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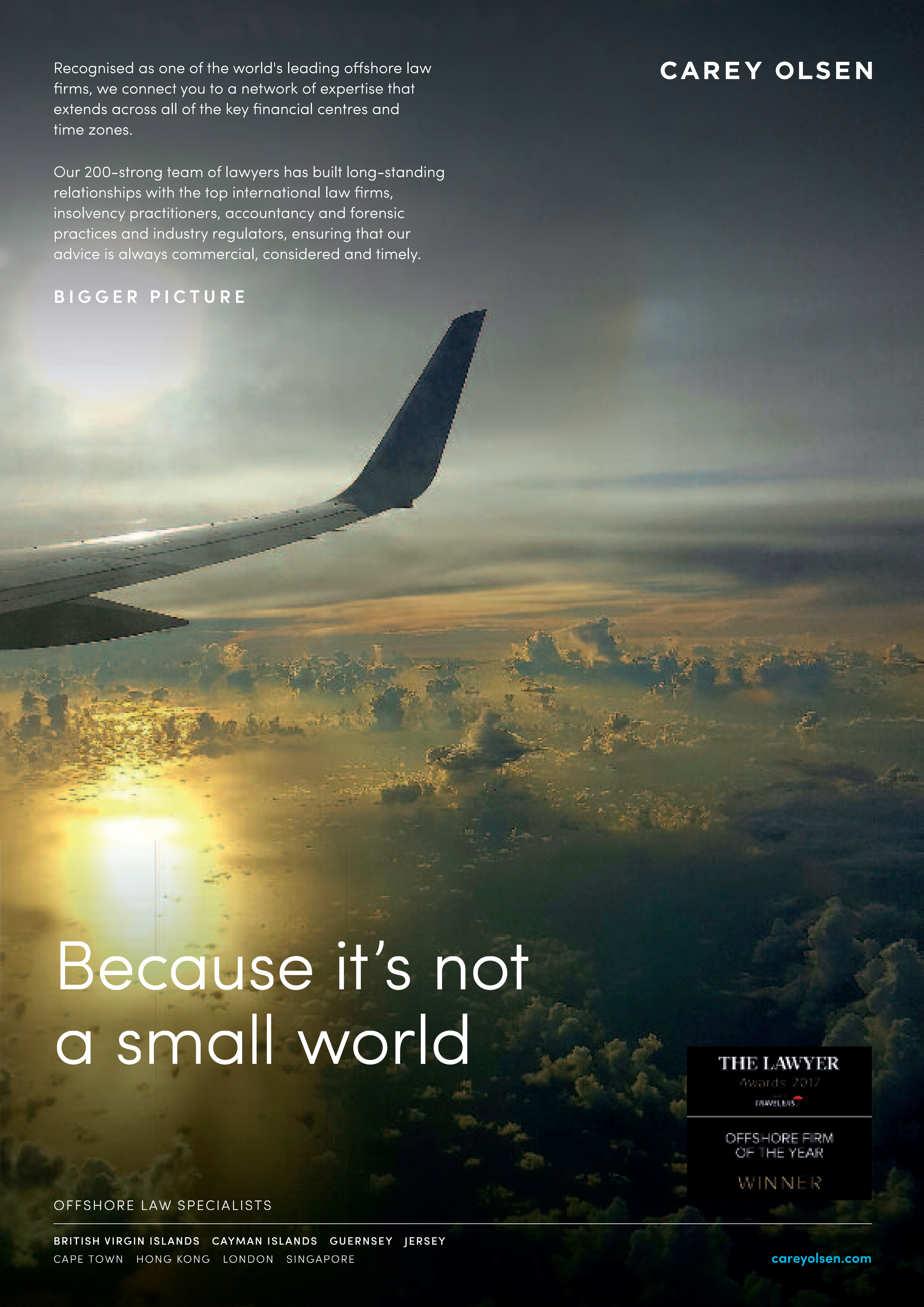
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Editors' Column

Ken Coleman
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Our focus this quarter is Latin America which has had more than its share of significant restructurings. The slowdown in the Chinese economy, the slow recovery of the US economy from the 2008 recession, declining commodity prices and corruption scandals have combined to shrink GDPs and create the worst financial crisis in decades. Brazil, with the region's largest economy, has had major parts of its economy – energy, construction, telecoms – subjected to insolvency and rehabilitation proceedings. Some of the cases and an assessment of how Brazil's legislation and restructuring professionals have handled the challenges are very thoughtfully laid out in The Recent Wave of Restructurings in Brazil by Fabio Rosas, Jose Luis Rosa and Luiz Guilherme Carnargo of the Sao Paulo firm of Souza Cescon and Laura Hall of Allen & Overy LLP. Judge Daniel Costa of the Bankruptcy Court of Sao Paulo discusses the treatment of bank's financial contracts in Brazilian insolvency proceeding and raises the question whether protection for banks is ultimately an impediment to restructurings. This is similar to the debate in the US on whether it is good policy to have safe harbor treatment of financial contracts to insulate them from the automatic stay and other features of the US Bankruptcy Code. Mexico is the next biggest player in the region. Gilberto Miranda Sola and Tania Garza Boland of Ontier walk through the legislation governing director's duties before and during Mexican insolvency proceedings. Chile suffered a major blow at the onset of the 2008 recession when the price of copper, its major export, plummeted and its currency depreciated against the US dollar. Ricardo Reveco of Carey y Cia discusses how Chilean law has responded to the need for tools to rehabilitate troubled business and preserve going concern value by protecting a debtor's contract rights during the restructuring process. Chile has also joined the list of jurisdictions with cross-border insolvency legislation by its adoption of the UNCITRAL Model Law. Some reflections on the first experience with the legislation is offered by Nicolas Velasco, *Fellow, INSOL International*. And the need for this type of legislation across the region is highlighted in the thoughtful work by Andrew Rosenblatt and Francisco Vazquez of Norton Rose Fulbright based on their experiences in the OAS and Oi cases.

Meanwhile, in other parts of the world, we have corporate rescue legislation in Singapore which aligns the country more closely with other jurisdictions which favor rehabilitation. This includes procedures permitting super priority financings, a form of cramdown on dissenting classes of creditors and the adoption of the UNCITRAL Model Law. All this is explained by Scott Atkins, *Fellow, INSOL International* and Oliver Perrottet of Henry Davis York in Corporate Rescue in the Lion City. Australia has also sought to change the landscape for rehabilitation by introducing new legislation to provide a safe harbor for directors from insolvent trading laws when they take action reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator. Scott Butler, *Fellow, INSOL International* of McCullough Robertson explains all this. It will be interesting to see how many directors step off the curb and into the traffic based on this protection.

Dhananjay Kumar, *Fellow, INSOL International*, and Vardaan Ahluwalia of Cyril Amarchand Mangaldas consider India's track record after nearly a year with new insolvency legislation. South Africa's somewhat longer track record with its insolvency law reform is considered by Dr Eric Levenstein of Werksmans. Of significance to the funds community and offshore economies, Mourant Ozannes discuss the Privy Council's decision in Pearson v. Primeo, another installment in the Bernard Madoff saga, which confirms the view that liquidation does not alter a fund's contractual arrangements. And finally, Mark Bloom of Greenberg Traurig and Bruce Markell of Northwestern Pritzker School of Law give us an update on the US law of substantive consolidation.

We thank all of our contributors whose work keeps this publication at such a high level and practically useful at the same time. We also thank Mourant Ozannes for sponsoring INSOL World and David Rubin & Partners for sponsoring the monthly electronic news update.

Ken Coleman

President's Column

By Adam Harris
Bowmans
South Africa

Dear Friends and Colleagues,
We like to say it. INSOL International is truly global.

Focus on Latin America

The reach of INSOL International across this significant region is extensive, and a highly successful programme of annual conferences throughout the region has been established. We have held seminars in Sao Paulo, Mexico City, Buenos Aires, Cartagena, Colombia and Santiago, Chile. These are well attended and run, of course, to INSOL International's usual professional standard.

Reviewing the work that we have done in Latin America in preparation for writing this note, I spoke with Howard Seife (Norton Rose Fulbright, New York), the Chair of the INSOL International Latin America Committee and asked him about the achievements and some of the highlights of his decade long involvement.

"My first experience with INSOL in Latin America was approximately ten years ago as a member of an INSOL task force, led by Neil Cooper, which spent a week in Colombia meeting with the judiciary, government officials and practitioners. The visit was in conjunction with new insolvency legislation passed by Colombia that included the UNCITRAL Model Law. We traversed the country with stops in Bogota, Cali and Medellin. It was a time of some turmoil in the country but we were well looked after by armed guards".

"The Santiago conference was particularly noteworthy", says Howard. "It was held on the eve of their adoption of the UNCITRAL Model Law and there was enormous local interest in learning how to implement the law. Thanks in no small part to the efforts of INSOL, the Model Law has now been adopted by four countries in Latin America – Mexico, Colombia, Dominican Republic, and Chile – and enacting legislation is pending in Brazil".

Having been involved myself in a number of INSOL International projects in various jurisdictions, I do know that Mother Nature does sometimes intervene and seeks to stamp her authority on things. Howard remarks that the seminar in Mexico City stands out for him personally, as the conference came immediately after the eruption of the Eyjafjallaj volcano in Iceland. Airborne ash resulted in the virtually complete shut-down of air traffic in Europe. International travel chaos! And INSOL's Penny Robertson was unable to fly to Mexico to run the seminar. Says Howard "left abandoned, and befuddled by the audio system, we nevertheless pulled it off and the seminars never missed a beat (primarily through Penny's extensive advance planning)".

Over the years, we have been able to establish an extensive presence in Latin America, with members in 9 different countries. We are already planning our next annual seminar to take place in 2018 in Buenos Aires. Our obvious successes and achievements across the region are in no small measure thanks to the committee under Howard's able leadership and guidance, and I must record our grateful thanks. And of course, the top flight organisational skills of Penny and more recently Susannah Drummond Moray deliver the best experience.

Our much-anticipated new website

I have certainly given the website some airplay in previous notes and for very good reason. We were treated to a live demonstration at a recent board meeting and I will just mention some of the highlights. What is new? Well, the site is infinitely superior to the one that we are hoping soon to forget. It is more modern, cleaner and has an entirely fresh look and feel, tying in with the look and feel of the products of the Task Force.

Navigation around the new website is much faster and more efficient. Each of our members will receive a personal user name and password. Once registered as a user, the new site will allow you to write and update your own profile and details online. You will also be able to register online for events such as seminars and conferences, and to pay for them, again all online. It will also hopefully do away with the difficulty which we have heard people complain of regarding the existing website that whilst there is certainly a wealth of information on the site, navigating your way around it and locating the target of your search has not always been easy.

After the launch we would like to have your feedback on your experience interacting with the new electronic front door to INSOL International. I am impressed and have no doubt that you will be too. Our compliments to Jason Baxter, Duncan Robertson and Tony Ashton and their professional advisers. Final adjustments are being made to refine the product, which is to go live shortly.

The Taskforce 2021 is making great progress

I am sure that, by now, you know that we launched our strategic plan (under the banner of Taskforce 2021) in March this year. I certainly hope that all our members are aware that this substantial project is steaming ahead. At our INSOL International Board meeting in London earlier this year, the 20 working groups which have been established reported back to the Board which reviewed the proposals from each group. These working groups will now be put to the task of further refining and developing the implementation of our strategic plan.

A number of points were raised during the course of the discussions at our board meeting. Of particular relevance to the member associations is that one of the working groups (WG3) will be reaching out to a number of the member associations to reassess our progress relative to the early stages of the task force process when, as some of you may recall, input and feedback was obtained from various sources.

Our various partners in the project and those who have assisted us with the Taskforce have spent many, many hours in progressing its work. There are over a hundred people involved in this particular phase of the development and implementation of our strategic plan. In fact we expect that many more will be involved over the next few years leading up to 2021, and indeed in the years beyond.

Global co-operation

Finally, I have had the privilege of flying the INSOL International flag at a number of events recently. These include:

- the INSOL Europe conference in Warsaw, Poland. I really look forward to working with Radu Lotrean, who has taken over at the helm of IE, and his excellent team;
- the INSOL International Lenders Group meeting in London, jointly hosted by INSOL International and INSOL Europe. This was chaired by well-known economist John Kay. The panel had fascinating insights into what the next financial crisis would be like.
- the SARIPA conference, which was held in Johannesburg, South Africa. My home team! They have also established a "Young Bloods" group of younger members, and attracted some 40 people for a pre-conference get-together. John Winter of ARITA was specially imported for the occasion and also addressed the group. John interfaced with the delegates and the organisation, and added a new dimension to the meetings – both front of house and backstage.

There is no doubt that successful collaboration between INSOL International and our member associations and partner organisation strengthens the collective. It allows us the opportunity of making a meaningful contribution, globally.

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Some considerations relating to the first foreign main proceeding recognition under the new Chilean insolvency law

By Nicolás Velasco Jenschke
Fellow, INSOL International
Chile

The new Chilean insolvency law has aligned with the best international practices, including the adoption of UNCITRAL's cross-border insolvency model law in its Chapter VIII (being the second country in the region in doing so). Such adoption responded to a series of specific factors in the current socioeconomic reality, which made it necessary to regulate the treatment of insolvency procedures where the debtor had a transnational presence in its commercial relationships – which has become the general rule at the moment.

Considering what has been said, it is worth analyzing the first recognized cross-border proceeding in Chile: Elimco Soluciones Integrales Agencia in Chile requested the recognition of the insolvency proceeding of Elimco Soluciones Integrales S.A., its parent establishment located in Seville, Spain, as a foreign main proceeding. Elimco Soluciones Integrales S.A. applied on 25 July 2015 for its voluntary bankruptcy procedure. The application for recognition in Chile was submitted in order that *"the Spanish administration* [of the main procedure] *be responsible for the liquidation of all the assets* [of the agency in Chile], *and allow to participate in such procedures to creditors domiciled in Chile* (...)," further requesting that "an observer –a Chilean insolvency practitioner focused on restructuring- *be appointed to administer, together with the bankruptcy administration in Spain, the assets* [of the Chilean agency] (...)". The Chilean court granted the recognition on June 2 2017, appointing the observer and granting the effects of the "sort of automatic stay" contemplated in articles 20 and 21 of the Model Law. On this particular case, the following observations may be made:

a.- As for the formula for liquidating the assets of the debtor, it must be considered that the Chilean legislature has made some adjustments to the aforementioned Model Law, due to the regulatory architecture of the new insolvency system, in force since 2014. Among them, and for the purposes of what concerns this article, it is important to emphasize that the Chilean parliamentarians chose to eliminate the presumption of insolvency as a cause of commencement of an insolvency procure, under the terms of Article 31 of the aforementioned Model Law. The general rule in Chilean law is that the initiation of insolvency proceedings falls exclusively on the debtor, especially in those cases where the process is about the restructuring of the business (reorganization of the company) or the rescheduling of the debts (renegotiation of the consumer). In line with that, if the recognition application seeks the liquidation of the debtor's assets to proceed with the payment of the debts -respecting the rights and preferences of the different creditors-, it must start a procedure of this nature in Chile – a liquidation – and seek the coordination of both procedures by establishing a single mass of creditors and assets. This would give the procedure more transparency and speed, which is also one of the founding principles of the Model Law.

b.- Likewise, we must remember that the Model Law orders the insolvency court to protect the interests of Chilean creditors. In line with the previous point, the beginning of a liquidation in Chile would allow the establishment of a credit verification period, the only tool available for the judge to determine the real extent of the debtor's liabilities in the national territory, and the order in which the different creditors must be paid. If such a credit verification period is generated as a measure to help the judges decision outside of an insolvency procedure, it would not line up with the effects of the liquidation resolution, which are a necessary requirement for verification, as they settle creditors rights in an irrevocable way, granting certainty.

c.- Regarding the appointment of an observer in a cross-border liquidation proceeding, we must have in mind that, according to Article 2 of the Chilean bankruptcy law, the work of an observer is limited to facilitating agreements between the debtor and its creditors, to facilitate the proposal of Judicial Reorganization Agreements and to safeguard the interests of the creditors, requiring the precautionary measures and conservation of the debtor's assets. Clearly, the designation of an observer in order to sell or manage the assets of the debtor as its odds with the very nature of the work entrusted by law to this individual, which is to adopt a conciliatory role between the parties and to supervise the actions of the debtor. At this point, it is important to remember that the observer usually only acts in reorganizations, which are processes to restructure the assets and liabilities of the viable company in order for it to remain in operation; the debtor remains as the administrator of the business; or exceptionally as supervisor of the actions of the debtor in relation to its assets during the trial of opposition, prior to the issuance of the resolution of involuntary liquidation.

d.- Also, some considerations regarding the use of this tool as a mechanism to avoid the eventual criminal responsibility of the debtor. Law No. 20,720 sought to create a pro-entrepreneurship legislation, decriminalizing the insolvency proceedings, regulating crimes associated with insolvency – guilty or fraudulent – in the Penal Code. These crimes, however, have as common denominator and basic requirement: the commencement of a liquidation, reorganization or renegotiation proceeding. In this sense, proceed with a liquidation procedure that pretends being assimilated to an insolvency procedure, but which has not been declared as such by a Chilean court, prevents the action of the criminal types, and in that sense the social interest that seeks to protect the regulation may be circumvented.

e.- Finally, to carry out the liquidation of the debtor's assets outside an insolvency procedure would prevent the debtor from enjoying one of the benefits specially incorporated in

the law in his favor, that is, the extinction of the unpaid balance of his obligations, aka the fresh start.

All the previous observations were made to the insolvency court, who with this background in hand, opted to suspend the above-mentioned procedure until the debtor clarified their situation and real intention, and granted the necessary guarantees so that all the interested parties can activate their rights.

This leads to the conclusion that, despite the fact that the new Chilean insolvency regulation incorporates many of the instruments necessary for Chile to establish itself as a regional center for debt restructuring, there is still a lack of greater knowledge and experience in the application of these institutions, both by users, practitioners and the courts, so that we can position ourselves as regional referents in this matter.structuring proceedings in all European Member States.

Financial companies as creditors in the Brazilian insolvency proceedings

By: Judge Daniel Costa PhD
1st Bankruptcy Court of São Paulo
Brazil

The Brazilian system generally shields banking contracts from insolvency proceedings, allowing financing institutions to stay away from the collective process of collection and proportional payments in liquidations proceedings. In the same path, the law granted banks immunity from the automatic stay in reorganizations proceedings, allowing them to take further actions against debtor's patrimony, recovering collateral, including through administrative freezing in order to obtain the contract's payoff, despite the existence of many other creditors.

Note that the credits derived from the most common bank loans are not reached by either of the insolvency proceedings set forth in the Brazilian law. Contracts of "alienação fiduciária em garantia", "cessão fiduciária de crédito em garantia" and foreign exchange advance contracts (Adiantamentos sobre Contratos de Câmbio, or "ACC") are largely used on the Brazilian's commercial transactions as a way to finance business activities. Those credits are exempted from the liquidation and reorganization proceedings.

DEED OF TRUST OR CONTRACT OF "ALIENAÇÃO FIDUCIÁRIA EM GARANTIA"

According to the Brazilian Bankruptcy Law[1], the credit represented by a contract bank loan named "alienação fiduciária em garantia", is not affected by the reorganization proceeding[2]. In this sort of contract, the bank finances the purchase of some car or real estate, for example, and takes the temporary ownership of such things as a collateral until the loan's payoff. During the performance of the contract, the purchaser has only the possession over the good offered as a collateral. In case of a filing of a reorganization proceeding and default of the contract, the bank can have the stay lifted to permit foreclosure or to take further actions enforcing a lien in such patrimony. In case of a liquidation proceeding, the creditor has the right to repossess the collateral, since it is not considered as property of the estate. The debtor has only the possession of the collateral and the bank has its ownership. In this sense, the bank can enforce the lien and repossess the collateral, no matter the liquidation proceeding.

In case of reorganization proceeding, art. 49, paragraph 3, of law 11.101/05 says that some contracts are not affected by the reorganization proceeding: chattel mortgage (Deed of Trust or "alienação fiduciária em garantia"), contract of commercial leasing (lease-purchase), title for deed with irreversibility clause and lien on ownership. However, the law says that during the stay period of 180 days, the creditor is forbidden to repossess the collateral from the debtor if the collateral is considered a capital good, which is essential for the company's production. This means that these kinds of creditors are not affected by the plan of reorganization, but they still are affected by the stay period of 180 days.

CONTRACT OF "CESSÃO FIDUCIÁRIA EM GARANTIA"

There is one even more common banking contract in Brazil, named "cessão fiduciária de créditos em garantia", which is also excluded from the reorganization proceeding. In this sort of banking contract the collateral consists of rights to payment (to be made in the future) – receivables – owed to the debtor by some third party. So, in case of default of the secured loan agreement, the bank can collect the amounts due from that third party.

There is no mention of this kind of contract in the Brazilian Bankruptcy Law. As we have seen above, art. 49 regulates creditors on chattel mortgage (Deed of Trust or "alienação fiduciária em garantia"), contract of commercial leasing (lease-purchase), title for deed with irreversibility clause and lien on ownership. However, in the contract of "cessão fiduciária em garantia" the collateral is structured in a similar way in comparison to the contract of "alienação fiduciária em garantia". But, in the "cessão fiduciária de crédito", the receivables owed by the debtor are given to the bank as the collateral. Normally, the bank opens an account where the receivables must be deposited by the debtors of the company. In this sense, if the contract is not performed, the bank can easily take the money from this account by itself.

The Supreme Court of São Paulo (TJSP)[3] has held that this kind of contract fits the legal description in article 49 of the Brazilian Bankruptcy Law and the bank can take the collateral, despite the reorganization proceeding.

Regarding the contract of "cessão fiduciária de créditos em garantia", in which the collateral consists of rights to payment owed to the debtor by some third party, the bank

1. Lei no 11.101, de 9 de fevereiro de 2005, Diário Oficial da União (D.O.U.) de 09.02.2005. (Braz.), art. 49, §3. "Tratando-se de credor titular da posição de proprietário fiduciário de bens móveis ou imóveis, de arrendador mercantil, de proprietário ou promitente vendedor de imóvel cujos respectivos contratos contenham cláusula de irrevogabilidade ou irretratabilidade, inclusive em incorporações imobiliárias, ou de proprietário em contrato de venda com reserva de domínio, seu crédito não se submeterá aos efeitos da recuperação judicial e prevalecerão os direitos de propriedade sobre a coisa e as condições contratuais, observada a legislação respectiva, não se permitindo, contudo, durante o prazo de suspensão a que se refere o § 4o do art. 6o desta Lei, a venda ou a retirada do estabelecimento do devedor dos bens de capital essenciais a sua atividade empresarial".
2. Lei no 11.101, de 9 de fevereiro de 2005, Diário Oficial da União (D.O.U.) de 09.02.2005. (Braz.), art. 49.
3. TJSP, Agravo de Instrumento No. 0408832-11.2010.8.26.0000, Relator: Des. Pereira Calças, 12.04.2011, Diário Oficial do Estado de São Paulo (D.O.E.S.P.), 25.04.2011 (Braz.).

can apply the administrative freeze of the debtor's account used by the third party to deposit the payments due and also can proceed to the payoff, considering that this sort of contract is not affected by the reorganization proceeding.

FOREIGN EXCHANGE ADVANCE CONTRACTS

Foreign exchange advance contracts (Adiantamentos sobre Contratos de Câmbio, or "ACC") also entitles the bank to proceed against the collateral, getting back the money that was given to the debtor in advance on an international trade. According to the article 49, §4 of the Brazilian Bankruptcy Law[4], the reorganization petition filed by the debtor does not reach this sort of contract.

In liquidation cases[5], the bank is also entitled to get back the money that was given to the debtor in advance on an international trade, considering that, in this kind of contract, the debtor is only in the possession of the money, which is owned by the bank. This is the reason why this money cannot be considered as part of the estate.

In many cases, the contract authorizes the bank to apply the administrative freeze. So, if the contract is not regularly performed, the bank can take the money from the debtor's account in order to make the pay off.

The Superior Court of Justice has already held that article 49, §4 of the Brazilian Bankruptcy Law has created a valid exemption since there is not any offense to the Federal Constitution. According to the Court[6], there is no doubt about the constitutionality of the law, so its terms are fully applicable.

However, there are some cases in which the bank simulates a contract of ACC in order to enhance its collateral. Instead of making a regular loan, the bank lends the money to the company by making an ACC (without any foreign exchange), because the collateral in this kind of contract is much more effective, allowing the bank to make the administrative freeze, for instance.

The Superior Court of Justice[7] has held that the recharacterization of the ACC as a mere bank loan agreement, requires cogent evidence of diversion purpose, including technical expertise assistance.

PUBLIC POLICY BEHIND THE EXEMPTIONS

It is clear that the law protects the banks and financing institutions, facilitating the collection of the loans provided for the companies and sole traders. The reason grows out of a simple need: to reduce financing costs for export and business activities in general. The greater the guarantees of recovery of money lent by banks to exporters and businesses in general, the lower the interest charged. The law aimed to address the public interest and stimulate socially useful behavior[8].

The Brazilian legislator has said explicitly, in the previous reasons for the project of law converted in the Brazilian bankruptcy law, that the protection to the bank loans and collateral in insolvency proceedings is essential to sustain the economic growth and to keep interest rates low[9].

However, on the other hand, this legal banking super-protection causes a big problem related to the reorganization financing. After the filing of the reorganization proceeding, the company will have severe difficulties to survive due to the lack of financing from the banks. On one side, the banks can proceed with the collection of their credits, going after the collateral and so on. But, at the same time, the banks are not likely to give new loans to the debtor due the highest risk of default, since the company is under a reorganization proceeding. So, the bank protection can be, at the same time, a solution and a problem to sustain the economic growth[10].

It is true that tax claims are super protected as well, but it's important to bear in mind the public nature of the taxation. The only private sector that has had favorable treatment by the insolvency proceeding in Brazil was the financing sector.

The reason why the legislator selected this option is obvious and somewhat fair: facilitating the recovering on bank loans promotes the commercial activities through the injection of capital and turning up the economy as a whole. The greater the protection of bank credits, the lower the interest rate charged on bank loans, at least in theory. But the problem is that other sectors of the economy are also important to the development of the country and should be helped by the law in order to achieve its potential. And more, the reality is showing that the bank's super protection is not working as it was thought. Interest rates in Brazil still are extremely high, despite the legal provisions brought by the bankruptcy law. So, this protection is acting in a very unfair way in relation to the other creditors that represents many different sectors of the national economy. Only the banks and almost no one else will have success on receiving the due payment.

The experience of the 1st Bankruptcy Court of São Paulo has been showing that the bank protection is an important factor against the success of the business reorganization. Many companies have a high level of debts with the banks and since those debts are not reached by the reorganization proceeding, it is a main cause for the failure of the system. Since the purpose of the business reorganization is to relieve the debtor of overwhelming debts, allowing the business to keep on going and being a source of employment and revenues (social benefits), it makes no difference to the debtor who the debts are owed to.

Lately in Brazil, the role of the banks in reorganization proceedings has been discussed. The financial markets are using only fiduciary collateral as a way to be immune to the bankruptcy system. Therefore, it is quite common that the company, facing a financial distress, may not be considered eligible for business reorganization since its debts will not be shielded against the financial creditors. In this sense, many companies are going out of business, without a chance to overcome the crisis, causing negative social effects such as unemployment.

It would be better if the banks could be involved in the reorganization proceeding, but in a special and favored category of creditors. In this way, the recovering of bank loans would continue to be facilitated as a manner to promote the commercial activities through the injections of capital. But, at the same time, the companies in financial distress would have the opportunity to negotiate with the banks in the business reorganization proceeding, having the right to be protected for a period of time under the judicial supervision.

4. Lei no 11.101, de 9 de fevereiro de 2005, Diário Oficial da União (D.O.U.) de 09.02.2005. (Braz.), art. 49 § 4o. "Não se sujeitará aos efeitos da recuperação judicial a importância a que se refere o inciso II do art. 86 desta Lei".
5. Lei no 11.101, de 9 de fevereiro de 2005, Diário Oficial da União (D.O.U.) de 09.02.2005. (Braz.), art. 86, II.
6. STJ, Recurso Especial No. 1.279.525,Relator: Min. Ricardo Villas Boas Cueva, 07.03.2013, Diário da Justiça (D.J.), 13.13.2013 (Braz.).
7. STJ, Recurso Especial No. 1.350.525, Relator: Min. Nancy Andrighi, 20.06.2013, Diário da Justiça (D.J.), 28.06.2013 (Braz.).
8. Fábio U. Coelho, Comentários à Lei de Falências e de Recuperação de Empresas 336-37 (8th edition, Saraiva, 2011).
9. Senado Federal. Comissão de Assuntos Econômicos. Exposição de Motivos da Lei 11.101/2005.Parecer534,http://redir.stf.jus.br/paginadorpub/paginador.jsp?docTP=TP&docID=580933. (last visited Oct. 10, 2015).
10. Manoel Justino Bezerra Filho, *Trava bancária e trava fiscal na recuperação judicial – Tendências jurisprudenciais atuais, in* 10 ANOS DA LEI DE RECUPERAÇÃO DE EMPRESAS E FALÊNCIAS – REFLEXÕES SOBRE A REESTRUTURAÇÃO EMPRESARIAL NO BRASIL, 325-334 (Luis Vasco Elias, ed., 2015)

Make-whole provisions in Mexico

By Luis Manuel C. Mejan
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Mexico

Introduction

A make whole provision is a clause usually incorporated to a bond's indenture whereby the issuer of the bonds, should he decide to prepay the bond prior to the maturity date, must make a payment to the bondholder in an amount equal to the net current value of the payments, the objection of including a make-whole provision is twofold:

a) to deter the issuers from calling or buying back the bonds because the cost represented by the make-whole clause;

b) to protect bondholders from the decision to repay prior to the maturity of the bonds, especially when they count on the cash flow that comes from the coupon payments.

Such a clause is also used when interest rates go down, then it's cheaper for the issuer to repay the bonds with the make-whole clause and reissue new bonds with a lower interest rate. Bondholders won't be happy with the decision because they will find themselves with liquidity that should to be invested at a lower interest rate.

Several disputes have arisen about the enforceability of such clauses specially in a bankruptcy scenario where the bonds are automatically accelerated and prepayments are forbidden.

The make-whole provision under Mexican legislation

There is no specific provision in a particular statute that mentions about make-whole provisions. It is important therefore to go through the different pieces of legislation in order to arrive at a conclusion about the practicality and enforceability of such clauses in Mexico.

- Usually, a debtor requires the consent of the creditor to make payments in advance, i.e. prior to maturity.[1]

1. (Article 2081 Federal Civil Code)

- The general rule is that parties can agree the conditions to a contract unless it is prohibited by law or contrary to the public interest.

- There is nothing under Mexican law to forbid such clauses. To the contrary what is ruled in Mexican law is:

  A – The indenture must contain:

  VI.- The term indicated for the payment of interest and capital and the terms, conditions and manner in which the obligations are to be amortized;[2]

  - According to this provision, the indenture should include the terms of amortization of the bonds.

  B - *It cannot be agreed that the bonds be amortized by means of drawings to a sum higher than their nominal value or with premiums or prizes, with the exception when they are intended to compensate the bondholders for the early redemption of a part or the entire issue*.[3]

It is therefore possible to say that the make-whole clause is allowed under Mexican law .

Issuers of bonds follow the common practices in the market, so it is possible that Mexican indentures include such clauses.

Due to foreign investment that is taking place in the country , it is a common practice to issue bonds with a specific provision stating a choice of law and a choice of forum particularly when the investors are based usually in New York.

What is the position if the bond issuer becomes bankrupt?

In the event of a bankruptcy, according to Mexican Bankruptcy legislation, all clauses or contractual stipulations that worsens the contract terms for the debtor shall be deemed not written.[4]

Since the make-whole clause does not worsen the conditions for the issuer if it becomes bankrupt, it is possible to argue that bankruptcy of the issuer of the bonds does not affect such clauses.

Effects of a bankruptcy judgement[5]

The following consequences:

a) all debtor's obligations become due

b) the credits due to periodic and successive claims shall be determined at present value on the basis of the agreed interest rate.

c) The unpaid principal and related financial charges of any Mexican currency credits without collateral, shall cease to earn interest and will be converted into UDIs.

d) The unpaid principal and related financial charges of any foreign currency credits without collateral, shall cease to earn interest and will be converted into Mexican pesos and then to UDIs.

e) If the credits have a collateral, such credits shall remain in the currency or unit in which they are denominated, and will only earn the interest stipulated in the contracts, up to the value of the property that serves as guarantee.

   A problem may arise as to whether or not the amounts covered by the make-whole clause should be included in the calculations provided.

   A possible opinion is that the amount of the outstanding credit must be accrued with the interest earned so far, and the amount of the make-whole clause should be included because it is a related financial charge. In addition, the situation for the bondholders is the same that if the borrower calls all the issue.

   On the other hand, an allegation can be made that the make-whole clause only applies when the debtor calls the loan and prepays and in insolvency. These opinions, however, can be a cause of litigation and courts will have to provide directions in time. (there is not so far, any case reaching the Mexican courts)

Position of a bankrupt Mexican bond issuer but the bonds are governed by a foreign law

A Mexican Judge will consider the indebtedness according to the local bankruptcy provisions. At the same time a foreign bondholder in the USA could file a Chapter 15 requesting for the recognition of the Mexican main proceeding and asking the Judge to request the cooperation of the Mexican Judge.

It is important to consider that both Mexico and the USA have adopted The UNCITRAL Model Law on Cross-border Insolvency. The provisions for the foreign creditors are similar.[6]

Some scenarios:

- The issuer is a Mexican company, the indenture is issued according Mexican law, bondholders are foreign creditors, the bankruptcy proceeding is conducted in Mexico.

  The Mexican court is going to apply Mexican law,

2. (Article 210 Law on Securities and Credit Operations)
3. (Article 211.- Law on Securities and Credit Operations - Ley General de Títulos y Operaciones de Crédito)
4. (Article 87- Business Reorganization Act – Ley de Concursos Mercantiles)
5. (Article 88 and 89- Business Reorganization Act – Ley de Concursos Mercantiles)
6. (LCM articles 290 and 310 – Bankruptcy Code, Chapt 15 §1513 and §1532)

foreign bondholders will be treated the same as the Mexican creditors. The only ground for discussion is whether the amount represented by the make-whole clause will be included in the amount of credit recognized to creditors.

- The issuer is a Mexican company, the indenture is issued according foreign law (let's say NY), bondholders are foreign creditors, the bankruptcy proceeding is conducted in Mexico.

  Mexican court is going to apply Mexican law, even if the indenture is ruled by New York law, the bond has finished its life and should be considered like any other credit. Foreign bondholders will be treated the same that Mexican creditors. Grounds for discussion will be: whether the amount represented by the make-whole clause will be included in the amount of credit recognized to creditors, and if the USA law provision will be different to the Mexican law with respect to enforceability of the make-whole clause, and for the conclusion of the bond.

- The issuer is a Mexican company, the indenture is issued according foreign law (let's say NY), bondholders are foreign creditors, the bankruptcy proceeding is conducted both in Mexico and in the USA.

  This depends on which of the two Insolvency proceedings is going to be designed as the Foreign Main Proceeding. If it's Mexico's (which we deem to be the logical answer) what is said in the second scenario above) will apply. If it's the one in the USA court, it court will have to decide and consider the objections raised by the Mexican creditors.

Conclusion

Make-whole clauses can be inserted in Mexican issues of bonds and will be enforceable. If the Mexican issuer is using a different choice of forum and choice of law it will be necessary to consider the laws of those forums.

If the Mexican issuer becomes involved in a bankruptcy proceeding the Mexican courts have yet to decide on these issues because these matters have not been litigated yet. There are two main issues to be solved: one, whether the make-whole clause is a clause that worsens the contract terms for the debtor, and if the answer is yes, then the clause will be considered as not written. The second is whether the automatic acceleration of debts will be considered as a pre-payment event and the amount of the make-whole provision should be added to the recognition in the credit claims.

As in Mexico the situation has not appeared so far in Court we can expect those problems to be the ground for litigation.

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The risk of competing insolvency proceedings highlights the need for Latin American Countries to adopt the UNCITRAL Model Law on Cross-Border insolvency

By Andrew Rosenblatt and Francisco Vazquez[1]

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USA

In today's global marketplace, many Latin American companies conduct a significant portion of their business abroad and, consequently, have a large number of foreign investors and jurisdictionally diverse creditor constituencies. Moreover, in some instances, local laws restrict the ability of Latin American companies to issue dollar-denominated debt. These factors have resulted in more and more Latin American-operated companies having a key subsidiary or affiliate – many times the organization's financing arm – located and/or registered in a country outside of Latin America. This dynamic, coupled with an expanding universe of sophisticated, knowledgeable, well-funded and proactive investors, has led to an increase in the filing of "competing" insolvency proceedings involving Latin American companies. Recent mega-cases from Brazil, including *OAS* and *Oi*, highlight this trend. In those cases, the debtors commenced voluntarily insolvency proceedings in Brazil, but creditors commenced competing insolvency proceedings in other jurisdictions. Competing cases can lead to increased uncertainty, delay and cost, all of which could ultimately jeopardize a debtor's prospects of successfully reorganizing and creditors' prospects of repayment.

The uptick in the filing of competing cases underscores the need for countries in Latin America to adopt formal cross-border bankruptcy legislation in order to provide for assistance and cooperation between courts in cross-border proceedings. Currently, 45 jurisdictions have adopted the UNCITRAL Model Law on Cross-Border Insolvency. Of those 45 jurisdictions, however, only four (Chile, Colombia, the Dominican Republic, and Mexico) are in Latin America. Formal cross-border legislation would help mitigate the risk of conflicting decisions issued by multiple courts regarding the same debtor and the concomitant delay and increased cost involved in resolving such disputes.

OAS: Competing Plenary Cases Causes Confusion

The OAS group of companies is one of the largest corporate enterprises in South America, and a key player in the engineering, construction, and infrastructure sectors. OAS was one of several Brazilian companies implicated in, and negatively impacted by, the corruption scandal known as "operation car wash." The fallout from the scandal precluded the company from tapping new financing sources and ultimately resulted in OAS S.A. and nine other companies in the OAS group commencing bankruptcy proceedings under the laws of Brazil. Notably, one of the OAS debtors–OAS Finance Limited, which was the company's finance arm–was not registered in Brazil. That entity, which was registered in the British Virgin Islands, was formed for the exclusive purpose of accessing capital markets outside of Brazil and had issued two series of U.S. dollar denominated notes to investors located primarily in the U.S. and Europe. The notes were guaranteed by OAS S.A. and other Brazilian debtors.

Prior to commencing bankruptcy proceedings in Brazil, the OAS group engaged in a series of out-of-court restructuring transactions that resulted in asset transfers within the OAS group. Certain U.S. noteholders challenged those transactions in Brazil on the basis that they prejudiced the noteholders' rights and ability to recover on their notes and related guarantees. The creditor challenges were largely rebuffed by the Brazilian courts in what was perceived by some as rulings that advanced the interests of the company and the social and economical welfare of Brazil over the rights and interests of creditors. Unsatisfied with their treatment in Brazil, the U.S. noteholders sued members of the OAS group in the U.S. to recover on their claims. In response, the OAS debtors commenced Chapter 15 cases in the United States Bankruptcy Court for the Southern District of New York, seeking to obtain recognition of the Brazilian bankruptcy cases as foreign main proceedings to (i) stay the creditor enforcement proceedings, and (ii) centralize the administration of the restructuring in Brazil.

Rather than stand pat in the face of the Brazilian proceedings and the Chapter 15 cases, the U.S. noteholders commenced insolvency proceedings in the British Virgin Islands for OAS Finance. In the BVI, the noteholders successfully obtained an order appointing joint provisional liquidators for OAS Finance. The BVI

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court's order purported to divest the company's directors of power and conferred exclusive authority to act for OAS Finance on the JPLs.

In furtherance of the BVI court order, the JPLs notified the directors of OAS Finance of the revocation of their authority to act for OAS Finance in Brazil and elsewhere. In addition, the JPLs, with the support of the U.S. noteholders, challenged the Chapter 15 petition seeking recognition of OAS Finance's Brazilian proceeding on the basis that the Brazilian foreign representative of OAS Finance did not have authority to act for the company. At the same time, the JPLs commenced their own Chapter 15 case seeking recognition of OAS Finance's BVI proceeding. The JPLs asserted that they had sole authority to speak for, and act on behalf of, OAS Finance. The foreign representative of the Brazilian proceeding disagreed and alleged that the BVI proceeding was not valid. Consequently, there were competing plenary proceedings with respect to OAS Finance, as well as competing ancillary Chapter 15 cases. To complicate matters further, the JPLs sought to intervene in the Brazilian proceedings by filing a motion seeking to exclude OAS Finance from the Brazilian restructuring proceeding. The JPLs motion was denied by the Brazilian court.

The strategy pursued by the U.S. noteholders resulting in dual and competing proceedings for OAS Finance created a dynamic that, at the time, raised a multitude of critical questions: Who had authority to act for OAS Finance? Would the officers and directors of OAS Finance continue to act for the company in Brazil and disregard the BVI court order? Would the Brazilian court ignore the BVI court order and ultimately approve a plan for OAS Finance over the objections of the JPLs? Could an insolvency of OAS Finance be administered in the BVI and, if so, what would the proceeding look like given the Brazilian proceeding? These issues created uncertainty, especially because Brazil has not yet adopted formal cross-border bankruptcy legislation to govern the Brazilian court's interaction with the BVI court.

Ultimately, these difficult questions were not resolved because a compromise was reached and the U.S. noteholders consented to a plan in Brazil. It was also agreed that the BVI proceeding would be held in abeyance pending resolution of the Brazilian proceedings. Although a settlement was ultimately reached, it is clear that the aggressive actions of the U.S. noteholders provided them some degree of leverage in negotiations with the debtors. As discussed below, this same strategy has been used in connection with another recent Brazilian bankruptcy case and it is not difficult to imagine that creditors in future cases may follow it as well. This would have the potential of creating a roadblock for Latin American debtors or, at a minimum, increasing the potential delay, cost and uncertainty surrounding insolvency proceedings filed in Latin America.

Oi: OAS Redux

Oi is another case involving a major Brazilian company that commenced insolvency proceedings in Brazil. *Oi* has striking similarities to *OAS* in that Oi, which is one of the largest integrated telecommunications service providers in Brazil, issued notes through a non-Brazilian affiliate (a Dutch entity) and that entity, along with Oi as guarantor under the notes, were debtors in the Brazilian bankruptcy proceedings. Shortly after commencing bankruptcy proceedings in Brazil, Oi and several of its affiliated debtors, including the Dutch entity ("Oi Netherlands"), commenced Chapter 15 cases in the United States Bankruptcy Court for the Southern District of New York. The Bankruptcy Court granted recognition to the Brazilian proceedings of the Oi debtors, including Oi Netherlands, as foreign main proceedings, finding that the center of main interest of each of the debtors was Brazil. Consequently, creditors were enjoined from taking actions against Oi and Oi Netherlands in the U.S.

Shortly before recognition of the Brazilian proceedings, certain U.S. noteholders initiated competing insolvency proceedings against Oi Netherlands in the Netherlands. Before the involuntary petitions were considered by the Dutch court, Oi Netherlands filed a petition for a provisional suspension of payments, which is a formal insolvency proceeding in the Netherlands that generally results in a stay of actions against the debtor. Ultimately, the Dutch court granted the suspension of payments petition and appointed an administrator for Oi Netherlands.

Approximately four months after his appointment, the Oi Netherlands administrator and some of the noteholders requested conversion of the suspension of payments proceeding to bankruptcy. The Dutch court denied the request. However, on appeal, the Amsterdam Court of Appeals reversed the Dutch court and declared Oi Netherlands to be bankrupt and appointed a trustee. In Brazil, in response to the trustee appointment, the debtors sought and obtained an injunction purportedly blocking the Dutch trustee from taking any action on behalf of Oi Netherlands. In denying a subsequent motion filed by the Dutch Trustee in Brazil to stay the injunction, a Brazilian appellate court noted that the injunction applies only to Oi Netherlands' assets and claims in Brazil. In a separate ruling, the appellate court found that the injunction has extraterritorial effect unless a foreign court "concludes otherwise in that regard." Subsequently, the Dutch court concluded that the Brazilian injunction would not be enforced in the Netherlands because there is not a treaty between the two countries.

The Oi Netherlands trustee, with the support of the U.S. noteholders that had commenced the original Dutch proceeding, then filed a petition seeking recognition of the Dutch bankruptcy proceeding as a foreign main proceeding under Chapter 15 of the Bankruptcy Code. Oi and a group of Oi noteholders have opposed the petition. Consequently, the Bankruptcy Court held an evidentiary hearing, which lasted four days, to consider the Chapter 15 petition. As of the date of this article, the Bankruptcy Court has not rendered its decision. Nevertheless, it is apparent that, in coming to its decision, the Bankruptcy Court seemingly will have to address many of the same issues raised in the OAS case that resulted from having dual and competing proceedings, including determining the location of Oi Netherlands' center of main interest (COMI), which will control whether the Dutch proceeding can be recognized as a foreign main proceeding.

Because a debtor can have only one COMI, should the Bankruptcy Court find that the Netherlands is Oi Netherlands' COMI, the court's prior order recognizing the Brazilian proceeding will likely be modified, at least as to Oi Netherlands. Should the court, consistent with its prior ruling, find that Brazil is Oi Netherlands' COMI, the court's earlier recognition order would likely stand undisturbed. At this point, it is unclear how the Oi cases will ultimately play out, but the filing of competing plenary proceedings and lack of uniform cross-border legislation in Brazil has created uncertainty and has resulted in increased litigation and concomitant delay and cost, all of which may negatively impact creditors.

Benefits of Implementing Formal Cross-Border Legislation

Although the Model Law may not be able to halt a creditor from commencing a competing insolvency proceeding against a Latin American debtor – as was the case in *OAS* and *Oi* – the Model Law creates a framework that fosters cooperation and coordination between courts, thus reducing, if not entirely eliminating, needless litigation, uncertainty, cost, delay and the risk of conflicting results. In particular, the Model Law and Chapter 15 expressly direct a court to "cooperate to the maximum extent possible with a foreign court or foreign representative" (Bankruptcy Code § 1525) and set forth a nonexclusive list of the types of cooperation that a court should consider (Bankruptcy Code § 1527). Indeed, the Model Law and Chapter 15 state that cooperation may be implemented "by any appropriate means" and set forth several examples, including, the entry of agreements or protocols concerning the coordination of multiple proceedings involving the same debtor and the communication of information by any means considered appropriate by the court.

Legislation incorporating the Model Law would have compelled the Brazilian court in OAS to engage the BVI court in discussions to coordinate the competing proceedings and, in particular, to address, in a consistent manner, issues related to the control of OAS Finance. Similarly, such legislation would have required the Brazilian court to cooperate with the Dutch court to facilitate a restructuring of Oi Netherlands. At the very least, communications between the courts in both cases could have narrowed, if not resolved, the contested issues and also could have resulted in the implementation of a more efficient and effective process for addressing the issues (*e.g.*, the coordination of pleadings and discovery and even the possibility of holding a joint hearing).

The United States and other countries have successfully implemented the Model Law, which has created a more predictable and stable legal framework for resolving cross-border bankruptcy cases. Latin American countries should follow suit.

The effects of a reorganization on the pending contracts of the debtor

By: Ricardo Reveco
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Chile

Law 20.720 *On the reorganization and liquidation of companies and individuals*, enacted in Chile in 2014, regulates different insolvency proceedings applicable to companies with financial difficulties, allowing the restructuration of their assets and liabilities or their liquidation (bankruptcy). Both the start of a reorganization proceeding ("Reorganization") and the approval of a Reorganization Agreement, have substantial effects on the debtor's contracts, especially concerning the remedies available to its counterparties (mainly regarding *ipso facto* clauses). These effects will be briefly analyzed in this article.

With the filing by the debtor of the motion for the start of the Reorganization, the court issues the Reorganization Resolution that opens the so-called Insolvency Protection Period (which lasts at least 30 working days extendable to up to 90 days depending on the support received from creditors). The Reorganization Resolution - among other effects- suspends executions and liquidation claims against the debtor (*stay order* similar to that established in Chapter 11 of the US Bankruptcy Law), and also orders that contracts maintain their terms and conditions of payment, prohibiting their termination due to the start of a Reorganization.

Below, we will review the main effects of the start of the Reorganization for the creditors of the debtor.

First, during the Insolvency Protection Period, judicial enforcement of contracts against the debtor is restricted: specific performance is restricted because the debtor will not be able to encumber or dispose of his assets, except in the ordinary course of business; and starting foreclosure proceedings against the debtor is also restricted. The exercise of *ipso facto* clauses, that is, those that pursue the automatic termination of a contract, the acceleration of credits or the execution of guarantees, is also restricted.

Chilean law – faced with the dilemma of authorizing or forbidding the early termination of contracts due to the start of a Reorganization – has opted for an intermediate solution. Thus, it impedes creditors from early terminating contracts due to the start of the Reorganization, but allows them to early terminate for different reasons. In this way, Chile recognized the *principle of preservation of business* of the company, expressed in the maintenance of the current contracts of the debtor company. The sanction to the creditor who infringes the legal prohibition is even more drastic than the nullity of the early termination. The infringer is postponed in the payment of its claims until both unsecured creditors and related entities creditors have been fully paid. If we consider that the average recovery in Chile in bankruptcy liquidations is less than 35% of the capital, this legal sanction means that, as a general rule, the infringer creditor will never be paid.

A second relevant effect of the Insolvency Protection Period is the creation of new general preferences that affect all assets and creditors of the debtor, creating a *"super preference"* in favor of suppliers and financiers that allow the company to continue during the negotiation of the terms of an eventual Agreement. These incentives benefit suppliers of goods and services that are necessary for the operation of the Company; those who finance foreign trade operations; and loans contracted for the financing of its operations. All these contractors have in their favor, as creditors, a first-class preference in the payment of their credits, even higher than workers' and tax credits, in the event that the reorganization is frustrated and results in liquidation.

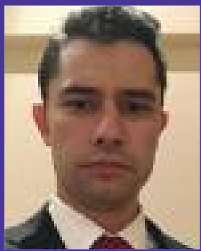
Third, the law implemented the principle of *subjective universality*, by which the Reorganization Agreement will be a collective agreement affecting all creditors, whether secured or unsecured, making a radical change to the previous legislation that in principle was only binding for unsecured creditors. Therefore, if the Agreement is approved, all the credits that are part of the proceeding will be understood to have been remitted, novated or renegotiated, as appropriate, for all legal purposes, which means that the debtor's and its creditors' patrimonial relationships are modified. In this way, the contracts will have to be adjusted to the conditions agreed in the Reorganization Agreement, whether related to the enforceability of the obligations (due to their renegotiation) or to the extinction of these (either by remission, cancellation, etc.1).

Fourth, given that the approved Reorganization Agreement is universally binding to creditors, the credits of creditors benefiting from collateral and personal guarantees affecting essential assets of the debtor company are also bound by its terms. Therefore, if a guarantee falls on an essential good, i.e. an asset which is necessary for the debtor's business, the credit will be bound by the terms of the Agreement. On the other hand, if the guarantee falls on a non-essential good, the creditor may separately foreclose its guarantee and be paid preferably from that foreclosure.

With the four effects described, Law 20.720 seeks to consolidate the *principle of preservation of the company*, establishing benefits for the debtor and allowing the debtor company to continue with its business by means of the reorganization of its assets and liabilities through the Agreement with its creditors. This regulation undoubtedly allows Chile to adjust its insolvency proceedings to international standards, since the initiation of a bankruptcy proceeding in our country is no longer synonymous with the termination of the debtor's economic activities and the termination of its contracts.

[1] To encourage the creditor to remit his credit in a Reorganization Agreement, the law authorizes the deduction of the remitted credit from income tax.

Obligations and responsibilities of directors before and during the insolvency proceeding according to Mexican law



By Gilberto Miranda Sola

and

Tania Garza Boland

ONTIER

Mexican legislation provides different obligations and responsibilities before and during an insolvency proceeding, as is established in the Insolvency Proceedings Law (*Ley de Concursos Mercantiles*) (the "Law"). Additionally, there are other regulations such as the Commerce Code (*Código de Comercio*), the Federal Civil Code (*Código Civil Federal*), the Federal Tax Code (*Código Fiscal de la Federación*), the General Law of Commercial Companies (*Ley General de Sociedades Mercantiles*), the Securities Market Law (*Ley del Mercado de Valores*) and the Federal Labor Act (*Ley Federal del Trabajo*), which also establish several obligations and responsibilities to the merchant. In case the merchant is an entity, these obligations and responsibilities shall be applicable to the individuals in management, directive and relevant positions or those that might have power of decision.

The Law provides that if a merchant is in general default of its payment obligations and suffered damage, the directors and relevant employees will have the responsibility to compensate: (i) for actions in which they voted in favor or taken decisions having conflicts of interest; (ii) for acts that had favored a particular shareholder or group of shareholders in detriment or prejudice to other shareholders; (iii) when they obtain benefits for themselves or seek them in favor of third parties; (iv) when they generate or leak false information; (v) when they order or cause the omission or alteration of the operations' registry; (vi) when they order or accept to register false data in the merchant's accounting; (vii) when they partially or totally destroy accounting systems or records; (viii) when they alter or order to alter active or passive accounts, contractual terms and conditions or register non-existent operations and expenses; and (ix) when they perform malicious, or illegal acts or in bad faith. The responsibility action is an exclusive action of the merchant, and it may be exercised by the merchant or the shareholders of the company that represent 25% or more of the company's share capital. The actions designed to hold accountable will prescribe within 5 years from the date that would have happened to any of the acts described above.

Nonetheless, there will be no responsibility of the directors and/or relevant employees when they acted in good faith, and such acts would have been: (a) done according to the law or the company's by-laws; (b) a decision based on the information provided by other relevant employees, the external auditors or other independent experts; (c) the most suitable alternative, according to its judgment or the possible damage would not have been foreseeable; or (d) made according to the agreements by the shareholders' meeting, provided that these were not against the Law.

However, the Law does not only establish responsibilities for the directors but also does so for the authorities that participate in the insolvency proceeding, being the examiner, conciliator or syndic positions, for their own acts or even for the acts of their assistants. So these responsibilities consist of compensation for damages caused to the merchant while performing their respective functions, for non-compliance of their obligations, and for revealing confidential data acknowledged while performing their positions. Also the proceeding judge may order compliance measures deemed convenient and request the individuals' substitution, in order to avoid damages against the assets in case their performance is not according to the Law.

In addition, the Law provides that when the insolvency proceeding has been declared, the merchant:

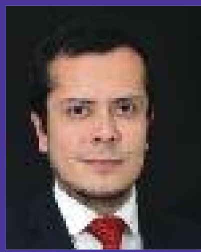
1. Shall be punished with a penalty of 3 to 12 years of prison for any act or conduct that caused or aggravated the payment default of the merchant's obligations. In the understanding that it shall be presumed that the merchant has caused or has willfully aggravated the general default of the payment obligations, when the accounting was carried out in a way that does not allow to know the financial situation or alters it, falsifies it or destroys it.
2. Shall be punished with a penalty of 3 to 12 years of prison the directors or director, CEO, relevant employees or representatives of the merchant, when they alter active or passive accounts, contractual conditions, make or order that non-existent operations or expenses are recorded, or perform any illegal or prohibited by law act or operation, that cause damage to the merchant or an economic benefit to the individual.
3. Shall be punished with 1 to 3 years of imprisonment when requested by the judge of the insolvency proceeding, the merchant does not put the accounting at the disposal of the judge or to whom the judge designated for this purpose, unless there is a cause of force majeure or an act of God.

The Law also regulates the fraudulent acts against the creditors, which include the acts that the merchant had done prior to the insolvency declaration and knowingly fraud the creditors and when the third party participating in the fraud knowingly done so. In the understanding that the fraudulent acts are those performed free of charge, those in which the merchant pays a significantly higher value or receives a significant lower price from its counterpart, also the operations celebrated by the merchant that the terms and conditions do not comply with the ones of the market or with the market's costumes, debt cancellation, payment of non-due obligations, among others. The responsibility action consistent in compensating damages may be exercised by: (i) the fifth part of the acknowledged creditors; (ii) those who represent at least 20% of the total amount of the acknowledged credits, in their character of acknowledged creditors; and (iii) the designated supervisor in the insolvency proceeding. For clarity effects the fraudulent acts against the creditors will not be effective against the assets.

Finally, the Law also provides for acts of third parties who intend to carry out the recognition of a non-existent or simulated credit, in the understanding that they will be punished with 1 to 9 years of prison.

The recent wave of restructurings in Brazil

By Fábio Rosas
Jose Luis Rosa
Luis Guilherme Halasz de Camargo
Souza Cescon, Brazil
And Laura Hall
Allen & Overy, USA



Over the past five years, Brazilian insolvency law has played a crucial role in helping the country weather the shocks to its economy caused by successive corruption scandals and the failure of some of the company's largest commercial concerns. This article considers the response of Brazilian and cross-border insolvency practitioners to these challenges through proceedings under Brazil's bankruptcy law, Federal Law 11.101/2005. The enactment of the Brazilian bankruptcy law was intended to shift from the prior liquidation-focused regime to a modern corporate restructuring tool that would support a rescue culture. As events have proven, it has succeeded beyond expectations and enabled the Brazilian restructuring profession to provide a bulwark against the fallout from recent economic and political upheaval.

By 2012, Brazil had emerged from the 2008 global financial crisis as a popular destination for cross-border investment, particularly in its oil & gas and construction sectors. In 2013, however, oil & gas company OGX, owned by then-multibillionaire Eike Batista, commenced judicial reorganization proceedings after experiencing results less than anticipated in drilling the pre-salt oil layer, calling into question its reported reserves. OSX, a shipbuilding company in Batista's empire that was expected to provide drill ships and shipping services to OGX, also filed for judicial reorganization.

In 2014, Brazil's oil & gas troubles deepened with government investigators' revelation of massive fraud, diversion of public funds, and corruption at Petrobras, the state-owned oil major, in the investigation known as *Lava Jato* (Operation Car Wash). The disclosure of the fraud had a ripple effect across the oil & gas sector as additional

RICHARD TURTON AWARD, 2017

Richard Turton had a unique role in the formation and management of INSOL Europe, INSOL International, The Insolvency Practitioners Association and R3, the Association of Business Recovery Professionals in the UK. In recognition of his achievements the four organisations jointly created an award in his memory. The Richard Turton Award is an annual award providing an educational opportunity for a qualifying participant to attend the annual INSOL Europe Congress and have a technical paper published.

In recognition of those aspects in which Richard had a special interest, the award for 2017 was open to applicants who fulfilled all of the following:

- Work in and are a national of a developing or emerging nation;
- Work in or be actively studying insolvency law & practice;
- Be under 35 years of age at the date of the application;
- Have sufficient command of spoken English to benefit from the conference technical programme;
- Agree to the conditions below.

Applicants for the award were invited to write a statement detailing why they should be chosen in less than 200 words. A panel representing the four associations adjudicated the applications. The panel members are as follows: Robert van Galen – INSOL Europe, Neil Cooper – INSOL International, Patricia Godfrey – R3 and Maurice Moses – IPA. The committee received outstanding applications for this year's award and it was a very close run decision. We are delighted that the award has attracted such enthusiasm and response from the younger members of the profession and know that Richard would also be extremely pleased that there had been such interest.

The committee is delighted to announce that the winner is **Bingdao Wang** from China. Bingdao is currently a third year PhD candidate at University of Leeds, UK. His research focuses on the development of cross-border insolvency law in developing countries, his research explores how experiences from Europe and other developed jurisdictions would help the imperative insolvency system reforms in emerging markets. This is the first time that we have had a winner from China. Previous winners have come from Uganda, Belarus, Hungary, India, Latvia, Lithuania, Poland, PRC, Romania, Russia and Serbia.

As part of the award, Bingdao was invited to attend the INSOL Europe Congress on the 5-8 October 2017, which is being held in Warsaw, Poland. He will be writing a paper on "Belt and Road: Is it an Oppertunity for a Regional Insolvency Solution?", that will be published in summary in one or more of the Member Associations' journals and in full on their website. We would like to congratulate Bingdao for his excellent application and would also thank all the candidates who applied for the award this year.

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R3

companies, such as *Sete Brasil, Schahin Group, Galvão Engenharia*, and others were implicated and all of them used judicial reorganizations.

The OGX, OSX, *Sete Brazil* and *Schahin* groups all had cross-border operations, but Brazilian bankruptcy law has no provisions addressing cross-border insolvency. The Brazilian courts demonstrated commercial sensibility and adaptability in finding ways to enable foreign-incorporated entities to participate in Brazilian insolvency proceedings (even while maintaining proceedings in their jurisdictions of incorporation) and thereby formulate a coordinated solution to each group's financial circumstances and operations worldwide. Had the courts taken a more rigid approach, the value of these integrated enterprises likely would have been diminished. Instead, relevant business of these companies were restructured and sold to investors as going concerns.

These massive insolvency proceedings proved, however, to be only the first wave of casualties from the Petrobras scandal. In 2015, further developments in *Lava Jato* implicated numerous large construction and infrastructure multinational groups, such as OAS, Mendes Junior, UTC Engenharia, Galvão Engenharia, and Odebrecht Oil and Gas in early 2017, caused the near-collapse of what had been one of Brazil's strongest sectors. The same period saw financial crisis in other sectors as well, affecting real estate companies Viver and PDG. With several thousands units sold, Viver and PDG used judicial reorganization proceedings to protect and restructure themselves although a dispute over "segregated" assets and special purpose companies as collateral for financers are still pending final decision. As a result, Brazilian courts and the insolvency profession more broadly were faced with new challenges that required them to innovate to preserve value, enable companies to continue operating and successfully emerge from the temporary (but already long) crisis.

In the OAS proceeding of 2015, the negotiation and restructuring mechanism formulated between the company and one of the investors, established one of the Brazil's most complex and complete programs of DIP financing, court-supervised asset auction, debt and corporate reorganization, credit bidding allowance, and continuity of core activities by the company. It pre-established terms and conditions for the plan: a court auction for the sale of a business unit (holding OAS's Invepar shares); a "stalking horse" bid in the auction to publicly disclose the first proposal and a "right to top" offer to balance the advantage of a third interested party. Furthermore, a DIP finance facility secured by collateral was created with the intention to preserve the company's business while the proceeding developed. Assets were finally sold to creditors (bondholders) through a credit bid in the auction. The DIP financing and restructuring structure allowed OAS to continue construction operations employing tens of thousands of workers in several countries. A similar structure was used in Abengoa's Brazilian judicial reorganization case in 2017.

Also in 2016, Brazil saw the commencement of its largest judicial reorganization yet—the filing by the Oi telecom group. Unlike the other cases discussed, the Oi filing arose from the company's historical business operations. The Brazilian Federal government is taking a leading role in the reorganization due to the thousands of consumers affected, vast territory reached and as one of the major creditors, which is still ongoing.

Through these successive waves of economic and political instability, insolvency proceedings have proven key to managing the effect of large corporate bankruptcies on the Brazilian economy. Although the judicial reorganization procedure lacks formal provisions for dealing with some of the complex issues that have arisen in these cases, Brazilian courts and insolvency professionals have proven themselves willing and able to innovate, both by looking to foreign models and by developing measures tailored to domestic legal and economic conditions. Importantly, developing a mechanism for funding for companies in judicial reorganization has enabled some of Brazil's largest employers to remain in business and forestalled the unrest that massive layoffs would have generated. But ad hoc procedures have also given rise to uncertainty, which may have led to delayed entry into judicial reorganization by some companies and clearly has generated massive litigation. Brazilian insolvency professionals are discussing amendments to the Brazilian bankruptcy law that would codify some recent developments and revise provisions that have proven inadequate. The goal is to create even faster and more efficient restructuring proceedings that will support a rescue culture, to the benefit of the broader Brazilian society and economy.

Substantive consolidation in United States bankruptcy cases

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The problem of closely-related debtors in financial distress is universal. In the US, in appropriate cases courts may substantively consolidate debtors to achieve fairness and equity, even when one of the debtors has not commenced a bankruptcy case.[1] As noted by a leading authority, substantive consolidation "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for inter-entity liabilities, which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor."[2]

In short, substantive consolidation consolidates two or more entities such that: (1) liabilities and assets are combined; (2) liabilities of the combined entities are satisfied from the assets of the combined entities; (3) distribution priorities are combined; (4)

1 In Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941), the Supreme Court authorized the combination of a non-debtor with a debtor in bankruptcy to prevent fraud.

2 In re Owens Corning, 419 F.3d 195, 205 (3d Cir. 2005) (quoting Genesis Health Ventures, Inc. v. Stapleton (In re Genesis Health Ventures, Inc.), 402 F.3d 416, 423 (3d Cir. 2005)).

intercompany obligations are eliminated; and, in a chapter 11 setting, (5) creditors are combined for purposes of voting to confirm a plan.

There is no statutory authority specifically authorizing substantive consolidation. As described by the Second Circuit:

> The power to consolidate is one arising out of equity, enabling a bankruptcy court to disregard separate corporate entities, to pierce their corporate veils in the usual metaphor, in order to reach assets for the satisfaction of debts of a related corporation.[3]

"A court's ability to substantively consolidate has been found to be within 'the court's general equitable powers as set forth in [Section] 105' of the Bankruptcy Code."[4] In addition, the Bankruptcy Code explicitly permits implementation of plans of reorganization though "merger or consolidation of the debtor with one or more persons."[5] Given the origins of the doctrine in equity and the lack of statutory authority, United States courts are not in agreement with respect to the test to be applied to impose substantive consolidation. Note, however, that while substantive consolidation is often perceived as a remedy available to and commonly invoked by creditors, all three of the leading cases discussed immediately below arose from debtor-driven Chapter 11 plans calling for substantive consolidation.

In the Third Circuit — covering the important venue of Delaware, as well as New Jersey and Pennsylvania — the court stated its test as follows:

> In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.[6]

The Second Circuit — which covers the important jurisdiction of New York — synthesized the prior precedents slightly differently in *Augie/Restivo Baking Co.* It viewed the extensive list of factors cited and relied upon by other courts as being

> merely variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit, …' or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors …."[7]

Very recently, the bankruptcy court for the influential Southern District of New York recast *Augie/Restivo* as seeking to find:

> whether (i) "creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit"; or (ii) "the affairs of the debtors are so entangled consolidation will benefit all creditors." . . . This test is in the disjunctive and the satisfaction of either prong can justify substantive consolidation. . . . The first prong, whether creditors relied on a separate existence of the debtors, is "applied from the creditors' perspective." . . ."The inquiry is whether creditors treated the debtors as a single entity, not whether the managers of the debtors themselves, or consumers viewed the [debtors] as one enterprise." . . . Under the second prong, courts typically analyze whether the debtors have demonstrated either an operational or a financial entanglement of business affairs.).[8]

Other courts have employed balancing tests, factoring in such elements whether there is substantial identity among the parties sought to be consolidated, or whether the benefits of consolidation outweigh the harms.[9] Others have examined such specific elements as: (1) the degree of difficulty in segregating and ascertaining individual assets and liabilities; (2) the presence or absence of consolidated financial statements; (3) the profitability of consolidation at a single physical location; (4) the commingling of assets and business functions; (5) the unity of interests and ownership between the various corporate entities; (6) the existence of parent and inter-corporate guarantees on loans; and (7) the transfer of assets without formal observance of corporate formalities.[10]

Finally, some courts have ordered substantive consolidation in circumstances that would have justified application of the "piercing the corporate veil" doctrine under applicable nonbankruptcy law, usually the law of the several states.[11]

As a general rule, given the powerful consequences of substantive consolidation, courts have adopted the view that "[t]he power to consolidate should be used sparingly" because of the potential harm to creditors of substantive consolidation.[12] As a result, while substantive consolidation remains a possible weapon to combat the fraudulent and sloppy use of the corporate form, its use is not common. The possibility, however, of this type of enforced merger requires significant consideration at the planning and drafting stage of any endeavor,[13] and vigilance after setup to ensure that separateness, if desired, is known and observed.

3 In re Continental Vending Machine Corp., 517 F.2d 997, 1000 (2d Cir. 1975).

4 In re Republic Airways Holdings Inc., 565 B.R. 710, 716 (Bankr. S.D.N.Y. 2017) (quoting Union Sav. Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co., Ltd.), 860 F.2d 515, 518 n.1 (2d Cir. 1988)).

5 11 U.S.C. § 1123(a)(5)(C).

6 In re Owens Corning, 419 F.3d 195. 208 (3d Cir. 2005)

7 Union Sav. Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co., Ltd.), 860 F.2d 515, 518 (2d Cir. 1988) (citations omitted).

8 In re Republic Airways Holdings Inc., 565 B.R. 710, 717 (Bankr. S.D.N.Y. 2017) (citations omitted). This case in particular reflects the flexibility of substantive consolidation as a remedy, in that the debtors were "deemed" consolidated only for purposes of plan confirmation, voting and distribution to creditors – the plan did not provide for a permanent merger of the reorganized debtors into a single company. Moreover, the substantive consolidation as ultimately approved was "partial" and not complete, in that the plan offered alternate treatment to a large creditor holding a guaranty that would have been extinguished through substantive consolidation.

9 See, e.g., Reider v. FDIC (In re Reider), 31 F.3d 1102, 1108 (11th Cir. 1994); Eastgroup Props. v. Southern Motel Assocs., Ltd., 935 F.2d 245, 2498 (11th Cir. 1991); In re Snider Bros., 18 B.R. 230, 238 (Bankr. D. Mass. 1982).

10 See, e.g., Kapila v. S&G Fin. Servs., LLC (In re S&G Fin. Servs. of S. Fla., Inc.), 451 B.R. 573, 583–84 (Bankr. S.D. Fla. 2011); In re Raymond Prof'l Grp., Inc. v. William A. Pope Co (In re Raymond Prof'l Grp., Inc.), 438 B.R. 130, 138 (Bankr. N.D. Ill. 2010); In re Vecco Constr. Indus., Inc., 4 B.R. 407, 410 (Bankr. E.D. Va. 1980).

11 See, e.g., In re Gulfco Inv. Corp., 593 F.2d 921 (10th Cir. 1979); In re Baker & Getty Fin. Serv., 78 B.R. 139 (Bankr. N.D. Ohio 1987); In re Stop & Go of America, Inc., 49 B.R. 743 (Bankr. D. Mass. 1985).

12 "[T]here appears to be nearly unanimous consensus that it is a remedy to be used "'sparingly.'" In re Owens Corning, 419 F.3d 195. 205–06 (3d Cir. 2005); see also In re Augie/Restivo Baking Co. Ltd., 860 F.2d 515 518 (2d Cir. 1988).

13 Indeed, in connection with virtually any financing or similar transaction involving a single or special purpose entity that is part of a multi-entity enterprise, closing of the transaction will be conditioned upon the furnishing of a satisfactory legal opinion from counsel that the entity will not be subject to substantive consolidation with affiliates in event of a bankruptcy filing.

India's Insolvency and Bankruptcy Code: Key issues so far

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India

Enactment of the (Indian) Insolvency and Bankruptcy Code, 2016 ("Code") was a watershed moment for resolution of Indian companies. If the last 11 months are anything to go by, one thing has become abundantly clear: like any other law, the success of the Code will primarily depend on the jurisprudence that develops under the Code.

Long Shadows of the Past

With a plethora of legislations dealing with debt recovery and insolvency, India has had a history of protracted litigation and of never-ending dispute resolution. With the average quantum of recoveries being as low as 20% of the debt, and insolvency resolutions taking around 4.3 years, typically, lenders have demanded significant tangible collateral coverage. Historically, resolution of the Indian companies has been under the aegis of Indian central bank guidelines with no effective tool for formal restructuring. Also, debtors continued to be in control during most restructurings. While provisions similar to those in the English law for undertaking schemes of arrangement are present in Indian company law, these have rarely been used for restructuring of distressed companies.

The Code: A paradigm shift

In contrast to the erstwhile regime, specific timelines relating to both procedural and substantive matters have been mandated by the Code. The Code contemplates a payment default of Rs. 1 Lakh (approximately USD 1532) and above as the trigger to initiate insolvency proceedings and prescribes specific timelines for both admission of an insolvency application (14 days) and completion of insolvency resolution (180 to 270 days). If no plan is agreed upon by 75% of the financial creditors (no classes are contemplated) in this 180-270 days, the company is sent into liquidation.

Upon admission of an insolvency application, the Code prescribes replacement of the existing Board of the corporate debtor with an independent insolvency professional vested all powers of the Board with oversight of the National Company Law Tribunal (a special company court) ("NCLT") and controlled by a committee of unrelated financial creditors ("CoC"). In the interest of encouraging market participation and appropriate price discovery of the distressed assets, the Code permits any person to submit a resolution plan to the CoC for their consideration.

Sanctity of Timelines, and Entrenched Management Rights

Undoubtedly, 'timelines' and 'management rights' are two most contentious issues under the Code. A series of decisions at the NCLT and the appellate court, the National Company Law Appellate Tribunal ("NCLAT"), culminated into: *Surendra Trading Company vs. JK Jute Mills Company* (Supreme Court of India, Judgement dated September 19, 2017) where the Supreme Court held that timelines relating to admission of an application are directory in nature, and may be extended subject to sufficient cause being shown by the person requesting for the extension; and *Innoventive Industries vs. ICICI Bank Limited* (Supreme Court of India, Judgement dated August 31, 2017), where the Apex Court underscored the paradigm shift in corporate insolvency in India and observed that the entrenched management cannot continue if they fail to pay their debts.

Natural Justice: a necessity

The provisions of the Code do not provide for an express right of hearing to the debtor (while a copy of the application is provided). Validity of this scheme was examined by the NCLAT as well the Supreme Court in Innoventive *Industries vs. ICICI Bank* (NCLAT Order dated May 22, 2017 and Supreme Court of India, Judgement dated August 31, 2017) where both courts held that a limited notice is to be given to the debtor and envisaged only a limited right to hearing to ensure a speedy resolution of the insolvency process.

Existence of Disputes: challenges lie ahead

Trade creditors of Indian companies have often presented winding up petitions under the Indian company law as pressure tactic (this avenue was closed with the Code). The Code considers a pre-existing dispute before a competent court of law or authority to be a valid defense to an insolvency application by a trade creditor. The lower courts in India had divergent view of interpreting existence of a dispute. The Supreme Court in *Mobilox Innovations vs. Kirusa Softwares* (Judgement dated

September 21, 2017) clarified that any real dispute as to the payment obligation (whether before a court or not) can be a valid defense. Though the view of the court may seem equitable, such an interpretation may encourage debtors to dispute all amounts owed by them to escape the provisions of the Code. In fact the present of "*bona fide*" dispute defense was one of the main reasons for delays in the erstwhile winding up regime.

Existing Winding-up Proceedings

Given that the Indian winding up regime is in the transition phase, questions relating to overlap of proceedings under the old regime and the Code have also vexed the judiciary. There have been suggestions that use of the Code, when the debtor is in (or is almost in) insolvency under the old regime, is forum-shopping. In fact, insolvency application against Era Infrastructure (one of the twelve companies that the Indian central bank, in an unprecedented move, instructed commercial banks to take to insolvency under the Code) is yet to be admitted and the NCLT has referred the question to a larger bench of judges.

Conclusion

As is evident, the jurisprudence of the Code is still evolving and it is imperative that the courts adopt a consistent approach towards interpretation of Code keeping in mind the objects of the law and the historical background in which the parading shift was needed. The Code is currently the most important tool for resolving Indian stressed companies and the long term and sustainable growth of the Indian credit market is dependent on the success of the Code.

Finding shelter in a storm
Australia introduces safe harbour from insolvent trading

By Scott Butler
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Over seven years after ARITA, the Law Council of Australia and the Turnaround Management Association Australia jointly recommended their introduction to the Australian Government[1], on 19 September 2017 Australia finally introduced a new set of laws[2] designed to provide a 'safe harbour' to directors in certain circumstances from Australia's harsh insolvent trading laws which make directors liable for debts they fail to prevent a company incurring when there were reasonable ground to suspect a company was insolvent.

The safe harbour will start to apply from the time the director, after beginning to suspect that the company may become insolvent, starts developing one or more courses of action, and one of those courses of action is reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator. The safe harbour applies to a director until the director stops taking the course of action or the course of action stops being reasonably likely to lead to a better outcome.

The Government's explanatory memorandum to the safe harbour changes explains that the phrase "reasonably likely" requires that there is a chance of achieving a better outcome that is not fanciful or remote, but is "fair", "sufficient" or "worth noting".[3]

There are an indicative and non-exhaustive list of factors which a court may have regard to in determining whether a course of action was reasonably likely to lead to a better outcome for the company at the time it was being taken. These are whether the director:

(a) properly informed himself or herself of the company's financial position;

(b) took appropriate steps to prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts;

(c) took appropriate steps to ensure that the company kept appropriate financial records consistent with the size and nature of the company;

(d) obtained advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; or

(e) developed or implemented a plan for restructuring the company to improve its financial position.

There is no definition or guidance in the new legislation as to what an 'appropriately qualified entity' is but the Government's explanatory memorandum to the safe harbour changes explains that "Appropriately qualified" in this context means "fit for purpose" and is not limited merely to the possession of particular qualifications and it is for the person who appoints the adviser to determine whether the adviser is appropriate in the context, having regard to issues such as:

(a) the nature, size, complexity and financial position of the business to be restructured;

(b) the adviser's independence, professional qualifications, good standing and membership of appropriate professional bodies (or in the case of an advising entity, those of its people);

(c) the adviser's experience; and

(d) whether the adviser has adequate levels of professional indemnity insurance to cover the advice being given.[4]

The safe harbour will end if, after starting to develop a course of action, the director fails to take a course of action within a reasonable period after that time. What is a 'reasonable period' will vary on a case-by-case basis. For a small company a reasonable period may only be days, while for a large complex company or group of companies, it may extend for weeks or even months.

The new laws are intended as a protection for competent directors who are acting honestly and diligently. To this end, there are certain factors which, if present in a given case, would make the safe harbour unavailable. Those are

1 Joint 'Safe harbour' submission to the Federal Treasury of the Commonwealth Government of Australia by ARITA (then the IPA), Law Council of Australia and the Turnaround Management Association Australia dated 2 March 2010 and supplementary submission of ARITA of 18 March 2010.
2 Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017 (Cth).
3 Explanatory memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, para 1.52.
4 Explanatory memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, para 1.69.

if, when the company incurs a debt, the company was not substantially complying with:

(a) its obligations to properly pay its employees (including superannuation); or

(b) its taxation reporting obligations.

Given smaller companies that fail are often found to have been behind in paying their employee entitlements or in their taxation reporting obligations, this will prevent the directors of many smaller companies from relying on the safe harbour carve out.

Safe harbour will also not be available if the director has failed to substantially comply with their obligations to assist an administrator, liquidator or controller (i.e. a receiver) to provide a report as to the company's affairs or to provide books and records. However, the restrictions will not apply to directors who were not notified by an administrator, liquidator or controller that a failure to provide the books and records will prevent them from being later used by the directors as evidence in relation to the safe harbour applying to them.

Holding companies

The new laws also introduce a safe harbour for a holding company, which would otherwise currently be liable to compensate creditors of their subsidiary for losses that arise as a result of insolvent trading of the subsidiary. A holding company will not now be liable for such debts if they were incurred by the subsidiary during a time the directors of the subsidiary had the benefit of a safe harbour and the holding company has taken reasonable steps to ensure that the directors of the subsidiary have the benefit of a safe harbour.

Conclusion

The new laws are a welcome addition to Australia's insolvency laws, but they are of most use to the big end of town. Directors of smaller companies often will already be behind in paying their employees or reporting their tax obligations by the time they consider getting external restructuring advice and by then the safe harbour will not be available to them unless they can first rectify both these issues. Whilst getting their tax reporting obligations up to date should generally be achievable, paying all their employee entitlements up to date may be very difficult if cash is short and a restructuring plan has not yet been successfully implemented.

For further information on any of the issues raised in this article please contact Scott Butler on +61 7 3233 8653.

Working Toward 2021 – Technical Update

In September this year, the INSOL International Board of Directors met with key members in the Taskforce Working Groups to review the various recommendations made by each of the Groups. The core remit provided to Working Group 17 was to – "recommend a range of options for technical education production to 2021. At a high level, this will involve – assessing the existing technical options and recommending options for refinement (content and delivery) and recommending new options".

In the coming months and years until 2021, INSOL members will see these recommendations being implemented in stages.

With this long-term plan in place, we would like to highlight and bring to the attention of our readers some of our key publications that we produced since the last technical update in this journal. On 21 September, INSOL held its G36 meeting in London and at that meeting we launched an excellent publication titled "The implications of Brexit on the restructuring and insolvency industry: A collection of essays. In this collection of essays, INSOL obtained a variety of opinions and viewpoints as to what the implications of Brexit on the restructuring and insolvency industry might be. As centrepiece to the collection, there is an essay dealing with the implications of Brexit on the restructuring and insolvency industry in the UK, seen from a UK perspective. The centrepiece essay was provided to commentators from other parts of the world to provide context for the views gathered from Europe, The United States, Canada and East Asia and the Pacific Rim.

Another publication we shared with our members was a survey report titled "Rubin aftermath - INSOL International survey". The decision by the UK Supreme court in the conjoined appeals of *Rubin & Anor v. Eurofinance SA & Ors; New Cap Reinsurance (In Liquidation) & Another v. AE Grant & Ors* was a disappointing one to many UK insolvency professionals and it was considered to be a missed opportunity. INSOL was keen to explore what the global restructuring community thought of this decision and carried out a survey. This report discusses the survey results and highlights the mixed reactions from some of the non-UK insolvency professionals. It is also important to note that since 2014 the UNCITRAL Working Group V has been working towards developing a draft model law for the "recognition and enforcement of insolvency-related judgments" and work is still in progress. The 51st session was held in New York in May this year.

In July we published a set of "Draft case management directions for an insolvent trust". (CMDs) These directions were developed since 2015 and extensive research was carried out in a number of jurisdictions. As a first step, these CMDs were shared with a select group of members so that they could provide feedback to INSOL. These CMDs have now been sent to all member associations and INSOL members in the hope that they will be adopted and submitted to legislators to consider as jurisdictions update their insolvency legislation.

Under the small practice technical papers series "A collection of practical issues important to small practitioners" three country studies for the British Virgin Islands, Czech Republic and Spain were published.

In the next few months insolvency practitioners can expect a range of technical publications rich in content and relevance to their daily work. These include publications on employee entitlements, intellectual property, insolvency in the retail industry – to name a few.

INSOL New York 29 April – 1 May 2018

Grand Hyatt New York

Registration Now Open – Early Bird Deadline 22 January 2018

All members should have received a copy of the registration brochure for INSOL New York in the post. It is also available online at **www.insol.org**. We encourage you to register early to ensure your place at the conference. We have a limited number of hotel rooms at the Grand Hyatt New York which are available on a first come first served basis.

The Conference opens with the Welcome Cocktail Reception kindly sponsored by BDO which takes place at the historic Cipriani's, formerly known as the Bowery Savings Bank. It is a national landmark conveniently located adjacent to the Grand Hyatt. Built in 1921 this Italian Renaissance inspired masterpiece showcases towering marble columns, soaring ceilings, magnificent inlaid floors and glorious chandeliers. This provides a beautiful, spacious setting to meet friends and colleagues from around the world. The reception runs from 6.00pm-9.00pm allowing delegates to meet up with old friends and colleagues and if they wish go on to dinner after the reception and sample the night life that New York offers.

We have a very exciting educational program which is preceded by an Offshore Ancillary meeting on the Sunday sponsored by Borrelli Walsh, Carey Olsen, FFP and Walkers with KRyS Global sponsoring the coffee breaks. The Offshore Meeting is preceded by an Offshore Delegates Cocktail Reception sponsored by KPMG on the Saturday evening. Details of the program can be found in the registration brochure.

The INSOL International Fellows are hosting a reception for Fellows on the Saturday evening followed by a half day refresher program on Sunday morning. The events are kindly sponsored by Curtis Mallet-Prevost, Colt & Mosle LLP, Davis Polk & Wardwell LLP, Nixon Peabody LLP and Schiebe und Collegen.

There will be a Small Practice Issues meeting on Sunday afternoon and a dinner on the Monday night sponsored by Porzio Bromberg & Newman P.C. For information on these events please contact Heather Callow at **heather@insol.ision.co.uk**.

The main conference is kindly sponsored by Borrelli Walsh, Lipman Karas, Norton Rose Fulbright and RSM. The program runs through Monday and Tuesday and offers break out choices on both days covering industry topics energy, retail and shipping. A review of the reform of Chapter 11 and an update on Chapter 15. New insolvency legislation in India, Russia, Africa and the UAE along with an update on Brexit, Fintech and a keynote speech on the darker side of IP- hacking, data breaches and your next restructuring engagement. A wide range of topics suggested by our members which we think offers an interesting and diverse program with subjects of interest to everyone.

On Monday evening, there is a younger members reception sponsored by Goodmans LLP. The Conference will close with the Gala Dinner on Tuesday evening kindly sponsored by AlixPartners LLP.

We look forward to seeing you in New York in 2018.

INSOL would like to thank our Conference sponsors:

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Current status of business rescue in South Africa

By: Dr.Eric Levenstein
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Introduction

"Business Rescue'' remains a viable option for financially distressed companies in South Africa. Some 7 years since the introduction of rescue legislation in 2011, (Chapter 6 of the 2008 Companies Act) ("the Act"), the mechanism allows failing companies to effect a business turnaround, and implement a strategic plan to restructure its business. The legislation provides an opportunity to appoint a business rescue practitioner to supervise the rescue process and effect a debt compromise with the company's creditors.

In this article, we provide feedback and identify certain of the fundamental challenges currently being experienced in the South African business rescue process since its implementation in 2011.

The business rescue procedure

Prior to 2011, financially distressed companies in South Africa had no alternative but to go into liquidation. Liquidation terminated the company's life, and brought an end to the company's business and the jobs of employees. With the introduction of the business rescue procedure in 2011, financially distressed companies could now elect to appoint an independent supervisor (the business rescue practitioner) to take control of the company's affairs. The practitioner would engage with all affected parties (creditors, shareholders, trade unions and employees) to restructure the company's liabilities, renegotiate prejudicial contracts, and the manner in which the company conducted its business. This provides the company with a "fresh start" by allowing the entity to be "rescued" and where it is given a second chance to continue trading on a profitable basis into the future.

During business rescue there is an imposed moratorium/(stay) on all claims against the company. The moratorium prevents any creditor from pursuing the company, and no creditor can apply to court to wind up the company. This gives the business rescue practitioner time to consult with all affected parties in order to draft a business rescue plan aimed at the restructuring of the company's debt and its business.

Once the plan is approved by creditors (and if necessary, the company's shareholders), the plan is implemented by the business rescue practitioner and the company exits from the rescue process, either with new owners or on a restructured basis and where it can continue to trade into the future.

The test for financial distress

Directors of companies that are financially distressed (which means that the company cannot pay its debts in the next 6 month period or where the company is about to become insolvent in the next 6 month period) must resolve by board resolution to place their companies into business rescue. The 6 month window ensures that the business rescue process commences as early as possible and whilst there is still value in the company. Critically, directors must believe that there is a realistic prospect of the company being rescued.

Importantly, if directors do not place financially distressed companies into business rescue, they face the prospect of becoming personally liable for the debts of the company. There are provisions in the Act which prohibit directors from trading recklessly, negligently and where directors (and management) trade their companies with an intent to defraud creditors.

Levels of co-operation and buy-in from all stakeholders

Creditors must be persuaded that in order for the company to be rescued, they must accept some form of debt haircut (compromise) on their outstanding claims as at the date of commencement of business rescue. Most business rescue plans would offer a dividend which far exceeds what would be available in liquidation. Customers (debtors) of the company would continue to be obligated to make payment of amounts due to the company. Post-commencement finance (provided by the company's shareholders, third party funders or from potential acquirers of the company) must be made available to the company in order to enable it to pay its ongoing expenses while the company is going through its restructuring period.

In summary, it is about cooperation between stakeholders and the business rescue practitioner to ensure that the business survives and continues to trade on a solvent basis into the future.

Sectors affected by the rescue process – 2016/2017

There has definitely been an increase in distress in the mining sector. Mines are highly susceptible to fluctuations in commodity prices and with ever increasing costs of mining, more resource companies are filing for rescue. The uncertainty around the draft South African Mining Charter has also not assisted.

In the retail space, the restructuring of Edcon, a major and long established South African clothing, footwear and textile company, came to its conclusion earlier this year with a complex restructuring of that company's debt – effected through a section 155 Compromise Procedure-sanctioned by the courts.

Stuttafords Stores is an example of a business rescue process that has failed. The company struggled with protracted shareholder disputes, a lack of funding, a retail model that was open to question and where their suppliers had lost faith after being severely prejudiced by having their historical debt compromised down to very low figures. Although there was an initial hope that shareholders would make an offer for the business, these efforts came to nought and the company will soon be placed into liquidation.

The construction sector is also under strain and we are seeing informal restructuring take place in this sector at the moment. We have also seen certain renewable energy companies being placed into liquidation.

Successful business rescues?

In the mining sector, Southgold Exploration Gold Mine went into rescue and was ultimately bought out by Witsgold through a hard negotiation with various stakeholders. The deal was sanctioned in a business rescue plan approved by creditors. Optimum Coal Mine went through and exited from a business rescue process. Top Tv (ODM), Pearl Valley Golf Estates, Advance Technologies Engineering (Aeronautical), Meltz Success (retail) and Ellerines – are all examples of companies that have exited successfully from the business rescue process. Many of these companies (or certain of its divisions) were acquired by third parties, with business rescue dividends being paid to creditors in excess of what they would have received in liquidation. Most importantly, in almost all of these instances, scores of jobs were retained - all of which would have been terminated in the event of liquidation.

Unfortunately, many companies that enter into business rescue end up in liquidation. In certain instances, companies should not have entered into the business rescue process in the first place. Certain business rescue practitioners take advantage of a lack of legal knowledge on the part of directors and persuade them to consider business rescue, mainly driven by the imposed moratorium (stay) on creditors' claims. Again, little consideration is given to whether in fact there is a realistic turnaround plan.

Conclusion

The South African business rescue process is robust and sophisticated. It is aligned (in many respects) with similar restructuring systems in the United States (Chapter 11), Australia (voluntary administration), Canada (the CCAA process) and the UK (administration process).

When directors of South African companies reach a required level of understanding of how business rescue works and where they recognise the potential upside of the process, we are going to see more and more directors of companies filing for business rescue as an alternative option, rather than just allowing their companies to end up in liquidation.

Generally, the South African business rescue process is positive in the sense that a successful business rescue delivers a restructured and viable company back into the South African economy and where jobs are retained in the process. It really comes down to the competence of the business rescue practitioner and his peculiar ability to persuade creditors that the business rescue process will deliver a better dividend then creditors would get in a liquidation.

INSOL International Lenders Group & INSOL Europe Financial Institutions' Group Joint Panel

Report by:
Alastair Beveridge, UK
And
Florian Joseph, Germany
– Co-Chairs INSOL Europe Financial Institutions Group
Derek Sach, UK
– Chair INSOL International Lenders Group

On 11th October INSOL Europe's Financial Institutions Group and INSOL International's Lenders Group held an inaugural joint seminar at the offices of The Commonwealth Bank of Australia. After a quick introduction by Matthew Phipson of Commonwealth Bank, the presidents of INSOL Europe (Radu Lotrean) and INSOL International (Adam Harris) gave very warm welcomes to all and endorsed strongly the collaboration between the two organisations.

The panel was introduced by Derek Sach, chair of INSOL Internationals' Lenders Group, who advised the audience about the current project, being led by Stephen Foster of Hogan Lovells, with the title "What will next time look like?". He referenced the historic effectiveness of the London Approach and the very extensive experience around in relation to complex restructuring but wondered how that might work given new ECB regulations and new accounting standards.

The chair of the panel, Professor John Kay (a renowned economist) started the discussion with his view on the different approaches taken to regulation in 1) financial services (written by lawyers and based on prescriptive rules and regulations) and 2) utilities (written by economists and based on structures and incentives) – he felt that the economists approach had probably been more effective, albeit not perfect. He felt that the financial crisis in 2008/9 had demonstrated a failure in regulation and he was concerned that adding more regulation may not be the answer and may have unintended consequences.

Stephen Foster then turned the discussion to the new IFRS9 rules and the move from provisioning on incurred losses (current rules) to lifetime expected losses (new rules from January 2018). He stated that for 1 in 6 banks this would result in a predicted need of a 50% increase in capital base and that for 80% of banks it would result in higher provisions. The likely consequence was that banks would have to sell positions early (or potential commence enforcement earlier) which would provide opportunities for secondary buyers. He also mentioned the restrictions in certain leveraged transaction documents of either white list (restricting lenders ability to sell) or need for borrower approval which might act to impede attempts to sell and result in an impasse.

Alistair Dick (PwC) took a slightly different tack talking about how the rules would impact companies/borrowers – he was concerned that it might actually restrict the availability of credit to companies at precisely the time they needed it most and that this could be very problematic. The inconsistent approaches in different countries to dealing with borrower and ultimately bank liquidity challenges were recognised as an issue generally which has continued since the crisis. Overall, he felt that trading of debt positions (which was expected to be a consequence of the new rules) was a good thing for the market and would help with the recycling of capital.

The discussion reverted to regulation with Simon Samuels (Veritum Partners) – in particular the differences between the regulated and un-regulated players. He felt that banks had had more capital than they really needed pre-crisis and were now being asked to increase that substantially – he felt this was an inefficient use of capital. Concerns were raised that Basel IV with its risk weighted floor provisions meant that banks would not only be encouraged (by the rules) to sell bad assets they would also be encouraged to sell good ones. He reminded everyone that IFRS9 was just about recognition of the losses – not about the amount of loss actually incurred – and that any dramatic event could quickly eat up capital reserves because of the way provisions would from 2018 have to be accounted for.

Stephen Kirk (Pelham Capital) started boldly stating that poor regulation caused the crisis, poor new regulation was stifling recovery and that Donald Trump's newly announced Treasury White Paper on bank de-regulation was ultimately the right way to go. A combination of low interest rates, high amounts of litigation and crushing regulation has led to banks being a very bad investment in recent years – he illustrated the extent of the value destruction by comparing the values of 2 very large banks who were now roughly 10% of the value they previously had. Overall, he felt the US was going in the right direction by proposed reductions in regulation, the UK was too hawkish and that after many years the ECB was starting to get a grip on European banks and making good progress.

Professor Kay then talked about his concern that too many stakeholders were pretending to have a level of knowledge about the world which they just didn't have. He queried whether in reality we are being naïve about what we expect regulation to actually be able to achieve. In his view, the ECB was moving away from using models (as they can only really do so much with limited knowledge often inviting the user to start with the desired result and work backwards) but at the same time IFRS9 was moving towards more modelling use.

A vigorous discussion then took place on the purpose of banks (where the panel had differing views), concentration risk and the benefits of diversification and the potential to split banks as between mortgage lending (still a huge part of many banks and generally done OK) from commercial and consumer lending. Without conclusion and out of time the session was wrapped up after questions by Alastair Beveridge (AlixPartners and Co-Chair of the INSOL Europe Financial Institutions Group).

An audience of around 50, drawn from an extensive spread of lenders and advisers, attended the session and the drinks and canapes which were available after the session. Another successful collaboration to add to the Tel Aviv conference in June this year. [INSOL Europe and INSOL International hope to be able to organise a further joint seminar early in 2018 to continue this fascinating debate.

INSOL International Guernsey One Day Seminar – 13 September 2017

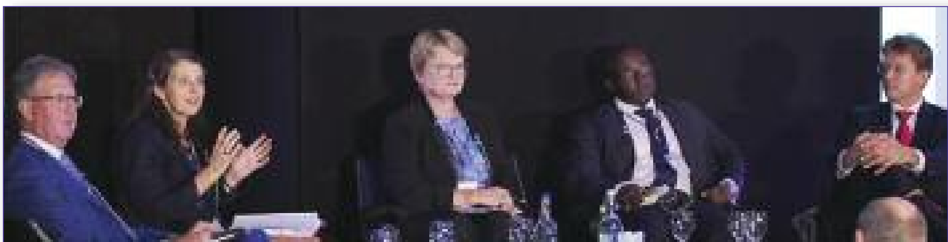
On 13 September 2017, around 145 delegates congregated at the Duke of Richmond hotel in Guernsey for the fourth Channel Islands one day insolvency seminar hosted by INSOL International in conjunction with ARIES. Whilst the bulk of the representative's present were from the Channel Islands and London, we welcomed a global audience with delegates and panel members from Cayman, BVI, Mauritius, Isle of Man, Ireland, Gibraltar, The Netherlands and Bermuda to what proved a thoroughly enjoyable, sell-out event.

Crypto - Insolvency

Following some introductory words of welcome from Richard Heis, INSOL Executive Committee, KPMG, the seminar started with a thought provoking panel session on the interaction of virtual currencies and insolvency. Chairman Jerry Garrood of Carey Olsen and panel members Bill Byrne of JTC, Claude Brown of DLA Piper, Liam Short of Elwell Watchorn & Saxton LLP and Marc Piano of Bedell Cristin identified and reflected on the legal and philosophical challenges we all face in the insolvency world with the rapid movement of virtual currencies from the fringes to the mainstream of commercial life. Between them they did a remarkable job of de-mystifying the jargon and concepts. It seems likely that the legal issues will challenge us all and that the topic will warrant frequent attention on future occasions as IPs, insolvency lawyers and courts grapple with this highly technical and complex area. Over time light will no doubt be shed on fundamental issues such as the categorisation of virtual currency as cash or asset, how to value virtual currency and questions of jurisdiction. Whatever you think of crypto currencies, the panel convinced us that they are plainly here to stay.

Schemes of Arrangement post Brexit

We were delighted to welcome Raquel Agnello QC and His Honour Mr Justice McGovern, President of the High Court in Dublin, to chair a panel whose members were tasked with pitching the case for why their jurisdiction had the best system for ordering and implementing schemes of arrangement, as well as to address any less positive features of their respective jurisdiction. This successfully drew upon the current competitive environment as between jurisdictions for scheme work, particularly considering the possible impact of Brexit on the UK as the market leader for schemes of arrangement. His Honour Ramesh Kanaan was unable to make the seminar in person, but he provided an excellent pre-recorded analysis of Singaporean schemes. This was followed by Jane Marshall of McCann Fitzgerald who spoke in persuasive terms about Irish schemes and examinerships. David Ampaw of DLA (as a late stand in for the injured Catherine Burton) made the case for why the English have little to fear from, and will breezily see off, the newly emerging foreign competition and Nico Tollenaar, Fellow, INSOL International of RESOR N.V. explained why The Netherlands would end the present English hold over this area of work and would soon become a global restructuring hub. A vote was taken in which the English system was given an overwhelming endorsement and vote of confidence, although suspicions remain that the audience was strongly biased. However, it will certainly be interesting to see what in-roads other jurisdictions, which are marketing themselves strongly, will make into this area in the coming months and years.



Guernsey & Jersey legislative change

The morning sessions were brought to a close by Will Callewaert of KPMG and Stuart Gardner of EY who provided an excellent and detailed summary of recent legislative changes, practice developments and key insolvency cases arising in Guernsey and Jersey respectively.

Virtual World

Immediately after lunch the virtual currency topic was picked up by two guest speakers, Daniel Broby and Anna Kurenkova, of the

Centre for Financial Regulation and Innovation at Strathclyde Business School. Their in-depth analysis of some of the highly technical issues of virtual currency and the blockchain technology which underpins it and the interaction of the technology on insolvency provided much food for thought as well as a powerful endorsement of crypto currencies and their increasing importance in the world and we are most grateful for their contributions.

Segregated cell entities

Thereafter, matters moved onto the less technical but nonetheless complex subject of segregated cell companies (known by that and other names), which have been around for two decades and are now used widely around the world for insurance and general investment structures. The session was chaired by Mat Newman of Ogier, with an expert panel comprising Grant Jones, Simmonds Gainsford Gibraltar LLP, Alex Potts, Sedgwick Chudleigh Ltd in Bermuda and Nick Vermuelen, PwC in Jersey. The discussion covered aspects of segregated cell companies from the point of view of various offshore jurisdictions and in particular mechanisms for winding up such entities when they become insolvent. It proved to be a lively and interesting session.

Battle of the cases

It can sometimes be a challenge to hold the attention of the audience through to the end of the last slot of a long day (especially when the audience has been treated to an analysis of some complex and thought-provoking issues throughout the day). However, the final panel rose to the "offshore challenge" in style. Lexa Hilliard QC handed the panel members the competitive task of advocating the importance, interest and significance of three recent cases, with a view to the audience voting on which case most captured the imagination and interest. All the panel members were intimately involved in the cases they spoke about and their pitches all were invested with passion and conviction. Nicole Langlois, XXIV Old Buildings offered her summary and personal insights into the recent O'Keefe judgment of the English High Court which deals in detail with limitation of claims against company directors under Jersey law. A subject of some importance to insolvency practitioners taking appointments over Jersey companies. Gordon McRae, Kalo Advisors, Cayman Islands then gave his first-hand analysis of the recent Privy Council judgment in the Primeo funds matter relating to the priorities of certain categories of redeemed investor. He called upon the sympathies of the audience given that he was the only non-professional advocate on the panel, although proceeded to advocate his case in the most articulate of terms. Lastly, Ian Swann, Babbé covered the hot-off-the-press judgment of the Royal Court of Guernsey in which he successfully defended the executive directors of Carlyle Capital Corporation. The session, which was excellently chaired by Lexa Hilliard QC, provided a thoroughly lively and entertaining final slot. Another arguably partisan audience voted strongly in favour of the Carlyle case.

And Finally

The joint chairs of the day, Alan Roberts, Grant Thornton and Rob Gardner, Bedell Cristin in Jersey wrapped up the day in light hearted fashion with some spoof items of late restructuring news from the Channel Islands. The seminar dinner was held at the Old Government House and was excellent fun and was well attended. The food was delicious, the wine flowed, Malcolm Cohen offered some words on behalf of dinner sponsor BDO LLP and the party atmosphere was boosted with a measure of Calvados, with the traditional toast to the Duke of Normandy being proposed by Karen le Cras of Carey Olsen as the dinner co-sponsor.

The Channel Islands one day seminar provided another excellent day of learning and networking for all those who attended and we look forward to welcoming delegates to Jersey in 2018.

Corporate rescue in the lion city: law reform and improved competitiveness

Scott Atkins
Fellow, INSOL International
And
Oliver Perrottet
Norton Rose Fulbright Australia

Singapore is the third most competitive financial centre in the world and an attractive destination for trade and investment.[1] In 2017, the World Bank ranked the Lion City second in the world for ease of doing business. The 'Doing Business' index measures a range of factors including the ease of forming a business, registering property, enforcing contracts, and business renewal and closure. One imagines a rapid creep towards first position is underway.

The strength of a country's insolvency and restructuring framework is one of the constituent indicators of the Doing Business index and despite being ranked highly across the board on most other metrics, Singapore is ranked only 29th for its effectiveness in 'Resolving Insolvency'.

The insolvency and restructuring indicator is particularly important in Singapore which has experienced almost $USD1 billion in bond market defaults since November 2015 and where the government has identified $USD250 billion in debt available for restructuring throughout the Asia-Pacific.[2]

Singapore has recently embarked on a path of reform with the goal of reinforcing its reputation as an international restructuring and insolvency hub by creating a more dynamic environment for debt restructuring.

On 29 March 2017, the Companies (Amendment) Act 2017 received presidential assent and became law. The amendments to the Companies Act (Act) are in response to recommendations made by the Insolvency Law Reform Committee (ILRC) and the Committee to Strengthen Singapore as an International Centre for Debt Restructuring.

On 24 August 2017, Minister for Law and Home Affairs, Mr K Shanmugam, signalled further reform to come in 2018 in the form of an "omnibus Insolvency Bill". This bill is intended to bring together personal and corporate restructuring and insolvency under one piece of legislation and to adopt the recommendations of the ILRC not covered in the March 2017 amendments to the Act, including a framework for regulating insolvency professionals.

This article outlines the key changes to the Act adopted in March 2017 and foreshadowed in the latest announcement.

Key Changes

Singapore's insolvency and restructuring regime consists of procedures for the winding up of businesses as well as rehabilitation processes (including schemes of arrangement and judicial management).

Singaporean rehabilitation procedures are drawn from English law and have to date remained quite creditor-centric. However, the new laws adopt many concepts from the United States' Chapter 11 procedure and tend to shift the distribution of rights towards debtors. The stated goal of the reforms is to "give business entities in financial difficulties greater flexibility to restructure and survive."[3]

Schemes of Arrangement

First, there are major amendments to the moratorium on proceedings or enforcement action against the debtor company. The following changes are significant:

- the court now has power to order a moratorium for such a period as the court thinks fit (s.211B(1) of the Act), to extend the remit of the moratorium to acts outside of Singapore (s.211B(5)), and to make an order for a moratorium restraining proceedings or enforcement action against a subsidiary, holding company or ultimate holding company of a company subject to a moratorium itself (s.211C);

- the company must file evidence indicating support from creditors for the proposed arrangement and an explanation as to the importance of that support for the overall success of the scheme (s.211B(4)); and

- the introduction of an 'automatic moratorium period' from the date an application to restrain proceedings is made up to 30 days or the date on which the application is determined by the court (s.211B(8)).

Second, drawing from the U.S. Bankruptcy Code, the court is empowered to make an order that rescue finance be accorded 'super-priority' over existing security interests (s.211E).

Third, the court may now approve a scheme and make it binding on all creditors notwithstanding the existence of a dissenting class or classes of creditors provided a majority in number (and 75% in value) of creditors agree to the scheme and the court is satisfied that the scheme does not discriminate unfairly between two or more

1 Z/Yen Group, "The Global Financial Centres Index 21", March 2017, 4.
2 Ministry of Law Singapore, "Keynote Address by Mr K Shanmugam, Minister for Home Affairs and Minister for Law, at Singapore Insolvency Conference 2017", 24 August 2017.
3 Ms Indranee Rajah, Senior Minister of State for Law and Finance, Second Reading Speech on the Companies (Amendment) Bill, 10 March 2017, 24.

classes of creditors and it is fair and equitable to each dissenting class(s.211H). Previously, the court could only approve a scheme if the scheme had obtained a majority approval in number (and 75% in value) from all creditors and classes of creditors.

A scheme will not be fair and equitable where a creditor receives an amount lower than what they would receive if the scheme does not pass (s.211H(4)(a)).

Judicial Management

The court may now make an order for judicial management if it is satisfied that the company is or is likely to become unable to pay its debts. Previously, an order could only be made if the court was satisfied that the company was or would become unable to pay its debts (s.227B(1)(a)).

Additionally, judicial management orders may be made despite objections from certain secured creditors where the court is satisfied that the prejudice that would be caused to that creditor if the order is made is not disproportionately greater than the prejudice that would be suffered by unsecured creditors if the order is not made (s.227B(5)).

Cross-Border Insolvency

The new law introduces three significant reforms intended to make the Singaporean framework more conducive to cross-border insolvency.

First, there is now further scope for winding-up and restructuring foreign companies in Singapore. The following changes are pertinent:

- an additional avenue for the winding-up of foreign companies. The Act now provides that a foreign company may be wound-up if it has a 'substantial connection' with Singapore (s.351);
- the Act lists certain factors that the court may rely on in determining whether there is a 'sufficient connection'. These include Singapore being the centre of main interests of the company, the company carrying on business in Singapore and the company having substantial assets in Singapore (s.351(2A)); and
- foreign companies can now take advantage of provisions relating to judicial management and schemes of arrangement.[4]

Second, the reforms abolish the 'ring-fencing rule'.[5] This rule provided that during a liquidation the Singaporean assets of a foreign company had to be applied to satisfy debts incurred in Singapore prior to any remittance to the foreign liquidator.

Finally, the Act adopts the UNCITRAL Model Law on Cross-Border Insolvency which allows foreign representatives to gain recognition and assistance in Singaporean courts. Whilst recognition was previously possible under common law, the adoption of the Model Law removes uncertainty and gives foreign representatives further confidence in the Singaporean framework.

Conclusion

There is a strong nexus between corporate rescue laws and innovation driven growth. A culture of innovation stems from a legislative framework which creates the institutional conditions for business to flourish. Recent reform in Singapore providing debtors with more space to restructure and survive will foster further innovation and growth.

The shift away from creditor-centric attitudes toward Chapter 11 styled provisions reflects a global trend in favouring corporate recovery over what might be perceived as an overly protective framework for creditors. An immediate consequence will be an improvement upon Singapore's already strong showing on the World Bank's Doing Business index. A number of the new reforms, specifically those regarding rescue financing, add immediately to the performance score for 'Resolving Insolvency'.

Pearson v Primeo – The Rocky Road to Redemption

Peter Hayden and Christopher Levers
Mourant Ozannes, Cayman Islands

In the recent decision in *Pearson v Primeo* [2017] UKPC 19, the Judicial Committee of the Privy Council confirmed the widely held view that investors who had been redeemed under a fund's articles of association, prior to the commencement of the fund's liquidation, are creditors of the fund in the sum of their unpaid redemption proceeds. Importantly, it also confirmed that the claims of these "redemption creditors" will be paid in priority to those of unredeemed shareholders but behind the claims of ordinary creditors.

Background

The litigation arose out of the collapse of Bernard Madoff L Madoff Investment Securities LLC (BLMIS). Primeo Fund (in official liquidation) (Primeo) was an indirect investor in BLMIS through its investment in Herald Fund SPC (in official liquidation) (Herald).

In late 2008, Primeo (along with other investors) submitted redemption requests for a redemption date of 1 December 2008. Those redemption requests were accepted by Herald and, on 1 December 2008, Primeo's shares were redeemed in accordance with Herald's articles of association.

However, prior to payment of those redemption proceeds (valued at approximately US$155m), Bernard Madoff confessed to the fraud on 11 December 2008 and, on 12 December 2008, Herald suspended the calculation of net asset value and payment of redemption proceeds. The suspension was not lifted and when Primeo successfully placed Herald into liquidation in 2013, Primeo's redemption monies remained outstanding.

Primeo's status as a creditor

Primeo subsequently sought to prove in Herald's liquidation for its unpaid redemption proceeds. Surprisingly, Herald rejected Primeo's creditor claim suggesting that, as a result of section 37(7) of the Companies Law, Primeo should be treated as if it had never redeemed its shares.

Section 37(7) provides, inter alia, that the redemption of shares which "are to be redeemed" or "are liable to be redeemed" but have not been redeemed before the commencement of the liquidation, may only be enforced if (a) the terms of the redemption provided for it to take place at a date earlier than the commencement of the winding up and (b) the company could have lawfully distributed the redemption proceeds prior to the commencement of its liquidation.

It was accepted that, if Primeo's shares had been redeemed, it would be a creditor. However Herald argued that redemption under section 37(7) did not occur in accordance with the fund's constitutional documents, but rather had a special meaning such that it only occurred when the redemption proceeds were paid. It contended that, as Primeo had not been paid its redemption proceeds, it was not redeemed for the purpose of section 37(7), notwithstanding that it had previously been redeemed under Herald's articles.

Herald's position was contrary, not only to the prevailing view that a redeemed investor was a creditor, but also to existing Privy Council authority. In Strategic Turnaround Master Partnership Limited v Culross Global SPC Limited [2010] 2 CILR 264, the Privy Council considered that, for the purpose of section 37(3) of the Companies Law, redemption occurred when a shareholder is redeemed under the articles. Importantly, it considered that the payment of the redemption proceeds was merely a matter of supplementary procedure and had no bearing upon the creditor status of a redeemed investor.

If Herald's contention was correct, it would require the word redeem to bear wholly different meanings within different sub-sections of the same section of the same piece of legislation. Perhaps more bizarrely, it would also mean that section 37(7) had the effect of converting a redeemed investor from a creditor back to a shareholder. A redeeming investor, who had already surrendered the shares to the company on the redemption date provided for in the articles, would somehow be given back his shares at some stage in the liquidation.

It will come as no surprise that Herald's arguments were rejected by the Cayman Islands' Grand Court and by a unanimous judgment of the Cayman Islands Court of Appeal. Both Courts accepted Primeo's position that, as its shares had been redeemed in accordance with Herald's articles, section 37(7) did not apply.

The Decision of the Privy Council

Dissatisfied with the dismissal of its claims at both first instance and on appeal, Herald appealed to the Privy Council. In rejecting Herald's arguments, the Privy Council unanimously held that redemption under section 37(7) could not have a different, autonomous meaning from redemption as defined in a company's articles. As a result, Primeo was a creditor for its outstanding redemption proceeds.

It also clarified that the purpose of section 37(7) was not to convert a redeemed investor back from creditor to shareholder, but rather permitted an unredeemed investor to enforce the terms of its redemption in the liquidation, provided it met the conditions set out in the section.

In deciding this question, the Privy Council also placed heavy reliance upon the concepts of freedom of contract and certainty, echoing its comments in both Strategic Turnaround and *Fairfield Sentry Limited v Migani* [2014] UKPC 9.

Having determined that Primeo had a provable creditor claim, the Privy Council also considered the question of where the claims of redemption creditors, such as Primeo, would rank. It agreed with the Cayman Islands Court of Appeal that, while the claims of redemption creditors (such as Primeo) would rank ahead of the claims of unredeemed investors, they fall within the scope of section 49(g) of the Companies Law such that they are subordinated to the claims of ordinary, unsecured creditors.

While the Privy Council did not determine the question of where the claims of those investors who successfully elevated their claims pursuant to section 37(7) would rank, in obiter, they considered that they may rank either *pari passu* or behind the claims of redemption creditors by virtue of section 37(7)(b) of the Companies Law.

Conclusion

The Privy Council's confirmation of the conventional view, whilst expected, is welcome. It clearly demonstrates that the Cayman Islands Courts will respect the contractual arrangements entered into by funds and their investors and the fact that a fund has subsequently gone into liquidation will not interfere with those arrangements.

Conference Diary

December 2017				
30 Nov – 2	ABI Winter Leadership Conference	Palm Springs, CA	ABI	www.abi.org
March 2018				
11	INSOL International Buenos Aires One Day Seminar	Buenos Aires, Argentina	INSOL International	www.insol.org
April 2018				
29 Apr – 1 May	INSOL New York Annual Regional Conference	New York, NY	INSOL International	www.insol.org
29 April	INSOL Offshore Program	New York, NY	INSOL International	www.insol.org
May2018				
23-25	R3 Annual Conference 2018	Vilamoura, Portugal	R3	www.r3.org.uk
24	INSOL International Yangon (Myanmar) One Day Seminar	Myanmar	INSOL International	www.insol.org
June 2018				
31 May-1June	Eastern European Countries Committee Conference	Riga, Latvia	INSOL Europe	www.insol-europe.org
July 2018				
11-13	INSOL Academics Colloquium	London, UK	INSOL International	www.insol.org
August 2018				
TBC	INSOL International Indonesia One Day Seminar	Indonesia	INSOL International	www.insol.org
September 2018				
TBC	INSOL International Channel Islands One Day Seminar	Jersey	INSOL International	www.insol.org
November 2018				
8	INSOL International Hong Kong One Day Seminar	Hong Kong	INSOL International	www.insol.org
	INSOL International Cayman Islands One Day Seminar	Cayman Islands	INSOL International	www.insol.org
March 2019				
17-19	INSOL Cape Town Annual Regional Conference	Cape Town, South Africa	INSOL International	www.insol.org

Member Associations

American Bankruptcy Institute
Asociación Argentina de Estudios Sobre la Insolvencia
Asociacion Uruguaya de Asesores en Insolvencia y Reestructuraciones Empresariales
Association of Business Recovery Professionals - R3
Association of Restructuring and Insolvency Experts
Australian Restructuring, Insolvency and Turnaround Association
Bankruptcy Law and Restructuring Research Centre, China University of Politics and Law
Business Recovery and Insolvency Practitioners Association of Nigeria
Business Recovery and Insolvency Practitioners Association of Sri Lanka
Canadian Association of Insolvency and Restructuring Professionals
Canadian Bar Association (Bankruptcy and Insolvency Section)
Commercial Law League of America (Bankruptcy and Insolvency Section)
Especialistas de Concursos Mercantiles de Mexico
Finnish Insolvency Law Association
Ghana Association of Restructuring and Insolvency Advisors
Hong Kong Institute of Certified Public Accountants (Restructuring and Insolvency Faculty)
INSOL Europe
INSOL India
INSOLAD - Vereniging Insolventierecht Advocaten
Insolvency Practitioners Association of Malaysia
Insolvency Practitioners Association of Singapore
Instituto Brasileiro de Estudos de Recuperação de Empresas
Instituto Brasileiro de Gestão e Turnaround
Instituto Iberoamericano de Derecho Concursal
International Association of Insurance Receivers
International Women's Insolvency and Restructuring Confederation
Japanese Federation of Insolvency Professionals
Korean Restructuring and Insolvency Practitioners Association
Law Council of Australia (Business Law Section)
Malaysian Institute of Certified Public Accountants
National Association of Federal Equity Receivers
Nepalese Insolvency Practitioners Association
NIVD – Neue Insolvenzverwaltervereinigung Deutschlands e.V.
Recovery and Insolvency Specialists Association (BVI) Ltd
Recovery and Insolvency Specialists Association (Cayman) Ltd
Recovery and Insolvency Specialists Association of Bermuda
REFOR – The Insolvency Practitioners Register of the National Council of Spanish Schools of Economics
Restructuring Insolvency & Turnaround Association of New Zealand
Russian Union of Self-Regulated Organizations of Arbitration Managers
Society of Insolvency Practitioners of India
South African Restructuring and Insolvency Practitioners Association
Turnaround Management Association do Brasil
Turnaround Management Association (INSOL Special Interest Group)

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On September 6, 2017, the British Virgin Islands suffered a catastrophic direct hit by Category 5 Hurricane Irma. Whilst the Islands suffered severe physical damage, the financial community has gathered together with a commitment to rebuild stronger and better than before.

Despite our offices suffered minimal damage, our BVI team has been relocated to the Cayman Islands. We remain committed to BVI and our presence there, and will be back operating as soon as practically possible.

We want to take the opportunity to thank all of clients, colleagues, friends and most importantly our team for their support during and following the hurricane. Without your encouragement and perseverance, the task of rebuilding would be a far greater burden.

- Cayman Islands
- Bermuda
- British Virgin Islands
- Guernsey
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