(1) of the Insolvency Act requires that a trader publishes notice of an intended transfer of business in the Government Gazette and newspapers in the district in which the business is carried on.

them to utilise the assets disposed of to settle their claims against the trader, whether or not the trader is insolvent.

Furthermore, where a creditor has instituted legal proceedings against a trader for a claim in connection with the business prior to a transfer and either: (i) the acquirer of the business knew of the legal proceedings instituted; or (ii) the legal proceedings were instituted in a Magistrate's Court or High Court of the district in which the business is carried on, the transfer of the business shall be void against the creditor for the purpose of enforcement of the creditor's debt,[56] regardless of whether the notice required in terms of section 34(1) was given.[57]

It is therefore important for a person acquiring assets from an entity under financial distress (or otherwise) to be aware of the existing legal proceedings instituted in the higher courts against a seller of a business. This risk can be averted by utilising a formal restructuring process such as business rescue (only if the trader is in financial distress) or an arrangement under section 155 of the Companies Act (whether or not the trader is in financial distress), both of which will be considered below.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

In addition to the common law *actio pauliana* and section 34 of the Insolvency Act, there are certain types of impeachable transactions provided for in the Insolvency Act that can be set aside by a court after being asked to do so by a trustee or liquidator during insolvency proceedings. These include dispositions not made for value,[58] voidable preferences,[59] undue preferences[60] and collusive dispositions.[61] We will briefly consider each of these in turn.

A disposition of property not made for value by an insolvent debtor may be set aside by the court if, immediately after the disposition was made, the liabilities of the debtor exceeded their assets (i.e. the debtor was factually insolvent). If the disposition was made more than 2 years before the insolvency proceedings commenced, the burden of proof is upon the trustee / liquidator to prove that, immediately after the disposition was made, the debtor was factually insolvent.[62] If the disposition was made less than 2 years before the insolvency proceedings commenced, the burden of proof is upon the person claiming under or benefited by the disposition to prove that, immediately after the disposition was made, the debtor was factually solvent.[63]

For a disposition of property to be made not for "value", no *quid pro quo* must have been received by the debtor in exchange for the disposition.[64] It is thus highly unlikely that this provision will be invoked in setting aside a transaction where an investor was involved.

A voidable preference may be set aside by a court when a disposition was made by the insolvent debtor less than 6 months prior to the commencement of insolvency proceedings, which had the effect of preferring one creditor over another and where the debtor was factually insolvent immediately after the disposition was made. A person in whose favour the disposition was made may, however, defeat such a claim by proving that the disposition was made in the ordinary course of business and that it was not intended to prefer one creditor over another.[65]

An undue preference occurs and may be set aside by a court where a factually insolvent debtor disposed of an asset with the intention of preferring one creditor above another. There is no limit

[56] Insolvency Act, sections 34(3)(a) and 34(3)(b).
[57] *Simon v DCU Holdings (Pty) Ltd and Others* 2000 (3) SA 202 (T) 222I-J.
[58] Insolvency Act, section 26.
[59] Idem section 29.
[60] Idem, section 30.
[61] Idem, section 31.
[62] Idem, section 26(1)(i).
[63] Idem, section 26(1)(ii).
[64] *Strydom N.O. and Another v Snowball Wealth (Pty) Ltd and Others* 2022 (5) SA 438 (SCA).
[65] Idem, section 29(1).

to the time that must have elapsed between the disposition and the commencement of insolvency proceedings.[66]

Lastly, a collusive disposition refers to where a debtor, prior to their sequestration / liquidation, in collusion with another person, disposed of property belonging to the debtor in a manner which had the effect of prejudicing their creditors or preferring one of their creditors over another.[67]

Provided a distressed investor is acting in good faith, and ensures their creditors are treated fairly in accordance with their rights under insolvency law, there is not much risk for a distressed investor for a transaction to be set aside as an impeachable transaction under the provisions of the Insolvency Act discussed in this section.

An investor that is taking over existing debt owed by a debtor ought to be aware of section 88 of the Insolvency Act, which is discussed in the next section.

1.4.3 *What risks exist for a new lender investing in a distressed business?*

There are certain legal risks for a new lender investing in a distressed business, particularly when the lender is taking security for the loan.

In circumstances where a new lender settles or takes cession of existing debts of the debtor and passes a mortgage bond over assets for the purposes of securing payment of the existing debts that were not previously secured, the lender is at risk of the mortgage bond being disregarded should the estate of the debtor be sequestrated or wound up within 6 months after the lodging for bond registration.[68] This applies in circumstances where the existing debt was incurred more than 2 months prior to the lodging of the mortgage bond. Courts have stressed that the key issue is when the debt was "incurred". A contingent or indemnity obligation only becomes a debt when the contingency materialises.[69]

In other words, a mortgage bond will provide a creditor with no preference in the case where: (i) the mortgage bond was registered in order to secure an existing debt of the debtor which had become unconditional more than 2 months prior to the lodgement of the bond; and (ii) the mortgage debtor is wound up within 6 months after the bond was lodged.

Another risk that lenders ought to be aware of when investing in a distressed business is the possibility of prior securities in favour of other lenders being in existence. This is a risk particularly in circumstances where the security does not require any registration to be valid, such as a security cession of book debts or a security cession of shares. The principle of "first in time, first in law" applies, meaning that any subsequent security right will rank behind prior security holders.[70] In the context of a security cession, this would mean a second cessionary would have a "reversionary interest" in the ceded debt – so that they have a residual right to the debt that only becomes enforceable once the first cessionary's claim has been satisfied.

1.4.4 *What risks exist for a new shareholder investing in a distressed business?*

There is a strict separation between the legal personality of a company and its shareholders under South African law and there are very limited instances where this may be disregarded. As such, the liability of a new shareholder in a distressed business is limited to their investment. Thus, the major risks for a shareholder investing in a distressed business are related to the economic risks facing the business, as well as hidden liabilities owed by the business that the shareholder may not have been aware of.

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66 Idem, section 30(1).
67 Idem, section 30(1).
68 Idem, section 88.
69 *Joint Liquidators of Glen Anil Development Corp Ltd v Hill Samuel (SA) Ltd* 1981 (1) SA 747 (A).
70 For instance, in *Silostrat (Pty) Ltd and Others v Strydom N.O. and Others* [2021] ZASCA 93 (25 June 2021) the Supreme Court of Appeal confirmed that where there are multiple competing security cessions, the ranking of the cessionaries' rights is determined by the date of cession.

In usual circumstances, apart from paying the subscription price for their shares, a shareholder does not have any other material duties and cannot be held further liable for the losses of a company. Certain risks may exist where the shareholder becomes a party to a shareholders' agreement. The agreement may, for instance, require the shareholder to bind itself as a surety for certain debts of the business.

A shareholder investing in a distressed company would be well-advised to ensure that no winding up proceedings have been instituted against the company. A transfer of shares of a company after the commencement of its winding up without being sanctioned by a liquidator is void.[71] Because winding up by court is deemed to commence at the time of the presentation to the court of the application for winding up,[72] a purchaser of shares in a distressed company that is unaware of a pending winding up application may have their purchase declared void retrospectively if the winding up application is thereafter granted by the court.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Under South African law, a claim for payment in money may be secured by rights in a debtor's assets by various means, including by virtue of a special mortgage or a pledge, among other forms of real security.[73] For lenders, the more commonly utilised forms of real security in South Africa in commercial agreements are mortgage bonds over immovable property, special notarial bonds over specified movable property,[74] as well as pledges over movable property.[75]

When a special notarial bond is registered over movable assets of a debtor, those assets are deemed to have been pledged to the mortgagee, despite the mortgagor retaining possession of the assets.[76] In other words, registration of the bond replaces the requirement of a transfer of possession to the creditor as is usually the case with a pledge.

A general notarial bond does not confer a real right to specified assets of the insolvent debtor, but does provide the mortgagee with a limited preference over the free residue of the debtor's estate, being the proceeds of unencumbered assets. From the free residue, claims of employees (limited to a certain amount per employee) are settled first, followed by certain statutory obligations of the debtor, including taxes, and thereafter the claim of the general notarial bond holder.[77]

The enforcement process for a distressed debt investor in South Africa will depend on whether the debt is secured and, if so, on the type of real security held by the creditor. To enforce a mortgage bond, a creditor may only do so in terms of a court order, while a pledge may be enforced without obtaining the permission of the court in certain instances if the agreement between the debtor and creditor allows for it.

A *parate executie* clause, which is an agreement that allows a secured creditor to realise the assets which are the subject matter of their security, is allowed under South Africa law[78] provided that the effect of the clause is not contrary to public policy and the secured creditor is only entitled to realise secured assets under their lawful possession. A *parate executie* clause is not valid in respect of immovable property.

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71 Section 341(a) of the Companies Act 61 of 1973.
72 Idem, section 348.
73 Real security implies a preference conferred in respect of the debtor's assets and not merely having a right of recourse against another entity for the debt which is referred to as "personal security".
74 Registered in terms of section 1 of the Security by Means of Movable Property Act 57 of 1993.
75 A pledge typically requires transfer of possession of the pledged asset by the debtor to the creditor. Movable incorporeal property, such as book debts or shares may be pledged by means of a cession *in securitatem debiti*.
76 Section 1(1) of the Security by Means of Movable Property Act 57 of 1993.
77 Insolvency Act, sections 98A, 99, 101 and 102.
78 *Bock and Others v Duburoro Investments (Pty) Ltd* 2004 (2) SA 242 (SCA).

A general notarial bond may be "perfected" by the holder thereof upon application to a court, which will allow the mortgagee to take possession of the debtor's movable assets through attachment by the sheriff, converting the form of security to a pledge of movable assets. The assets may thereafter be sold by public auction to pay the creditor's claim.

For debts that are unsecured, a creditor must first obtain a court order against the debtor for payment of the creditor's claim. The creditor can then issue a warrant of execution against the property of the debtor. A warrant of execution authorises the sheriff to attach the property of the debtor and sell the property by public auction. The proceeds from the sale of the property may then be used to pay the creditor's claim.

Usually, a sale of execution is by public auction in respect of both movable[79] and immovable property.[80] Where a creditor holds a mortgage or notarial bond over the assets that are the subject of the sale in execution, the creditor's consent is necessary for the sale to be consummated if the proceeds thereof are less than the amount for which the creditor is secured in terms of the bond.

2.2 What involvement does the court have in these processes?

In certain instances, court involvement is mandatory for the enforcement of debts. As discussed above, both an unsecured debt and a general notarial bond require the attachment of assets by the sheriff in terms of an existing court order.

Furthermore, where a secured creditor does not have possession of the secured assets, as would typically be the case with a special notarial bond, the secured creditor would require a court order to lawfully obtain possession of the assets that form the subject matter of their security should the debtor refuse to voluntarily transfer possession of the assets to the creditor. Typically, a special notarial bond would require the debtor to give up possession of the bonded assets upon default by the debtor. If a debtor does not cooperate, possession may only be obtained pursuant to a court order.

Where a debt is secured by a mortgage bond over immovable property, a court order would typically be required for the creditor to take possession of the property and sell it, which would be done by the sheriff of the High Court by public auction.[81] Alternatively, a creditor and debtor may conclude an agreement, post-default by the debtor, authorising the creditor to sell the property privately at a fair price. A sale in execution of residential immovable property that is owned by a natural person is subject to additional requirements,[82] which we do not consider in this publication.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

In the context of a pledge, a *pactum commisorium* is an agreement that allows a creditor to take ownership of a pledged asset at no value upon default by the debtor. Such an agreement is void under South African law.[83] A term in an agreement of pledge which provides for the immediate sale of the pledged asset upon default by the debtor is valid, but a debtor may seek the protection of the court if it can show that the agreement has a prejudicial effect on the debtor.[84]

The enforcement of a pledge of shares will therefore depend on the terms of the pledge agreement. If there is no *parate executie* clause explicitly providing for immediate execution by the creditor, the creditor will have to apply to court for an order authorising the sale of the shares.[85] Having obtained the order, the creditor may then realise the shares in accordance with the court order, which would typically be done by the sheriff.

79 Uniform Rules of Court, rule 45(7)(a).
80 Idem, rule 46(10).
81 Ibid.
82 Idem, rule 46A.
83 *Sun Life Assurance Co of Canada v Kuranda* 1924 AD 20.
84 Supra note 78 at para 7.
85 *Mercantile Bank of India Ltd and Another v Davis* 1947 (2) SA 723.

A share pledge in terms of which the creditor and debtor agree to allow the creditor to immediately sell the shares at a fair price upon default by the debtor is valid. However, the sale of the shares will remain subject to the limitations of the transferability of the particular shares as provided in that company's memorandum of incorporation and the Companies Act.[86]

We consider further relevant considerations in enforcing a pledge of shares in the following sections.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

An agreement whereby the pledgee creditor may keep the pledged shares upon the debtor's default at a fair price determined at the date of the default is valid under South African law.[87]

In other words, a debt-for-equity swap may be implemented if the shares are pledged as security for a debt owed by the company in which the shares are held and if expressly agreed to in the pledge agreement. In such circumstances, no transfer of money is required, and the creditor's claim may be discharged by setting off the fair value of the pledged shares against the debt.

If the shares are in a private company, the restrictions on the transferability of the shares contained in the company's memorandum of incorporation would still apply. Therefore, the other shareholders in the private company would typically have to consent to the debt-for-equity swap in these circumstances, unless the company's memorandum of incorporation provides otherwise.

2.3.2 Is a public auction mandatorily required or are private sales possible?

As discussed above, where a pledge agreement provides for a method of realising pledged shares, this process may be followed by the creditor, provided that the debtor remains entitled to the surplus proceeds, if any, and that the shares must be sold at a fair price.

Where there is no agreement as to the method of realising the pledged shares, the creditor and debtor may thereafter agree on the method of realisation. If no agreement is reached, the typical method of realising movable assets by the sheriff is by public auction where practicable.[88] In the context of shares, either in public or private companies, this is not the most appropriate method of realisation, and a court order will delineate the method by which shares are to be realised, which would typically be by private sale in the context of shares in a private company, or through a stock exchange in the context of a public company.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Shares in a private company remain subject to the transfer limitations set out in the constituent documents of the company even where the share has been pledged.[89] These limitations may not be set aside unless done in terms of an order of court, but a court is unlikely to grant such an order unless in exceptional circumstances.

2.3.4 Is "market testing" mandatorily required?

Market testing is not a mandatory requirement in the enforcement of a pledge of shares unless specifically required in terms of a court order authorising the sale of pledged shares.

As discussed above, a share pledge agreement may allow the pledgee to sell the shares immediately upon default by the pledgor, provided the shares are sold at a fair price. To prevent a transaction being attacked either by the borrower or other creditors of the borrower at a later stage, market testing to determine the market value of the shares would be advisable.

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86 *Smuts v Booyens, Markplaas (Pty) Ltd and Another v Booyens* [2001] 3 All SA 536 (SCA).
87 Supra note 78 at para 9.
88 Uniform Rules of Court, rule 45(10).
89 Supra note 72.

2.3.5 Are valuation reports mandatorily required?

Valuation reports are not mandatorily required under South African law when enforcing a pledge of shares unless expressly required in the court order authorising the sale. To substantiate that the sale of the shares is at a fair price, it is highly advisable that a valuation report is obtained from an independent expert.

Often a share pledge agreement may provide for the creditor to have the option to purchase the pledged shares at a valuation to be determined by an expert valuator agreed on by both parties.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

There are two formal pre-insolvency processes that apply generally to businesses in South Africa: business rescue[90] and a compromise with creditors in terms of section 155 of the Companies Act. Curatorship may be seen as a third formal pre-insolvency process, but its application is limited to financial institutions and banks, and the process would differ depending on whether a financial institution[91] or bank[92] is placed under curatorship.

In this Chapter, we will focus on business rescue and a compromise with creditors, which have a more general application and can both be utilised by distressed debt and M&A investors.

3.1.1 Business rescue

Business rescue is the pre-eminent restructuring procedure in South Africa. It entails the appointment of a business rescue practitioner (BRP), a licensed professional who takes over management control of the financially distressed[93] company, but may delegate powers to existing management, and is tasked with developing, publishing and implementing a business rescue plan,[94] provided the plan is approved by creditors (and sometimes shareholders) of the company.

Under business rescue proceedings, a moratorium against enforcement action by creditors, except with the leave of the BRP or court[95] and with certain other exceptions, provides the distressed company with respite pending the publication of the business rescue plan.

The business rescue plan must contain certain prescribed background information[96] and must also contain the restructuring proposal – setting out, among other things, the extent to which the company is to be released from the payment of its debts, the ongoing role of the company, the order of preference in which creditors are to be paid and the benefits of adopting the business rescue plan as opposed to if the company were to be placed in liquidation.[97]

The Companies Act is not prescriptive as to the types of restructuring proposals that may be made in a business rescue plan. Plans may provide for, among other things, proposals to compromise creditors' claims, the sale of the company's business, a new investor to purchase creditors' claims, the conversion of debt to equity or a combination of these and more.

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[90] In terms of Chapter 6 of the Companies Act.
[91] Section 5 of the Financial Institutions (Protection of Funds) Act 28 of 2001.
[92] Section 69 of the Banks Act 94 of 1990.
[93] Section 128(1)(f) of the Companies Act provides that for a company to be "financially distressed", it must appear reasonably unlikely that it will be able to pay all of its debts as they become due in the ensuing 6 months or alternatively it appears that the company will become insolvent in the ensuing 6 months.
[94] Companies Act, section 140(1)(d).
[95] Idem, section 133.
[96] Idem, section 150(2)(a) – including, among others, an asset list indicating which assets are subject to creditors' security, a list of creditors indicating which creditors are secured, preferent or concurrent in terms of the laws of insolvency and, importantly, a probable dividend that would be received by creditors in their specific classes if the company were to be placed in liquidation.
[97] Idem, section 150(2)(b).

Business rescue has become the primary process whereby distressed M&A transactions take place in South Africa. Where a business rescue plan is successfully adopted by creditors of the company,[98] it allows for a "cram down" on dissenting creditors across classes of creditors, so that the company's pre-business rescue debts are ring-fenced and dealt with in terms of the rescue plan. In addition, a business rescue plan may provide for the altering of shareholders' rights, in which case it must be approved by a simple majority of shareholders in each class whose rights are affected by the plan.[99]

An important concept in business rescue as it relates to distressed debt and M&A investors is post-commencement finance (PCF), which is finance provided to the company after the commencement of business rescue proceedings with the approval of the BRP, either by lenders or by suppliers of goods or services who agree to defer payment for their supplies. Claims arising from the provision of PCF rank ahead of all unsecured claims against the company, but after business rescue costs and employees' claims relating to remuneration or other amounts payable to employees during the company's business rescue proceedings. This ranking remains in place if the company goes into liquidation after business rescue.

Although there was debate over whether PCF claims may be settled from the proceeds of encumbered assets ahead of creditors holding security interests in those assets, this debate has been settled by the Constitutional Court, which held that a pre-commencement secured creditor's rights cannot be diluted by PCF claims in a subsequent liquidation.[100] In addition, the Supreme Court of Appeal has confirmed that post-commencement creditors are "creditors" for purposes of voting on the adoption of a business rescue plan.[101]

3.1.2 Section 155 arrangement

Section 155 of the Companies Act provides for a company to enter into a compromise or arrangement with its creditors, which may be proposed either by the company's board of directors or by the company's liquidator, should it be in liquidation. For the purpose of this section, we shall focus on the situation where the arrangement is proposed by the company's board of directors.

Under the section 155 procedure, the company's existing management remains in control of the company. The section 155 procedure is therefore akin to certain "debtor-in-possession" procedures in other jurisdictions.

The procedure under section 155 entails the publication of a proposal to creditors (section 155 arrangement), which must contain substantially the same prescribed background information as a business rescue plan, along with the restructuring proposal to be voted on by creditors of the company. The section 155 arrangement may propose that a debt moratorium be imposed,[102] but unlike business rescue, it is not automatic.

At the meeting of creditors to consider the proposal, creditors must vote and if it is supported by a majority in number, representing at least 75% in value of the creditors or class of creditors at the meeting, it will be adopted by creditors.[103]

An important distinction between the section 155 arrangement and a business rescue plan is that for a section 155 arrangement, creditors must vote in separate classes and the proposal must be

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[98] Idem, section 152(2). To be adopted by creditors a plan must be voted for by 75% of creditors (in value) who took part in the vote as well as a simple majority (over 50%) of independent creditors (in value) who voted.

[99] Idem, section 152(3)(c). A debt-for-equity swap under a business rescue plan would require shareholders' consent in the form of a simple majority vote by all affected classes if the swap involves an amendment of the memorandum of incorporation of a company to authorise the issuing of more shares. Should the plan involve issuing already-authorised shares as part of a debt-for-equity swap, a resolution by the board of directors would be sufficient. In practice, shareholders often have little incentive to oppose a reasonable debt-for-equity proposal, as the alternative outcome – liquidation – typically leaves them with no residual value.

[100] *Diener N.O. v Minister of Justice and Correctional Services and Others* 2019 (4) SA 374 (CC).

[101] *Mashwayi Projects (Pty) Ltd and Others v Wescoal Mining (Pty) Ltd and Others* 2025 (3) SA 441 (SCA).

[102] Companies Act, section 155(3)(b)(i).

[103] Idem, section 155(6).

adopted by each class of creditors whose rights are affected by the proposal.[104] Classes are determined by whether creditors' rights and interests are sufficiently similar to enable them to consult together with a view to a common interest.[105] Creditors whose legal rights or treatment under the compromise differ materially must be placed in separate classes. Most often, creditors would be classed based on their ranking and rights if a liquidation were to follow – secured, preferent and concurrent.

However, "secured" and "preferent" may be too broad where creditors in those classes would have materially different rights in a liquidation. For instance, in a liquidation employees would rank ahead of the South African Revenue Service for at least a portion of their claims[106] and therefore ought not to be part of the same class in a section 155 proposal if they would have different expected outcomes in a liquidation.[107] Once the proposal is adopted by creditors of each affected class, the company may apply to court for an order to sanction the proposal, in which case it becomes binding on all creditors of the company.[108]

The section 155 procedure allows for a comparatively quick and inexpensive process to enable a company to restructure and ring-fence its historic debts. It is not a pre-requisite for a company to be under financial distress for the section 155 procedure to be utilised. This procedure may be effectively utilised in a distressed M&A transaction as, after being sanctioned by a court, it provides a new investor with certainty over the treatment of the company's historic debts, which overcomes the risks posed by, for instance, section 34(3) of the Insolvency Act as discussed at paragraph 1.4.1 above.

The section 155 procedure does not itself allow for a change of shareholders' rights but may be used in conjunction with a consensual sale of shares or scheme of arrangement[109] to provide for a new equity investor.

A common structure utilised in distressed acquisitions under both business rescue and using the section 155 procedure is a "loan to own", whereby an investor lends to the distressed entity which loan is used to provide creditors with a payment constituting a portion of their claims, while the investor will acquire shares in the entity at a nominal value. The existing claims of creditors are ceded to the new investor whose loan was used to provide creditors with a settlement, and these claims will then be subordinated in order to allow the company to return to solvency.[110]

3.2 What involvement does the court have in these processes?

Business rescue proceedings may take place without any direct involvement from the court. A BRP is an "officer of the court" and therefore, as an independent professional, ought to provide oversight of the process to ensure that it is fair and that the interests of all stakeholders are appropriately balanced.

Although court involvement is not necessarily required under business rescue, there are certain instances where a court will be involved. Examples of this include, among others:

- a company may be placed in business rescue by a creditor, shareholder, employee, or trade

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104 Ibid.
105 The principle that creditors within a class must share a commonality of interest derives from long-standing jurisprudence on schemes of arrangement under section 311 of the Companies Act 61 of 1973, where courts determined whether separate meetings of classes were necessary. South African courts, for instance in *Rosen v Bruyns NO* 1973 (1) SA 815 (T), have applied the English law principles set out in *Sovereign Life Assurance Co v Dodd* (1892) 2 QB 573.
106 Sections 98A and 99 of the Insolvency Act.
107 See *Commissioner, South African Revenue Service v Logikal Consulting (Pty) Ltd* 2019 (6) SA 472 (GP) where under a section 155 proposal employees and SARS were placed in the same class. The proposal purported to place employees and SARS in the same class despite the fact that under the proposal employees' claims were left intact while SARS's claim was heavily compromised. The court refused to sanction the proposal on this and other grounds.
108 Companies Act, section 155(7).
109 Idem, section 114(1).
110 *Ex Parte De Villiers and Another NNO: In re Carbon Developments (In liquidation)* 1993 (1) SA 493 (A).

union by means of a court order;[111]

- a BRP may apply to court to cancel onerous contracts that the company in business rescue is a party to;[112]
- if a business rescue plan is not published within 25 business days of the BRP's appointment and an extension for publication is not granted by creditors, the BRP must obtain an extension by an order of court;[113] and
- a BRP may be removed by an order of court.[114]

Under the section 155 procedure, the court plays an important role in sanctioning the proposal after it has been adopted by creditors. Although the Companies Act provides that a company *may* apply to court for an order approving an adopted proposal,[115] for it to be binding on dissenting creditors, it must be sanctioned by the court. In circumstances where 100% of creditors vote in favour of the proposal, the court's sanctioning is not necessary.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

3.3.1 Main players in business rescue proceedings

Under business rescue proceedings, the BRP is the most important player. The BRP is in control of the business rescue process, and the success of the process often hinges on their competence. The BRP must balance the interests of all stakeholders[116] in formulating the business rescue plan and will typically be the main point of contact for a potential investor in the distressed business.

In circumstances where the company is placed under business rescue by its board of directors, the BRP is appointed by the board of the company.[117] If the company is placed under business rescue by an order of the court, the party who brought the application will nominate a BRP, whose appointment would then need to be ratified by a simple majority of independent (non-related) creditors at the first meeting of creditors thereafter.[118]

The other important players in business rescue proceedings are "affected persons",[119] being creditors, employees, shareholders and trade unions representing employees of the company. Any affected person may bring an application to place a company under business rescue, or to remove the BRP, and may participate in any court proceedings that arise during a company's business rescue. All affected persons must be given notice of each court proceeding, decision, meeting or other relevant event concerning the company's business rescue.

Of the affected persons, creditors are the most important group, as they ultimately determine whether a business rescue plan is adopted. The creditors may elect a committee to consult with the BRP. The committee can play in important role in the process and may themselves formulate potential restructuring proposals for consideration by the BRP. The committee may not, however, instruct the BRP, who remains in charge of the process.

Creditors with the largest claims, such as banks, typically hold the most sway over the process. Because creditors vote in a single class (unlike in the section 155 process), the creditors with the largest claims will decide the outcome of the process even if their rights may be less materially

[111] Companies Act, section 131.
[112] Idem, section 136(2)(b).
[113] Idem, section 150(5)(a).
[114] Idem, section 139.
[115] Idem, section 155(7).
[116] Idem, section 7(k).
[117] Idem, section 129(3)(b).
[118] Idem, section 131(5) read with section 147(3).
[119] See the definition of "affected persons" in section 128(1)(a) of the Companies Act.

impacted than minor unsecured creditors, who may be required to write off a large portion of their claims.

Employees and trade unions must be consulted with by the BRP and may also form a committee that can make proposals to the BRP concerning the business rescue plan.[120] Employees' rights are specifically protected under business rescue proceedings. Their claims for consideration that fall due post-commencement of business rescue rank ahead of post-commencement finance claims. It may even be said that employees are more protected under business rescue proceedings than outside of it, due to the fact that a BRP may not undertake any retrenchments of employees prior to the publication of the business rescue plan.[121] Although employees labour rights are protected, their influence on the restructuring proposal itself is generally negligible due to their relatively small voting interest.

During business rescue, the alteration in the classification or status of issued shares may only be done by an order of court or if contemplated in a business rescue plan that is approved by creditors and the classes of shareholders whose rights are be affected by the plan.[122] To be approved, a simple majority of each affected class of shareholders must vote in favour of the plan.[123] What is permissible as an alteration in the classification or status of issued shares in terms of a business rescue plan is yet to be clarified by the courts.

It is submitted that a plan may include any transaction that may be done in terms of a scheme of arrangement between a company and its shareholders, which may, among other things, include a share repurchase or expropriation of shares by the company.[124] A scheme of arrangement outside of business rescue requires a special resolution of shareholders,[125] while in business rescue, it is submitted that merely a simple majority of each affected class is required.[126] The cram-down on dissenting shareholders can be a useful tool in implementing a distressed M&A transaction.

A further group of stakeholders in a business rescue that bears mentioning are the existing directors of the company. Usually, a company's directors are responsible for placing it in business rescue and appointing the BRP.[127] Having done so, directors must continue to exercise their functions as directors, subject the authority of the BRP, and must attend to requests of the BRP. The BRP may apply to a court for an order to remove a director if, among other things, the director impedes the BRP in the performance of their functions.[128]

3.3.2 Main players in the section 155 procedure

Under the section 155 procedure, when it is used outside of liquidation proceedings, the company's directors will, after having taken legal advice, make the decision to propose an arrangement or compromise under section 155 to the company's creditors. Legal advisors will play an important role in drafting the proposal and, usually, an independent professional with expertise in restructuring and insolvency will be appointed as the chairperson to preside over the meeting to adopt the proposal.

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[120] Idem, section 148(1)(b).

[121] *South African Airways SOC Ltd (In Business Rescue) and Others v National Union of Metalworkers and Others* 2021 (2) SA 260 (LAC).

[122] Companies Act, section 137(1).

[123] Idem, section 152(3)(c).

[124] A scheme of arrangement outside of business rescue is provided for in terms of section 114(1) of the Companies Act. Section 115 contemplates that a scheme of arrangement may take place in terms of a business rescue plan, in which case it does not require approval in terms of section 115.

[125] A special resolution is adopted with the support of at least 75% of the voting rights exercised on the resolution or a different percentage as provided in the company's memorandum of incorporation. See the definition of "special resolution" in section 1 of the Companies Act.

[126] This has not been confirmed by the courts and is not expressly stated in the Companies Act, although it is arguably implied. Supra note 107 and see Levenstein, E. *South African Business Rescue Procedure,* Part III, 9.7 (the business rescue plan), page 9-134(7).

[127] Unless the company is placed in business rescue by a court order.

[128] Companies Act, section 137(5).

At the meeting, as mentioned above, each class of creditors affected by the proposal must approve the proposal for it to be adopted by creditors. For the proposal to be approved by a class of creditors, it must be supported by a majority in number and at least 75% in value of the creditors present and voting at the meeting. Therefore, under the section 155 procedure, each class of creditors has the same ability to affect the adoption of the proposal, unlike under business rescue where the larger creditors (who are often at least partly secured) typically dictate the outcome.

Once a proposal has been adopted, the court must sanction the proposal for it to become binding on dissenting creditors, and the court order must be filed with the Companies and Intellectual Property Commission (CIPC).[129]

Usually, the proposal would provide for an independent insolvency and restructuring professional to act as receiver for creditors who is responsible to oversee the implementation of the proposal, although this is not required by the legislation.

3.4 Is there a typical due diligence process followed?

The due diligence that is followed by an M&A or debt investor would not be substantially different in distressed circumstances, except that there would be a specific emphasis on identifying some of the risks discussed earlier in this chapter.

There is no court imposed due diligence process that is followed in pre-insolvency procedures in South Africa. Under business rescue proceedings, the BRP would present much of the information required for a prospective investor's due diligence in a business rescue plan, which would typically include a professional valuation of the company's assets. The due diligence process that is followed would depend on which stage a prospective investor enters the process.

Any investor would conduct their own due diligence as they would for any M&A transaction, but may rely more on information compiled by a BRP if they enter later in the process when a plan is being drafted or has already been published. Usually, a potential investor would be involved early in the process, as without potential investment, there is often not a reasonable prospect of rescuing a company, which is a requirement for the company to be placed in business rescue. Even so, where there are multiple interested investors, a business rescue plan may often allow for a bid-out process between potential investors.

Where a merger or acquisition takes place in conjunction with a section 155 proposal, or where a new debt investor enters the fray in terms of a section 155 proposal, the due diligence would arguably need to be more stringent. The investor cannot rely on an independent BRP to compile information, and under the section 155 procedure, new investment typically needs to be secured before, and subject to, the adoption of the proposal.

3.5 What is the typical timeline of a M&A sale under a pre-insolvency process and how does the process work?

3.5.1 M&A sale under business rescue

As mentioned above, business rescue can provide a useful mechanism for an M&A sale to take place due to the cram down on dissenting shareholders. Aside from a cram down on shareholders through a business rescue plan, which may include the issuing of new shares, buy-back or expropriation of shares by the company, and conversions of debt to equity, M&A transactions may also be implemented under business rescue through a sale of business (not shares) or a consensual sale of shares.

In terms of the legislation, the business rescue process is intended to last for 3 months but will usually endure for longer with the consent of creditors, especially in larger and more complex matters which may take years to finalise. Where prospective investors are involved early in the

[129] Idem, section 155(8)(a).

process, the typical timeline would be 3 to 6 months, or quicker if a "pre-pack" is implemented, which we discuss below.

3.5.2 M&A sale with section 155

The section 155 procedure is in some instances a quicker process, although there may be delays in sanctioning the proposal due to the time it takes to obtain a court date in non-urgent applications. Because it does not provide for any automatic moratorium on enforcement of claims against the company, a company that is facing financial distress cannot afford to waste time in formulating and then implementing such a proposal. A section 155 proposal may be used in conjunction with a sale of a business, a consensual sale or transfer of shares, or a scheme of arrangement,[130] to implement a distressed M&A transaction.

This process comparatively quicker than business rescue and will usually take between 1 month and 6 months to conclude, depending on the size and other circumstances. In a contentious matter where there are litigious creditors or other parties, it may take over a year to conclude and have the process finally approved by a court.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

Because business rescue remains a relatively new process, having been introduced into South African law in 2011, there is not a large amount of case law dealing with circumstances in which transactions under business rescue are later challenged by creditors or in a subsequent liquidation.

However, based on the wording of the relevant provisions of the Companies Act, a sale of a business or assets that is done in terms of a duly adopted business rescue plan, is protected from creditors and therefore from being subsequently set aside in later liquidation proceedings, unless the sale constitutes an impeachable transaction that may be set aside in terms of the relevant provisions of the Insolvency Act that are discussed above. This is highly unlikely to be the case, as long as a plan recognises the hierarchy of creditors' claims that would apply under insolvency.

The High Court has recently held that section 34 of the Insolvency Act, discussed in paragraph 1.4.1 above, does not apply to the disposal of a business by a company in terms of an approved business rescue plan.[131]

A sale of a business or assets that is implemented in terms of a duly adopted section 155 proposal and that is sanctioned by a court is protected from being later challenged by creditors, to the same extent as under business rescue. However, a sale of business contemplated in the section 155 proposal would in addition need to be approved by a special resolution of shareholders,[132] which is not a requirement under business rescue. A change in shareholding in an entity cannot occur in terms of section 155. As mentioned previously, a shareholding restructure would need to be implemented in terms of an agreed transfer of shares or a scheme of arrangement in terms of section 115.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

A "pre-pack" business rescue process is not expressly permitted or prohibited under South African law, and may occur in circumstances where an investor (either an existing stakeholder or outside party) is engaged prior to entering business rescue and lock-up agreements are entered into providing for the restructure of the business's debts with major creditors and, potentially, providing for the restructuring of the company's shareholding. These agreements would be with

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[130] The implementation of a scheme of arrangement may cause delays if the resolution proposing the scheme was opposed by at least 15% of voting rights exercised on the resolution, in which case it must be approved by a court.

[131] *Reiscor Two (Pty) Ltd t/a Bootleggers (In Business Rescue) v Anheuser-Busch Inbev Africa (Pty) Ltd and Others* (2022/2731) [2024] ZAGPJHC 363 (11 April 2024).

[132] Section 112(1)(a) read with section 115(2) of the Companies Act.

creditors (and potentially shareholders) holding the requisite majority voting interests to adopt a business rescue plan and would be subject to a business rescue plan being adopted.

A "pre-pack" business rescue allows for the business rescue process itself to unfold in the shortest possible time,[133] and may occur in the following steps:

(i) The distressed company's board and shareholders enter into agreements with new funders and lock-up agreements with existing creditors and engage with a potential BRP, who conducts their pre-assessment on the viability of a rescue of the company. Because there is already a restructuring proposal on the table, and the majority of creditors are in favour of the proposal, there would be a reasonable prospect of the business being rescued.

(ii) The company's board files for business rescue, appointing the BRP. Notices are sent to affected persons giving notice of the first creditors' meeting and the first employees' meeting, and the business rescue plan is simultaneously published along with a notice convening the meeting to consider the adoption of the business rescue plan.

(iii) Post-commencement finance is advanced to the company in terms of funding agreements to cover the professional fees of the process as well as immediate working capital requirements.

(iv) The first meetings of creditors and employees, and then the meeting to consider the adoption of the business rescue plan, are held consecutively on a single day, 5 business days after the commencement of business rescue proceedings.

(v) If the plan is adopted and if it provides for business rescue proceedings to terminate after the plan is adopted, the BRP can file a notice of substantial implementation to terminate business rescue proceedings.

As such, a pre-pack business rescue plan can be adopted within 5 business days of the company entering business rescue. Although it would not always be completed within 5 business days, a pre-pack business rescue is not uncommon in South Africa. The pre-commencement negotiations and subsequent implementation would of course take longer, so the whole process can reasonably be completed within a month.

One potential pitfall in the effectiveness of pre-pack business rescue is that, strictly, if a company's board of directors has reasonable grounds to believe that a company is financially distressed, it *must* file for business rescue or liquidation, failing which it must provide a notice to each affected person explaining why the company has not been placed in business rescue.[134]

Failing to do so can result in the directors being held liable for creditors' losses resulting from a failure by the directors to place the company in business rescue.[135] This risk may materialise in circumstances where negotiations for a pre-pack are drawn out and ultimately no agreement is reached between the necessary stakeholders.

A pre-pack section 155 arrangement is also not expressly contemplated in the legislation, but also can be an effective mechanism for a debt restructuring to take place. Under a pre-pack business rescue, the company will enter into agreements with funders and lock-up agreements with creditors holding the requisite voting interest to adopt the section 155 proposal prior to the proposal being published.

Upon publication of the proposal, simultaneous notice of the meeting to consider the proposal is given. There is not a minimum notice period specified for the meeting to consider the proposal, but it would be prudent to provide creditors with at least 5 business days' notice, consistent with the requirement for the meeting to consider a business rescue plan. Once adopted, an application can be made to the High Court to sanction the proposal.

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133 Prior negotiations and the implementation of the plan may however take longer.
134 Companies Act, section 129(7).
135 Idem, section 218(2).

The court date to sanction the proposal would likely be at least 2 months after the application was made, unless in cases where there is a need for urgency for the proposal to be successfully implemented (in which case a court date may be obtained around 2 weeks after the application is made).

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

A "pre-pack" business rescue plan or a "pre-pack" section 155 proposal may include a sale of a business. Therefore, a pre-pack sale is permitted under either of the pre-insolvency proceedings discussed above. A fully pre-packed sale ought not to occur under liquidation (formal insolvency) proceedings, which proceedings ought to be entered into by a party with the intention of winding up a company.

That said, a form of pre-pack can technically occur in liquidation where an acquiror purchases the claims of all (or substantially all) creditors prior to the liquidation and, by doing so, is able to control the liquidation process, as any sale of business in a liquidation would require the liquidator to obtain extended powers from the creditors, the Master or the court after the company has already been placed in liquidation.[136]

Because of this, such a transaction would generally be quicker and cheaper to implement through business rescue or a section 155 compromise. In some cases, however, liquidation may be used to discharge the company's obligations towards employees, but if a liquidation application is transparently brought for this purpose it could arguably be characterised as collusive or an abuse of process – albeit one that may be difficult to prove.

Regardless, business rescue is generally regarded as the most suitable process for a pre-pack sale, because speed is often essential to the success of such a transaction and, unlike liquidation or section 155, business rescue does not require court involvement.[137]

For a "pre-pack" sale to be implemented in terms of a business rescue, the same process as described above would apply with necessary changes specific to a sale of business, in particular:

(i) The distressed company's board and shareholders enter into negotiations with a potential acquiror of the business and agree in principle on the terms of a sale of business. The company enters into lock-up agreements with existing major creditors and engages with a potential BRP who conducts their pre-assessment on the viability of a rescue of the company. Because there is already a proposed sale of the business on the table, and the majority of creditors are in favour of the sale, there would be a reasonable prospect of the business being rescued.

(ii) The distressed company's board and shareholders enter into negotiations for agreements with new funders and lock-up agreements with existing creditors.

(iii) The company's board files for business rescue, appointing the BRP. Notices are sent to affected persons giving notice of the first creditors' meeting and first employees' meeting. The BRP signs a sale of business agreement, to be contained in a business rescue plan and subject to approval of the plan. The business rescue plan which contemplates the sale of the business is simultaneously published along with a notice convening the meeting to consider the adoption of the business rescue plan.

(iv) The first meetings of creditors and employees, and then the meeting to consider the adoption of the business rescue plan, can be held consecutively on a single day, 5 business days after

[136] Section 386(4)(h) of the Companies Act 61 of 1973 (read with item 9 of Schedule 5 to the Companies Act 71 of 2008).

[137] Section 155(7) of the Companies Act provides that a company "may" apply to court to sanction an arrangement under section 155, but if there is a dissenting creditor, a court's sanction would be necessary under section 155(8)(c) to make the compromise "final and binding on all of the company's creditors".

the commencement of business rescue proceedings.

(v) If the plan is adopted, the sale of business becomes binding and can thereafter be implemented.

Like business rescue, the section 155 procedure provides a means for a potential purchaser of a business to prevent the transaction from being challenged later by a rogue or disgruntled creditor in terms of, for instance, section 34 of the Insolvency Act, and may be done as a "pre-pack" sale. This would work as follows:

(i) The company enters into a sale of business agreement with the prospective purchaser which is subject to lock-up agreements being concluded with major creditors, the requisite special resolution by the shareholders of the company (discussed above), and the transaction being approved by creditors in terms of a section 155 proposal.

(ii) Having entered into lock-up agreements with major creditors holding a sufficient voting interest to adopt the proposal, and after a special resolution of shareholders approves the possible sale of business, the board of the company publishes the section 155 proposal and gives notice of the meeting to be held within 5 business days.

(iii) The proposal is adopted by all classes of creditors and an application is made to the High Court to sanction the proposal which contemplates the sale of business.

(iv) Upon the court sanctioning the proposal, the sale of business is consummated and can be implemented thereafter without a risk of being challenged later by a creditor.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The main players in a pre-pack sale would be the prospective purchaser, along with the same parties as discussed in paragraph 3.3 above, with certain adjustments.

In business rescue proceedings, employees, trade unions and shareholders would play a smaller roll in a pre-pack business rescue sale. Employees would, by virtue of section 197 of the LRA, as discussed in paragraph 1.3 above, have their employment be protected and their employment contracts would automatically transfer to the purchaser of the business. Shareholders would not have a say in the adoption of the pre-packed plan contemplating a sale of business, because their rights as shareholders would not be altered if the company's assets are sold.

In a section 155 pre-pack sale, the seller company and the prospective purchaser would be the key players, along with the other parties referred to in paragraph 3.3 above in relation to the section 155 procedure.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Because a pre-pack sale cannot occur under formal insolvency proceedings, insolvency practitioners are not involved in the process.

A prospective purchaser in a pre-pack sale can require in their offer to purchase the business that a certain BRP is appointed to implement a pre-pack business rescue plan or, in the context of a section 155 proposal, can request that specific professionals be involved in implementing the proposal.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

South African law provides special protection to employees in the transfer of a business, as discussed in paragraph 1.3 above. This protection applies to any transfer of a business, including a pre-pack sale.

A further consideration is that section 134 of the Companies Act provides particular protection to secured creditors of a company in business rescue. Secured creditors' express prior written consent is required for the company / BRP to dispose of assets in which the creditor holds a security or title interest, unless the proceeds from the disposal would be sufficient to fully discharge the indebtedness protected by that creditor's security or title interest.

4.5 Is there a typical due diligence process followed?

The due diligence under a pre-pack sale would not materially differ from a typical sale of business, although a clear understanding of the pre-pack process and players involved would need to form part of the due diligence. Among other things, due diligence would typically include a professional valuation of the real and intangible assets of the business.

Naturally, any purchase of a financially distressed business would require an enhanced due diligence as the business would likely be sold *voetstoots*, or "as is", without either the board or the BRP providing any warrantees or indemnities relating to the financial performance of the company.

4.6 Is "market testing" mandatorily required?

Market testing is not mandatorily required under the legal framework for pre-pack sales, although, to obtain creditors' buy-in, a prospective purchaser of a business and the debtor company would need to demonstrate to creditors that there are no better offers available. Purchasers would also typically require certain warranties or indemnities.

In the context of a business rescue, a practitioner would usually limit warranties to fundamental matters only – namely that the company (or practitioner) has authority to conclude the sale and that the company has good title to the assets being sold.

By contrast, in a section 155 transaction where directors are concluding the sale on behalf of the company, purchasers may seek broader warranties, for example:

(i) that books and records have been properly maintained;

(ii) that necessary licences or permits are in place and valid;

(iii) that existing litigation and known liabilities have been disclosed; and

(iv) that key contracts have been disclosed and are enforceable.

In either context, a practitioner or distressed seller will resist giving extensive commercial warranties (such as those relating to profitability, employees or future performance), given the distressed circumstances.

4.7 Are valuation reports mandatorily required?

Valuation reports are not a legal requirement for any pre-pack sale. As mentioned above, however, a professional valuation would typically form part of a prospective acquiror's due diligence process and would also be useful in obtaining the buy-in of creditors to justify the proposed selling price.

4.8 What is the typical timeline of pre-pack sales?

It is likely that the negotiations and due diligence, prior to the implementation of the pre-pack sale, may be the longest part of the process. There is no set timeline for this stage of the process which may vary depending on the circumstances, size and complexity of the transaction and can take anything from a month to a year (or more).

As discussed in paragraph 3.7, once agreements are in place, a pre-pack business rescue plan can be adopted within 5 business days, after which the plan must be implemented, which again can take some time, although should not be more than a few months.

Although generally section 155 is seen as the quicker process as opposed to business rescue (outside of a pre-pack scenario), a pre-pack sale under section 155 would usually take longer than a pre-pack business rescue sale because of the required sanctioning by the court. Once agreements are in place, the section 155 process would take between 1 to 6 months to implement, depending on the court dates obtained to sanction the proposal.

THE NETHERLANDS

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

The sale and purchase of equity in the Netherlands is governed predominantly by the rules set out in Book 2 of the Dutch Civil Code (*Burgerlijk Wetboek*, DCC). The transfer of the shares in the capital of a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*, BV) requires a notarial deed. The transfer will, subsequently, be registered in the shareholders' register of the company. Comparable rules apply to the transfer of the shares in the capital of a public limited liability company (*naamloze vennootschap*, NV). In addition, separate rules apply to the trade of the shares in a listed company. However, for the purpose of this Chapter, we will focus only on the sale and purchase of the shares in the capital of a BV that is not listed on a stock exchange.

Turning to distressed M&A, no separate rules apply to the transfer of the shares in the capital of a distressed company in the Netherlands. The rules that govern the sale and purchase of the equity of non-distressed companies apply to the sale and purchase of the equity of a distressed company. The Netherlands does not have a specific legal regime that applies to selling and purchasing distressed equity.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

The sale and purchase of debt and / or a loan may occur through the assignment (*cessie*) of the debt claim or through the transfer of contract (*contractsovername*) of the loan agreement. The assignment of a debt claim requires a deed and a notification to the debtor, unless there is an undisclosed assignment in which case no notification to the debtor is needed provided there is a notarial deed or a private deed which is registered with the Dutch Tax Authorities. The transfer of contract requires a deed between the seller and the buyer as well as cooperation from the counterparty to the loan agreement (i.e. the borrower under the loan).

These rules apply to the sale and purchase of a performing loan as well as to a non-performing loan. Under Dutch law, no special regime applies to the sale and purchase of distressed debt or a non-performing loan.

Pursuant to the general banking conditions which apply to all banks in the Netherlands, a bank has a duty of care *vis-à-vis* its borrowers. Besides the provisions of the general banking conditions, the duty of care of banks is further shaped in case law where the emphasis has been on the role of a bank in society as well as on general principles of reasonableness and fairness (*redelijkheid en billijkheid*). For instance, a bank may not always be authorised to accelerate a loan agreement with a borrower if this is unacceptable on grounds of reasonableness and fairness.[1] This equally holds true if the relevant bank was authorised to terminate the facility agreement based on the contractual provisions contained therein. The exact content and scope of this duty of care is heavily dependent on the specific circumstances and the relationship between the bank and its borrower. The scope of the duty of care will, among other things, depend on the level of complexity of the financial product offered by the bank and the borrower's expertise with banking transactions.

If a bank sells and transfers distressed debt to a non-banking institution, the aforementioned duty of care does not transfer to the buyer by force of law or otherwise. However, under those circumstances, the transferred contractual provisions governing the loan may be limited by the duty of care resting upon the selling bank.

Under Dutch law, the provisions governing the debt itself may be limited by rules of reasonableness and fairness pursuant to the duty of care resting on the seller, and these limitations will transfer to the buyer when acquiring the debt claims.[2] Therefore, a distressed debt investor should be mindful of potentially obtaining claims limited by the duty of care resting on the selling bank when purchasing distressed debt and non-performing loans. In addition, general principles

1 Dutch Supreme Court 10 October 2014, ECLI:NL:HR:2014:2929 (*ING/De Keijzer*).
2 Dutch Supreme Court 10 July 2020, ECLI:NL:HR:2020:1276 (*Van Lanschot / Cerberus*).

of reasonableness and fairness will govern the legal relation between the distressed debt investor (as the new creditor of the debt claim) and the borrower. Under certain circumstances, this may imply that the distressed debt investor should act in accordance with the duty of care comparable to that resting on banks.

Finally, special rules may apply to the purchase of distressed debt and non-performing loans a company originally made to consumers. However, given the focus of this book is on professional parties, we will not elaborate on special rules that apply to consumer loans under Dutch law.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

Under Dutch law, certain companies are required to install a works council if certain conditions are met (e.g. if the company has more than 50 employees). The works council is a corporate body that represents the interest of the employees of the company. The works council needs to be consulted for advice on certain important decisions that the company takes. For example, large M&A deals or obtaining an important debt financing with the granting of security requires works council advice.

A company's works council is also required to be enabled to render its advice if there is a change of control (whether direct or indirect) in respect of the governance of the company. As a result, distressed M&A transactions may be subject to works council advice.

The sale and transfer of distressed debt does not require separate works council advice. However, if the distressed investor is pursuing a loan-to-own strategy with the purchase of the distressed debt, the subsequent acquisition of the shares may be subject to works council advice, depending on how the deal is structured.

In such a case, the relevant company should ensure the works council is adequately enabled to render its advice in respect of the proposed transaction. This means that the works council is required to be involved with the transaction at a moment in time where it can still substantially influence the proposed transaction.[3] If the distressed company's works council does not agree with the proposed transaction and issues negative advice, a waiting period of 1 month may apply. Furthermore, the works council may initiate litigation proceedings before the Dutch Enterprise Chambers (*Ondernemingskamer*). This may delay and possibly even frustrate the transaction.

1.4 What risks exist for an investor of distressed business?

There are specific legal risks associated with investing in distressed business under Dutch law. The most prominent risks relate to avoidance actions (*actio pauliana*).

The concept of *actio pauliana* is comparable, but is not identical, to the legal concept of fraudulent conveyance and preferred transactions in other jurisdictions. *Actio pauliana* may lead to annulment of transactions. Dutch law provides for *actio pauliana* both outside and in a bankruptcy scenario.

In bankruptcy proceeding, only the bankruptcy trustee (*curator*) may initiate such *actio pauliana*. Furthermore, in bankruptcy proceedings in the Netherlands, a different legal regime applies to legal acts that are conducted on a voluntary basis by the debtor than that applying to legal acts that are performed on the basis of a statutory or contractual obligation of the debtor. However, it is possible to mitigate the risk of *actio pauliana* in a restructuring under the Act on the Court Confirmation of Restructuring Plans (*Wet Homologatie Onderhands Akkoord*, the WHOA). This is discussed in more detail in paragraph 0 below.

[3] Amsterdam Court of Appeal (Enterprise Chamber) 17 November 2016, ECLI:NL:GHAMS:2016:5232 (*Nalco*).

1.4.1 *What risks exist for the transaction to be challenged and overturned outside of bankruptcy?*

Outside bankruptcy, individual creditors have the right to annul voluntary legal acts by the debtor if the debtor and its counterparty knew or should have known that this act would adversely affect the means of recourse of one or more of the creditors of the debtor. It is generally difficult for a creditor to successfully invoke this ground for annulment of a transaction. This is because a creditor is generally not prejudiced in its means of recourse outside of bankruptcy of the debtor given that the debtor is not insolvent and the creditor may still take recourse against the assets of the company.

1.4.2 *What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?*

In a bankruptcy, individual creditors lose their right to invoke the *actio pauliana*. In bankruptcy proceedings in the Netherlands, the bankruptcy trustee has the exclusive right to annul legal acts entered into by the debtor prior to its bankruptcy. A bankruptcy trustee may seek to invalidate both voluntary acts as well as obligatory legal acts by the debtor. A legal act is regarded as voluntary if there is no statutory or contractual obligation for the debtor to perform such legal act. A legal act is obligatory if the debtor has a statutory or contractual obligation to perform such legal action.

The bankruptcy trustee may annul a voluntary legal act by the debtor if: (i) creditors of the debtor have been prejudiced as a consequence of this voluntary legal act; and (ii) the debtor and its counterparty had knowledge of the prejudice. These two requirements are further developed in case law of the Dutch Supreme Court.

With respect to distressed investments, it is relevant that the Dutch Supreme Court has provided some additional protection for legal acts performed in a restructuring scenario. The Dutch Supreme Court ruled that a legal act entered into during a restructuring cannot be annulled by invoking the *actio pauliana* in a subsequent bankruptcy procedure, if it cannot be proved that both the debtor and its counterparty could have foreseen at the time of entering into the transaction that their intended rescue plan could not be successful at the time of the transaction.[4]

Furthermore, a legal act cannot be annulled by invoking the *actio pauliana* if creditors of a debtor have not been prejudiced as a result thereof. Whether creditors are prejudiced is determined by comparing the actual situation with a counterfactual scenario in which the relevant legal act would have not taken place.[5] In this respect, the purchase price paid by the distressed investor to the seller is a relevant factor. It is important to assess whether the consideration for the assets sold to a distressed investor reflects their fair market value.

However, this is not decisive as Dutch Supreme Court case law indicates that a transaction may be prejudicial to creditors – and susceptible to annulment on the basis of the *actio pauliana* – even if the consideration reflects the fair market value of the relevant asset (e.g. when such consideration is used to pay certain creditors, while in bankruptcy the same consideration would have been used to pay all creditors on a *pari passu* basis).[6]

Another relevant factor in this respect is the question whether there has been any market testing. These factors may mitigate the risk of annulment of the transaction in a subsequent bankruptcy procedure on the basis of *actio pauliana*.

As stated, a different legal regime applies to legal acts performed on the basis of a legal obligation under Dutch law. The bankruptcy trustee may annul such acts of the debtor if: (i) the counterparty of the debtor knew that a bankruptcy petition against the debtor was already filed at the time of entering into it; or (ii) the legal act is the result of conspiracy between the debtor and its counterparty aimed at preferring the latter over the other creditors of the debtor.

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[4] Dutch Supreme Court 12 November 1999 (*Muurmans q.q./Lückers*).
[5] Dutch Supreme Court 19 October 2001, ECLI:NL:HR:2001:ZC3654 (*Diepstraten/Gilhuis*).
[6] Dutch Supreme Court 22 May 1992, ECLI:NL:HR:1992:ZC0615 (*Montana*).

Based on Dutch Supreme Court case law, these requirements are interpreted restrictively. For that reason, the threshold for a bankruptcy trustee to successfully invoke this ground for annulment is high.

The bankruptcy trustee may invoke the *actio pauliana* by making an extra-judicial statement. Whenever there is disagreement between the bankruptcy trustee and a party affected by the annulment, the bankruptcy trustee usually brings the matter to court. The bankruptcy trustee may seek to obtain a declaration of law from the court that the *actio pauliana* was validly invoked.

Annulment based on the *actio pauliana* has retroactive effect. Hence, once annulled, the specific act is deemed to have not occurred at all. In bankruptcy, this usually means the purchaser loses ownership over the asset purchased and in return it will obtain an ordinary unsecured claim against the bankruptcy estate.

However, in bankruptcy the relevant act is only annulled for the benefit of the bankruptcy trustee and, hence, may only be relied upon by the bankruptcy trustee. The *actio pauliana* aims to reconstruct and return to the bankruptcy estate all assets that have been removed.

1.4.3 What risks exist for a new lender investing in a distressed business?

There is no specific legal regime for lenders investing in a distressed business in the Netherlands. However, as mentioned in paragraph 1.2 above, if the distressed investor is purchasing distressed debt from a bank, it needs to be aware of a duty of care *vis-à-vis* the distressed borrower.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

If an investor buys the equity of a distressed business and that business subsequently enters bankruptcy, the distressed investor risks being held liable as a *de facto* director of the company by the bankruptcy trustee under Dutch law if it has been actively involved with the day-to-day management of the company. According to Dutch legal literature, the investor may only be held liable under Dutch bankruptcy law if it actually and individually determined the policy of the company over and above the statutory directors. This forms quite a stringent criterion that is not easily met.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Under Dutch law, a claim for an amount of money can be secured by a right of mortgage (*hypotheekrecht*) or a right of pledge (*pandrecht*), provided that such asset is not restricted from being made subject to a security right.

In principle, a right of mortgage may be created over registered assets (*registergoederen*) – i.e. vessels, aircraft and real estate, while a right of pledge may be created over all other types of assets. If the pledgor or the mortgagor is in default in respect of the obligations secured by the security right, the pledgee or the mortgagee, as the case may be, is authorised to enforce its security right. The secured parties can then apply the proceeds of the enforcement to satisfy their claims against the provider of the security.

The default method of enforcement for both the right of pledge and the right of mortgage is a public auction. The reasoning is that a public auction will, in theory, lead to the optimal purchase price in consideration for the secured asset.

The public character of the auction should ensure that the party that is willing to pay the highest amount of money for the asset is aware of the sale and enabled to make an offer.

Optimal sales proceeds serve the interests of the secured party, the debtor and the other creditors. The secured party obviously benefits from optimal sales proceeds as it is the primary beneficiary of those proceeds. The debtor benefits from seeing its debt level decrease maximally if optimal sales proceeds are obtained. Assuming that only one security right is vested on the secured asset, the debtor will also have an interest in the actual proceeds of the enforcement sale. In such a case, the debtor is entitled to any surplus proceeds above the amount of the secured claim and the costs of enforcement. Further, other creditors will also be interested in the proceeds of the enforcement sale. These parties will benefit from an optimal purchase price, as that will maximise the debt level decrease of the pledgor in respect of whom they are a creditor. Creditors benefit from a de-leveraged debtor, as this decreases the probability of default and the loss given default of that debtor.

While, in theory, a public auction should lead to a maximum purchase price, this is not always the case in practice. In addition to public auction, the pledgee or the pledgor may petition the court to grant relief for a private sale of the pledged assets. This is an alternative method of enforcement. Further, in respect of a right of mortgage, a private sale with court approval is also possible at the request of the mortgagor, the mortgagee or a party that has levied an executory attachment (*executoriaal beslag*) on the secured property. The court is then required to approve the proposed transaction. The enforcement processes for a right of pledge and a right of mortgage with court approval are comparable.

Further to the modalities described above, a right of pledge may also be enforced by consensual agreement between the pledgor and the pledgee with the sale of the pledged asset to a third party. This method of enforcement requires cooperation and agreement between the pledgee and the pledgor, which might not always be realistic given the circumstances in an enforcement scenario. As this method qualifies as enforcement, the arrangement between the pledgor and the pledgee may only be executed after the pledgee has become authorised to enforce the right of pledge.

A consensual sale of the asset secured by a right of mortgage is also possible if all interested parties agree to this method of sale. Consequently, sales proceeds may be optimised. In general, the secured asset will be sold by the mortgagor and the mortgagee will be the primary beneficiary to the proceeds in consideration for giving up its right of mortgage upon the sale of the secured asset. The mortgagee should obtain a right of pledge on the sales proceeds or have the proceeds directly transferred to its account to ensure adequate protection of the sales proceeds in its favour.[7] In practice, this method of sale often raises questions of potential risks of personal liability of directors as well as risks of annulment of the transaction on the basis of *actio pauliana*.

Under Dutch law, unsecured obligations may be enforced by levying attachments on the debtor's assets. The enforcement is generally conducted by obtaining relief from the interim relief court to levy a conservatory attachment (*conservatoir beslag*) on the debtor's assets, followed by a judicial procedure to obtain an executory title (*executoriale titel*) to transform the conservatory attachment into an executory attachment.

After this has been successfully conducted, the sale of the assets subject to the attachment can be sold for the benefit of the party levying the attachment and any other party that is entitled to the proceeds. The party levying the attachment should be mindful of security rights resting on the attached assets, as the (seniority) rights of the holder of the security right should be respected and that party is authorised to take over the enforcement process.

2.2 What involvement does the court have in these processes?

If the security right is executed by way of a public auction, no judicial involvement is required in the enforcement process. Absent judicial supervision, the public auction is held under the supervision of a bailiff or a notary to safeguard due process.

As noted in paragraph 0, the court might be involved in the enforcement process if the security right is enforced by way of a private sale. In a private enforcement sale of both the right of pledge and the right of mortgage by the judicial route, the court will have to provide its approval for the proposed transaction. The court will primarily assess whether the proposed sale of the secured

7 Dutch Supreme Court 19 November 2004, ECLI:NL:HR:2004:AR3137 (*ING/Gunning*).

asset leads to optimal sales proceeds. It will conduct such an assessment to protect the interests of the non-petitioning party, the holders of a lower ranked security rights over the enforced assets and other creditors of the pledgor.

The court will not have any involvement if the secured asset is sold pursuant to an agreement between the debtor and the secured party (and any other interested party, as the case may be).

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

Under Dutch law, a right of pledge may be created over the shares in a company. As stated in paragraph 0, the default position by law is that the enforcement of such a pledge occurs by public auction. However, enforcement of a pledge on shares through a public action is rarely applied in practice for various reasons.

First, a public auction limits the possibility for due diligence. Second, in principle, the transfer restrictions in the articles of association of a company remain applicable in the case of a share pledge enforcement and this creates additional complexities in an enforcement sale. Third, while a public sale leads to optimal sales proceeds in theory, in practice this is not necessarily the case *inter alia* due to the aforementioned reasons. Fourth, a public auction leads to loss of control over the process for the stakeholders who might be closely involved with the sale of the asset. Fifth, a share pledge enforcement through a public auction often leads to practical challenges given the lack of a market for public sales of shares in Dutch companies. Share pledge enforcements have, therefore, increasingly been effectuated through private sales with court approval over the last decade, often to implement a financial restructuring in the Netherlands.

A share pledge may be enforced by way of a private sale. This method of enforcement can be effectuated through the court, or by agreement among the pledgee and the pledgor. Whether the second option is realistic will largely depend on the level of cooperation between the pledgor and the pledgee.

If the share pledge enforcement is effectuated through the court, the pledgee[8] is required to petition the court to approve the proposed transaction. The court will then schedule a hearing, during which interested parties are provided the opportunity to express their views and concerns in respect of the transaction. The court will primarily assess whether the proposed transaction leads to optimal sales proceeds.

When dealing with share pledge enforcements, case law shows that the court will interpret the term “optimal proceeds” broadly, as it will also consider non-cash elements.[9] These non-cash elements may consist of a variety of items, including the willingness of existing lenders to continue the financing or, in the event of a debt-for-equity swap, any debt reduction.

The court will also consider competing bids for the shares, if any. In considering these bids, the court will assess whether the bids are actually realistic and can lead to a final deal, and whether such bids imply higher sales proceeds than the proposed transaction (again interpreted broadly, by taking into account any non-cash elements).[10]

If consent between the pledgor and the company is reached regarding the share pledge enforcement by way of agreement, this method of sale might pose considerable advantages compared to the share pledge enforcement through the court. The consensual route mitigates execution risks, avoids judicial costs and can be implemented in a shorter timeframe as there is no dependency on the court. Furthermore, transfer restrictions in the articles of association that govern the company whose shares are being sold might be disapplied by having the articles of association amended prior to the transfer. As stated in paragraph 2.1, this method of enforcement may not always be possible due to the required consent between the pledgor and the pledgee.

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[8] Both the pledgee and the pledgor can file a petition for enforcement of a share pledge with court approval. However, given the topic and scope of this book, the share pledge enforcement is approached from the perspective of the pledgee.

[9] District Court of Amsterdam 13 May 2020, ECLI:NL:RBAMS:2020:2681 (*Royal IHC*).

[10] District Court of Amsterdam 23 September 2009, ECLI:NL:RBAMS:2009:BJ8848 (*Schoeller Arca*).

The disadvantages of an enforcement sale through consent rather than through the court are equally considerable and consist of clawback risks based on *actio pauliana* as well as directors' liabilities risks.

Other interested parties may afterwards start litigation procedures to challenge the consensual enforcement sale and a bankruptcy trustee may start *actio pauliana* litigation in a subsequent bankruptcy of the pledgor. These risks jeopardise the deal for a considerable time after the deal is executed. Given that enforcement of a share pledge through the court is conducted on the basis of court approval, these risks are largely mitigated when taking the route of court approval.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

It is established case law that the non-cash consideration for the shares sold pursuant to a share pledge enforcement can consist of a debt write-off and / or a conversion of that debt into equity. This way a debt-for-equity swap can be effectuated by a credit bid and cash consideration of EUR 1.

2.3.2 Is a public auction mandatorily required or are private sales possible?

As set out in the previous paragraphs of this part 2, a public auction is the default method of enforcement sales under Dutch law but is rarely used in respect of share pledge enforcements. A private sale of shares is possible under Dutch law and is the preferred option when enforcing a right of pledge over shares.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Under Dutch law, the shares in a company may in principle be made subject to a right of pledge. However, the articles of association of a company may prohibit the creation of rights of pledge over the shares of the company and / or may contain transfer restrictions.

It is established case law that these transfer restrictions, in principle, also apply in respect of a transfer of the shares pursuant to an enforcement sale.[11] The transfer restrictions may be set aside by the court but courts will not grant the request to set aside transfer restrictions easily.

2.3.4 Is "market testing" mandatorily required?

Market testing is not necessarily required under Dutch law when enforcing a right of pledge. However, market testing can be supportive of the transaction and increase the chances of a successful enforcement process.

If the enforcement of the right of pledge over the shares is enforced with court approval, the court will assess whether the proposed transaction will yield the optimal sales proceeds. A market testing report or analysis will assist the court in this assessment and will render it more difficult for opposing parties to argue that the proposed transaction does not yield the optimal proceeds, provided the market testing report contains positive results for the pledgee.

Based on established case law, the court will also take a market testing approach to review the merits of the proposed transaction.[12] Furthermore, a positive market testing report will reduce clawback risks based on *actio pauliana* by a bankruptcy trustee. In such instances, it will be difficult to prove that the joint creditors of the debtor are prejudiced by the sale of the shares, given that the consideration of the sold assets was optimal.

2.3.5 Are valuation reports mandatorily required?

In the event of enforcement of a right of pledge over shares through a private sale with court approval, a valuation report is mandatorily required to be submitted to the court under the court's

[11] Dutch Supreme Court 22 June 2018, ECLI:NL:HR:2018:972 (*Rabobank/Bethanie*).
[12] District Court of Amsterdam 20 July 2019, ECLI:NL:RBAMS:2019:6505 (*Lebara*).

procedural regulations.

A valuation report is not strictly required in a consensual enforcement scenario but given the litigation and clawback risks mentioned in this part 2, parties may prefer a valuation report in such instance.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

Under Dutch law, two formalised pre-insolvency processes are available to distressed debt and M&A investors. These are the suspension of payments (*surseance van betaling*) and restructuring plan proceedings under the WHOA. While both of these procedures are aimed at preventing the bankruptcy of the debtor and facilitating an out-of-bankruptcy solution for its debts, there are some considerable differences. For instance, the WHOA is considered less formal than the suspension of payments. In this part 3, we will elaborate on these two proceedings in more detail.

The suspension of payments is aimed at providing the debtor some breathing room to restructure its debt when it finds itself in the vicinity of insolvency. When the petition for the suspension is granted, the debtor is provided temporary relief from its obligations *vis-à-vis* its creditors. Any attachments laid on its assets by affected creditors are lifted and any bankruptcy petitions will be suspended.

The main objective of the debtor during the suspension of payment procedure is to restructure its debt through a restructuring plan. During this period, the debtor will be assisted in the process by a court-appointed administrator (*bewindvoerder*). The restructuring plan may be confirmed by the court, provided the requisite majority of creditors have voted in favour of the plan and no rejection grounds are successfully invoked. The requisite majority consists of: (i) a simple majority of the admitted creditors who appeared at the creditors' meeting; and (ii) who together represent at least half of the admitted or provisionally accepted claims by value of the total claims of the debtor. Once the plan is confirmed by the court, it is binding on all affected creditors.

The suspension of payments has not proven to be a successful restructuring tool in practice and is often followed by a bankruptcy proceeding. This is due to several reasons.

First, by suspending obligations of the debtor, the procedure is mainly focused on liquidity issues but is not always effective to solve the underlying problems, such as unsustainable solvability ratios. Second, the suspension of payments is not applicable to secured or preferred creditors who, in most restructuring cases, play a vital role in the restructuring process. Third, the suspension of payments procedure is a public procedure that potentially leads to reputational damage and operational issues as a result of, for instance, the impact on suppliers and enforcement action by secured creditors. However, the suspension of payments has been used successfully in bond debt restructurings, mainly because the relevant restructurings related to unsecured bond debt.

The WHOA forms the implementation of the EU Restructuring Directive[13] in the Netherlands and is inspired by the United States Chapter 11procedure and the United Kingdom scheme of arrangement. It is a relatively new procedure, but after its enactment on 1 January 2021 it has gained much traction among a wide range of distressed corporates.

The WHOA deals with the issues encountered in a suspension of payments by affecting secured and preferred creditors, introducing a private procedure alongside a public one and being flexible and effective enough to deal with a wide variety of issues during the restructuring process. Recently, the WHOA has also been utilised by multinational companies to restructure their debts, often with parallel proceedings in the United States through Chapter 11 or in the United Kingdom with a scheme of arrangement or restructuring plan.

[13] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

The WHOA is a debtor-in-possession (DIP) proceeding. A debtor is allowed to commence a restructuring procedure under the WHOA if it is likely that it will not be able to continue to pay its debts in the foreseeable future (i.e. generally the court looks 1 year ahead).

The debtor stays in control of its business and will, in principle, take the lead in preparing and offering the restructuring plan. However, this will not always be the case under the WHOA. Creditors, shareholders and the works council or employee representative body have the right to petition the court for the appointment of a restructuring expert.

If appointed by the court, the restructuring expert will take on the responsibility of preparing and offering the restructuring plan (while the debtor remains in control of the business itself). The court may, at the request of the debtor or the restructuring expert, declare a moratorium to preserve the debtor's business during the preparation of the restructuring plan.

The WHOA is not applicable to the rights of employees. Distressed equity investors should be mindful of this exception, given that the workforce of a company cannot be restructured under the WHOA.

Under the WHOA, a debtor – or the restructuring expert as the case may be – can present a restructuring plan to its creditors, who will be entitled to vote on the plan. The restructuring plan is not required to include all classes of creditors or shareholders of the debtor.

Under the plan, the rights of creditors and shareholders that are a party to the restructuring plan may be amended. A WHOA procedure may be utilised to effectuate, for example, a debt write-off, an extension of the maturity date of the loans or a debt-for-equity swap.

Voting on the WHOA plan takes place per classes of creditors and / or shareholders. Before the voting procedure commences, creditors will be divided into separate classes. Creditors may be placed in the same class if their claims against the debtor are sufficiently comparable. The comparability of claims is determined by the position of the relevant creditors in a hypothetical bankruptcy of the debtor or on the basis of what is offered to them under the restructuring plan.

A class is considered to have voted in favour of the restructuring plan, if holders of two-thirds of the value of the claims of the creditors and / or shareholders that have cast a vote in that class have voted in favour of the restructuring plan.

To render the restructuring plan eligible for judicial confirmation, at least one class of "in-the-money" creditors must have adopted the plan. A class is deemed to be "in-the-money" if the creditors in that class are expected to receive a payment on their respective claim in a hypothetical bankruptcy of the company. If the restructuring plan is adopted (by at least one "in-the-money" class of creditors), the court will assess whether the restructuring plan can be confirmed. The court will assess the general rejection grounds in relation to due process *ex officio* and additional rejection such as the "best interest of creditors test" and the "absolute priority rule" if dissenting creditors or shareholders have invoked those grounds.

3.2 What involvement does the court have in these processes?

During the suspension of payments procedure, the court is involved throughout the process and a supervisory judge (*rechter-commissaris*) is appointed to supervise the entire proceeding.

A suspension of payments procedure formally commences when the competent court grants the suspension of payments provisionally. Initially, the suspension of payments is granted provisionally and, once creditors have cast a vote, the suspension of payments will be granted definitely.

After the commencement of the procedure, the court remains involved. This court involvement is illustrated by the court deciding on whether a moratorium is granted or whether the procedure is terminated. If the court decides to terminate the procedure, it may convert the suspension of payments into a bankruptcy proceeding at the same hearing. The court is also authorised to confirm the restructuring plan, once the required majority of creditors has voted in favour of the plan.

It will refuse the confirmation of the restructuring plan if:

(i) the liquidation value of the debtor's assets exceeds the value realised by the plan;

(ii) the performance of the debtor's obligations under the plan is not sufficiently guaranteed;

(iii) the plan is fraudulent; or

(iv) the fees of the administrator and the other experts (if any) are not paid or the payment of those fees is not adequately secured.

Upon provisionally granting the suspension of payments procedure, the court will appoint an administrator as well as a supervisory judge. The administrator will work alongside the debtor throughout the restructuring and his or consent, cooperation and assistance is formally required for particular acts and steps that the debtor would like to take (such as entering into certain transactions). The supervisory judge is formally tasked with advising as well as supervising the administrator.

The WHOA is generally more informal and debtor-led compared to the suspension of payments. The level of court involvement is kept to a minimum under the WHOA. However, this does not mean the court is necessarily less involved. The court may be requested to declare a moratorium during the WHOA procedure. Furthermore, the court may appoint an observer or a restructuring expert. The court may be requested to answer preliminary questions of the debtor or the restructuring expert and provide interim judgments on issues that are relevant for the confirmation of the restructuring plan. In addition, the court may be requested to provide interim measures on a wide variety of matters to safeguard the interests of the creditors or the shareholders during the preparation of the restructuring plan. Finally, the court is required to confirm the restructuring plan before it becomes legally binding on all affected parties.

As stated in paragraph 0 above, the court will assess whether the plan contains all the elements prescribed by law, meets the requirements regarding procedural fairness and, at the request of certain creditors or shareholders, will review whether the "best-interest-of-creditors test" is met and whether the "absolute priority rule" is respected.

Whilst the involvement of the court is mandatorily required for the confirmation of the restructuring plan, the other forms of court involvement in a WHOA procedure are optional and available at the request and discretion of the interested parties. The actual level of court involvement will ultimately depend on the amount of consent among the parties, the level of opposition and the complexity of the restructuring.

The WHOA is considered to be a relatively complex procedure, where not only legal questions, but also financial questions are relevant. Dutch courts have adapted hereto by establishing a pool of specialised WHOA judges, who are well equipped to deal with all aspects relevant to a restructuring, including financial aspects as well as other specific restructuring-related matters.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

As the suspension of payments procedure is characterised as a semi-DIP proceeding, the debtor plays a crucial role during the procedure. Most importantly, the debtor is exclusively authorised to present a restructuring plan to its creditors. These creditors play an equally important role, given they have the discretion whether to accept that restructuring plan.

As stated in paragraph 0, secured or preferred creditors are not formally affected by the suspension of payments procedure. They generally play an important role nonetheless, since they retain their enforcement rights and are thus able to derail any restructuring process. Furthermore, given that the suspension of payments does not affect their rights, secured or preferred creditors cannot be crammed down through the suspension of payments. This means that, in practice, secured or preferred creditors are required to unanimously support the restructuring plan from the outset to prevent enforcement and ensure their cooperation with the sanctioned plan.

Further, there are two court-appointed parties in a suspension of payments procedure: the administrator and the supervisory judge. The administrator is appointed by the competent court. He or she is tasked with safeguarding the interests of the joint creditors of the debtor and assisting the debtor with the restructuring process. During the suspension of payments procedure, the debtor is not authorised to dispose of its assets without the approval of the administrator. In complex suspension of payments procedures, the court can decide to appoint two administrators. The role of the supervisory judge is to advise as well as supervise the administrator.

The WHOA procedure has partially the same players and has introduced partially other players to the restructuring proceeding. The WHOA is a DIP proceeding, so the debtor is at the centre of the proceeding. During a WHOA procedure, creditors affected by the restructuring plan play an important role as they are entitled to vote in favour or against the plan. The same applies to shareholders affected by the plan. They are also entitled to vote on the plan.

Furthermore, creditors and shareholders affected by the plan may oppose *among others* at court hearings in relation to interim judgments, relief measures, the moratorium and the confirmation of the restructuring plan. However, the aforementioned only applies to creditors and shareholders that are affected by the restructuring plan, given that creditors and shareholders that are not affected by the restructuring plan will enjoy full performance of the obligations the debtor has towards them and formally do not have a role in the WHOA proceeding itself. Nonetheless, they will play an important role in the restructuring itself (e.g. critical suppliers that are not affected by the plan, but whose contracts are key for the going concern of the business).

As a starting point, the debtor is in the lead in a WHOA proceeding, whereby the debtor is exclusively authorised to present the restructuring plan to creditors and shareholders for a vote and, once adopted (at least by one "in-the-money" class of creditors), the debtor will petition the court for sanctioning. As stated in paragraph 0, this changes if a restructuring expert is appointed by the court. In that case, the restructuring expert takes over the restructuring process and is exclusively authorised to present the restructuring plan for a vote and petition the court to confirm the plan. The responsibility of the restructuring expert is limited to the restructuring plan and even after the expert's appointment, the debtor remains in control of the ordinary course of the business as well as the daily operations of the company. To ensure the going concern of the enterprise, the debtor retains its right to dispose of its assets without the approval of the restructuring expert or the court.

Under the WHOA, two different insolvency practitioners may be appointed by the court: the observer and the restructuring expert. These practitioners cannot be in function at the same time.

If an observer is appointed first, he or she will be superseded by the restructuring expert if appointed and if a restructuring expert is appointed an observer cannot be appointed. The observer may be appointed at the request of the debtor or *ex officio* by the court.

If the court grants a moratorium, the parties affected by the moratorium will also become authorised to petition the court for the appointment an observer. The observer acts in the interests of the joint creditors and supervises the preparation of the restructuring plan. He or she has no formal rights and obligations to interfere with the contents of the restructuring plan. The observer will be heard on all important matters presented to the court (e.g. interim judgments, requests for the appointment of a restructuring expert and the confirmation of the restructuring plan).

If the interests of the joint creditors are adversely affected or if it appears that the restructuring procedure will not be successful, the observer is obliged to inform the court. The court may then take the measures it deems fit.

We discuss the role of the restructuring expert briefly above. The restructuring expert has a more active role in the WHOA process compared to the observer. The restructuring expert may be appointed at the request of the debtor. However, any creditor, shareholder, works council or employee representative body may also petition the court to appoint a restructuring expert.

After its appointment, the restructuring expert is responsible for the restructuring plan and is exclusively authorised to present the restructuring plan to creditors and shareholders as well as to petition the court to sanction the plan. As with the observer, the restructuring expert acts in the interests of the joint creditors.

The introduction of the restructuring expert in a restructuring procedure also safeguards the impartiality of the process. In practice, this may also give the party petitioning for the appointment of the restructuring expert some level of control over the restructuring process.

The petitioning party is required to nominate two or three candidates for the role of the restructuring expert, so that party can present the expert of his or her choice. If introduced at a relatively late stage in the restructuring process, the restructuring expert may (initially) delay the process as he or she needs to get "up-to-speed". For this reason, the Dutch legislator has acknowledged that a petition for the appointment of a restructuring expert may be filed by opposing parties to derail the restructuring process or to create nuisance value.[14] In such instances, the court will not grant the petition for the appointment of a restructuring expert.

3.4 Is there a typical due diligence process followed?

The due diligence carried out by a distressed debt and / or equity investor in Dutch pre-insolvency procedures does not materially differ in a suspension of payments or WHOA proceeding compared to consensual restructurings outside of a formal restructuring process. However, distressed debt and / or equity investors should be aware of the WHOA procedure, as it may give them an additional tool for their post-investment restructuring.

3.5 What is the typical timeline of a M&A sale under a pre-insolvency process and how does the process work?

We are not aware of any instance where the suspension of payments procedure was used to implement an M&A process. However, the WHOA has proven to be a valuable restructuring tool for implementing a distressed M&A transaction as it allows for distressed M&A transactions, cram down of shareholders, debt-for-equity swaps and clawback protection for the M&A transaction in a subsequent bankruptcy procedure.

Assuming the relevant M&A transaction is part of the overall restructuring proceeding under the WHOA, the timeline for a distressed M&A sale under the WHOA may vary from 2 months up to 8 months (the latter being the maximum duration of the moratorium).

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

In principle, the suspension of payments does not provide any form of protection for M&A sales or asset sales. However, if a sale is effectuated pursuant to a restructuring plan sanctioned by a court under the suspension of payments, this may provide the relevant parties with some comfort, but formally they do not have any form of protection.

Under the WHOA, the debtor may seek protection for M&A sales or asset sales. A debtor may request the court to protect certain legal acts entered into by the debtor as part of the restructuring. In such case, the legal act will have protection against annulment based on *actio pauliana* in a subsequent bankruptcy procedure.

[14] Explanatory Memorandum (*Memorie van Toelichting*), see *Kamerstukken II* 2018-2019, No. 35 249, Nr. 3 (*MvT*), p. 8.

The court will grant such a petition if that legal act is necessary to continue the debtor's business during the preparation of the restructuring plan or is otherwise necessary in respect of the plan and if the protection is in the interest of the debtor's joint creditors and no individual creditor's interests are materially affected by granting the protection.

The debtor may include a specific transaction in the restructuring plan and request the court to review that specific transaction. If the court subsequentially confirms the plan, that transaction is protected from annulment based on *actio pauliana* and the parties to that transaction are protected from any tort claims in a subsequent bankruptcy procedure. When reviewing the transaction, the court will assess whether that transaction is necessary for the implementation of the restructuring plan and does not materially affect the interest of the debtor's joint creditors. If the debtor enters into a new financing arrangement in respect of the restructuring plan, it is obliged to ask the court to review that financing transaction.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Pre-packaged restructuring plans are permitted under a suspension of payments as well as under a WHOA. While they are not that common under the suspension of payments, such pre-pack processes are used in larger WHOA proceedings. The debtor will enter into a lock-up agreement or restructuring support agreement with creditors and shareholders that are supporting the restructuring and after certain required majorities of creditors and shareholders have entered into such lock-up agreement or restructuring support agreement, the debtor will file for a WHOA proceeding. The expectation is that, subsequently, the WHOA proceeding may be completed soon. Part 4 contains a further elaboration on "pre-pack" sales (which are distinct from the "pre-pack" processes or pre-packaged restructuring plans discussed here in this part 3).

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

A pre-pack sales procedure is not expressly permitted (nor is it expressly prohibited) under Dutch law. In the aftermath of the global financial crisis in 2008, pre-pack procedures were successfully used and became part of the Dutch restructuring landscape, despite lacking an explicit statutory basis. This lack of statutory basis led to a judicial divide in respect of pre-pack procedures. The majority of the district courts in the Netherlands facilitated pre-pack procedures in practice, while others district courts refused to follow this approach.

The pre-pack procedure in the Netherlands consists of the following steps. A debtor in financial distress that has found a purchaser for the viable parts of its business will request the court to disclose the names of the individuals that will be appointed as bankruptcy trustee and as supervisory judge in its subsequent bankruptcy procedure.

The prospective bankruptcy trustee will – under supervision of the prospective supervisory judge – monitor the preparation of the sale of the viable parts of the business of the debtor through an asset deal. Once all elements of the deal are agreed upon, the debtor will file for bankruptcy.

Upon the declaration of bankruptcy, the prospective bankruptcy trustee and the prospective supervisory judge are appointed as bankruptcy trustee and supervisory judge respectively. Shortly after the opening of the bankruptcy proceeding and the appointment of the bankruptcy trustee and the supervisory judge, the deal is executed by the bankruptcy trustee with approval of the supervisory judge.

To address the lack of a statutory basis for the pre-pack, the Dutch legislator aimed to codify the pre-pack in the Dutch Bankruptcy Act. However, this process has been delayed significantly, given that the Dutch legislator wanted to await the outcome of litigation regarding matters relating to the European Directive on Transfer of Undertakings and Protection of Employees (the TUPE

Directive), in particular on the treatment of employment contracts.[15] The TUPE Directive prescribes that in case of a transfer of an undertaking employees of a business are transferred to the purchaser of such business by operation of law without changes to the terms of their employment contracts. However, this rule does not apply if the transferor is:

(i) subject to bankruptcy proceedings or any analogous insolvency proceedings;

(ii) which have been instituted with a view to liquidate the transferor's assets; and

(iii) are under the supervision of a competent public authority.[16]

Initially, the Dutch restructuring market assumed that this bankruptcy exception applied to pre-pack procedures in the Netherlands, given that as part of a pre-pack procedure the seller formally enters a bankruptcy procedure.

Contrary to the abovementioned assumption in the market, the European Court of Justice (ECJ) ruled that the bankruptcy exception in the TUPE Directive regarding the rights of employees did not apply in the Dutch pre-pack case of *Estro*.[17] This ruling led to uncertainty in the Dutch restructuring market and, as a result, there was a decline of pre-pack procedures in the Netherlands.

However, a more recent procedure before the Dutch Supreme Court provided other insights into the view of the ECJ on the Dutch pre-pack. In the restructuring of *Heiploeg*, the Dutch Supreme Court indicated that it believed that under certain circumstances, the bankruptcy exception in the TUPE Directive may apply to pre-packs in the Netherlands. The Dutch Supreme Court accordingly asked the ECJ new preliminary questions to shed (once again) its light on the Dutch pre-pack.[18] In its response, the ECJ generally concurred with the Dutch Supreme Court. It stated that it is to be determined on a case-by-case basis whether the pre-pack procedure is aimed at the liquidation of the business of the debtor instead of at reorganisation.

Further, the ECJ confirmed that the prospective bankruptcy trustee and the prospective supervisory judge were supervised by a competent authority. This meant that, under certain circumstances, the bankruptcy exception under the TUPE Directive may apply to Dutch pre-packs according to the ECJ. In addition, the ECJ pointed out that the lack of a legal framework regarding the Dutch pre-pack procedure is the main source of legal uncertainty. The ECJ, furthermore, explained that a pre-pack procedure should be governed by statutory or regulatory provisions.

It is now up to the Dutch legislator to codify the pre-pack procedure into Dutch law.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The key players in a Dutch pre-pack are the debtor as the seller of the business and the buyer of the business. They need to agree on the commercial and legal terms of the distressed M&A transaction. The debtor then requests the court for the name of the prospective bankruptcy trustee and prospective supervisory judge and, subsequently, files for bankruptcy. Hence, the bankruptcy trustee is another important player in this process as he or she needs to enter into the transaction with the buyer. Further, the supervisory judge is an important party in the process. Creditors are also important players in any restructuring, although their role could be less proactive in a pre-pack process.

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[15] Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

[16] Article 5(1) of the Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

[17] European Court of Justice 22 June 2017, C-126/16, ECLI:EU:C:2017:489 (*Estro*).

[18] Dutch Supreme Court 17 April 2020, ECLI:NL:HR:2020:753 (*Heiploeg*).

The prospective bankruptcy trustee and the prospective supervisory judge are not strictly speaking "appointed" by the court. The court will merely disclose who they would appoint in the bankruptcy of a distressed debtor. The prospective bankruptcy trustee would then consider the chances of a pre-packaged restructuring deal with the debtor or a third party buyer. The eventual sale will be executed in bankruptcy, while the whole process is conducted under the supervision of the (prospective) supervisory judge.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

As described in paragraph 4.2 above, the prospective bankruptcy trustee and the prospective supervisory judge are not, strictly speaking, appointed at the start of the pre-pack procedure, but their names are rather disclosed to the party petitioning for this. Only once the court has declared the debtor bankrupt will the court then appoint a bankruptcy trustee and a supervisory judge.

In selecting a (prospective) bankruptcy trustee and a (prospective) supervisory judge, the court will look at its relevant pool of officials and select a suitable candidate, who has confirmed being able to take on the role. The interested parties to the restructuring have no formal influence over who the court will select as (prospective) bankruptcy trustee and as (prospective) supervisory judge.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Dutch law provides special protection to employees of the debtor. In principle and as a matter of European law, the employment relationship between the debtor and the employee transfers to the purchaser in a pre-pack procedure by operation of law.

However, the bankruptcy exception under the TUPE Directive as described in paragraph 0 may apply in specific cases during an insolvency procedure, which disables the protection of employment contracts. The ECJ has confirmed that this bankruptcy exception may apply to Dutch pre-pack procedures. Whether the exception actually applies needs to be assessed on a case-by-case basis by testing whether the proposed pre-pack deal is aimed at the liquidation of the assets of the debtor rather than at reorganisation.

4.5 Is there a typical due diligence process followed?

The due diligence carried out by a distressed equity or distressed debt investor in a Dutch pre-pack procedure does not materially differ compared to those of distressed companies outside of a pre-pack procedure. Given the distressed state of the target (group), investors should be mindful that warranties and indemnities will generally not be provided by a selling bankruptcy trustee. Hence, adequate due diligence is very important.

4.6 Is "market testing" mandatorily required?

Market testing is not formally required in respect of a pre-pack sale under Dutch law. Best practice rules, however, prescribe that the prospective bankruptcy trustee reviews whether market testing has taken place. For practical reasons, a pre-pack sale will be structured as a private sale in bankruptcy with the bankruptcy trustee being the seller. For such a sale, the bankruptcy trustee requires the approval of the supervisory judge. The supervisory judge will have to assess whether the sale leads to optimal sales proceeds. In doing so, the supervisory judge will consider market testing reports or efforts, if available.

4.7 Are valuation reports mandatorily required?

Paragraph 4.6 above applies *mutatis mutandis* to valuation reports. Specifically, valuation reports are not formally required in respect of a pre-pack sale, but the approval of the supervisory judge is required for the pre-pack sale and a valuation report will be helpful in convincing the supervisory judge that the proposed sale leads to optimal sales proceeds.

4.8 What is the typical timeline of "pre-pack" sales?

The negotiations on the restructuring and the pre-pack sale are not bound by any timeline. The parties involved will take the time needed, but in our experience there is much time pressure on the process and depending on how much time parties have this may take place in a couple weeks to a couple of months.

However, once the commercial discussions have taken place and it is clear that a consensual sale is not achievable, the execution phase of a Dutch pre-pack procedure commences. This phase will generally be completed in a couple of days up to 2 weeks.

A prospective bankruptcy trustee and a prospective supervisory judge will generally be "appointed" approximately up to 2 weeks prior to the actual bankruptcy. Once the prospective bankruptcy trustee is actually appointed by the court, time is of the essence to avoid the pre-pack procedure becoming publicly known. After the court has declared the debtor bankrupt, the supervisory judge generally grants its permission for the proposed pre-pack deal in a short timeframe to ensure the deal can be swiftly executed.

UGANDA

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

Uganda does not have any specific legal requirements or regulations applicable to purchasing distressed equity.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Uganda does not have a special legal regime for purchasing distressed debt or non-performing loans. However, below are the general applicable laws:

- the Financial Consumer Protection Guidelines 2011, which were issued by the Bank of Uganda to promote fair and equitable financial services practices by setting minimum standards for financial services providers in dealing with consumers. This is with a view to enhance transparency, in order to inform and empower consumers of the financial services sector and to provide efficient and effective mechanisms for handling consumer complaints relating to the provision of financial products and services;
- the Contracts Act Cap 284, which serves as the foundational statute governing the law of contracts in Uganda;
- the Mortgage Act Cap 239 (Mortgage Act), which provides for the manner of transfer of mortgages in land from one creditor to another;
- the Security Interest in Movable Property Act, Cap 293 (SIMPA), which provides for the transfer of security interests in movable assets; and
- the Stamp Duty Act Cap 339, which provides for stamp duty to be paid on all transactions.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

From the debtor's perspective, this is more relevant for listed and regulated entities. Regulated entities require:

- consent of the regulator – this is applicable to every capital or shareholder related decisions of a regulated entity;
- shareholder approval; and
- for leased properties, landlord consent to mortgage or transfer property.

From the investor's perspective, the following is required:

- compliance with the Investment Code Act Cap 74, especially for foreign investors. Section 19 requires foreign investors to register with the Uganda Investment Authority prior to investing or participating in any investment activity in Uganda. Section 12 provides for incentives for investing in particular sectors;
- tax compliance under the Tax Procedures Code Act Cap 343 and related tax laws; and
- merger control compliance under the Competition Act Cap 66 and the Competition Regulations 2025 for distressed takeovers that qualify as mergers to the extent that they confer control on the acquirer.

1.4 What risks exist for an investor of a distressed business?

In Uganda, the highest risks are:

- fraud and inaccuracies in information provided by the proprietor;
- inaccurate / misleading due diligence results due to limited records and the highly informal businesses;
- underwriting assets of questionable quality, leading to failure of the reorganisation plan;
- lack of creditor cooperation because there is still limited awareness about distressed investments in Uganda;
- an inflexible business culture;
- the unfavourable interpretation of applicable tax laws by the tax authority; and
- delayed rebuild of stakeholder confidence (e.g. employees, regulators, suppliers and creditors).

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

The risks include:

- when the transaction was conducted without full shareholder or creditor approval;
- when the transaction involved a related party or entity;
- when a court order stopping the transaction has been ignored; and
- when the transaction is likely to result in unfair trade practices and anti-competitive effects.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

The most common risks are contained in sections 15 to 18 of the Insolvency Act Cap 108 (Insolvency Act). Notably:

- under section 15, there is a risk that the transaction can be voided for being a preference transaction when the investor (in a situation where the investor was a creditor) is better off than other creditors;
- under Section 16, a transaction is voidable on the application of the creditor, receiver, member or contributory, liquidator or trustee when:

  (i) it was entered into within 1 year preceding the commencement of the liquidation or bankruptcy;

  (ii) the value of the consideration received is significantly less than the value of the consideration provided by the company; and

  (iii) when the transaction was entered into, the company was unable to pay its due debts;
- under section 17, a transaction creating a charge over any property of a company in respect of any debt is voidable on the application of the creditor, receiver, member or contributory liquidator or trustee if the charge was given within 1 year preceding the commencement of the liquidation or bankruptcy on account of the antecedent debt unless:

  (i) the charge secures the actual price or value of property sold or supplied to the company or individual or any other valuable consideration given by the person making the charge prior to the execution of the security and, immediately after the charge was provided, the company was able to pay its due debts; or

(ii) the charge is in substitution for a charge given more than 1year preceding the commencement of the liquidation or bankruptcy.

It must be noted that, unless the contrary is proved, a company giving a charge within the 6 months preceding the commencement of the liquidation or bankruptcy is presumed to have been unable to pay the company or individual's due debts immediately after giving the charge: and

- under section 18, a transaction entered into 12 months preceding the insolvency by a company relating to any asset of the insolvent is voidable on the application of the liquidator, receiver, member or contributory, trustee or creditor if the transaction involves:

  (i) a spouse, siblings or children of any person with a close social proximity to the insolvent;

  (ii) employees, officers, professional or other service providers of the insolvent; or

  (iii) business associates, partners, shareholders, directors or other similar persons.

  Unless the contrary is proved, such a transaction is deemed a preference or a transaction aimed at aiding the insolvent to put the assets of the insolvent's estate beyond the reach of creditors.

1.4.3 What risks exist for a new lender investing in a distressed business?

These risks include:

- incomplete or wrong due diligence due to information asymmetry and other information gaps;
- default risk;
- unfavourable changes in legislation and government policy – for instance taxes and other regulatory policies; and
- death of key individual in the distressed business. This risk arises because many businesses in Uganda are controlled by one individual.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

These risks include:

- incomplete or wrong due diligence due to information asymmetry and other information gaps;
- organisational cultural shock differences;
- delayed investment returns because of the volatile investment and market environment in Uganda; and
- unfavourable changes in the legal and regulatory framework.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Currently, Uganda does not have a specific regulatory framework for distressed debt investors and there is no specific enforcement process for M&A investors.

However, general measures, such as mortgage or chattel foreclosure and judicial execution of judgments, could be resorted to.

2.2 What involvement does the court have in these processes?

Enforcement processes in Uganda, whether concerning a mortgage over land or a charge over movables, typically do not require court involvement. Courts get involved in cases of disputes or where enforcement is likely to be contested, in which case lenders seek court assistance to ease the process.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

The enforcement of a pledge on the shares of a legal entity is governed by the SIMPA.

It is essential for the enforcing party to thoroughly review the security agreement between the secured party (creditor) and the grantor (debtor), which delineates the terms and conditions of the security interest and the rights and obligations of both parties. Additionally, ensuring that the agreement is supported by requisite company resolutions (board and ordinary resolutions), duly executed and registered under the law, is paramount. Registration with the SIMPO Registry at the Uganda Registration Services Bureau is a crucial step in enforcement, granting the creditor a legal interest in the shares, prioritised over subsequent interests.

Upon default, the enforcing party issues a default notice, notifying the company of the breach and allowing an opportunity to remedy it within a specified period, in accordance with the security agreement and the SIMPA. If the company fails to comply, the enforcing party serves a notice of disposition, similar to a notice of sale in mortgage enforcement cases. Both notices must be registered with the SIMPO Registry.

Subsequently, the sale is conducted via public auction, or private sale when there is a court order or defaulter's consent. Upon completion of the sale, the enforcing party must account for the received funds, with any surplus returned to the company / defaulter.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

It is possible to implement a debt-for-equity swap as part of a share pledge enforcement in Uganda. There is no specific legislation regulating these kinds of transactions, save for cases of listed companies whose transactions must be approved by the Capital Markets Authority. Accordingly, general contract law and company law apply to these transactions.

2.3.2 Is a public auction mandatorily required or are private sales possible?

In enforcement action, public auction is the default position under Ugandan law. Under section 28 of the Mortgage Act, where a sale is to proceed by public auction, it is the duty of the mortgagee to ensure the sale is publicly advertised in advance in such a manner and form as to bring it to the attention of persons likely to be interested in bidding for the mortgaged land.

The Mortgage Act goes on to provide that public advertisement may include placing an advert (including a colour picture of the mortgaged property) in a newspaper which has wide circulation in the area concerned, specifying the place and date of the auction, being no earlier than 30 days from the date of the first advert. However, private treaty sales are allowed, subject to a court order or with the prior concurrence of the debtor.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

It is possible to set aside transfer restrictions where the restriction was introduced after the relevant pledge agreement was executed and registered. Ideally, like any security document, it is important for a clause to be included that restricts any transactions that affect the shareholding without the consent of the pledgee. Where a restrictive article is introduced into the constituent documents, it can be set aside if it is demonstrated that it was procured in contravention of the already existing pledge agreement.

2.3.4 Is "market testing" mandatorily required?

Market testing is not mandatorily required in Uganda.

2.3.5 Are valuation reports mandatorily required?

Valuation reports are a requirement under the Mortgage Act. The law requires that every mortgagee must, before realising mortgaged property, have a valuation report for the property which is not older than 6 months.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

Under the Companies Act Cap 106 (Companies Act), companies have the option (although this option is not restricted to pre-insolvency) to enter into compromises or arrangements with their creditors before insolvency proceedings commence. The process requires a company or creditor to seek the intervention of a court to order a meeting of the creditors or shareholders to enter into a compromise or arrangement.

3.2 What involvement does the court have in these processes?

The compromise or arrangement is court-sanctioned. The court grants the company permission to convene a creditors' (or shareholders') meeting to consider the plan or proposal. It also provides guidelines on how the meeting should be conducted, including the creation of required classes of creditors (or shareholders). After the meeting, the court reviews and sanctions the plan or proposal.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The key players in these processes are the debtor, the creditors (or shareholders) and the court.

3.4 Is there a typical due diligence process followed?

Investment in distressed assets is not well tracked in Uganda. However, the typical due diligence process is based on market standards – which involves early engagement with secured creditors who are mostly financial institutions. Investors seek the input of the secured creditors to ensure their cooperation and in some cases a better deal. This may allow investors to secure enhanced terms such as discounted pricing on book values, priority access on restructuring and super majority of their claims (under pre-commencement and post-commencement financing in the Insolvency Act).

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

There are no official records of pre-insolvency M&A sales and it is therefore difficult to ascertain the typical timelines.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

Yes, under the Insolvency Act, M&A and asset sales conducted under pre-insolvency processes in Uganda are generally protected, provided they meet certain criteria.

The key requirement is demonstrating that the transaction was conducted in good faith. This involves showing that all parties acted honestly and reasonably believed the sale was the best possible outcome for the company and its stakeholders.

To defend against actions to set aside the transaction, it is crucial to prove transparency and creditor participation in all meetings and events leading up to the sale. Thorough documentation of the decision-making process and active involvement of relevant stakeholders further strengthen protection against avoidance actions. These sales typically enjoy clawback protection, ensuring they are upheld in subsequent bankruptcy proceedings, as long as they were carried out fairly and transparently.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Uganda does not have formalised legal provisions specifically for pre-packaged insolvency processes (pre-packs). While pre-pack processes are not explicitly outlined, companies may utilise schemes of arrangement under the Companies Act or engage in informal negotiations with creditors and potential buyers to facilitate restructuring before formal insolvency proceedings commence. These arrangements, while not formalised as pre-packs, must adhere to existing insolvency laws and procedures.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Uganda does not have legislation permitting pre-pack sales.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Not applicable.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Uganda does not have a regulatory framework for pre-pack sales. In any event, the control over who is appointed as an insolvency practitioner in administration proceedings is legally reserved for creditors through the creditor meetings. In one case, the court appointed an administrator to replace a former administrator who had been removed.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Not applicable.

4.5 Is there a typical due diligence process followed?

Not applicable.

4.6 Is "market testing" mandatorily required?

Not applicable.

4.7 Are valuation reports mandatorily required?

Not applicable.

4.8 What is the typical timeline of "pre-pack" sales?

Not applicable.

UNITED KINGDOM

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

No specific legal requirements apply in England and Wales (E&W) for the purchase of distressed equity that do not exist for the purchase of non-distressed equity.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Save as set out below, no special legal regime exists in E&W for the purchase of distressed debt that does not apply to the purchase of non-distressed debt.

If the seller of non-performing loans (NPLs) is an EU credit institution, the potential application of the Non-Performing Loans Servicer Directive needs to be borne in mind.

Restrictions on trading on material non-public information and market abuse need to be considered in the context of distressed debt trading. LMA secondary trading documentation is customarily used for individual trades, whereas bespoke documentation is commonly negotiated for NPL portfolio trades.

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

Where the business and assets of a distressed company are sold, the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE Regulations) will apply, with the consequence that the employment of persons engaged in the business will transfer to the buyer of the business. In advance of the transfer, the TUPE Regulations require the outgoing employer to inform and consult with appropriate representatives of the affected employees.

Pension liabilities pose a significant risk to investors because the Pension Protection Fund and the Pensions Regulator can assert substantial claims or impose contribution obligations which need to be factored in by relevant stakeholders.

There are also specific pensions and taxation regimes that may apply in the context of distressed investing.

Data protection and confidentiality rules will need to be adhered to, as will anti-money laundering, sanctions, competition and national security investment rules.

Investors need to consider their own regulatory environment when making distressed investments, including the regulatory capital treatment of their distressed holdings.

1.4 What risks exist for an investor of a distressed business?

Distressed investing carries a range of risks that are more acute than in a non-distressed scenario.

In terms of legal risks, the rights of shareholders and creditors can by affected by laws related to insolvency and reorganisation.

In particular, on insolvency proceedings being commenced:

- contractual and other personal rights will reduce proportionately with all similar rights, and contractual provisions which would conflict with this principle (such as a pro rata sharing clause) are ineffective;
- transactions (including security) entered into in the period before the insolvency proceedings commence (that period generally being no longer than 2 years) may be set aside in certain circumstances, as considered in more detail below; and

- the ability of a creditor to enforce its security or otherwise enforce its rights against a debtor may be subject to limitations, for instance in an administration or moratorium.

Further, the jurisdiction of the courts in relation to insolvency matters is not dependent on the submission of the parties to the jurisdiction. The precise scope of that jurisdiction depends on the facts of the case and the nature of the insolvency procedure in question. Insolvency brings heightened risks for de jure directors, and for those persons who may be considered shadow directors or de facto directors. In enforcing security, the security holder owes certain duties to those with an interest in the equity of redemption (including subordinated creditors and the debtor). Economic torts also need to be considered, particularly inducing a breach of contract.

In terms of commercial risks, the absence of reliable financial and trading information may make it difficult to accurately assess the true financial condition of the distressed business (and therefore the value of the distressed investment). This may be exacerbated where key staff have left the business, such that their knowledge and experience is absent. Financial stress may mean there are actual or threatened breaches of finance arrangements, contractual arrangements and / or any licences or authorisations that are key to the operation of the business.

In a distressed environment, there is an increased risk of litigation and stakeholders seeking to utilise flexibility in documentation to improve their position to the detriment of other stakeholders (so called lender-on-lender violence). Control is more likely to be lost where a debtor is in default and parties can enforce their rights, including by commencement of insolvency proceedings, the outcome of which can be difficult to predict. Costs can quickly spiral out of control in a default situation.

There is also a risk that the reputation of the investor will be adversely affected by actions taken (or not taken) in a distressed scenario. For example, an investor could find themselves on a blacklist that could restrict the investor's ability to purchase distressed debt of certain sponsors in the market.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

A transaction entered into by a company can be set aside if: (a) it occurred in breach of duty by the company's directors; and (b) the counterparty has actual or constructive notice of that fact. Shareholders may bring derivative actions against directors for breach of duty on behalf of the relevant company. This risk is particularly acute in the distressed environment where upstream / cross-stream guarantees and / or security are sought from subsidiary companies for debt incurred by their parent / affiliate.

Further, in the context of guarantees, English law has traditionally been protective of guarantors and has developed several defences for them. Although guarantees generally purport to exclude many of these defences, a guarantee, and any third party security generally, will be construed in favour of the guarantor or grantor of security where possible.

A transaction entered into by a company can also be set aside outside of insolvency proceedings where it was at an undervalue and for the purpose of putting assets beyond the reach of a person who may have a claim against the debtor (or otherwise prejudicing their interests).

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

Insolvency officeholders appointed as administrators or liquidators have powers to review transactions entered into by the company in the period leading up to its insolvency.

Where the company enters into a transaction for consideration worth significantly less than its true value within 2 years of its insolvency, the transaction may be set aside by the court on the application of the officeholder. The company must have been insolvent at the relevant time or have become insolvent as a result of the transaction, and this is presumed in the case of connected persons.

For the purpose of the Insolvency Act 1986, a "connected person" is a director or shadow director of the company, an associate of a director or shadow director or an associate of the company (as defined in section 435). There is an exemption where the transaction was made in good faith for the purpose of carrying on business.

Transactions that put a creditor or a surety or guarantor of any of the company's liabilities in a better position on insolvency than they would otherwise be may be challenged as a preference. The court may set the preference aside on the officeholder's application. The look-back period is 2 years for connected parties and 6 months for unconnected parties. There must also have been a "desire to prefer" the person, but this is presumed where the parties are connected.

A floating charge created by a debtor will be invalid in its liquidation or administration if it was created: (a) in favour of a connected person within 2 years of the relevant proceeding; or (b) in favour of any other person within 1 year before the commencement of the relevant proceeding and if the company was insolvent at the time, except to the extent of the value of certain consideration, including money paid, after the creation of the charge.

Where a winding up petition is outstanding, any disposal of the company's property or shares will be void if a winding up order is subsequently made, unless the court has ordered otherwise (by granting a validation order). A winding up petition search is therefore essential prior to closing any transaction.

1.4.3 What risks exist for a new lender investing in a distressed business?

English law has no concept of liability for a lender to a company in financial difficulties (unless the lender is acting as a shadow or de facto director or is liable for an economic tort). Lenders may also, potentially, be liable if they have engaged in conduct that risked pension scheme benefits under a defined benefit pension scheme.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

Under English law, the liability of a shareholder of a limited liability company is limited to unpaid capital (unless the shareholder is acting as a shadow or de facto director or receives unlawful distributions or other payments or is liable for an economic tort). Liability may also arise under pension and environmental law. Reputational damage is also something that would need to be taken into account.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Where the investor holds a mortgage or fixed charge security, this can be enforced by appointing a receiver over the charged asset or by acting as "mortgagee in possession" of the charged asset.

The holder of a qualifying floating charge (QFC) – i.e. a charge over all or substantially all of the company's assets and undertaking – may enforce their security by appointing an administrator using a simple, out-of-court process.

Where the QFC falls within certain exceptions (e.g. certain public private partnerships, capital market transactions or where the QFC pre-dates 15 September 2023), the QFC holder may alternatively opt to appoint an administrative receiver. Unlike an administrator, who owes their duties to creditors as a whole, an administrative receiver principally owes duties to their appointor.

The enforcement of security will be subject to any moratorium imposed in the administration of the relevant debtor.

Public auctions are not mandatorily required and private sales are possible and common as a part of the enforcement processes. What is important is that the seller achieves the best price reasonably obtainable at the time the assets are sold and acts reasonably and in good faith for the purpose of recovering the secured debt.

Security documents usually allow for voting rights in favour of the security holder, which can provide for the replacement of boards through the obligor structure.

2.2 What involvement does the court have in these processes?

Generally, a security holder will not require court approval to enforce their security once it has become enforceable.

A receiver may be appointed under a fixed charge out-of-court by giving notice of the appointment.

Where a QFC holder chooses to enforce their security by appointing an administrator, they may do so using the out-of-court process (which involves filing prescribed documents at court) or they may apply to court for a judge to order the administrator's appointment.

Where a company is in administration, subject to exceptions where the security constitutes a "security financial collateral arrangement" (which may include security over shares) such that the UK Financial Collateral Regulations apply, security cannot be enforced, nor any legal process commenced or continued, without the administrator's consent or leave of the court. This is also the case where the company has the benefit of a moratorium under Part A1 to the Insolvency Act 1986 (see Part 3 below for further details). A Part A1 moratorium restricts floating charge holders from giving notice to crystallise their floating charge or from otherwise restricting the disposal of assets secured by the charge.

An administrator may dispose of assets subject to floating charge security without the charge holder's consent. However, they must still account to the charge holder for the proceeds in accordance with the statutory waterfall applicable on insolvency.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

Security over shares is typically by way of charge (usually a fixed charge). A share mortgage is also available (but not commonly used). It is not possible to pledge registered shares.

A share charge will usually be enforceable on an event of default. The charge document will usually provide for the security holder to enforce the security by appointing a receiver, becoming the holder of the shares, going into possession of the shares as mortgagee, selling the shares or otherwise receiving the benefit of the shares in any way it may decide. The powers of the receiver are typically set out in the security document and should include a power of sale. It is also possible to apply to the court for the appointment of a receiver, in which case their powers will be determined by the court order.

Alternatively, the security holder may be able to enforce by way of appropriation where the security constitutes a "security financial collateral arrangement" in accordance with the UK Financial Collateral Regulations. This permits the charge holder to acquire the shares without an application to court. The security holder appropriates the shares in discharge of the equivalent value of debt, but it must account to the chargor for any surplus value in excess of the secured obligations.

Where the security holder has the benefit of a legal mortgage, or an equitable mortgage with the contractual agreement to create a legal mortgage over shares, the remedy of foreclosure is available, although is not commonly used. It requires a court application to sell the shares.

It may be that the security holder takes possession of the shares (e.g. by appointment of a receiver) and changes the board of directors of the relevant subsidiary company (and its subsidiary group companies) in advance of more substantive enforcement action such as a sale or to encourage refinance by the sponsor to re-take control.

Certain restrictions on enforcement may apply. For example, where the enforcement triggers a mandatory or voluntary notification under the National Security and Investment Act 2021 (NSIA), the ability to enforce will be subject to the requirements of that Act.

The NSIA applies to certain designated sectors and transactions that may pose a risk to national security. In the case of a mandatory notification, clearance from the Secretary of State will be required. In the case of a voluntary notification, the Secretary of State may exercise a power to call in and review the transaction. The Secretary of State may then impose restrictions on enforcement.

Security over shares would usually be combined with security over intercompany debts owed by the relevant subsidiaries to the parent grantor, which security would usually be enforced at the same time as the share security to transfer the rights in the intercompany debts to the purchaser of the shares. Further, it would also be usual for an intercreditor agreement to include distressed disposal provisions that provide for the release of any claims of subordinated lenders against the subsidiaries of the subject of the enforcement process. This is designed to deliver subsidiaries to the purchaser that are clean of subordinated debts.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

A secured creditor can implement a debt-for-equity swap by enforcing share security and selling the shares (usually together with any intra-group debts) to a new company controlled by the creditor in consideration for a reduction of debt equivalent to the fair market value of the shares (i.e. a credit bid transfer). The consideration for such a sale may be cash or non-cash (e.g. new instruments). No court application is required.

Appropriation in accordance with the UK Financial Collateral Regulations provides an out-of-court mechanism for the security holder to achieve a debt-for-equity swap without transferring the shares to a new company.

As with any debt-for-equity swap, where the lender is a regulated bank, consideration will need to be given to the usual suite of regulatory provisions applicable to banks holding equity on a proprietary basis, including the participating interest regime of the PRA as well as, if applicable, the US Bank Holding Company Act.

2.3.2 Is a public auction mandatorily required or are private sales possible?

As above, private sales are possible and common as a part of the enforcement processes. There is no requirement for a public auction, but the security holder must obtain the best price reasonably obtainable at the relevant time and a public auction can be a more robust test of the market than a private sale (albeit with the disruption that comes from a public process).

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Restrictions in the constituent documents of a legal entity will usually be disapplied as part of the grant of the share security. However, where such restrictions still exist at the time of enforcement then, assuming it holds the requisite portion of equity, the secured creditor should be able to use its powers in the security agreement to change the constituent documents to remove the transfer restrictions. If the secured creditor cannot use its powers to set aside the transfer restrictions, then those transfer restrictions will continue to apply in an enforcement scenario.

2.3.4 Is "market testing" mandatorily required?

Where a power of sale is exercised, the security holder / receiver owes a duty to the chargor to act in good faith and achieve the best price reasonably obtainable at the relevant time. There is no mandatory requirement for market testing, but this may form a part of the process required for the relevant seller to be comfortable that the sale is for the best price reasonably obtainable.

Where no (or limited) market testing is carried out, the seller would be well advised to obtain other evidence of fair value, such as an independent valuation.

Where enforcement is by way of appropriation under the UK Financial Collateral Regulations, the security document will provide for how the shares will be valued. The security holder must value the shares in accordance with the agreement and in a commercially reasonable manner.

2.3.5 Are valuation reports mandatorily required?

Valuation reports are not mandatory when enforcing security over shares but are usually obtained as evidence that the price paid was the best price reasonably obtainable (including by reference to contractual safe harbours).

As noted above, in the case of appropriation, the security holder must value the shares in accordance with the agreement and in a commercially reasonable manner.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

Where consensual proceedings to restructure the distressed debt are unsuccessful, a debtor may seek to use an arrangement with creditors in the form of a restructuring plan under Part 26A of the Companies Act 2006 or a scheme of arrangement under Part 26 of the Companies Act 2006. Both processes involve a court-sanctioned compromise with classes of creditors and / or members and are "debtor-in-possession" processes that do not involve the appointment of an insolvency officeholder.

A scheme is available to solvent or insolvent companies, while a restructuring plan is available to companies that have encountered, or are likely to encounter, financial difficulties that may affect the ability to carry on business as a going concern. Classes are determined based on the creditors' rights against the company.

For a scheme of arrangement, 75% in value and a majority in number of each class must approve the scheme. The court will then decide whether to exercise its discretion to sanction the plan. When exercising its discretion, the court will consider the fairness of the scheme and whether it is one that an honest and intelligent person could reasonably approve, whether the classes were correctly constituted and fairly represented at the meetings, whether the classes voted in respect of their interests, and whether there is any blot on the scheme. Where the statutory requirements are met, the courts have held that there will be a "fair wind" behind the scheme in respect of sanction.

For a restructuring plan, 75% by value of each class must approve the plan. There is no numerosity requirement for a majority in number to approve the plan as there is in a scheme of arrangement.

However, where the plan is approved by at least one class of creditors with a genuine economic interest in the company in the "relevant alternative", the court may order dissenting classes to be crammed down provided they will be no worse off than if the plan is not sanctioned (under the relevant alternative). The "relevant alternative" is whatever the court considers most likely to occur if the plan is not sanctioned (e.g. liquidation). Whether or not cross-class cram down is applied, the court must exercise its discretion to sanction the plan for the plan to take effect.

In exercising its discretion, the court will consider the same factors described above in the context of schemes of arrangement, but where the court is asked to impose cross-class cram down there will be no presumption in favour of sanction simply because the statutory conditions have been met. The court will apply the "horizontal" comparator test (i.e. the position of crammed down creditors when compared with other creditors and stakeholders). This will involve an assessment of whether the restructuring surplus (i.e. the benefits or upside of the restructuring) is being distributed fairly.

A company voluntary arrangement (CVA) is a further "debtor-in-possession" procedure involving an arrangement with all the creditors and members (rather than specific classes of them) of the debtor. A CVA cannot bind secured or preferential creditors (including employees and His Majesty's Revenue and Customs in respect of certain tax debts) without their consent. Approval requires 75% in value of creditors voting unless more than 50% (by value) of the unconnected creditors vote against it.

A standalone moratorium process is also available pre-insolvency under Part A1 of the Insolvency Act 1986. This provides an initial 20 business day moratorium and payment holiday in respect of most pre-moratorium debts – subject to certain exceptions, including debts owing under financial services contracts (e.g. debts under lending, financial leasing and guarantee agreements, as well as securities and commodities contracts), which are excluded from the payment holiday.

Moratorium debts (those falling due during the period of the moratorium) must still be paid. The moratorium period may be extended for up to 1 year. The process may be used in conjunction with a CVA, scheme, or restructuring plan, but has not been frequently used in practice.

3.2 What involvement does the court have in these processes?

With a restructuring plan or scheme of arrangement, the court will order a convening meeting of classes of creditors and / or members. Following voting at the class meetings, a second court hearing will be necessary to sanction the plan. The court has a wide discretion to sanction a plan or scheme, as set out above.

With a CVA, there is no requirement to obtain court sanction, although creditors may challenge the CVA in court on grounds of unfair prejudice or procedural irregularity.

A Part A1 moratorium may be obtained by filing prescribed documents at court. However, where a winding up petition is outstanding, it will be necessary to apply to court for the moratorium.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

With a restructuring plan or scheme of arrangement, the scheme / plan is almost always proposed by the company (the directors remain in control of the company through the process). It is not necessary to appoint an insolvency practitioner.

A CVA is implemented under the supervision of an insolvency practitioner acting as "nominee". Once the proposal is approved, the "nominee" becomes the "supervisor" of the CVA. However, the directors remain in control of the company.

A Part A1 moratorium is overseen by an insolvency practitioner acting as a "monitor", although the directors retain day-to-day control of the company.

3.4 Is there a typical due diligence process?

Valuation evidence will be crucial in determining where the value breaks on an insolvency. Valuations, financial forecasts and expert reports will be crucial in determining how much creditors ought to receive under a restructuring plan, scheme of arrangement or CVA.

In the case of a restructuring plan, it is possible for the court to order that creditors who are "out of the money" be excluded from voting on the plan. Moreover, where the court is asked to impose cross-class cram down on a dissenting class(es), the court will need to be satisfied that those dissenting creditors will be no worse off under the plan than they would be under the "relevant alternative". Evidence will also need to be provided to satisfy the court that the pleaded "relevant alternative" is the mostly likely to occur if the plan is not sanctioned. For example, the relevant alternative may involve an alternative plan being formulated, an accelerated sale on a going concern basis or an insolvency involving a series of disposals based on a break-up value.

Depending on the company and the location of its assets, expert evidence may be necessary to demonstrate that the plan or scheme will be recognised in foreign jurisdictions.

Where the arrangement involves a transfer of assets, the due diligence carried out by a distressed investor will not materially differ compared with a typical acquisition. There is no "typical" due diligence to be undertaken in these circumstances (or indeed timescales for undertaking it).

However, there is likely to be considerable time pressure such that there will be a need to focus on the parts of the target business that are critical to its value proposition. For example, the buyer should consider whether key service / supply agreements are being complied with or whether defaults have already arisen, such that customers or suppliers may seek to terminate or secure amendments to key contracts.

Once a company enters certain formal restructuring or insolvency processes, providers of goods or services are prevented from terminating their supply or imposing amended terms conditional upon continued supply (subject to exceptions, including for financial contracts and the supply of commodities). This includes where the court orders the first stage convening hearing in respect of a Part 26A restructuring plan or where a CVA takes effect.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

There is no typical timetable for an M&A sale under a pre-insolvency process. However, the financial pressures affecting the target may drive a timeline which runs in days or weeks rather than months. Where merger control or foreign direct investment approvals are required, or notifications to the UK Government are required under the National Security and Investment Act 2021 (whether mandatory or voluntary), it is unlikely to be possible to shorten approval timelines notwithstanding financial condition of the target business.

Restructuring plans and schemes typically take at least 8-12 weeks and often several months from conception.

A CVA typically takes at least 6-8 weeks.

A Part A1 moratorium lasts for an initial period of 20 business days, which may be extended if certain conditions are met.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

Asset sales by companies in the period prior to formal insolvency proceedings may be challenged by a subsequently appointed administrator or liquidator. However, where those sales form a part of a scheme of arrangement, restructuring plan and / or a CVA then they are unlikely to be susceptible to avoidance actions in a subsequent insolvency proceeding.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

In the context of schemes of arrangement and restructuring plans (described above), it is common for plan companies to invite creditors to enter into lock-up agreements confirming they will support the arrangement, in consideration for a small fee. The arrangement can therefore be said to be "pre-packed" in the sense that the company is likely to meet the requisite creditor support thresholds through the process.

Restructuring plans and schemes of arrangement are relatively expensive given the need for two court hearings (the convening hearing and the sanction hearing) and the need for detailed valuation and expert evidence. Lock-up agreements can therefore assist with providing a level of certainty and avoiding wasted costs in promoting a plan that is not likely to succeed. The English courts have upheld this practice provided the opportunity is offered to all creditors and the quantum of fees in comparison to the debt is reasonable (0.5% is not uncommon).

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

Pre-pack sales are negotiated prior to the company commencing formal insolvency proceedings (usually administration). Once a purchaser is selected and the terms of the sale are negotiated, the administrator(s) will be appointed to effect the sale. This allow the business to continue under a new legal entity and for employees to be transferred to the purchaser. It also preserves value in the business by avoiding the destruction of goodwill.

Where the appointment of administrators is made by directors and there is a QFC holder (with security over the whole or substantially the whole of the company's assets and undertaking), it will be necessary to file a Notice of Intention to Appoint Administrators at court and give 5 business days' notice of the appointment to the QFC holder (the QFC holder may consent to shorten the notice period). Notice must also be given to certain prescribed parties, including the company.

Once the sale documentation is agreed, a Notice of Appointment is then filed at court, which formally appoints the administrator(s), allowing the sale to be completed. Where a QFC holder makes the appointment, 2 business days' notice must be given to any prior ranking floating charge holder.

Where the sale is to a connected party, the purchaser should obtain a qualifying report from an independent evaluator prior to the transaction completing. This should state whether the evaluator is satisfied that the consideration to be provided for the assets and the grounds for the substantial disposal are reasonable in the circumstances.[1]

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

Typically, the directors will approach an insolvency practitioner to assess the business' options. If a pre-pack sale is identified as the best strategy, valuations will be obtained and the insolvency practitioner (who will go on to be appointed as administrator) will seek expressions of interest and (in practice, usually discreetly) market the business to preserve goodwill and maintain business continuity. Once a purchaser is selected, the parties' lawyers will agree the sale documentation. Usually, the insolvency practitioners will then be appointed using an out-of-court appointment procedure, but in certain circumstances a court application to appoint may be necessary. Regardless of the appointment method used or identity of the appointor (directors or a creditor), once appointed the licensed insolvency practitioner will be an officer of the court, acting in the interests of creditors as a whole.

As noted above, where the sale is to a connected party, the purchaser should obtain a qualifying report from an independent evaluator in advance of the purchase or else prior creditor approval will be required.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

The choice of insolvency practitioner in an administration generally will be for the appointor. However, if the directors make the appointment, they will need to give 5 business days' notice to any QFC holder, who may take the opportunity to appoint an administrator of their choosing. Once appointed, an administrator must act in the interests of creditors as a whole.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Under the TUPE Regulations, employees will transfer automatically to the purchaser where there is a going concern sale in administration. This means the purchaser will become responsible for

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[1] Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021 (the Regulations), SI 2021/427.

those employee liabilities. However, other liabilities owing to creditors do not benefit from such protection and are often left behind in the insolvent company.

4.5 Is there a typical due diligence process followed?

The scope of the due diligence exercise will depend on the nature of the business and the identity of the parties. Often, pre-pack sales involve a disposal to existing management or a connected party who will have in-depth knowledge of the business. However, where the purchaser is a third party, standard due diligence checks usually completed in solvent sales will need to be undertaken – albeit in a compressed timetable as delays could lead to value in the business being lost or potentially a liquidator being appointed in the meantime if there are any outstanding winding up petitions presented by creditors.

4.6 Is "market testing" mandatorily required?

Insolvency practitioners appointed as administrators are required to comply with Statement of Insolvency Practice 16 (SIP 16) when undertaking a pre-pack sale. Where the purchaser is a connected party, the Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021 (the Regulations), SI 2021/427 also apply.

SIP 16 confirms that marketing a business is an important element in ensuring that the best available consideration is obtained in the interests of the company's creditors as a whole and will be a key factor in providing reassurance to creditors. The insolvency practitioner should advise the company that any marketing should conform to the marketing essentials as set out in the appendix to SIP 16. This includes marketing the business as widely as possible proportionate to the nature and size of the business. Where there has been deviation from any of the marketing essentials, the administrator must explain to creditors in their subsequent report how a different strategy has delivered the best available outcome.

Pursuant to the above-mentioned Regulations, where the sale is to a connected party and creditor consent to the pre-pack is not obtained (typically because the sale takes effect immediately following the administrator's appointment), the purchaser should obtain a qualifying report from an independent evaluator. This should state whether the evaluator is satisfied that the consideration to be provided for the assets and the grounds for the substantial disposal are reasonable in the circumstances.

4.7 Are valuation reports mandatorily required?

SIP 16 states that any valuations obtained should be carried out by appropriate independent valuers and / or advisors, carrying adequate professional indemnity insurance for the valuation performed. Where no valuation is obtained, the administrator should provide reasons for not having done so and explain in their report to creditors how they were satisfied as to the value of the assets.

4.8 What is the typical timeline of "pre-pack" sales?

The entire process, including negotiation of the terms of sale, usually takes several weeks.

Once a purchaser is identified, the terms of sale will be negotiated. As noted above, pre-pack sales typically involve an appointment of administrators using an out-of-court method, whereby prescribed documents are filed at court.

Where the directors are proposing to make the appointment, 5 business days' notice must be given to any QFC holder (although the QFC holder may consent to the appointment to shorten the period). Where a lender holding a QFC intends to make the appointment, any prior ranking floating charge holder must be given 2 business days' notice.

In certain circumstances, additional factors may lengthen the time-period. For example, where the company is FCA registered, the FCA's consent will be required.

Where the transaction falls within the scope of the National Security and Investment Act 2021, a mandatory or voluntary notification may be necessary, which will require clearance on behalf of the Government.

The sale of the business and assets is legally finalised shortly after the administrator is appointed.

UNITED STATES OF AMERICA

1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity?

United States law does not, generally speaking, create separate rules for the transfer of shares in distressed companies (or even provide a consistent definition of what constitutes distressed equity). For publicly listed companies, however, major exchanges generally have in-house rules – which vary from exchange to exchange – for addressing distressed shares. For example, exchanges will generally delist shares that fall below US $1 per share and fail to recover within a specified period of time (e.g. 1 month, 6 months, etc).

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans?

Secondary market loan trades in the United States typically occur using standard documentation developed by the Loan Syndications and Trading Association (LSTA), which is similar to Europe's Loan Market Association (LMA).

The LSTA has separate sets of standard documentation for "par" debt and distressed debt, the terms of which differ materially. Key differences between "par" and "distressed trade" documents include:

- price – par (typically including accrued interest) versus agreed price;
- form of documentation – assignment agreement for par debt; assignment agreement *and* a purchase and sale agreement for distressed debt;
- obligations transferred all obligations are transferred from the existing lender to the new lender for par debt; for distressed debt, all obligations are transferred excluding pre-settlement date obligations as well as obligations arising from seller's misconduct;
- representations and warranties – for distressed trades, the seller provides a "no bad acts" representation, backed by an indemnity;
- transaction history – the buyer is given upstream transaction / trade documents in a distressed trade; and
- settlement timing – T+7 for par debt; T+20 for distressed debt.

It is important to note, however, that there is no rule that strictly *requires* distressed loans to trade on the LSTA distressed forms (or, for that matter, on LSTA forms at all). Taking that a step further, parties may, in some instances, trade below par using the par LSTA forms. It is incumbent on the parties – and particularly on the purchaser – to verify whether a loan should be traded using the distressed forms.

Setting aside the mechanics of trading distressed loans, certain institutions have a variety of legal restraints on their ability to trade in distressed debt. Banks, for example, are subject to periodically updated regulatory guidance governing the accounting of allowances for credit losses (ACL) that applies to distressed assets. This guidance was recently updated and, although highly technical, generally applies FASB principles for accounting for credit losses.[1]

1.3 Other than regulatory requirements for specific industries, what are the general regulatory requirements that need to be considered in the case of distressed investments (e.g. work council requirements)?

United States law generally lacks features such as the establishment of work councils for distressed businesses. However, while not strictly unique to distressed businesses, United States

[1] https://www.federalregister.gov/documents/2023/04/27/2023-08876/interagency-policy-statement-on-allowances-for-credit-losses-revised-april-2023.

law and individual state laws establish a number of employee-specific protections that can become relevant in distressed situations. The most well-known of these is the Worker Adjustment and Retraining Notification (WARN) Act. That law requires, in simple terms, that employers with 100 or more employees must provide at least 60 calendar days' notice in advance of planned closings and mass layoffs.

1.4 What risks exist for an investor of a distressed business?

Aside from the obvious business and credit risks, an investor in a distressed business should be aware of three principal legal risks.

First, in the United States, the transfer of a debtor's interest in property or the incurrence of an obligation may be avoided or unwound as a fraudulent transfer. A transfer would include the granting of liens and an obligation would incur debt. Thus, a distressed investor's lien over the debtor's property or claim for unpaid debt may be subject to avoidance as a fraudulent transfer.

Second, a distressed investor's claim may be recharacterised as an equity investment in a bankruptcy case.

Third, a distressed investor's claim may be equitably subordinated to other claims in a bankruptcy case.

These are discussed in greater detail below.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy?

Outside of a bankruptcy case, which is governed by the United States Bankruptcy Code (a federal or national law), an individual creditor of a transferor typically has standing to pursue a fraudulent transfer under state law.

There are generally three types of state fraudulent transfer statutes: the Uniform Fraudulent Transfer Act (UFTA), the Uniform Voidable Transactions Act (UVTA) and the Uniform Fraudulent Conveyance Act (UFCA). The statutes generally differ in, among other things, terminology, burden of proof, statutes of limitations and certain defences.

Otherwise, they generally provide for the avoidance of transfers or obligations that were made or incurred: (a) with the intent to hinder, delay or defraud any creditor of the debtor; or (b) for less than reasonably equivalent value at a time when the debtor was insolvent, unable to pay its debts as they matured, or left with unreasonably small capital to conduct its business.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings?

In a bankruptcy case, an individual creditor does not generally have standing to pursue fraudulent transfer claims. Instead, the Bankruptcy Code confers standing on a trustee or a debtor-in-possession to bring certain claims and causes of action for the benefit of its creditors.

A bankruptcy court may, however, under certain circumstances grant standing to a party in interest to pursue such estate causes of action for the benefit of the estate. Indeed, creditors (as part of an official committee of unsecured creditors or individually or as an ad hoc group) may seek standing to pursue claims against a debtor's pre-petition lender to improve their negotiation position and leverage a favorable plan settlement for creditors as a whole. A bankruptcy court may grant such standing to a creditor if it demonstrates, at a minimum, that: (a) there is a colourable claim; and (b) the trustee or debtor unjustifiably refused to pursue that claim.

A trustee, debtor or party that has been granted standing would generally be allowed to pursue fraudulent transfer claims under state law (e.g. UFTA, UVTA and UFCA) or federal bankruptcy law.

Like state law, the federal bankruptcy law allows the avoidance of a transfer or an obligation that was made or incurred: (a) with the intent to hinder, delay or defraud any creditor of the debtor; or (b) for less than reasonably equivalent value at a time when the debtor was insolvent, unable to pay its debts as they matured or left with unreasonably small capital to conduct its business.

To the extent a transfer of a debtor's property is avoided in a bankruptcy case, section 550 of the Bankruptcy Code permits a claimant to "recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property." The purpose of section 550 is "to restore the estate to the financial condition that it would have enjoyed if the transfer had not occurred."

Consequently, the remedy for a fraudulent transfer generally is either the unwinding of the transaction in question or a monetary claim for the value of the property transferred, subject to a credit for the value of any amount conveyed to the transferor. There is nothing to "recover" when an obligation is avoided because such avoidance simply eliminates the claim against the debtor.

With respect to an actual fraudulent transfer claim, the claimant can rely on circumstantial evidence sometimes referred to as "badges of fraud" to support such a claim. The "badges of fraud" that courts typically consider include:

(1) the relationship between the debtor and the transferee;

(2) the consideration for the conveyance;

(3) insolvency or indebtedness of the debtors;

(4) how much of the debtor's estate was transferred;

(5) reservation of benefits, control or dominion by the debtor over the property transferred; and

(6) secrecy or concealment of the transaction.

A defendant should be able to defend a constructive fraudulent transfer claim if it can demonstrate that it gave reasonably equivalent value for the transfer or the obligation. Regardless of whether it provided reasonably equivalent value, a transferee defendant should receive credit for the value it gave in good faith and for any improvements to the transferred asset. Moreover, the Bankruptcy Code provides that a transferee that takes for value and in good faith has a lien on or may retain any interest transferred to the extent the transferee gave value to the debtor in exchange for the transfer.

Good faith is determined according to an objective or "reasonable person" standard, rather than on the subjective knowledge or belief of the transferee. Courts thus look to what the transferee objectively knew or should have known concerning the nature of the underlying circumstances involved with the transfer; or stated otherwise, whether the transferee was on "inquiry notice" of fraud.

Additionally, once a transferee is on notice of suspicious circumstances regarding a transfer, it is obliged to conduct a diligent investigation which must "ameliorate" the issues that placed it on inquiry notice in the first place. The failure to do so can be fatal to a good faith defence.

Under this standard, a transferee is not automatically protected by the good faith defence merely because it had no actual knowledge that a fraud was being perpetrated. The transfer can still be avoided as against the transferee if the circumstances were such that, as a reasonable person, it should have known that there was something suspicious about the transfer but failed to investigate.

Most investments in distressed businesses are unlikely to create any true exposure under United States avoidance laws. However, certain types of transactions – notably leveraged buyouts and dividend recaps – have traditionally been subject to significant scrutiny in the event of a subsequent failure of the business.

1.4.3 *What risks exist for a new lender investing in a distressed business?*

In certain circumstances, a bankruptcy court may recharacterise a loan as equity, thereby subordinating payment of the purported loan to creditors. As a court of equity, a bankruptcy court is not bound by a party's characterisation of a transaction and may, where appropriate, acknowledge economic reality by recharacterising debt as equity. In general, a court may recharacterise a loan as equity if it determines that the parties intended the transaction to be an equity investment.

A court can determine the parties' intent by considering certain factors, including:

- the names given to the instruments;
- the presence or absence of a fixed maturity date and schedule of payments;
- the presence or absence of a fixed rate of interest and interest payments;
- the source of repayments;
- the adequacy or inadequacy of capitalization;
- the identity of interest between the creditor and shareholder;
- the security for the advances;
- the corporation's ability to obtain financing elsewhere;
- the extent to which the advances were subordinated; and
- the extent to which the advances were used to acquire capital assets.

In addition, the Bankruptcy Code provides that a court may "equitably subordinate" all or part of a lender's claim to other claims to remedy inequitable conduct by the lender. Equitable subordination has three elements:

(a) the claimant must have engaged in some type of inequitable conduct;

(b) the misconduct must have resulted in injury to the creditors or conferred an unfair advantage on the claimant; and

(c) equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Code.

Courts have consistently recognised that equitable subordination is an extraordinary remedy available only in extreme circumstances. Generally, there are three recognised categories of misconduct that may be deemed to constitute inequitable conduct for insiders:

(1) fraud, illegality and breach of fiduciary duties;

(2) under-capitalisation; or

(3) a claimant's use of the debtor as a mere instrumentality or alter ego.

For non-insider claimants, egregious conduct must be established to justify equitable subordination. Obtaining a security interest alone is generally insufficient to find inequitable conduct. Rather, the party must have engaged in some parallel behaviour that demonstrates it unfairly obtained the security interest.

A lender may also be subject to so-called "lender liability claims." In the United States, lender liability is not a statutory cause of action, but rather a generalised term that encompasses theories of liability that have been used against financial institutions, including breach of contract and various tort claims.

Additionally, a plaintiff may allege that a lender has breached its implied duty of good faith and fair dealing, which under certain state laws requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct. General allegations of bad faith conduct are not sufficient. Rather, the plaintiff must allege a specific implied contractual obligation and demonstrate how the violation of that obligation denied the plaintiff the fruits of the contract.

Duress is another cause of action that falls under the rubric of lender liability. Duress requires the plaintiff to show that it was deprived of freedom of choice, and is commonly used as a defence to an action by a financial institution to enforce a promissory note or a workout agreement which contained waivers of lender liability.

Finally, a lender may be the subject of breach of fiduciary duty claims. The relationship between a borrower and lender is typically referred to as that of debtor and creditor. However, a fiduciary relationship may emerge if the lender exercised control over a debtor or where it has given extensive business advice to a customer that relies on that advice after having placed its trust and confidence in the lender. In limited circumstances, a lender may be found to have breached its fiduciary duties.

In certain types of transactions, lenders may also face fraudulent transfer risk. This is unusual given that new money loaned is, almost by definition, reasonably equivalent value for debts incurred. However, certain transactions where the company realises little or no benefit from the new debt – failed leveraged buyouts and dividend recaps being the prime examples – lenders may have liability (subject to a variety of potential defences). Lenders engaging in cross-collateralised refinancing may also, in some circumstances, find themselves with potential exposure.

1.4.4 What risks exist for a new shareholder investing in a distressed business?

Under the laws of certain states, including Delaware where many corporations are registered or incorporated, directors, officers and controlling shareholders are entrusted with certain fiduciary duties.

In general, fiduciary duties consist of: (1) the duty of due care; and (2) the duty of loyalty and good faith.

The duty of care focuses on the decision-making process and requires that a fiduciary be informed of all material information reasonably available before making a business decision.

The duty of loyalty requires, among other things, that a fiduciary not put its personal financial interests above the interests of the corporation.

To prevail on a claim of breach of fiduciary duty under Delaware law, a plaintiff must prove that the shareholder owed a fiduciary duty and breached it. A fiduciary may have breached its duty of loyalty if the fiduciary: (1) was on both sides of a transaction; or (2) derived a personal financial benefit by self-dealing.

A shareholder may also be subject to a claim for aiding and abetting a breach of fiduciary duty. Under Delaware law, a plaintiff must prove that someone owed and breached its fiduciary duty and that the shareholder knowingly participated in that breach, which resulted in damages. Knowing participation in a fiduciary breach generally requires that the third party act with the knowledge that the conduct advocated or assisted constitutes a breach and that their conduct was legally improper.

Finally, continuing a theme, new shareholders that have acquired distressed businesses through debt-heavy transactions may face challenges related to that method of acquisition in the event the company collapses under its debt burden.

2. Enforcement processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors?

Although United States insolvency law is federal (and thus, subject to interpretation of local courts, uniform across the country), the substantive law that governs investments in distressed businesses is state-specific. Most states have adopted, subject to generally minor modifications, the Uniform Commercial Code (UCC). The UCC is a model law designed to, among other things, promote uniformity in the enforcement of security interests across states.

As an initial issue, the type of enforcement process that is available to a distressed investor will depend on what type of security, if any, has been granted in favour of the investor. While many distressed investors insist on security before extending loans, the United States also has a very well developed high-yield unsecured bond market, as well as more exotic types of unsecured investments that many not have security.

For distressed investors that lack security, the first enforcement step following an event of default is to convert the defaulted instrument into security that may be enforced. New York law (which governs many debt documents) provides an accelerated mechanism for making a claim in respect of a defaulted note, and allows a lender to commence an action with a motion for summary judgment rather than filing a complaint.[2] That said, "accelerated" in this sense is a relative term, and such an action still typically takes many months to complete, a pace that is distinctly suboptimal in any environment, to say nothing of a highly distressed situation.

If a lender does have security, the next question is: what kind of security? Security interests in most types of property – including physical assets and equity interests – are governed by the UCC, which operates in a broadly similar manner in most United States jurisdictions. Security interests in real estate (mortgages), by contrast, are governed by state laws that vary wildly by local jurisdiction and type of property. As such, enforcement against real estate is generally beyond the scope of this Chapter. However, enforcement against real estate in almost any jurisdiction the process is materially more complex and time-intensive than enforcement under the UCC.

Assuming enforcement is taking place under the UCC, there are three separate process questions to consider. First, will enforcement take place at the equity level (resulting in a change of ownership of the business) or at the asset level (resulting in a change of ownership of the business's assets)? Although the legal process of enforcement is essentially the same regardless of whether an asset or equity foreclosure is taking place, different considerations apply to each.

In particular, under the UCC, a foreclosure generally discharges junior liens against the specific asset being foreclosed upon. As a result, an asset-level foreclosure will (generally) discharge all junior liens across the whole range of a business's assets. An equity level foreclosure, by contrast, will discharge other liens that may exist on the equity, but will leave in place all liens and claims that may exist at the underlying business. In this respect, an asset-level foreclosure may appear more desirable. Nevertheless, asset foreclosures present their own complications which, more often than not, result in secured parties opting to foreclose at the equity level.

As an initial matter, businesses often have assets that cannot easily be foreclosed upon using the UCC (or even at all). For example, a business may hold a mix of real property and personal property, which would force an asset-level foreclosure to proceed in parallel under the UCC and local real estate laws to capture the full business. As another example, businesses often rely on permits or licences that are not subject to liens and cannot be foreclosed upon as assets (but may be transferrable with the rest of the business in an equity transaction, albeit often subject to applicable government consents).

[2] N.Y. CPLR 3213.

Another consideration is the speed with which an equity foreclosure can take place. A party secured by equity interests will often have physical shares in its possession and will have a right to displace officers and directors of the business in a default scenario. As a result, rather than going through a slow and cumbersome process of gathering physical collateral, a secured party can simply transfer equity into its own name (for the purpose of proceeding with enforcement) and execute appropriate resolutions to terminate existing directors and / or officers and install new individuals to those roles.

Second, regardless of whether a UCC foreclosure is occurring at the equity or asset level, the parties will need to decide whether the transaction will be a consensual "strict" foreclosure or a more typical non-consensual process.

With respect to the former, the UCC permits a secured party, with the consent of the borrower (and assuming no other party with an interest in the collateral objects), to retain collateral in full or partial satisfaction of a secured debt.[3] This process is known as a strict foreclosure. It involves, essentially, the secured party circulating a "proposal" with respect to the contemplated retention of collateral to the borrower and other interested parties, the borrower consenting to the proposal (generally by affirmatively agreeing in writing after the occurrence of a default) and no other interested party objecting within a specified notice period. If any interested party objects, regardless of reason, the strict foreclosure does not proceed and alternative enforcement is required.

Third, assuming a strict foreclosure is not being pursued, a secured party will want to determine whether any judicial intervention is desirable. Under the UCC, foreclosure is fundamentally a non-judicial process. There is no court involvement whatsoever as part of the foreclosure process itself. However, the UCC does not override existing state court mechanisms for foreclosing or enforcing through a judicial process. As a result, in certain limited circumstances, a party may opt for a court-driven foreclosure process.

Assuming a non-judicial, non-strict foreclosure process is pursued (which is the norm), enforcement is a fairly straightforward, mechanical process that ends with the disposition of the collateral and the distribution of the proceeds of that disposition. The secured party is required to give notice to the debtor, as well as certain other parties (e.g. other parties with liens on the asset being foreclosed upon). This notice should:

(i) describe the borrower and the secured party;

(ii) describe the collateral to be sold;

(iii) state the method of intended disposition (i.e. private sale, public sale, type of auction, etc);

(iv) state that the debtor is entitled to an accounting of the unpaid indebtedness and the charge for that accounting; and

(v) state the time and place of a public disposition or the time after which any other disposition is to be made.

The notification should be provided after default, but at least 10 days prior to the disposition.

In terms of the actual strategy for marketing and disposing of collateral, the UCC is enormously flexible. Rather than attempting to set strict requirements, the UCC recognises that different types of collateral will need different monetisation strategies.

As such, the UCC simply requires that all aspects of a disposition be "commercially reasonable." In practice, this means that parties disposing of collateral will generally undertake a marketing process – supported by appropriate professionals – that resembles (albeit often on an accelerated timeline) that for a sale of any other distressed asset. The end point of the process can be either a

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3 UCC § 9-620-621.

public disposition or a private sale, depending on what is judged to be most desirable in the circumstances.

2.2 What involvement does the court have in these processes?

As noted above, where security is enforced either through a UCC strict foreclosure or a standard UCC foreclosure, there is no judicial involvement. Nor is there, typically, involvement from any other public official. Instead, secured parties are given wide latitude to construct and implement a "commercially reasonable" enforcement process free from court oversight.

Certain states do, however, permit (rather than require) judicial enforcement. In New York, for example, judicial foreclosure can be commenced through filing and service of a summons and complaint, which would attach relevant pledge agreements and loan documents.

The borrower / defendant then would have an opportunity to appear and answer, or move to dismiss the complaint.

Because judicial foreclosure entails substantial additional cost and delay and has limited advantages over non-judicial approaches, it is rarely pursued. The exception, as noted above, is with respect to real estate foreclosures which, in many cases and in many states, require a judicial process.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

In principle, enforcement of a pledge of shares of a legal entity works precisely the same as any other foreclosure: enforcement can occur under the UCC and formally begins with the lender providing notice of default and, following any applicable cure periods, a notice of disposition that meets the requirements outlined in paragraph 2.1 above. In practice, a party enforcing against shares may take certain additional steps to ensure an orderly enforcement process.

If the shares are not publicly traded, then the enforcement process itself operates in accordance with the normal provisions of the UCC. However, New York law pledge and security documents over equity interests typically provide additional enforcement and control rights in favour of a lender, including the right, during the continuance of an event of default, to exercise voting power over the pledged shares. This authority may be used to remove and replace directors, which lenders often consider as one option for preventing the borrower from taking action to thwart an impending UCC foreclosure.

If the shares in question are publicly traded, an enforcing party may be able to short-cut the normal enforcement process. For collateral that is ordinarily sold on a recognised market (stock exchanges such as the New York Stock Exchange being the quintessential example) and thus has a known price, an enforcing party may proceed directly to the sale step without providing advance notice to the borrower or other interested parties. While the sale must still be commercially reasonable, a private sale at prevailing market price would generally qualify.

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

Yes, this can occur in in multiple ways in the United States.

First, if there is consensus between the secured party and the borrower that a debt-for-equity swap is desirable, this can be accomplished through a strict foreclosure as outlined in paragraph 2.1, above. In a strict foreclosure, either some or all of the defaulted debt may be exchanged for equity. While a strict foreclosure is subject to objection by other parties with an interest in the collateral, in an equity level transaction that right to object would only extend to a limited group of parties, primarily other creditors with liens on the equity itself (rather than the underlying assets). Assuming no such liens are in place, a strict foreclosure can provide a quick and effect method of exchanging defaulted debt for equity.

If the borrower is not amenable to a debt-for-equity swap or is amenable in principle but insists, for liability reasons, on a market-testing of the equity's value, a lender may opt for a standard UCC foreclosure on the equity, during which it elects to "credit bid" some or all of its debt for the equity. Assuming the lender is ultimately the winning bidder, the effect of such a credit bid is to exchange debt for equity. There is, however, a limitation on this approach: a lender may only seek to retain collateral in a public disposition. Subject to very limited exceptions, a lender may not foreclose and sell collateral to itself in a private transaction.

2.3.2 Is a public auction mandatorily required or are private sales possible?

Private sales are expressly permitted in enforcement under the UCC. Indeed, official commentary to the UCC suggests that, in many instances, private sales are preferred as they are viewed as the value-maximising path. As noted above, there are certain limitations with respect to private sales. Primarily, a lender may not itself retain collateral in a private transaction unless "the collateral is of a kind that is customarily sold on a recognised market or the subject of widely distributed standard price quotations."[4] So, for example, a lender secured by commodities or shares in a publicly traded company could retain that collateral in a private transaction. A lender secured by intellectual property or the equity of a privately held business could not.

Any private sale must, like a public sale, be commercially reasonable in every respect.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Transfer restrictions in constituent documents may only be set aside to a limited degree in enforcement outside of a Chapter 11 process. The UCC expressly overrides provisions of constituent documents that restrict the creation or perfection of security interests in, among other things, general intangibles (including operating agreements for limited liability companies).[5]

That override does not, however, fully extend to enforcement of a security interest. For example, it is common for a limited liability company agreement to prohibit the admission of a transferee of a membership interest in the limited liability company as a member without the consent of the other members. It is also common for limited liability company membership interests to be pledged as collateral to lenders and the UCC generally permits such a pledge to be made.

However, if a lender enforces against the membership interest it may, unless it received consent to step in as a member from the other members in connection with receiving the pledge, only be entitled to receive "proceeds and distributions" of the membership interest after enforcement. Put differently, in the face of transfer restrictions, an enforcing lender may be able to obtain economic, but not governance rights.

These types of restrictions may encourage lenders wishing to obtain complete equity control to drive a defaulted business towards a formal Chapter 11 filing.

In Chapter 11 (discussed in more detail below), transfer restrictions may often be fully overridden, either through a direct sale pursuant to section 363 of the Bankruptcy Code, or pursuant to a plan of reorganisation in which old equity is eliminated and equity in the reorganised business is issued to the lender.

2.3.4 Is "market testing" mandatorily required?

Market testing is not strictly required but is generally advisable. As noted above, the enforcement of security interests under the UCC is flexible rather than prescriptive. The touchstone of an appropriate sale process is the somewhat nebulous concept of commercial reasonableness. In the great majority of cases, that standard leads parties to conclude that some degree of market testing is appropriate. This can take the form of advertising in advance of a public auction, a

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4 UCC 9-610(c)(2).
5 UCC 9-408.

traditional investment banking process ahead of a private disposition, or any other commercially reasonable approach.

Market testing is not strictly required, however, and purely private sales without broader marketing efforts can and do occur in certain instances.

2.3.5 Are valuation reports mandatorily required?

Valuation reports are not required in either consensual or non-consensual enforcements under the UCC. In some instances, parties considering a consensual strict foreclosure might commission a valuation report to confirm and validate the propriety of the transaction and insulate debtor-side decisionmakers from being second-guessed.

More often, however, if there is a genuine question as to valuation, a debtor's representatives would instead insist on a non-consensual process, which allows the market to establish the value of an asset or, in the alternative, puts the risk of an inadequate sales process on the secured party.

3. Pre-insolvency processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors?

Under United States law, there are no formal pre-insolvency processes available to distressed debt and M&A investors. Nevertheless, such parties can engage with a financially distressed company to negotiate an out-of-court transaction (e.g. debt restructuring, equity infusion) at any time. Such a transaction may be implemented without court intervention so long as all the required parties participate and agree to its terms. Often, however, a transaction, particularly a debt restructuring, requires substantial (although often not universal) creditor support.

In recent years, restructurings in the United States ahead of, or as an alternative to, a formal in-court process have been marked by increasingly creative structures.

In particular, distressed debt investors have increasingly pursued so-called "liability-management transactions" (LMTs) to restructure a financially distressed company's capital structure. LMT is a generic term that would cover all potential capital restructuring transactions. These transactions, through different means, effectively enhance the participating investors' exposure to the borrower and affiliates, while limiting the recovery of other existing creditors, especially creditors that outright refuse to provide funding or to otherwise participate in the LMT. Three types of LMTs have been favoured in the post-pandemic (and post-low interest rate) era.

First, there is the "uptier transaction," pursuant to which certain funded debt (e.g. bonds, loans) are effectively subordinated to new debt or investors through amended and / or new financing documents that were not barred by the existing financing documents (e.g. indentures, loans). In a typical uptier transaction, the company will enter into an agreement with the requisite majority of holders or lenders to approve an amendment to the existing financing documents to allow the company to issue new, senior-secured debt that, in substance, primes the existing debt held by creditors that did not participate in the LMT.

To incentivise creditor participation, the new agreements will generally permit participating creditors to exchange their existing debt for new, discounted debt that is junior to any new money, but senior to the existing debt held by creditors that did not participate in the LMT.

Second, there is the "drop-down" transaction, pursuant to which a company will structurally subordinate non-participating creditors by transferring assets to an affiliate that is neither a borrower nor a guarantor under the company's existing financing documents. If done properly, the existing creditors' liens on the transferred assets will be automatically released and the affiliate is allowed to use those now-unencumbered assets free of the obligations under the existing financing documents, including to secure the new senior indebtedness. Unlike an uptier transaction, a drop-down transaction may not be subject to creditor consent because it can be implemented without amending existing financing documents.

Third, there is the "double-dip" transaction, pursuant to which a new money lender will obtain the benefit of multiple guarantees and liens from a company and its affiliates that are obligors under existing financing documents. In a typical double-dip transaction, the borrower will identify or create a subsidiary that is not an obligor on the existing debt. That subsidiary will borrow funds from the lender. The borrower and its other affiliates will guarantee the subsidiary's repayment of the new debt, resulting in the first "dip" against the existing creditors' obligors. The subsidiary uses the borrowed funds to fund an intercompany loan to its parent company and affiliates. Thus, the subsidiary will have an intercompany receivable owed from its parent and affiliates. The subsidiary will pledge the intercompany receivable to secure its obligations on its loan, thereby resulting in the second "dip" against the existing creditors' obligors.

Companies have used these three types of LMTs to restructure their capital structure. The likelihood of their success will depend on the terms of the existing financing documents and the willingness of the participants to face any challenges asserted by creditors that do not participate in the LMT. Some of those potential challenges were briefly discussed in paragraph 1 above.

Absent sufficient creditor support for a LMT (or document flexibility sufficient to permit a non-consensual LMT such as a drop down), a debtor may not be able to adequately address balance sheet pre-insolvency challenges without court intervention. Moreover, a debtor would not have the benefit of the automatic stay outside a formal bankruptcy process. Consequently, solvent but nevertheless financially distressed companies sometimes turn to Chapter 11 after negotiating a restructuring transaction.

3.2 What involvement does the court have in these processes?

LMTs are generally not implemented in a formal process and thus are not subject to court approval. However, LMTs often result in litigation by creditors that are not included in the favourable treatment being afforded by a proposed transaction and, in that sense, are often "stress tested" in court. Sometimes they are even used (unintentionally or otherwise) as a precursor to a formal Chapter 11 filing.

Other restructurings, particularly non-consensual ones, can be implemented in a Chapter 11 case. The culmination of any Chapter 11 case, whether it involves a LMT or other transaction, and whether it is pre-packaged, pre-negotiated or traditional, is the confirmation of a Chapter 11 plan.

3.3 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

In a LMT, the key players are:

(a) the company;

(b) one or more major creditors that often form an ad hoc group that organises the proposed transaction and reaps most of the creditor-side financial benefits;

(c) participating non-leading creditors, who may share *pari passu* with the lead creditors or may receive some lesser, but still beneficial, treatment for participating without objection; and

(d) non-participating creditors, who suffer the brunt of the LMT.

Transactions are then often followed by litigation, but no insolvency practitioners are typically appointed (except as advisors to the company and creditors in question).

3.4 Is there a typical due diligence process followed?

The due diligence carried out by a distressed debt and / or equity investor in connection with a pre-packaged or pre-negotiated Chapter 11 case would not materially differ from the due diligence sought in an out-of-court consensual restructuring. However, distressed debt and / or equity investors should be aware of these processes as they provide for the ability to implement a restructuring or other transaction over the objection of creditors in an expedient manner following the filing of a formal proceeding.

3.5 What is the typical timeline of a M&A sale under a pre-insolvency process and how does the process work?

There is no typical timeline for a LMT. The timing will depend on the complexity of the borrower's capital structure, the terms of the existing financing documents and the goals of the participants. Similarly, there is no typical timeline to negotiate a Chapter 11 plan. Some negotiations may last a few weeks, while others may span nearly a year.

As noted in paragraph 3.7 below, a pre-packaged plan will typically be confirmed 30 to 90 days after commencing the formal process, whereas it may take 6 months to a year to confirm a pre-negotiated plan.

3.6 Are M&A sales / asset sales protected under the pre-insolvency processes?

A transaction negotiated outside of a formal proceeding is not entitled to any special protections. Indeed, LMTs and similar transactions are often fodder for court challenges (with varying degrees of success).

In contrast, if that transaction is implemented pursuant to a Chapter 11 plan confirmed by a bankruptcy court, it will not be subject to subsequent challenge. Simply stated, it will be shielded from a later challenge (other than appeals or requests for the court to reconsider) by virtue of it having been approved by a court order. In addition, the Bankruptcy Code provides additional protections. For example, it allows the transfer or sale of assets "free and clear" of liens, claims and encumbrances. Such liens, claims and encumbrances would generally attach to the proceeds of such transfer or sale. Moreover, the court's order would likely absolve the distress investor from liability for any claims against the debtor premised under successor liability theories.

3.7 Are "pre-pack" processes (i.e. pre-packaged restructuring plans) permitted and how do they work?

Although the United States lacks a formal pre-insolvency process, a financially distressed company will often engage interested parties, including distressed debt and M&A investors, in negotiating a transaction (and sometimes obtaining approval thereof) prior to commencing a formal insolvency process. Ultimately, the transaction would be approved in a subsequently filed Chapter 11 case. There are generally two types of Chapter 11 cases that entail significant pre-insolvency negotiations, namely "pre-packaged" and "pre-negotiated" cases.

The Bankruptcy Code provides that acceptance of a Chapter 11 plan solicited and received prior to the filing of a bankruptcy petition may be used to confirm a plan (a Pre-packaged Plan) in a subsequent bankruptcy case. The plan of reorganisation may then be filed at the same time the bankruptcy petition is filed.

A Pre-packaged Plan is a consensual restructuring and, generally, must be accepted by each class of creditors and stockholders whose claims or equity interests are restructured. It has the advantage of being quick and uncontentious, and therefore, less costly and disruptive. In general, a debtor may obtain confirmation of a plan 30 to 90 days after commencing the formal process. There have been some instances where the debtor obtained confirmation hours after the filing. Those cases are rare and involved unusual circumstances. Regardless, the parties usually extend multiple months negotiating a plan in the period leading up to the formal filing.

A Pre-packaged Plan is only effective when the universe of creditors in each class and the amount of their respective holdings is readily identifiable. Where a Chapter 11 plan provides less than full payment to creditors with unliquidated or contingent claims, pre-petition solicitation of those creditors becomes very difficult.

For this reason, most Pre-packaged Plans seek only to restructure institutional indebtedness and leave general unsecured claims unimpaired or unaffected by the Chapter 11 filing.

Where this is not possible, the next best alternative is a "Pre-negotiated" Plan where the debtor, prior to filing, negotiates the terms of the restructuring with its major creditors. This procedure expedites the Chapter 11 case substantially and virtually ensures a successful confirmation if prior commitments to support the plan are obtained from the requisite creditors in advance. A Pre-negotiated Plan will often take 6 months to a year from commencement of the Chapter 11 case to be confirmed by the bankruptcy court.

4. Pre-pack sales

4.1 Are "pre-pack" sales (i.e. pre-packaged sales of all or parts of the business) permitted and how do they work?

As described above, pre-packaged restructurings are permitted by the United States Bankruptcy Code. They have become a significant feature of United States restructuring practice. The majority of pre-packaged cases involve debt-to-equity conversions of some kind rather than outright sales. However, because a Chapter 11 plan may itself be used to implement a sale, a pre-packaged plan may be used to implement a sale of a business.[6]

Fundamentally, the mechanics for a pre-packaged sale are precisely the same as for a pre-packaged reorganisation, with the exception that the debtor company will have, often in consultation with its key lenders, marketed its assets pre-petition in order to identify a buyer that would be willing to acquire the assets and thereby sponsor distributions under a plan.

Once that transaction has been fully negotiated, the company would – pre-petition – prepare both a plan and disclosure documents, solicit votes in support of the plan and execute required transaction documents. Once those steps are completed, the debtor files for Chapter 11 and immediately files the sale plan documents as well as materials reflecting the required affirmative votes. A hearing to consider the plan and sale will then be scheduled quickly: often within 45 days and, in certain outlier instances, in as little as one day.

In addition to using a pre-packaged plan to drive a sale, there are certain examples of, effectively, pre-packaging a sale of assets using section 363 of the Bankruptcy Code (which allows assets to be sold in bankruptcy free and clear of liens, claims and encumbrances).

Generally speaking, to pre-package a bankruptcy sale in this manner, the seller would need to develop a robust record with respect to pre-petition marketing of the asset, leaving no doubt in the court's mind that the seller has captured the highest and best offer. The company then files for bankruptcy and, as part of its first day filings, submits a motion for permission to sell the assets in question, which is supported by a declaration (and typically live testimony) detailing the marketing process. Because section 363 sales do not require creditor votes like pre-packaged plans, courts may be hesitant to approve a sale until an official creditors' committee has been appointed and has had a chance to evaluate the transaction.

There are, of course, famous exceptions to the usual process. The most notable exception remains Lehman's sale of its brokerage business to Barclays almost immediately after Lehman's Chapter 11 filing. Lehman, however, is viewed as an exception to the rule given the overhang of a potential collapse of the global financial system absent immediate approval of the sale. Other examples include the sale of the Chicago Cubs during the Tribune Company bankruptcy. In that transaction, Chapter 11 debtors spend months laying the groundwork for the sale, but only actually brought the relevant entity – which was until that time held outside of bankruptcy as a non-debtor subsidiary – into Chapter 11 to immediately execute a court-approved sale.

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[6] *See* 11 U.S.C. § 1123(a)(5)(D) ("Notwithstanding any otherwise applicable non-bankruptcy law, a plan shall … provide adequate means for the plan's implementation, such as … sale of all or any part of the property of the estate, either subject to or free of any lien").

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The key players in a pre-packaged sale process are precisely the same as those in a pre-packaged restructuring, with the addition of a purchaser. The key players are thus the debtor, the debtors' lenders, the purchaser, the bankruptcy judge and, to a lesser extent, the Office of the United States Trustee and (possibly) an official creditors' committee. There would typically be both legal professionals and financial advisors advising the debtors and the lenders, as well as one or more investment banking firms. There are no court-appointed insolvency practitioners tasked with monitoring the sale.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

There are usually no court-appointed insolvency practitioners in the United States in a Chapter 11 case, given that it is a debtor-in-possession proceeding. On rare occasions (typically involving fraud or gross mismanagement), an outside trustee may be appointed to displace management in a Chapter 11 case, but in those instances there would almost certainly not be a pre-packaged or pre-arranged plan.

4.4 Is there special protection for certain types of creditors in "pre-pack" sales?

Because pre-packaged sales are subject to the standard provisions of Chapter 11, the usual Bankruptcy Code protections for creditors apply, including robust protections for secured creditors and administrative claimants and the absolute priority rule for unsecured creditors.

4.5 Is there a typical due diligence process followed?

The level of due diligence performed by distressed investors intent on acquiring an asset through a pre-packaged plan varies, but is often less than a comparable party would perform outside of the context of a Chapter 11 case. Because of the Bankruptcy Code's ability to cleanse assets and deliver them free of claims and encumbrances, certain of the risks often associated with distressed assets (e.g. unknown or unexpectedly high liabilities) can potentially be left behind. In a pre-packaged plan that leaves unsecured creditors unimpaired, however, full diligence may still be required.

4.6 Is "market testing" mandatorily required?

Market testing is not formally required and, if a pre-package sale is being accomplished through a true pre-packaged plan, may not be necessary so long as the requisite votes are obtained. In the event that a "pre-packaged" sale is being delivered through a section 363 sale process, then market testing is effectively mandatory in order to obtain accelerated approval. Absent evidence of an extremely robust process, the bankruptcy judge may order that marketing be conducted on a post-petition basis, which will extend the case timeline and increase costs materially.

4.7 Are valuation reports mandatorily required?

Valuation reports, as such, are not required in connection with United States bankruptcy sales, although they are often submitted as evidence. In a sale accomplished through a pre-packaged plan, the debtor / seller has the obligation to show that the sale, among other things, would leave creditors better off than would be the case in a hypothetical liquidation of the company. However, the "liquidation analyses" submitted in connection with Chapter 11 plans are a far cry from a robust multi-method valuation report.

To the extent that a pre-packaged sale is, for whatever reason, challenged on the basis of delivering insufficient value, evidence in support of the plan / sale would almost certainly include some type of valuation report.

United States case law is, however, abundantly clear that the best evidence of an asset's value is its sale price. Thus, evidence of a robust marketing process having yielded a specific sale price is far more valuable than the opinion of an expert on the hypothetical worth of the asset in question.

4.8 What is the typical timeline of "pre-pack" sales?

The time that a company will spend in Chapter 11 in a pre-packaged sale case is often very short – perhaps 60 days and sometimes substantially less. On day 1, all of the substantial motions, including the plan / sale papers, are filed and a hearing is scheduled as rapidly as possible.

That time period is, however, the tip of the iceberg. The very concept of a pre-packaged sale case is to do as much of the difficult work as possible pre-petition, as this minimises interference and cost. There is no set timeline for how long the pre-petition process may take. Commercial negotiations followed by drafting of the required documents often take many months. Voting is then usually limited to a few essential parties and occurs immediately before the case is filed.

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Member Associations

AAESI Asociación Argentina de Estudios Sobre la Insolvencia
ABI American Bankruptcy Institute
AKPI Asosiasi Kurator Dan Pengurus Indonesia
APACSA Asociación Profesional de Administradores Concursales Sainz de Andino
APDIR Associação Portuguesa de Direito da Insolvência e Recuperação
ARIES Association of Restructuring and Insolvency Experts (Channel Islands)
ARITA Australian Restructuring, Insolvency and Turnaround Association
ATIK Association of Turnaround and Insolvency Kenya Ltd
AUAIRE Asociación Uruguaya de Asesores en Insolvencia y Reestructuraciones Empresariales
BLRRC-CUPL Bankruptcy Law and Restructuring Research Centre, China University of Politics and Law
BRIPAN Business Recovery and Insolvency Practitioners Association of Nigeria
BRP Business Recovery Professionals (Mauritius) Ltd
CAIRP Canadian Association of Insolvency and Restructuring Professionals
CIRIP Ghana Chartered Institute of Restructuring and Insolvency Practitioners Ghana
CLLA Commercial Law League of America (Bankruptcy and Insolvency Section)
DRA Dutch Restructuring Association
EISAR Bankruptcy Commission (Saudi Arabia)
FILA Finnish Insolvency Law Association
GDABA Guangdong Association of Bankruptcy Administrators
HKICPA Hong Kong Institute of Certified Public Accountants (Restructuring and Insolvency Faculty)
IAIR International Association of Insurance Receivers
IBR Instituto Brasileiro de Estudos de Recuperação de Empresas
IIDC Instituto Iberoamericano de Derecho Concursal
IIDC Colombia Instituto Iberoamericano de Derecho Concursal – Capitulo Colombiano
IIIPI-ICAI Indian Institute of Insolvency Professionals of the Institute of Chartered Accountants of India
INSOL Europe
INSOL India
INSOLAD Vereniging Insolventierecht Advocaten
IPAM Insolvency Practitioners Association of Malaysia
IPAS Insolvency Practitioners Association of Singapore
IWIRC International Women's Insolvency and Restructuring Confederation
JFIP Japanese Federation of Insolvency Professionals
LCA Law Council of Australia (Business Law Section)
MIA Malaysian Institute of Accountants
MICPA Malaysian Institute of Certified Public Accountants
NAFER National Association of Federal Equity Receivers
NIVD Neue Insolvenzrechtsvereinigung Deutschlands e.V.
R3 Association of Business Recovery Professionals
RISA Bahamas Restructuring and Insolvency Specialists Association (Bahamas)
RISA Bermuda Restructuring and Insolvency Specialists Association of Bermuda
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RITANZ Restructuring Insolvency & Turnaround Association of New Zealand
SARIPA South African Restructuring and Insolvency Practitioners Association
SBLA Serbian Bankruptcy Law Association
TMA Turnaround Management Association (INSOL Special Interest Group)
TMA Brasil Turnaround Management Association Brasil
XMABA Xiamen Association of Bankruptcy Administrators

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