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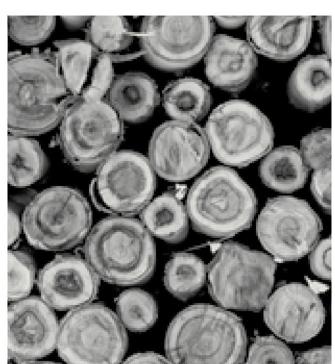
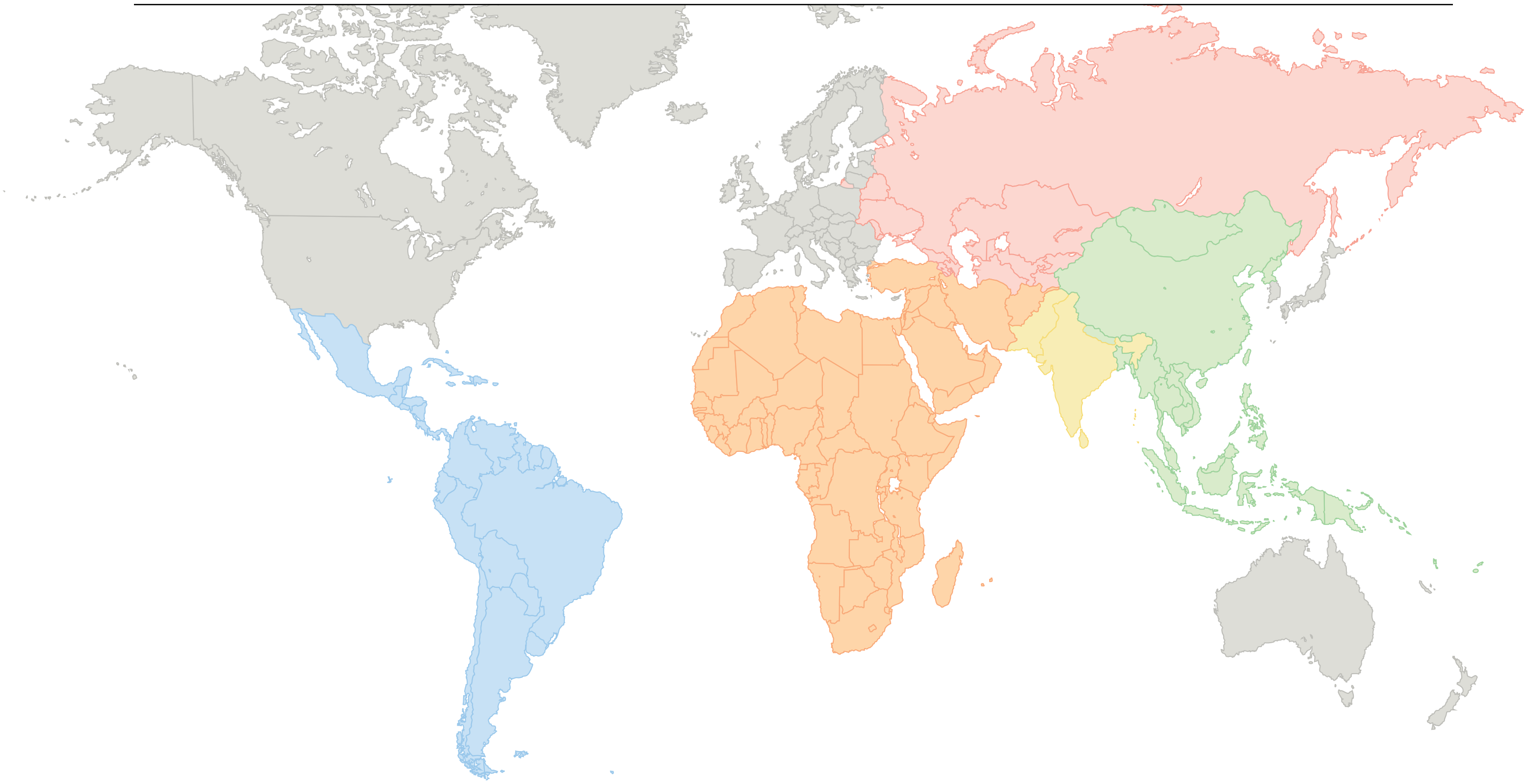



In This Issue



Contributors

KHAITAN & CO.

Nikhil Narayanan

KINSTELLAR

Andriy Nikiforov
Serhiy Mykhaylyk

EMSO ASSET MANAGEMENT

Charles Antoine Wauters
Patrick Esteruelas

HUGHES & HUGHES

Hector Ferreira

OLANIWUN AJAYI

Damilola Salawu
Maryam Olawunmi Oyebode

WONG PARTNERSHIP

Manoj Pillay Sandrasegara
Smitha Menon
Harold Foo

REBAZA, ALCÁZAR & DE LAS CASAS

José Jiménez
Daniel González

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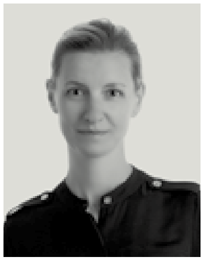
Reem Gasir, Abu Dhabi
Mariam Al-Alami, Abu Dhabi
Alejandro Canelas Fernandez, New York
Lev Breydo, New York
Matthew J. Livingston, New York
Carlo de Vito Piscicelli, Milan
David Billington, London

Letter from the Editors



At the point of writing this note, the markets are still reacting to the outcome of the U.S. presidential election. Coupled with the Brexit vote in the UK earlier this year and the surge in populist politics in Europe, these events suggest that we may have come to a turning point in the popular acceptance of globalisation in the West. If the developed economies turn inwards, this will have repercussions in the emerging markets, as will the secondary effects of the U.S. elections, such as depreciating currencies and increasing interest rates, all of which will put pressure on emerging markets companies and sovereigns with international indebtedness. The one thing that is certain in these uncertain times is that old sins will cast long shadows. As the situation develops, we hope that we will cover these issues in depth in future editions.

This current issue has a number of pieces that we hope readers will enjoy. One recurring theme is the drive by policy makers to clean up the balance sheets of local banks. In India, this has resulted in the greater use of debt aggregation vehicles that has enabled foreign investors to participate in the local distressed debt market. In Ukraine, this policy goal has led to the introduction of a novel out-of-court procedure but questions linger as to whether this is somewhat of a missed opportunity.

The articles in this issue also have broad geographic scope. Focussing on Latin America, we have an article questioning whether debtor-in-possession financing is possible in Peru and another showing how insolvency laws in Uruguay toe the balance between debtors' rights and creditor protections. In the Middle East and Africa, there are features on the new insolvency laws being considered in Saudi Arabia and an article on the debt restructuring options for local players in the Nigerian oil and gas industry. Further east, our contributors explore whether Singapore is carving out a niche of a modern entrepôt for debt restructuring, true to its roots as the island nation was founded as a trading post of the British East India Company.

We also offer two complementary articles on bond restructurings to insolvency practitioners: one setting out the issuer's roadmap to restructure high yield bonds and another questioning whether exit consents can continue to be part of the restructuring toolkit in the post-Marblegate and Caesars world. Our contributors have also dug deep into two recent insolvency cases, namely Chile's Automotores Gildemeister and the China Fishery cross-border bankruptcy saga involving Peru, Hong Kong and the U.S.

Lastly, there is a thought-provoking piece on why emerging markets sovereigns would be motivated to support its quasi-sovereign companies and what this means to the situation in Venezuela. This may be something of a preview into the drama that is on the horizon.

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

Distressed Debt Investing in India—the Use of Debt Aggregation Vehicles

By **NIKHIL NARAYANAN**

Although the security enforcement landscape in India has historically posed a number of challenges, the market in India is evolving. Recent efforts on the part of the Reserve Bank of India ("**RBI**") to encourage Indian banks to clean up their balance sheets has created an opportunity for debt funds to acquire substantial debt portfolios in India. This, together with recent regulatory changes intended to encourage greater investment in the debt market and to improve the local security enforcement process, has led to increased inflows of debt capital into India. Much of this investment has centred around the acquisition of "*distressed debt*" portfolios in India and many international investors have chosen to participate through the use of long term debt aggregation vehicles.

There are two potential debt aggregation vehicles in India: asset reconstruction companies and non-banking finance companies. This article discusses the type of debt that asset reconstruction companies can acquire, the extent to which international investors can invest in such vehicles, the normal investment considerations and the benefits that asset reconstruction companies offer international investors. It also compares asset reconstruction companies to non-banking finance companies in the distressed debt context and considers the impact of the recently enacted Insolvency and Bankruptcy Code 2016 on security enforcement by such debt aggregation vehicles.

Two potential debt aggregation vehicles in India: asset reconstruction companies and non-banking finance companies.

Background to the use of debt aggregation vehicles in India

"Distressed debt" in the Indian context

Investors seeking to participate in the debt market in India do not need to do so through debt aggregation vehicles. Indeed, most mezzanine debt or mezzanine-style investments are structured as bespoke secured bond investments through instruments known as "*non-convertible debentures*". Whilst this structure provides access to the capital of highly levered companies, it does not provide direct access to portfolios of distressed loans (although these bonds could themselves become distressed if they suffer an event of default). In contrast, debt aggregation vehicles provide for immediate and direct access to portfolios of distressed loans.

In this regard, distressed debt has a particular meaning. It refers to debt which has failed certain RBI default guidelines. In India, debt is usually regarded as being distressed when, in the RBI's parlance, it is an "SMA-2 account", meaning that payment under the loan is more than 61 days overdue. This is the point at which it can be sold to asset reconstruction companies (see discussion below) and the debt is treated as "non-performing" when payment is more than 90 days overdue.

Borrowers of this nature are often in need of significant restructuring. That is also true of distressed investments elsewhere in the world, but in the Indian context, a successful outcome for an investor often requires the cooperation of the controlling shareholder as well as the borrower's management and labour force. Indeed, the RBI sees the role of private capital as being able to absorb this debt from the banks and to work with the borrowers rather than to undertake "*asset stripping*". This does not mean that security is unenforceable or that the RBI will obstruct creditor action to protect its rights, but that the RBI will expect investors to have a plan in place to re-schedule the debts and enforce security (amongst others). Therefore, investors seeking to invest distressed debt in India are lending into this construct.

Benefits of debt aggregation vehicles in this context

Apart from providing access to distressed debt, the main benefit of using debt aggregation vehicles is that certain of them benefit from certain enhanced security enforcement tools in India under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI**"). SARFAESI allows certain lenders to enforce security or take certain other measures to protect their interests without any judicial intervention. These include the right to change the management and to take over the secured assets to realise their value without judicial intervention. In light of the difficult security enforcement regime in India, these remedies are seen as being desirable by international debt investors. The provision of SARFAESI have been strengthened by amendments in 2016, which extend its benefits to certain bond instruments as well.

Whilst it is certainly helpful for an investor to have these tools in its armoury, historically, lenders have had mixed success in using these provisions in practice. Therefore, if this is the only reason for the use of a debt aggregation vehicle rather than a more bespoke investment structure, then investors should consider this aspect of emerging market enforcement risk carefully, i.e. this is not a silver bullet that addresses all enforcement risk in India. In addition, although this is generally considered to be a welcome measure for creditors, the newly enacted Insolvency and Bankruptcy Code 2016 ("**Bankruptcy Code**") does adversely affect SARFAESI (and indeed, that is the intention). The Bankruptcy Code, as a matter of policy, is intended to replace individual creditor enforcement actions with a collective creditor enforcement process upon the onset of insolvency. It achieves this through a moratorium that restricts SARFAESI rights during the insolvency resolution process (discussed further later in this article). The effect of this moratorium is more pronounced in relation to debt aggregation platforms (in comparison to certain other SARFAESI qualifying lenders). Therefore, SARFAESI rights should not be the sole determining factor in an investor's decision to set up or participate in a debt aggregation platform.

Asset reconstruction companies (ARCs) are the most commonly used debt aggregation vehicle, as far as pure distressed investments are concerned.

In addition, there are certain tax advantages in relation to the use of certain debt aggregation vehicles, as discussed further below.

Asset Reconstruction Companies

What is an ARC?
The most commonly used debt aggregation vehicle, as far as pure distressed investments are concerned, are "*asset reconstruction companies*" ("**ARCs**"). The term ARC does not refer to a special type of legal entity in itself, but to a registration with the RBI under SARFAESI. ARCs act as managers to the security trusts that actually acquire the distressed debt portfolio. The security trusts then issue security receipts in relation to the underlying debt acquired.

Investors will also need to consider their overall investment objectives in this regard. An ARC is required under SARFAESI to only undertake "*asset reconstruction*" activity (unless it has received RBI approval for any other activity). Therefore, if an international investor intends to lend more widely, then there may be other structures that are more appropriate.

International participation in the equity and the management of ARCs
International investors now benefit from greater flexibility than in the past.

Historically, international investors were subject to a number of restrictions both in relation their investment in the equity of the ARC itself as well as a cap on its holding of security receipts. However, recent changes to India's foreign direct investment policy and SARFAESI mean that international investors can now invest in up to 100% of the equity of ARCs (although any investments of above 10% will require the investor to also satisfy the "*fit and proper*" person test and hold all the security receipts in any tranche.[1] Of course, that latter point is affected by the separate RBI requirement for ARCs to hold 15% of the security receipts which is discussed further under the heading "*Issuance of security receipts*" below. The changes mean that there is no longer any regulatory reason for an international investor to seek a local partner. That said, some investors have chosen to retain a local partner to assist with local sourcing of opportunities and management of local regulatory and diligence issues (see discussion under the heading "*Regulatory and operational issues*" below).

International investors are free to appoint directors and structure the governance of the ARC as they wish (provided that these arrangements comply with Indian company law), although the RBI does impose an incremental layer of regulation. Some of this relates to ensuring that the directors are appropriately qualified with the right level of experience. However, any "substantial change of management", which is defined to include the appointment of any director or managing director or CEO of the Asset Management Company, will need the RBI's approval.

Acquisition of distressed debt portfolios by the security trust
The debt is required to be of a certain regulated grade of distress before ARCs can seek to acquire them. The RBI requires Indian banks to classify debts using certain codes. Debts which are overdue over 61 days can be sold to ARCs (these are called "SMA-2 accounts", where the debts are 61-90 days overdue and "non-performing assets" where the debts are more than 90 days overdue). In addition, debts which are part of a consortium loan, 75% of which is "non-performing" (as defined above) can also be sold to ARCs.

With that background, there are two ways for an ARC to acquire distressed debt: (a) by participating in a public auction process (discussed further in the paragraph below); and (b) through bilateral arrangements (these are directly between the holder of the debt and the purchaser and it is not common for these sales to involve a third party). The former is more common and the RBI is seeking to introduce greater transparency to this process.

The RBI's main concerns in this regard are to ensure that buyers undertake proper diligence (and its regulations have enabling provisions allowing buyers two weeks to conduct their due diligence) and to ensure transparency. It is also focussed on ensuring that the auctions result in real sales of distressed debt, rather than being a price discovery exercise alone. To this end, in guidelines issued on 1 September 2016 ("**Distressed Debt Sale Guidelines**"), the RBI has set out detailed requirements encouraging the use of electronic auctions, requiring the banks to indicate the discount rate that they are using and to put in place policies to sell debt through the "*Swiss*

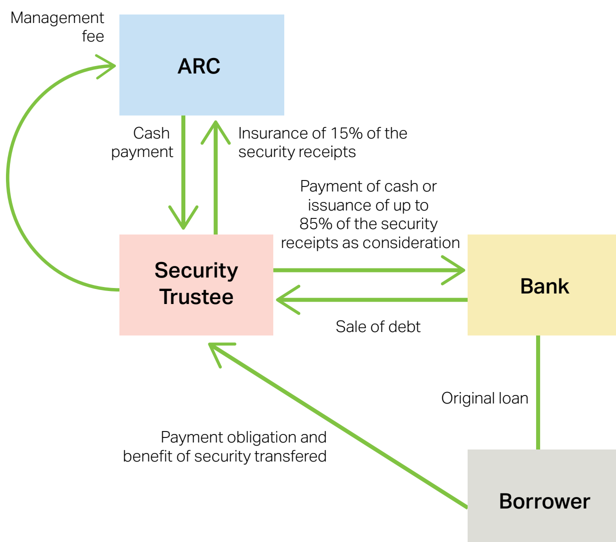
Challenge" method (where the failure to sell results in the bank having to put in place higher bad debt provisioning).

Recent amendments to SARFAESI mean that the acquisition of distressed debt by an ARC will not be subject to stamp duty (although stamp duty will apply when one ARC sells any distressed debt to another ARC).

Issuance of security receipts

An ARC will be required to formulate a policy (to be approved by its board) relating to the issues of security receipts by its security trust. The security trustee will then be required to prepare a scheme for the issuance of security receipts and the RBI's Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions 2003 (the "**RBI 2003 Guidelines**") contemplate the preparation of an offering document. The disclosure in this document is quite basic and, to date, there is no regulatory framework for the listing of security receipts.

Illustration of an ARC structure



The security receipts have a number of features that benefit investors. They are required to have a credit rating, which is based on their net asset value ("**NAV**"). The rating is to be on a "*recovery rating scale*" and the RBI has set out a number of rules governing this rating (including the disclosure of any conflicts of interest). Also, there is no minimum maturity period in relation to the security receipts. In addition, following changes introduced in 2016, security receipts benefit from "*pass through*" treatment with regard to the coupon and any redemption premium payable on the security receipts issued by securitisation trusts (there is withholding in India, but treaty benefits will apply).[2]

The RBI requires the ARCs to acquire 15% of the security receipts so that it has direct "*skin in the game*", but otherwise, the security receipts can be issued to "*qualified buyers*".[3] It is common practice for a security trust to acquire distressed loan portfolios from banks and issue them with 85% of the tranche of security receipts (so that the ARC holds its required 15% of security receipts) rather than paying out cash. However, the RBI is seeking to discourage this practice in its recent Distressed Debt Sale Guidelines, by imposing higher provisioning requirements on the banks in such circumstances.[4]

Ability of the ARC to transfer or syndicate its security receipt exposure

From a risk mitigation perspective, any debt investor will want the ability to exit its investment by selling down its exposure at any time (particularly since the credit default swap market in India is currently quite limited). Equally, the ARC may wish to syndicate its exposure at the outset. With regard to investments made by an ARC in security receipts, whilst there is no "lock-in" period, this is possible subject to certain constraints.

Firstly, there is the 15% "*invest and hold*" requirement on the part of the ARCH in relation to each tranche of security receipt. ARCs cannot transfer this stub holding requirement.

Secondly, the sale can only be to other "*qualified buyers*" (this is required to be a term of the security receipt issuance scheme under the RBI 2003 Guidelines). Of course, it may be the case that these qualified buyers constitute much of the addressable market, but before undertaking any sale, this is a point that an ARC will want to check.

Thirdly, the drafting of certain exchange control provisions creates some regulatory ambiguity in relation to the ability of foreign portfolio investors ("**FPIs**") to acquire security receipts in the secondary market (i.e. not directly from the issuer). FPI status is a securities registration allowing international investors the ability to participate in the Indian securities market. Historically, this has been one of the simplest ways for debt investors to hold Indian high-yield securities. The definition of "*qualified buyers*" includes a reference to "*foreign institutional investors*". Since that was the regulatory predecessor of FPIs, that does not cause concern. The issue of concern arises from the fact that the drafting of the relevant provisions of RBI's Transfer or Issue of Securities Regulations 2000 suggests that as far as non-primary acquisitions are concerned, FPIs can only participate if the security receipts are listed. To date, there is no mechanism to list security receipts. Indeed, the Securities and Exchange Board of India ("**SEBI**") regulations that introduced the FPI concept do not refer to listed security receipts. Therefore, this seems to be an inadvertent regulatory oversight that ought to be capable of being explained to the RBI, but it would be prudent for an ARC to seek RBI guidance on this at the outset to avoid facing issues later.

Funding of ARCs

The funding of ARCs requires careful consideration at the outset. Equity funding is the default position, but will an ARC be able to "*leverage*" itself by capitalising itself with debt (i.e. can an ARC leverage its 15% security receipts holding)?

As an initial gating question, any ARC will need to consider to what extent this such leverage will be consistent with RBI's guidelines (which envisage the ARC retaining skin in the game). Beyond that, all Indian companies are subject to a number of restrictive RBI rules on "*external commercial borrowings*" and ARCs would not ordinarily qualify as permitted borrowers under that. That said, there may be other bond instruments (such as "*non-convertible debentures*") which may be capable of being used.

Synthetic exposure

Another question that international investors sometimes consider is their ability to hedge themselves by creating derivative instruments outside India based on the Indian underlying debt (i.e. the debt portfolio acquired). In general, SEBI, India's security regulator, very carefully scrutinises any such arrangements which it refers to "*off-shore derivative instruments*" and its FPI regulations permits the creation of such derivative instruments if the underlying securities are either listed or are "to be listed". Since the security receipts are not listed instruments (and there is no framework to do so), that will impose a restriction in practice.

Commercial arrangements in relation to the ARC

The RBI closely regulates a number of the commercial aspects of the functioning of an ARC.

A Non-Banking Finance Company (NBFC) is a company that provides financial services in the Indian market (which may include lending and, if so permitted, deposit taking too).

The RBI requires the ARC's management fees to be calculated as a percentage of the net asset value based on the lower end of the NAV range indicated by the credit rating agency (rather than being based on the outstanding value of the security receipts). In addition, the fees cannot exceed the acquisition value of the distressed loan portfolio acquired. Management fees are to be recognised on an accrual basis.

The RBI also regulates the treatment of a number of accounting matters. For example, with regard to pre-acquisition expenses (e.g. due diligence), the RBI requires these to be immediately expensed in the profit and loss statement for the period to which such costs relate. There are also detailed provisions with regard to post-acquisition cost expensing. These guidelines also regulate matters such as revenue recognition (including on yield, upside income and management fees) and the accounting treatment of security receipts in the hands of investors. Therefore, any investor seeking to invest in these securities should carefully study these rules to understand the accounting implications as an initial regulatory diligence matter.

Regulatory and operational issues

ARCs are regulated entities and this comes with its own compliance requirements, including a number of periodic filings with the RBI. Well advised lenders will also want to keep a close eye on their portfolio and so this does mean that setting up an ARC will require an effective local presence in practice. Outsourcing arrangements are unlikely to be practical here and it also seems unlikely that the RBI would accept this outside of certain defined boundaries. For this reason, a number of international investors have chosen to partner with Indian counter-parties who are more familiar with the regulatory landscape.

Non-Banking Finance Companies

In addition to ARCs, another form of lending vehicle that is used in the domestic context is the "non-banking finance company" ("**NBFC**"). An NBFC is a company that that provides financial services in the Indian market (which may include lending and, if so permitted, deposit taking too). NBFC are closely regulated by the RBI, which imposes a number of prudential capital norms. They are broken down further into a number of categories, deposit-taking and non-deposit taking and systemically important and non-systemically important. In addition to the RBI guidelines, there an overlay of foreign direct investment regulations that adds an additional layer of regulation for international investors.

Is this a suitable vehicle for distressed debt investment?
NBFCs are commonly used for general financing transactions in India and the number of NBFCs currently in existence is far greater than the number of ARCs. However, despite that, NBFCs have historically not been the default choice of vehicle to undertake distressed debt investments. Part of that reason is that until September 2016, there were certain restrictions on NBFCs that had received international investment. Those restrictions have been removed, so the issue does now merit closer scrutiny.

The main benefit of NBFCs is that they are able to undertake a broad range of finance activities and have access to accounts before they reach the 61-day default stage (which is when ARCs can acquire such debt). This means that they are able to acquire and aggregate debt that has a better chance of recovery. NBFCs can also borrow outside India, subject to certain conditions, unlike ARCs (which are not permitted to borrow under India's "*external commercial borrowings*" exchange controls).

However, there are a number of tax disadvantages to the use of NBFCs. Any instruments they issue will not benefit from tax pass through treatment (unlike security receipts issued by ARCs). Also, any distressed debt that NBFCs acquire will be subject to stamp duty as the exemption recently introduced to SARFAESI in 2016 only applies to acquisitions by ARCs.

From an enforcement perspective, the right to enforce security without the approval of the courts under Section 13 of SARFAESI has recently been extended to certain NBFCs that have a capital of INR 5 billion, roughly $75 million at current exchange rates (and where the secured debt is at least INR 10 million, or about $150,000 at current exchange rates). However, other provisions of SARFAESI, such as the "*deemed assignment*" (by operation of law) of any distressed debts do not apply to NBFCs and they only apply to ARCs. Of course, ARCS can benefit from contractual assignment, so this may not be the most significant disadvantage in practice, but it is a point of difference.

ARCs v NBFCs

A more detailed comparison of ARCs in comparison to NBFCs is set out below.

Consideration	ARC	NBFC
Permitted activities	Limited to asset reconstruction activity, i.e. suitable for the acquisition of distressed loan portfolios but not wider lending.	NBFCs can undertake a broad range of lending activities as permitted by the RBI.
Restrictions affecting foreign investment	None.	Previous restrictions under India's foreign direct investment regulations have now been eased on in September 2016. However, any depending on the nature of activity being undertaken, the regulations of other regulatory bodies (e.g. the RBI) may be relevant.
Need for RBI registration	Yes.	Yes.
RBI approval for change of management	Yes for substantial changes of management (appointment of a director, managing director or CEO). Shareholders holding 10% or more of the shares of an ARC must be "*fit and proper*" persons.	Yes for the following: (a) takeover or change of control (regardless of whether or not it results in a change of management); (b) the transfer of 26% of shares in the company; or (c) a change of 30% of the board (excluding independent directors).
Subject to prudential capital or capital adequacy requirements?	Yes (the 2003 RBI Guidelines).	Yes (there are detailed and separate guidelines on these).
Stamp duty on acquisition of distressed debt portfolio?	No (there is an exception under SARFAESI).	Yes.
Debt capital instruments that it can issue (other than convertible instruments)	Security receipts and non-convertible debentures (there is no explicit restriction in relation to the latter). It is currently unclear as to whether the RBI will accept ARC issuing "masala bonds" and practice is yet to evolve in that regard.	Non-convertible debentures and "masala bonds".
Ability to borrow outside India (outside the instruments referred to in the row above)?	No, ARCs are not permitted to borrow under India's "external commercial borrowing" exchange control rules.	Yes, NBFCs are permitted to borrow under "Track 3" of India's "external commercial borrowing" exchange control rules.
Pass through tax treatment on instruments issued?	Yes on security receipts issued by an ARC.	No.
Benefits from SARFAESI enforcement processes (Section 13)	Yes.	Yes for NBFCs with assets of over INR 5 billion and provided the security interest secures a debt that has a principal of at least INR 10 million.
Benefits of deemed assignment provisions under SARFAESI	Yes.	No.

Impact of the bankruptcy code on both ARCs and NBFCs

Individual v. collective enforcement processes
ARCs and qualifying NBFCs which benefit from SARFAESI will be equally affected by the advent of the recently enacted Bankruptcy Code, which, at the date of publication of this article, is not in force.

SARFAESI constitutes debt recovery legislation, which enables creditors to enforce individual rights. In contrast, the Bankruptcy Code establishes a collective insolvency procedure by imposing a UK style quasi administration regime for insolvency companies. The inter-relation between the two laws will need to establish itself in practice, but there is an obvious tension here.

Moratorium on SARFAESI action
Under the Bankruptcy Code, once the insolvency process commences, a moratorium is imposed upon creditor rights. This restricts not only current and potential legal proceedings, but also rights under SARFAESI. Section 14(1)(c) of the Bankruptcy Code states that the moratorium applies to "any action to foreclose, recover or enforce any security interest" including under SARFAESI. That begs the question as to whether the rights to replace management under SARFAESI would be affected. The language here is not as clear as would have been ideal and there may well be some exploitation of this gap in the future, but the legislative intent is clearly to restrict such type of action as well.

Therefore, if a creditor initiates the bankruptcy process (by applying to the court), the moratorium will take effect and any secured creditors cannot stop this from taking effect and SARFAESI action will need to come to a halt and be replaced by the collective insolvency procedure. Of course, ARCs and NBFCs will be part of the creditor committee which is part of the insolvency process, where decisions need to be undertaken by with a 75% majority (by value and including unsecured creditors). This may give ARCs and NBFCs some leverage to affect the outcome of the insolvency process.

Liquidation
The insolvency process is time bound (180 days extendable by no more than a further 90-day period) and if there is no resolution during that time, the default is for the company to be liquidated. In such circumstances, any secured creditors (including ARCs and NBFCs) can elect to receive proceeds in liquidation (by relinquishing their interest to the liquidation estate) or stand outside this by informing the liquidator and directly enforcing their security interests. Therefore, SARFAESI may play a role in enforcement in this regard.

Will the Bankruptcy Code weaken the attraction of ARCs and NBFCs?
Although, ARCs and NBFCs still hold other advantages for investors (for example, by providing access to distressed debt in India), their attractiveness may be affected by the Bankruptcy Code, once it comes into force and once the institutions and professional bodies that it contemplates come into existence.

In order for ARCs and NBFCs to be able to utilise their SARFAESI rights, they will need to have initiated and completed their SARFAESI sales prior the occurrence of an insolvency trigger (non-payment of debts when they are due and payable). ARCs and NBFCs are only permitted to enforce after the debt has defaulted by certain periods and after then have given the borrower certain further notice periods. In practice the company is almost inevitably likely to be insolvent by the time they are able to exercise their rights, which will dilute the value of their SARFAESI rights.

This dynamic should, in practice, encourage investors to invest in distressed debt through the qualifying permitted debt instruments (which also benefit from SARFAESI), because the event of default in these cases does not need to be tied to the debt being "non-performing" (i.e. having been significantly overdue).

However, it remains to be seen as to how this dynamic plays out in practice, particularly still the institutions and eco-system needed to make the Bankruptcy Code a success will undoubtedly take time to evolve. During this interim period, SARFAESI will continue to be a useful tool.

Alternative Investment Funds

Background
Other than ARCs and NBFCs, some investors have also considered the use of "alternative investment fund" ("AIF") registrations to establish their credit platforms in India. An AIF is a fund pooling vehicle that is incorporated or established in India and is registered with SEBI. AIFs can receive investment from investors both inside and outside India. There are different categories of AIF registrations which are subject to different investment restrictions, but "Category II" AIFs are permitted to make debt investments and hence this provides another route for international investors to access debt capital issued by Indian companies.

Pros and cons
However, AIFs do not benefit from any special enforcement treatment. Also there are restrictions on the ability of Category II AIFs to leverage themselves and so such AIF vehicles do have their limitations. But provided they are properly structured, as the law currently stands, Category I and II AIFs do benefit from tax pass-through treatment and this has been one of their attractions.

Some Closing Thoughts

There is no doubt that debt aggregation vehicles do offer a number of advantages for investors seeking to engage in a long term basis in the distressed debt market in India, particularly in an enforcement scenario. It is also clear that ARCS currently offer a greater range of benefits than NBFCs in this regard.

However, given the time and cost of setting up and ARC and the ongoing regulatory requirements, the bigger question that an international investor will need to ask is what its investment objectives are entering India and whether an ARC will help achieve those objectives, given the investor's preferred modus operandi. These structures will be useful to investors who have the ability to undertake restructurings of the borrower. In the Indian context, that will require the cooperation of the controlling shareholder of the borrower and its management (and in context of corporate India, non-controlled companies are relatively rare).

Also, debt aggregation vehicles mitigate but do not fully eliminate the emerging market risk with regard to enforcement. Whilst in theory SARFAESI (particularly as amended in 2016) offers enhanced security enforcement mechanisms, lenders have historically had mixed success in implementing these provisions successfully and there have been some unhelpful judgments in this regard (for instance, the case of Blue Coast Hotels Limited v. IFCI Limited, dated 23 March 2016, where the court annulled a security enforcement sale under SARFAESI). Therefore, investors will need to bear in mind that "enhanced enforcement rights" do not guarantee a successful outcome. In addition, when the Bankruptcy Code comes into force, it will impose a moratorium on SARFAESI enforcement rights in favour of a collective insolvency process. Therefore, any SARFAESI rights will need to be enforced and security realised ahead of the insolvency trigger under the Bankruptcy Code. This may be difficult to achieve in practice and this may weaken some of the appeal of debt aggregation vehicles. However, it may be some time before the institutions and professions needed for the proper functioning of the Bankruptcy Code are in existence and before the market develops confidence in them. Until then the SARFAESI advantages will remain intact.

With those caveats, for an investor willing to engage with distressed companies and their management in India and willing to take on emerging market risk, ARCs offer a number of positives. ■

1. This is a recently introduced requirement (August 2016) and the RBI has not yet published guidelines on this requirement. Until then, in practice, parties seeking a registration should be guided by the guidance that the RBI has published in the context of other financial institutions. For example, in the context of non-banking finance companies, the RBI in relation to the *"fit and proper"* test for management, the RBI considers the qualifications of management, their technical expertise, track record, integrity and factors of this nature.
2. Any interest and redemption amounts will be taxed as income in the hands of the holder. The applicable tax rate depends on a number of factors. Qualifying NCDs currently benefit from a withholding rate of only 5% until 30 June 2017 (unless extended by law). For other debt instruments, if the debt is structured through a Mauritian holder, it will benefit from a withholding of 7.5% (provided the holder has substance in Mauritius and provided the other requirements of the Indo-Mauritius tax treaty are satisfied). Other jurisdictions such as Luxembourg and Netherlands are sometimes also used to structure debt investment as they also have tax treaty provisions that parties can utilise. However, the default rate on interest on rupee debt in the purely domestic context is 40%.
3. The regulatory definition covers financial institutions (which is itself defined and includes certain defined public institutions, the International Finance Corporation, debenture trustees for secured debt securities, asset reconstruction companies and, following certain recent amendments, non-banking finance companies with assets over INR 5 billion (and where the secured payment exceeds INR 10 million)), insurance companies, banks, state finance corporations, state industrial development corporations and the trustee of an RBI registered asset management company.
4. These enhanced provisioning requirements currently apply when the bank holds 50% of a tranche of security receipts relating to any debt sold to a Security Trust, but from 1 April 2018 the holding of just 10% of the security receipts by the selling bank or financial institution will trigger this enhanced provisioning.

▼ **Nikhil Narayanan** is an M&A partner at Khaitan & Co. with extensive international and cross-border experience, having advised corporate clients, financial sponsors and investment banks on high value and often market leading M&A and ECM transactions, both in London and in India. He has advised a number of private equity funds in relation to various structured investments in India and has advised a number of debt funds on their India entry strategy. Narayanan received his MBA from London Business School and was a Merrill Lynch Scholar, his BCL from St. Catherine's College, Oxford University and was a Radhakrishnan Scholar, and his BA and LLB, with Honors, from the National Law School of India University.

LEGISLATION WATCH / MIDDLE EAST

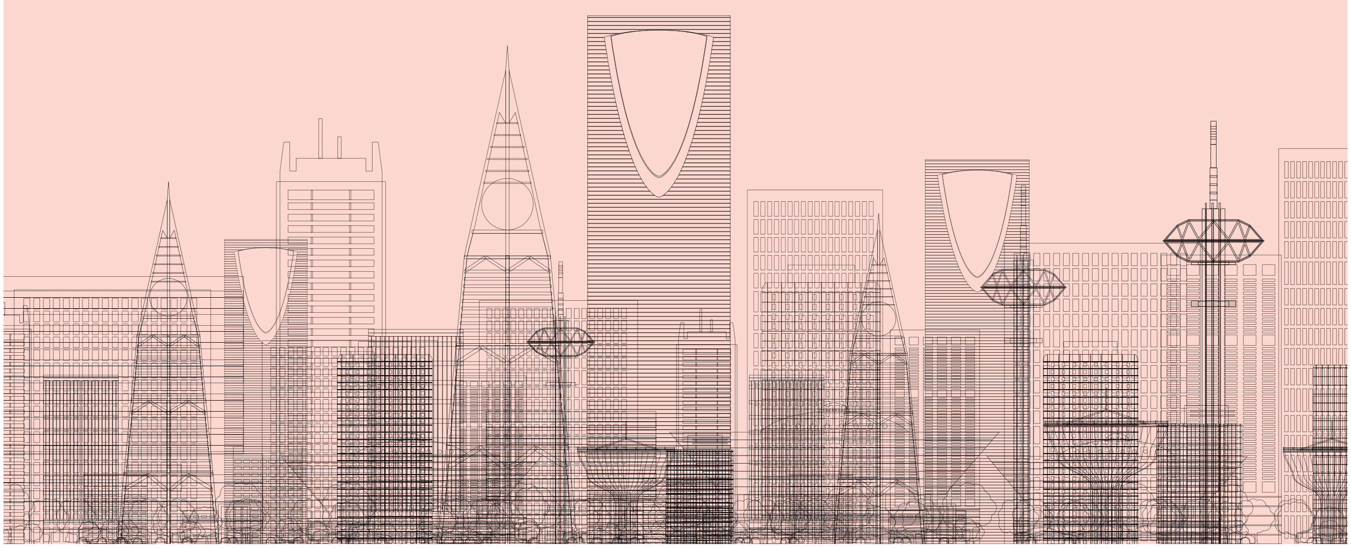
Saudi Arabia Set to Welcome New Insolvency Law

By: **REEM GASIR** *(rgasir@cgsh.com) and* **MARIAM AL-ALAMI** *(malalami@cgsh.com)*

The Ministry of Commerce and Investment of the Kingdom of Saudi Arabia (the "**Ministry**") is at the latter stages of its plan to introduce a new insolvency law. The Ministry published a policy paper in March 2015 setting out the framework and the main guiding principles of the new insolvency regime, received commentary on the policy paper and recently published a first draft of the proposed law (the "**Draft**") in September 2016.

The current insolvency regime, which is detailed in Chapter 10 of the Saudi Commercial Court Law 32/1350 (the "**CCL**") and the Royal Decree M/16 of 1416 (1996) on the Law of Settlement Preventing Bankruptcy, has generally been criticized as inadequate and a hindrance to economic activity and the revitalization of failing businesses. For example, the insolvency procedures prescribed in the CCL do not have much value in practice given that creditors are required to obtain an express admission of insolvency by the debtor or a final court judgment establishing that the debtor is insolvent in order to initiate the insolvency procedures, which renders the whole process inefficient. Moreover, the existence of multiple sources of regulations pertaining to insolvency, which are often ambiguous and difficult to interpret, leads to a perception that the court's application of the rules is highly discretionary.

The Ministry therefore set out to develop a modern, simple and coherent insolvency regime that primarily aims to encourage economic activity in the Kingdom of Saudi Arabia. The proposed regime benefits from a comparative analysis of the insolvency laws of Czech Republic, England and Wales, France, Germany, Japan, Singapore and the United States, drawing from the best practices in these jurisdictions, while taking into account local conditions and Shari'ah compliance. The proposed regime aims to encourage economic activity by favoring conciliation and rehabilitation over formal bankruptcy proceedings. The Ministry also hopes to develop a procedure that allows for an orderly liquidation of businesses, that is largely driven by creditors. To achieve these goals, the Draft proposes that the following procedures be made available to debtors and their creditors:



- **Protective settlement procedures:** a conciliation procedure that can be initiated by the court upon the request of either (i) debtors that are insolvent, in distress or likely to have difficulties repaying their debts, or (ii) the regulator of such debtor's activities. Under a protective settlement procedure, the debtor would be able to apply for a short stay (up to 90 days) against creditors' claims and could remain in possession of its assets. Debtors would also be permitted to obtain financing or new loans while the procedures are ongoing. Unlike the current Law of Settlement Preventing Bankruptcy, which does not distinguish between different classes of creditors, the protective settlement procedures provided for in the Draft allow for the categorization of creditors into different classes. Additionally, the proposed rules extend voting rights to creditors to approve debtors' proposals and allow the court to compel dissenting creditors to accept a debtor's proposal if two-thirds of the creditors accept such proposal.

- **Rehabilitation:** a newly introduced procedure that debtors, creditors or the regulator of a debtor's activities can commence when the debtor is in distress or insolvent. The procedure entails appointing a licensed insolvency professional, upon a formal judicial management/administration process, who will have broad powers in managing the assets of the debtor and will be responsible for preparing rehabilitation proposals to be voted on by the creditors.

  As in a protective settlement procedure, debtors would be permitted to obtain financing or new loans during the rehabilitation process. If such loans are secured, a court's approval of the loans must be obtained before or after the confirmation of the protective settlement or the rehabilitation proposal. Approval by the court is not required for new unsecured loans.

- **Liquidation:** if the debtor is insolvent and there is no chance of conciliation through a protective settlement procedure or of rehabilitation because of, for example, a lack of enterprise value and operational efficiency, the court could initiate a liquidation process on its own initiative, or upon the request of the debtor, a creditor or the regulator of the debtor's activities. Under the Draft's proposed rules, insolvency would be determined by a simple cash flow test.

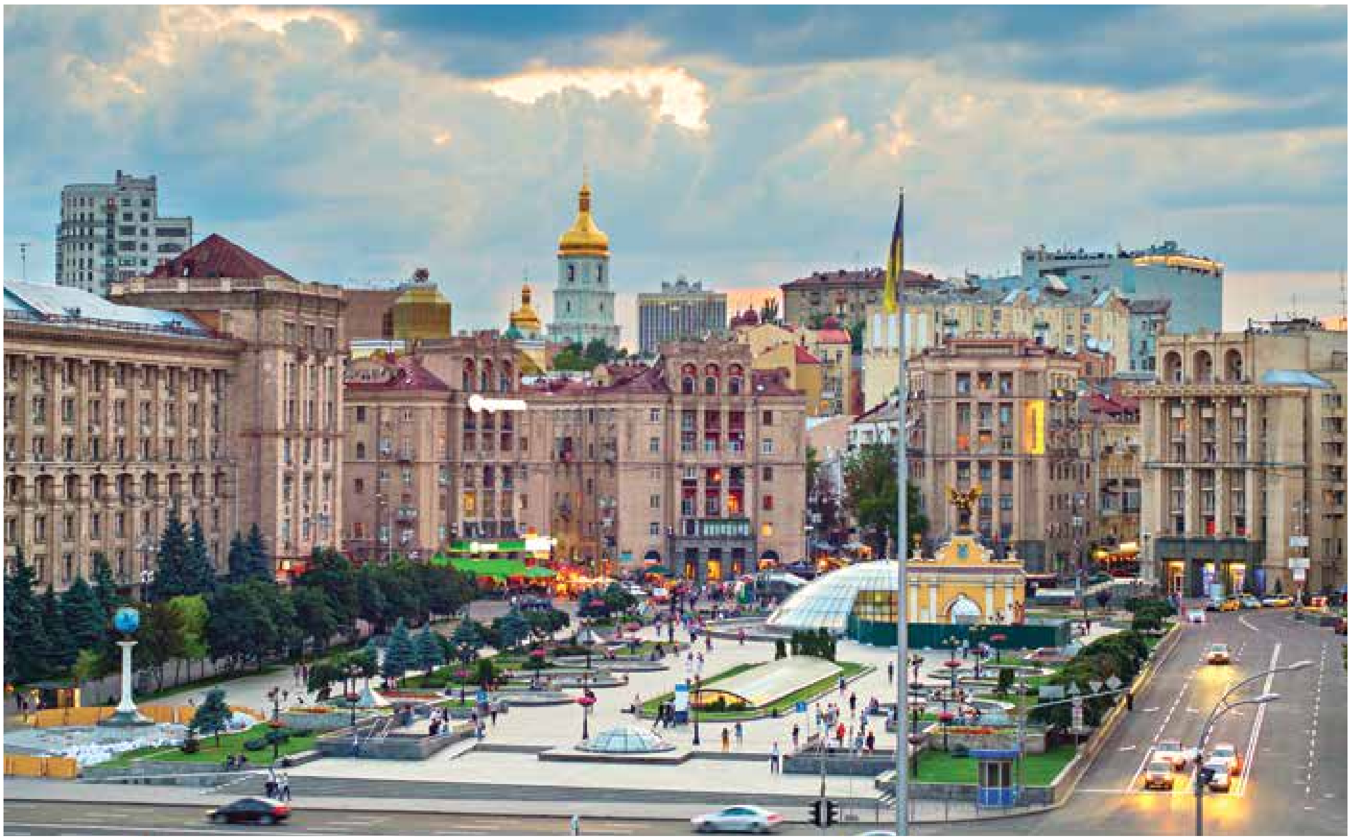
  New loans can also be obtained during liquidation but must be approved by the creditors and the court, whether secured or unsecured, prior to the commencement of the liquidation process. It is worth noting that all new loans will be considered priority claims.

The Draft provides simplified models of the above-mentioned procedures designed for small entities with limited assets and allows creditors to benefit from set-off rights and debt netting arrangements. In addition, financial collateral will be exempt from the effects of insolvency, such as a stay of enforcement against creditors.

The Draft will be discussed and reviewed by the Saudi Bureau of Experts at the Council of Ministers, and is expected to be signed into law by the end of the first quarter of 2017.

New Ukrainian Debt Restructuring Law: Upgrading the Parties' Pre-Insolvency Toolkits

By ANDRIY NIKIFOROV *and* SERHIY MYKHAYLYK



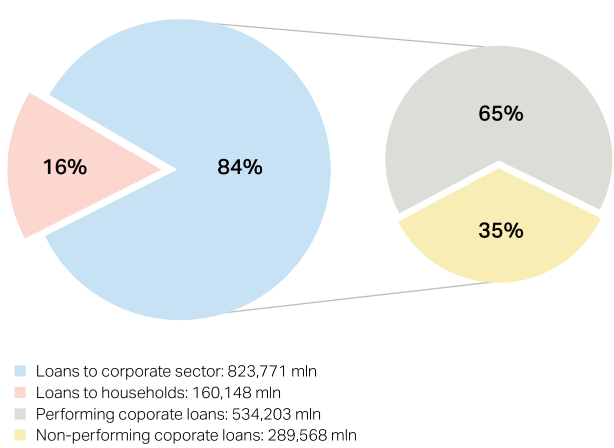
Background to the Financial Restructuring Law

On June 14, 2016, the Ukrainian Parliament adopted the long-awaited Law of Ukraine "On Financial Restructuring" (the "**Restructuring Law**") that introduced an out-of-court procedure for the restructuring of liabilities of Ukrainian debtors other than banks or other financial institutions.[1] This procedure will complement the long-established Ukrainian insolvency process and the court administered pre-insolvency procedure under Article 6 of the Law of Ukraine "On Restoration of Debtor's Solvency and Declaration it Bankrupt," dated May 14, 1992 (the "**Insolvency Law**"). The Restructuring Law came into force on October 19, 2016 and will continue in effect for the next three years when it will terminate in accordance with its terms. According to the Restructuring Law drafters, three year period should suffice to assess whether the law has made a difference. Thereafter, the Restructuring Law will be amended to continue to apply or the Article 6 process will be brought up to speed with the existing restructuring practices.

Although the Restructuring Law has been criticised for being somewhat limited in the scope of its application, there are two key features about the law that are worth highlighting. First, the Restructuring Law allows the debtor company to include in the process not only credits of commercial creditors, but also the credits owed to state-owned banks as well as the Ukrainian tax and other state authorities. Second, Ukrainian debtors may also benefit from the tax incentives set out under the Law of Ukraine "On Amendments to the Tax Code of Ukraine and Other Laws of Ukraine On Ensuring Balance of Budget Revenues in 2016," dated December 24, 2015, which applies exclusively to restructurings under the Restructuring Law.

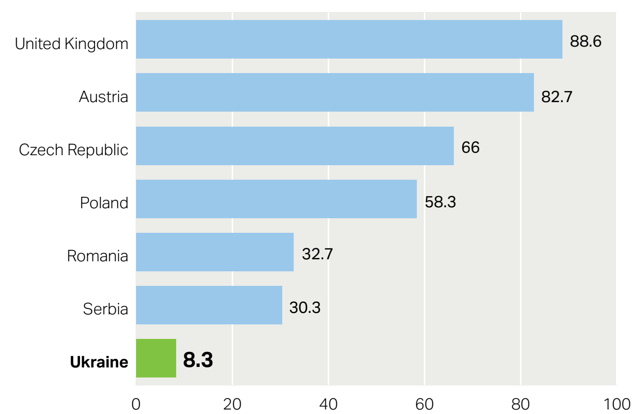
The introduction of the Restructuring Law is one of the policy responses to address the problem of non-performing corporate loans on the balance sheets of Ukrainian banks according to the National Bank of Ukraine. As of August 2016, such non-performing corporate loans amounted to almost 30% of the total bank credit portfolios of Ukrainian banks.[2] In its letter of intent to the IMF dated April 22, 2014 and the accompanying Memorandum of Economic and Financial Policies, Ukraine committed to take steps to facilitate the restructuring of non-performing loans in the banking sector, thereby boosting depositor confidence and promoting healthy credit growth. This commitment eventually took the shape of the Restructuring Law, the development of which was sponsored by the European Bank for Reconstruction and Development and the World Bank.

Loans to Ukranian Residents, UAH 985,970 mln
(as of 31 August 2016)



The other reason for the adoption of the Restructuring Law is the historically low rate of creditor recoveries in Ukrainian insolvency proceedings compared to other jurisdictions. The chart below shows how the insolvency recovery rate in Ukraine compares to recovery rates in other European economies, including Ukraine's neighbouring countries.[3]

Recovery Rate (cents on the dollar)



Where Article 6 Pre-Insolvency Process Failed

The adoption of the Restructuring Law is also an acknowledgement that Article 6 of the Insolvency Law establishing the pre-insolvency court-managed debtor financial rehabilitation procedure, which was introduced in 2013, failed to achieve the desired goal of facilitating restructuring of Ukrainian non-performing loans. When compared, for example, to the UK scheme of arrangement to which a multitude of corporates worldwide have turned in recent years, the Article 6 procedure requires the consent of all secured creditors and the majority in value of unsecured creditors where the UK scheme simply needs the approval of a majority of creditors holding at least 75% by value. The requirement of unanimous consent of secured creditors is an unrealistically high threshold for many restructurings and is ultimately the Achilles heel of the Article 6 procedure. Also, although the Article 6 procedure may at first appear to provide for an immediate moratorium on creditor claims, this moratorium will only come into effect after the restructuring plan has been approved by the requisite majority of creditors and therefore is perceived to be too late.

Key Features of Financial Restructuring Procedures under the Restructuring Law Compared to Procedures Under the Insolvency Law

	Article 6 Pre-Insolvency Procedure under the Insolvency Law	Financial Restructuring Procedure under the Restructuring Law
Nature of procedure	Court supervised process	Out-of-court process with the involvement of a specialized body created by the state (secretariat)
Applicability	Applicable to all debtors, regardless of their liability composition	Only applicable to those debtors that owe liabilities to at least one financial institution
Who can initiate the procedure?	Debtor or creditor(s)	Debtor only. Multiple debtors in the same corporate group may have a joint proceeding under the Restructuring Law where they have at least one common financial institution creditor and 2/3 of all participating financial institution creditors by value, in relation to each debtor, have consented to such a joint restructuring.
Commencement of procedure	Court commences procedure and introduces moratorium if the majority of unsecured creditors by value and all secured creditors of debtor approved the restructuring plan	Secretariat resolves on commencement of restructuring procedure, provided that financial institution(s) holding at least 50% of all financial institution claims (excluding the debtor's related parties) have consented to the restructuring. The secretariat's resolution is a basis for automatic introduction of moratorium.
Moratorium	Moratorium binds all creditors	Moratorium binds (i) all participating creditors (including state bodies that are treated as such by operation of law) and (ii) non-participating creditors in relation to the non-current (including fixed) assets of the debtor that are not subject to the non-participating creditors security.
Duration of procedure	Cannot exceed 12 months	Cannot exceed 180 days
Scope of restructuring/ rehabilitation plan	Rehabilitation plan binds all creditors	Restructuring plan binds (i) all creditors that agreed to participate in restructuring, (ii) subject to exceptions, tax, customs, state treasury and enforcement bodies and (iii) related parties of debtor.
Cramdown of minority creditors	Unsecured creditors may be crammed down if the plan has been approved by the majority of unsecured creditors by value and all secured creditors of debtor	The following creditors may be crammed down, if the plan has been approved by more than 2/3 of the participating creditors by value and the arbitration tribunal of the secretariat: (i) other participating creditors (ii) state authorities that are participating creditors by operation of law (iii) related parties of the debtor
Tax incentives	No	Yes

Creditors Eligible to Join in Financial Restructuring Procedure under the Restructuring Law

The Restructuring Law's application is limited to liabilities owed to creditors that agreed to participate in the restructuring by signing consent letters (the so-called "participating creditors"), related parties of the debtor and, subject to some exceptions, tax and other state authorities. It is therefore not possible to impose the restructuring plan under the Restructuring Law on non-participating holdout creditors other than the state authorities and debtor's related parties. Where participating creditors had agreed to the process but then decided to pull out and did not vote for the restructuring plan, the law allows cramming them into the plan if it was supported by more than 2/3 of the total participating creditors by value and approved by the arbitration tribunal of the secretariat. The failure to include a full-scale cramdown mechanism on holdout minority creditors is somewhat of a missed opportunity and would limit the utility of the Restructuring Law in debt restructurings. Ukrainian debtors may need to resort to other procedures if they wish to cram down minority creditors.

The Restructuring Law procedure is commenced only if the debtor's petition is supported by one or more financial institutions holding at least 50% of all financial institutions' claims (excluding claims by the debtor's related parties). The definition of financial institutions under the Restructuring Law includes the financial institutions as determined under Ukrainian law, international financial organizations and non-resident financial institutions that extended loans to the debtor. Therefore, if, for example, all of the creditors are investment funds and none of them meets this financial institution test, the Restructuring Law process may not be used. The Restructuring Law procedure would most likely suit Ukrainian debtors whose pool of creditors is comprised primarily of Ukrainian banks and international financial institutions such as the European Bank for Reconstruction and Development or the International Finance Corporation.

The Restructuring Law expressly provides that it is applicable to the restructuring of liabilities owed to international financial organizations and certain non-resident financial institutions, as well as to the agreements governed by a foreign law. Nevertheless, it may not be possible to restructure liabilities using a Ukrainian restructuring procedure if the debt agreement is not governed by Ukrainian law because of the conflict of laws issues. For example, it is a longstanding principle under English law that English law-governed debt may only be amended using English law procedures. In practice, non-Ukrainian creditors (and the Ukrainian debtor) may prefer to use, potentially in parallel with a new restructuring regime (as described in more detail below), tried-and-tested restructuring routes such as an English law scheme or a US Chapter 11 procedure to the extent that these are available.

Use in Cross-Border Restructuring Context

It remains to be seen if the restructuring agreements implemented under the Restructuring Law will gain traction in the context of a purely domestic Ukrainian restructuring. This said, some of the process features such as the moratorium, the Ukrainian law-governed standstill agreement and the ability to stay the bankruptcy proceedings may come handy in cross-border restructurings as well. It may be worth considering whether the Restructuring Law procedure may apply in parallel with other non-Ukrainian procedures in the context of a cross-border restructuring in order to benefit from the following procedural advantages under Ukrainian law.

Moratorium. The moratorium under the Restructuring Law is imposed automatically for a 90-day period upon commencement of the restructuring proceeding by the secretariat (which, as noted above, is a specialized body created by the state). As long as the moratorium is in place, the debtor may not:

— discharge its obligations to any creditors, except when approved by 2/3 of the participating creditors by value and is done in the ordinary course of business;

— dispose of its property, other than in the ordinary course of business, except when approved by 2/3 of the participating creditors by value;

— be the subject of any corporate reorganization, except when approved by 2/3 of the participating creditors by value; and

— enter into agreements with a view to granting a pledge or mortgage over the debtor's property, except when it secures new money financing within the financial restructuring procedure. The debtor may borrow new money from any funding source, provided that the transaction has been approved by the 2/3 of the participating creditors by value. Under the Restructuring Law, the security granted in respect of such new money financing must be, in the first place, over the assets that have not been previously encumbered and, if these are not sufficient, over the already encumbered assets upon the consent of the respective creditors.

The moratorium primarily concerns the claims of the participating creditors (including state authorities that may be treated as participating creditors by operation of law) and the related parties of the debtor. The moratorium also prohibits the participating creditors from:

— enforcing against the collateral provided by the debtor or a third party, in each case to secure the debtor's obligations to those creditors;

— enforcing against non-current unencumbered assets of the debtor;

— taking any action to obtain possession of or control over the debtor's property, including by entering into any contract; and

— offsetting their claims against the debtor's counterclaims.

The moratorium provisions of the Restructuring Law target primarily the debtor company and its participating creditors, but they also provide a stay of some proceedings commenced by non-participating creditors. Non-participating creditors may not enforce over non-current unencumbered assets of the debtor, although the law does not limit such creditors' rights to enforce against collateral created for their benefit or to offset their claims.

Notwithstanding the moratorium, any creditor has the right to commence or continue legal proceedings to seek a court judgment against the debtor company with a view to recovering the debt or enforcing over the debtor's property. However, if successful, such creditor would need to wait for the expiry of the moratorium to proceed to the enforcement of the court judgment. Finally, the Restructuring Law prohibits any creditors from charging any late payment interest or other monetary penalty in respect of any debtor's obligation subject to the moratorium. The moratorium also suspends limitation period under the statute of limitations and any other similar time period within which creditors may seek remedies, whether established by law or contract.

Standstill Agreement. Under the Ukrainian Code of Commercial Procedure applicable to disputes between legal entities and insolvency cases, an agreement of the parties to refrain from bringing a lawsuit in court is invalid. Prior to the Restructuring Law, the invalidity of such agreements discouraged the parties from entering into any kind of standstill agreement governed by Ukrainian law. Now, the Restructuring Law expressly allows a debtor company to lock its creditors into a standstill and contains an express provision that makes it clear that the Restructuring Law overrides all other Ukrainian legislation.

As described above, once the debtor's application for the Restructuring Law procedure has been filed and accepted by the secretariat, the statutory moratorium will automatically take effect. Going forward, the participating creditors may enter into a standstill agreement to change the scope of the moratorium, to replace the general ban on the disposal of assets by the debtor company with a set of affirmative or negative covenants tailored to the debtor's business as well as to formalize the intercreditor relations. Participating creditors that failed to enter into the standstill agreement will continue to be subject to the process in all respects, other than with respect to the terms of the standstill agreement.

Effect on Bankruptcy Proceedings. The process under the Restructuring Law is also helpful in circumstances where the debtor is aware that a rogue creditor may file (or even has already filed) for the debtor's bankruptcy. Under the Insolvency Law, the court must commence the insolvency proceedings, subject to some exceptions, within nineteen days following the date of receipt of the insolvency claim. If the debtor company has the requisite support of the majority of financial institutions, it may apply for the financial restructuring process under the Restructuring Law prior to the court's ruling on commencement of the insolvency proceedings. In this case, the insolvency proceedings will be suspended for a period of at least 90 days or indefinitely if the debtor and its creditors agree on a restructuring plan to which the dissenting creditor's liabilities are subject (i.e., if the dissenting creditor ultimately becomes a participating creditor). However, given that the Restructuring Law procedure essentially does not contain a cramdown procedure on minority creditors, the suspension of the insolvency proceeding may only be temporary and the debtor company may still need to find an alternative solution to the holdout problem.

Timeline and Important Deadlines

The Restructuring Law provides for a number of strict deadlines that are aimed at preventing any abuse by the debtor and the participating creditors of the benefits granted by the law. In particular, once the financial restructuring procedure has been initiated, it must be completed within 180 days and may not be extended further. If the financial restructuring fails, the debtor and creditors will not be able to resort to the Restructuring Law nor the Article 6 proceedings for the next 18 months excluding the time that lapsed from the commencement of the earlier process and up to its termination.

Day 1	The debtor submits a written application for restructuring to the secretariat accompanied by consent(s) of financial institution(s) holding in aggregate at least 50% of total claims of all financial institutions (excluding claims of the debtor's related parties).
Day 2—Not later than on the next business day after Day 1	The secretariat resolves on the commencement of the restructuring process and notifies the creditors indicated in the debtor's application of the date of the first creditors meeting. The moratorium on the creditors' claims is imposed automatically for the initial 90-day period.
Within 10 business days, but not earlier than 7 business days, after Day 2	The first creditors meeting must be held.
7 business days prior to the date of the first creditors' meeting	The debtor must provide the participating creditors with, in particular, (1) the background for restructuring, (2) information on overdue debt, (3) information on creditors' contractual rights to accelerate any loans, (4) information on any breaches of the security agreements, (5) the debtor's 12-month financial forecast and (6) list of existing court and enforcement proceedings.
2 business days prior to the date of the first creditors' meeting	The debtor may supplement the list of the participating creditors.
Within 30 days after Day 1	The debtor may recall its application for restructuring.
Within initial 90 days after Day 2 (that may be extended up to 180 days)	The restructuring plan must be approved in respect of the debtor.
Within 18 months from the date of commencement of the previous restructuring procedure or Article 6 rehabilitation procedure	The debtor may not again file for restructuring under the Restructuring Law.

Conclusion

Despite the mixed reception it received in the Ukrainian restructuring professionals' community, the Restructuring Law is not without merit. Although the financial restructuring procedure does not allow the debtor company to impose a restructuring plan supported by the majority creditors on the minority holdouts, the Restructuring Law procedure does come with certain procedural advantages such as the statutory moratorium and the suspension of any Ukrainian insolvency proceedings. In a cross-border restructuring context, it may be desirable in the right circumstances to pair the Ukrainian Restructuring Law mechanism with a foreign procedure such as a UK scheme of arrangement or a US Chapter 11 process in order to construct a debt restructuring procedure that is less vulnerable to attack by rogue creditors. ■

1. The matters related to insolvency of Ukrainian banks are regulated by the Law of Ukraine "On the Deposits Guarantee System", dated February 23, 2012. Other Ukrainian financial institutions are subject to the Insolvency Law, including the Article 6 process.
2. Source: Report on monetary and financial statistics, https://bank.gov.ua/control/uk/publish/article?art_id=27843415&cat_id=44578#1
3. Source: Doing Business survey of the World Bank dated June 2015, http://www.doingbusiness.org/data/exploretopics/resolving-insolvency

▼ **Andriy Nikiforov** is a counsel at Kinstellar based in the firm's Kyiv office and the Head of the local Banking, Finance & Capital Markets as well as Restructuring & Insolvency practices. Mr. Nikiforov has broad experience in the areas of capital markets, finance, debt restructuring, financial regulation, derivatives as well as M&A. Andriy acted on some of the most visible transactions in the Ukrainian market, including establishment of the majority of Ukrainian MTN programmes and drawdowns thereunder, and the debt restructuring of Metinvest, the largest Ukrainian private business. He received a law degree with distinction from the Kyiv Taras Shevchenko National University and LL.M degree with honours in Corporate Finance and Securities from the University of California, Berkeley School of Law.

▼ **Serhiy Mykhaylyk** is an associate at Kinstellar based in the firm's Kyiv office. He received a law degree with distinction from the Kyiv Mohyla Academy National University and LL.M in Commercial Law from the University of Cambridge. Mr. Mykhaylyk's practice areas include finance, capital markets, debt restructuring and insolvency, M&A and financial regulation.

Emerging Market Sovereigns' Frequent Indulgence for their Quasi-Sovereigns

By: **CHARLES-ANTOINE WAUTERS** *and* **PATRICK ESTERUELAS**

The difference between the credit spreads of non-domestic law bonds issued by quasi-sovereign issuers[1] and the credit spreads of the bonds of such issuers' controlling sovereigns has attracted our attention.[2] These credit spreads suggest that the market does not view quasi-sovereigns as benefiting from timely, sufficient and unconditional support of the sovereign. Instead, the market seems to assume a different treatment by the controlling sovereigns of the quasi-sovereigns' debt versus the sovereign's own debt. Our research suggests that, except for some extremely limited cases, this market view is unfounded. Below, we explore a series of questions that illustrate the faults in the market's view, and show that quasi-sovereigns do benefit from sufficient support from, or follow the same course as, their controlling sovereigns.

Has the quasi-sovereigns' debt been restructured without the controlling sovereign's debt having also been restructured?

While there are numerous examples of debt of quasi-sovereigns being restructured alongside and under similar terms as the debt of their controlling sovereigns[3], our research has not produced any example of emerging market quasi-sovereigns' non-local bond debt being restructured outside of the context of a restructuring of its controlling sovereign.

Why are there no such cases?

We see a number of reasons why there are no such cases. First, sovereigns may have avoided the need for a restructuring by providing support to quasi-sovereign issuers in subtle ways that are inconspicuous to the market. Equity injections or taking advantage of certain tax measures are examples of such support that the market may not necessarily associate with sovereign support, specifically for the debt of a quasi-sovereign. Second, quasi-sovereign bond buybacks can be used by a sovereign to lessen the burden of a maturity or interest payment and to avert a distress situation. Third, as we will discuss below, a quasi-sovereign default will likely present many potential negative repercussions that the sovereign would rather avoid. Finally, there is not a long history of emerging market quasi-sovereigns with bonds outstanding in times of market distress, as historically their debt has mostly consisted of bank debt.

> Credit spreads suggest that the market does not view quasi-sovereigns as benefiting from timely, sufficient and unconditional support of the sovereign. Instead, the market seems to assume a different treatment by the controlling sovereigns of the quasi-sovereigns' debt versus the sovereign's own debt.

What are a sovereign's motivations for avoiding a default or restructuring of its quasi-sovereigns?

There are two main reasons why a sovereign would be motivated to support its quasi-sovereigns in order to avoid a default or restructuring.

A default by a quasi-sovereign could be very disruptive for the sovereign in a number of ways:

1. Quasi-sovereigns typically perform essential services or tasks for its sovereign and do so on more favourable terms for the sovereign than a private sector counterparty would. Examples of such quasi-sovereigns might include commodity producers that generate significant revenues for the sovereign, companies involved in distribution of electricity, water, and other essential services to the population, or key actors of the banking system;
2. Quasi-sovereigns are often 'brain children' of political regimes, and it may be symbolically difficult for the regime to turn its back on them without discrediting the regime and its policies;
3. Quasi-sovereigns have a corporate form, and do not benefit from sovereign immunity. This means that their assets can be vulnerable to creditor attachments;
4. Quasi-sovereign restructurings can be messy, time consuming, costly, and have an unpredictable outcome;
5. Quasi-sovereigns are usually counterparties to various contractual arrangements, most of which will contain customary termination provisions triggered by a default on their debt;
6. Finally, a default may limit the quasi-sovereign's market access, and market access for the sovereign itself may be negatively impacted as a result, as the default could generate doubts as to the sovereign's willingness to pay its own debt (see, for example, recent Moody's ratings reports on Petrobras and Brazil).

In addition, while a default of a quasi-sovereign would be disruptive to its sovereign, sovereign support that is provided to prevent such a default is relatively inexpensive. For example, a sovereign guarantee doesn't require a cash outlay, but it sends a signal to the market that is salvatory for both the sovereign and the quasi-sovereign.

Examples of restructurings in a similar (but not identical) context

We have seen a few restructurings of companies with close ties to their sovereign that support the findings discussed above, but these are not exact examples of stand-alone quasi-sovereign restructurings. In particular, **Naftogas**, **Dubai World** and **BTA** have been restructured in the recent past.

Naftogas, a gas company controlled by the Ukrainian government, restructured approximately USD 1.6 billion of term loan facilities from foreign banks, including USD 500 million of loan participation notes, in 2009. While this was a standalone restructuring, the notes were exchanged, within two weeks of the default, for new government-guaranteed bonds with a higher coupon and a 5-year maturity extension. In NPV terms, the new bonds provided an 85-90 cent recovery and the restructuring presented no NPV loss relative to the then current trading price. Coupled with the value provided by the guarantee, this restructuring barely affected the value of the notes.

Dubai World, a large real estate investment firm owned by the Emirate of Dubai, restructured its bank debt in 2015, while its non-domestic law bonds were not restructured.

BTA, a Kazakhstan-based bank, restructured its bonds in 2009 and a follow-up restructuring was conducted in 2012. BTA's restructuring does not qualify as an example for our purposes because (1) in 2009, the government was not a controlling shareholder of BTA (that only happened as a result of the 2009 restructuring); and (2) in 2012, the controlling sovereign did not have non-local law bonds outstanding. It is still useful to note, however, to show the breadth of the research that has been done on these types of cases.

Takeaway

One example may come to play in the coming months or years: Petroleos de Venezuela S.A. (PDVSA). For the reasons already discussed above, we think that PDVSA will follow the fate of Venezuela; we apply those reasons to PDVSA below. There are other PDVSA or Venezuela-specific reasons the discussion of which would fall outside of this article.

— *Essential services*—Oil constitutes 95% of the country's exports and >50% of its GDP. The slightest disruption of its activities would be fatal to the government, its policies and its market access.

— *Brainchild of regime*—PDVSA is not the archetypal example of a brainchild of a regime because (1) it was created by a prior regime and (2) the government has floated the idea of creating a "side-car" and leaving PDVSA as a shell (which may well be challenged by creditors based on fraudulent conveyance rules in the U.S.). On balance, it still is very close to the regime's heart because of its Maduro regime-laden governance.

— *Attachments of assets*—PDVSA is a corporation whose assets (e.g., oil sale receivables; refineries, in particular those outside of Venezuela) could be attached — we do not discuss here the likelihood of success of attachment efforts. In addition, there is no realistic chance of a U.S. bankruptcy proceeding offering a stay that protects assets located in the U.S. whether through a main proceeding (Chap 11) or recognition of a foreign one (Chap 15).

— *Unpredictability of restructuring*—restructuring PDVSA debt without restructuring Venezuela debt will likely run into a quagmire due to intercreditor fights (most bondholders own debt of both, compounded by the involvement of various powerful creditors like China). This unpredictably is increased by the uncertainty of the outcome of litigation along the lines of the Argentina holdout case or as a result of the possible use of exit consents.

— *Contractual arrangements*—Offtake or hedging agreements (which we cannot verify as they are not public) will likely contain customary termination provisions triggered by a default on PDVSA.

— *Defaults*—The government's reliance on PDVSA for revenues joins by the hip the quasi-sovereign with its controlling sovereign. As an example, PDVSA's recent exchange offer (aka, the "swap") generated almost the same volatility on the sovereign bond trading prices as it did on PDVSA's. ■

1. A quasi-sovereign is a corporate entity, legally separate from, but controlled by, a sovereign. Bonds issued by quasi-sovereigns do not cross default to bonds issued by the respective sovereigns. This is a key difference from bonds benefiting from a guarantee of a sovereign.

2. This article only examines non-local law bonds. Bonds and bank debt are sometimes treated differently in a restructuring because bank debt can more easily be renegotiated with its creditors. Banks may receive other consideration to entice them in a restructuring, for example, contracts or other business from the sovereign or other quasi-sovereigns. Banks may also be subject to certain pressures from the sovereign as to their business in the sovereign's jurisdiction. Bonded debt, on the other hand, represents a key source of financing that a sovereign does not often have the luxury of foregoing. Also, in cases were the bonded debt represents a smaller portion of total debt than bank debt, remaining current on the bonded debt payments is less problematic.

3. For example, in certain past debt restructurings of the Mexican Government, Petroleos Mexicanos S.A.'s (Pemex, a Mexican quasi-sovereign) external indebtedness was treated on the same terms as the debt of the Mexican Government and other public sector entities

▼ **Charles-Antoine Wauters** is portfolio counsel and research analyst at EMSO and based in London, covering investments in both the sovereign and corporate areas that are driven by legal considerations. Prior to joining EMSO in October 2013, Charles-Antoine was an associate at the law firm of Cleary Gottlieb Steen and Hamilton LLP in Brussels (2006) and New York (2007-2013). His practice was focused on financing transactions. He represented domestic and foreign issuers and financial institutions in acquisition financings, high yield securities offerings, debt restructurings and liability management, and he also advised clients on questions relating to covenants and credit support of debt instruments. He represented domestic and foreign corporations or financial advisors in domestic or cross-border transactions. Charles-Antoine completed a LLM in corporate law at New York University, in connection with which he was offered a Fulbright fellowship and was a Belgian American Educational Foundation Fellow. He also holds a Master's in Financial Management from the Vlerick Leuven Gent Management School. He is a law graduate from the Université Catholique de Louvain and the Facultés Universitaires Notre Dame de la Paix of Namur, and studied at the University of Ottawa as an Erasmus honors student. Charles-Antoine is a member of the Bar in New York.

▼ **Patrick Esteruelas** is the senior analyst, sovereign credit at Emso, focusing on political risk analysis. Patrick started his career in 2000 at the Inter-American Development Bank, where he served in various consulting capacities. He then joined Eurasia Group as director for Latin America where he actively supported the Latin American investment strategies of multiple hedge funds, mutual funds and money managers. Prior to joining Emso, he was a Vice President at Moody's Sovereign Risk Group, where he covered multiple countries across the ratings space. His deep knowledge and experience in political risk analysis complements the portfolio management team's market experience in Emso's investment process. Patrick earned an MA in International Relations and Economics from Johns Hopkins School of Advanced International Studies (SAIS) and a BA in European Studies from the London School of Economics.

The Nuts and Bolts of Uruguayan Insolvency and Bankruptcy Laws

By **HECTOR FERREIRA**

Uruguay has a substantial tradition of bankruptcy laws which have allowed many foreign creditors to recover the value of their investments and recognized international insolvency proceedings.

The Uruguayan insolvency regime is regulated by Act No. 18.387 (*Ley de Proceso Concursal or the "Act"*) enacted in 2008 and as further amended by Act Nos. 18.593 and 18.937.

Under this law, business reorganization and debtors' rights, which have been the pillars of the traditional Uruguayan insolvency regime, were balanced with newer international trends seeking more efficient proceedings and creditor protections.

An overview of the act and the Uruguayan insolvency system

The Uruguayan insolvency system has the following main objectives:

1. Reduce the risks of significant losses caused by liquidation proceedings;
2. Encourage negotiations and agreements between the parties;
3. Increase the opportunities for the debtor to continue as a going concern;
4. Limit the number of financially-strapped companies in the market; and
5. Seek the best solution for creditors.

However, the insolvency proceedings under the Act do not apply to:

1. Other individual debtors (*i.e.*, non-investment professionals), whose reorganization and bankruptcy proceedings are governed by similar rules laid down at the civil procedure code;
2. State, local governments and public sector companies; and
3. Financial Institutions *(e.g.*, banks, private equity funds, hedge funds, insurance firms and venture capital firms), which are subject to regulations promulgated by the Central Bank of Uruguay (*Banco Central de Uruguay*).

Under the Uruguayan system, there is no distinction between insolvency proceedings involving corporations and investment professionals. A single set of rules regulates the insolvency proceedings of any investment professional or corporation doing business in Uruguay. Uruguayan lawmakers have also expanded the scope of the Act to address other special reorganization or bankruptcy situations such as a deceased debtor's estate reorganization and claims from his or her heirs.

The Reorganization Proceeding: the "*Concurso*"

There is only one reorganization proceeding called "*concurso*" which can generally be initiated when the debtor is in default. In Uruguay, the parent company of a conglomerate can file for a reorganization proceeding or bankruptcy for the whole group. By the same token, any creditor of any of the companies can file for a reorganization proceeding or bankruptcy of the entire corporate group.

When a corporation falls behind in its debt payments, the Uruguayan insolvency regime encourages parties to act quickly. Under the Act, the debtor has the obligation to request a reorganization proceeding within 30 days after the debtor had known or should have known of its insolvency status. Once the debtor files for a reorganization proceeding, seeking to save its business and protect its creditors, the debtor is still permitted to receive interim financing to continue its operations during the proceeding. In addition, the debtor's actions, except for those related to gross negligence, fraud and the like, that contributed to its financial woes will not be criminally prosecuted, provided creditors are compensated in accordance with the Act.

Creditors cannot abandon an in-court reorganization proceeding once initiated. In addition, creditors are held liable for damages to the debtor if the petition was unreasonable or abusive. The Bankruptcy Court (*Juzgado Letrado de Primera Instancia de Concursos*) may ask creditors to post a judicial bond (except in the case of creditors who are also employees of the debtor) to indemnify the debtor from any loss arising out of the legal proceeding.

Stages of the Concurso

The Act divides the insolvency proceeding in the three stages below. However, the debtor may enter at any point into private, out-of-court agreements with creditors to avoid liquidating the company's assets, and these agreement are only binding on the parties that have signed them.

1. **Negotiation with creditors:** The debtor and creditors negotiate and enter into an agreement to restructure the business with a plan that may feature any of the following: (a) partial discharge of creditor claims; (b) extension of the debtor's maturity terms; (c) assignment of assets to creditors; (d) formation of a company made up of creditors without any preferred claims; (e) debt capitalization; (f) formation of a trust; (g) company reorganization; or (h) partial or complete asset management in benefit of the creditors.

   Even if the business is insolvent, the company continues to operate during the first stage of the reorganization proceeding and is either managed by the debtor (with a co-manager appointed by Court) or by a receiver. This first stage may last at least 60 business days from the first creditors' meeting.

2. **Selling the business as a going concern:** If negotiations with creditors are unsuccessful, Section 171 of the Act states that every effort would be made to seek the sale of a business as a going concern. The Act encourages the survival of the business by selling it as a going concern instead of selling it off in different pieces. For example, the Act now allows for an auction process that fairly balances the objectives of ensuring a reasonable continuation of the business, securing strong workers' protection and satisfying creditor claims.

   If the business continues, employment agreements are not terminated and any lawsuits brought by employees are typically dismissed. In addition, worker cooperatives or other employee organization running a company that is in default may participate as credit bidders (as opposed to cash bidders) in the auction process. In that event, the employees would apply the capital of the acquired company to their credits against the debtor.

3. **Selling the business into different pieces:** The liquidation of the company's individual assets may be completed in the event that no agreement is reached to sell the company as a whole. The Act requires the receiver to present a liquidation plan to the creditors' commission, which is formed by the members of the creditors' meeting, within 30 days from the Bankruptcy Court's resolution ending the sale of the business as a whole. Note that even if the business is divided into individual assets, the Act encourages sales of the business in "productive units" *(venta en bloque de la empresa en funcionamiento).*

The Receivership

If the Bankruptcy Court declares a debtor insolvent, which depends on various factors such as the debtor's short-term and long-term debt, financings and overall liquidity, one of the first measures to be taken is the appointment of a receiver to

manage the debtor's assets and creditors' claims (either alone or in cooperation with the debtor). The company's directors and management team may or may not be removed once a received is appointed.

A registry of receivers was created under the supervision of the Bankruptcy Court. A limited number of receivers have been included in the registry and will remain in their positions for a period of four years.

Receivers must have some previous experience in the company's business and at least five years of professional practice or be a professional organization (in which case, their members must comply with aforementioned qualifications). They must report to the Bankruptcy Court when requested.

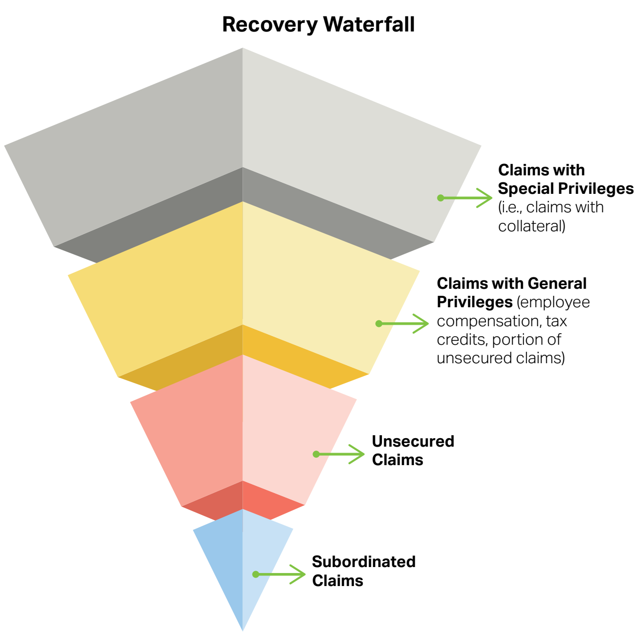
Any receiver appointed by the Bankruptcy Court may be removed from their position in the event they extend their term for more than two years since the ruling authorizing the winding down of the business. In this case, the receiver will cease to receive a salary, and the amounts received since their appointment would be disgorged.

The Ranking and Payment of Claims In the Proceeding

The Act modified the preferential treatment of claims from the former insolvency system. The preferential ranking of the claims are: claims with special privileges, claims with general privileges, unsecured claims and subordinated claims.

The receiver must set aside the corresponding funds to pay legal fees and claims that are conditioned on a monetary judgment against the debtor or could trigger an additional penalty or claim.

The Act authorizes the Bankruptcy Court to pay in advance, at any point of the proceeding, employee compensation that is not barred by the statute of limitations, which is generally one year following the termination of employment.



Claims with Privileges

There are two types of claims with privileges (special and general). Claims with special privileges are the ones collateralized by a pledge of personal property or mortgage of real property. The Act provides that the creditors will not be able to foreclose on the collateral for a period of 120 days in order to rule out the possibility of selling the business as a going concern.

Claims with general privileges have three subcategories:

1. Employee compensation of any kind accrued up to two years prior to the ruling that initiated the reorganization proceeding and up to a maximum amount of USD 31,500 per worker. Certain tax debts that the debtor did not pay to the government retirement services are also included in this category.
2. National and local tax credits payable up to two years prior to the ruling that initiated the reorganization proceeding.
3. 50% of the unsecured claims of the creditor(s) that initiated the reorganization proceeding, with a legal cap of 10% of the debtor's total liabilities—effectively giving unsecured creditors an incentive to initiate the reorganization proceeding.

Claims with general privileges are paid with proceeds of the foreclosed assets owned by the debtor. If the claims became insufficient to pay the debts, these credits will be paid pro rata in the following order: employees´ compensation; national and local taxes and 50% of the claim of the creditor(s) that initiated the reorganization proceeding.

Subordinated Claims

Subordinated claims include fines and penalties due to the government (federal and local) and claims from creditors who have other familial or commercial ties with the debtor, such as:

1. **Natural Persons:** (a) current spouse or domestic partner or those who used to have this status within two years before the ruling that initiated the reorganization proceeding; (b) parents, natural born children, their children and siblings of the debtor or of any person mentioned in (a); (c) spouse or domestic partner of parents, issues and siblings of the debtor; and (d) people who shared dwelling with the debtor within the last two years unless they were entitled to employee compensation;
2. **Business Associations:** (a) partners with unlimited personal liability and partners, members or shareholders with limited liability that owned more than 20% of the maximum share capital authorized by the company's constitutional documents; (b) managers or directors in law or in fact and liquidators as well as the ones that held those positions within two years before the ruling that initiated the reorganization proceeding; (c) business associations that are members of a group of companies which is formed when one company is led by another, when many companies are led by only one natural person or business association or when different companies work systematically in accordance; and

3. **Assignees:** refers to assignees of claims owned by original creditors who fall within the two categories above if those claims were bought within two years before the initiation of the reorganization proceeding.

State, Governmental and other Public Entities
The state, local governments, public sector companies, public governmental and non-governmental persons and other public institutions are able to participate in the reorganization proceeding seeking recovery from the debtor. They will be considered as an unsecured creditor (other than their subordinated claims) in terms of voting rights and participation in the proceeding.

Out-Of-Court Agreements

Under Article 214 of the Act, an in-court reorganization proceeding could be avoided if an out-of-court agreement between the debtor and its creditors is reached. The structure of the agreement is flexible, and the Act allows for special preferences among the creditors in the way they will be paid. Once an agreement is reached, it is submitted to the creditors' meeting[1] for approval. At least a two-third majority of the debtor's unsecured creditors must vote in favor of the agreement in order to approve it. If approved, the debtor may have it finalized by either having the agreement notarized or approved by the Bankruptcy Court.

Those unsecured and subordinated creditors who do not consent to the agreement are, as a matter of law, bound by the agreement. However, they can challenge the agreement under any of the following four grounds: (i) the agreement is in violation of the law; (ii) the signatories of the agreement do not correspond to the real holders of the credit or have been obtained in such a way that goes against the equal treatment among the unsecured creditors; (iii) compliance with the agreement is unfeasible and (iv) there is fraudulent concealment or exaggeration of an asset or liability. The challenge must be submitted through a written notice to the debtor within a period of 20 days. The debtor has 10 days to present a response to the challenge before a bankruptcy judge. If the debtor fails to respond, any creditor may request the declaration of bankruptcy before the Bankruptcy Court, in which case the Bankruptcy Court has the obligation to approve such request.

Following the approval of an out-of-court agreement, the debtor will not be held in default, there is an automatic stay imposed for one year, any foreclosures on the debtor's assets are suspended or not allowed for a period of 120 days and, in certain cases where the debtor's assets are in jeopardy, the debtor would need to receive the Bankruptcy Court's authorization to run the business.

If the debtor breaches an out-of-court agreement, for which there is no cure period provided, a new reorganization proceeding may be initiated any creditor, and the debtor will be deprived from the right of seeking other out-of-court agreements with its creditors.

Cross-Border Insolvency Proceedings

Uruguayan courts have jurisdiction over foreign debtors (natural persons, corporations and other legal entities) who have their home office (or "nerve center") abroad if this debtor had run its business in Uruguay (both maintain a physical office in Uruguay and generated sales or income in Uruguay).

General Principles
All assets and rights owned by debtor will be considered in the reorganization proceeding regardless of whether such assets or rights are located in Uruguay or abroad.

However, if the debtor asks for a reorganization proceeding or bankruptcy in a country different from Uruguay only the remaining assets and rights, after termination of the international proceeding, will be part of the Uruguayan proceeding.

Uruguayan law will be applicable to all restructuring and bankruptcy proceedings declared in Uruguay. The only exceptions are in the context of executed contracts with a choice of law provision, which will be construed based on the law chosen by parties in the contract.

Pursuant to Uruguayan law, there will be no discrimination on the ground of nationality, *i.e.*, all creditors of the debtor, regardless their nationality, will be treated in the same way by Uruguayan law. As an exception, employees have a preference claim over the proceeds from the realization of assets located in Uruguay.

However, if Uruguayan citizens are given unequal treatment in reorganization proceeding of a foreign country, Uruguay will apply the same treatment of that foreign country towards their citizens.

Other Features of the Modern Insolvency System

Totally or Partially Unexecuted Contracts
The Uruguayan system under the Act now offers several alternatives when the company has totally or partially unexecuted contracts at the date of the declaration of insolvency. One possibility is that receiver or the debtor may unilaterally terminate contracts pending of execution authorized by a court-appointed auditor. However, this alternative is not possible for any contacts that involve assignment of credits or rights, whether present or future, including real property rights and guarantee trust.

Small Proceedings
Before the Act, there was no expedient manner by which to address claims against a debtor that involve a relatively small amount. As a result of the Act, small proceedings in which debts are less than approximately USD 360,000 can be processed. Proceedings of this type are typically easier and shorter depending on circumstances of each case.

Abandoned Businesses
In addition, if the debtor fails to participate in the reorganization proceeding and the company's creditors are comprised of only its employees, the company may be assigned to such employees on a temporary basis. Once the proceeding has initiated, publications will be issued giving notice of the proceeding to creditors, and the debtor will receive be notified. If it is found that there are only claims with employees or other creditors do not challenge their claims, the company will be definitively assigned to the employees.

Criminal Liability in Insolvency Proceedings
The Act also provides that an insolvency proceeding may be treated as intentional or unintentional. It would be intentional when intentional wrongdoing or gross negligence were performed by the debtor (managers or directors in law or in fact/liquidators in case of companies) is proven. It would be also intentional when the debtor breaches the agreement with his creditors, provided that intentional wrongdoing or gross negligence performed by debtor is proven. The remaining cases would be considered unintentional.

If the proceeding is categorized as intentional, the debtor (managers or directors in law or in fact/liquidators in case of companies) and their accomplices will be disqualified as an investment professional, as well as held liable for damages, payment of fines and illegally obtained assets and rights.

The white collar crime called "insolvency fraud" is triggered when the debtor conceals or lies when declaring his liabilities and assets, grants illegal preferential treatment among creditors, or benefits in consideration of votes and conceals the corporate books.

If any receivers, court officers, expert witnesses and the like received knowledge to such illegal activity and about facts that can lead to a criminally punishable conduct, they must report any suspicions to the Bankruptcy Court.

Conclusion

The main objective of the Act under the modern insolvency system is to reduce the number of insolvent companies in favor of preserving the value of businesses through corporate restructurings. In our experience, the insolvency proceedings now possible under the Act have improved the local business environment in Uruguay. However, although Uruguayan proceedings offer both creditors and debtors some benefits, they remain relatively untested for international creditors and further practical experience is needed before it can be determined whether they provide truly meaningful opportunities for recovery. ■

1. Pursuant to Article 115 under the Act, there is no requirement on the number of creditors present or a minimum threshold of the percentage claims they represent against the debtor and no matter whether or not the debtor is present—a creditor's meeting is considered valid without any of these features. The time, date and place of the first creditors' meeting is decided by the judge at the proceeding in which the insolvency is declared.

▼ **Hector Ferreira** is a partner at Hughes & Hughes in Montevideo, Uruguay. His practice focuses on corporate M&A, banking and finance, corporate reorganization and project finance within Latin America. He received his LLM from the University of California, Davis, his JD from the Catholic University of Uruguay and a degree in International and Comparative Law from the Academy of American and International Law in Dallas, Texas.

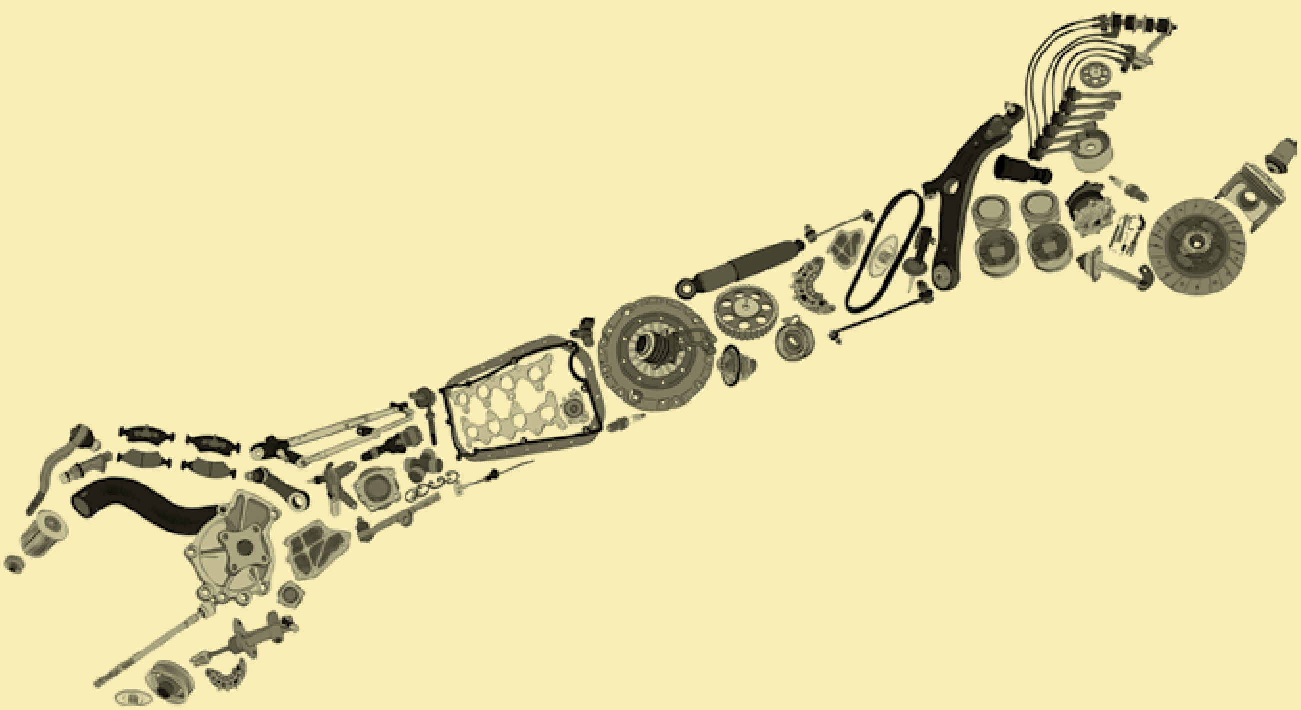
DEAL NEWS / CHILE

Restructuring Chile's Automotores Gildemeister

by **ALEJANDRO CANELAS FERNANDEZ** *(acanelasfernandez@cgsh.com)*

After a years-long boom fueled by increasing consumer spending and high commodity prices, economic growth in Chile in 2014 fell to its slowest pace since the 2009 recession. Few Chilean companies suffered more as a result than **Automotores Gildemeister**, one of the largest vehicle importers and distributors in Chile. The company, which also has significant operations in Peru and elsewhere in Latin America, faced a perfect storm of decreased vehicle sales due to lower consumer demand and higher import costs due to a weakening Chilean peso. With vehicle sales declining by over 15% in Chile and nearly 10% in Peru, credit rating agencies and financial analysts began asking whether Gildemeister would be able to continue servicing its debt, including $700 million in U.S. dollar-denominated bonds issued during the boom years.

In April 2015, Gildemeister first sought to restructure its debt by offering holders the opportunity to exchange their original bonds for a combination of new bonds with a higher coupon and non-interest-paying notes denominated in Chilean inflation-linked units. The exchange was conditioned on participation by at least a majority of the original bonds, as is typical for an out-of-court restructuring of New York-law governed debt. Although it ultimately did not obtain the requisite participation, in part due to what some analysts described as the excessive risk presented by the inflation-linked notes, this initial exchange offer did signal to the market that Gildemeister was willing to take a constructive approach to restructuring its debt.



Following negotiations with an ad hoc group of holders representing over 70% of the original bonds, Gildemeister launched a second exchange offer in December 2015. As in April, the exchange offer featured multiple securities: in this case, a combination of new bonds, preferred shares and warrants exercisable for common shares. Certain terms were made more attractive to entice bondholders to participate, including guaranteeing the new bonds with real estate and other assets. The company also sought additional financial flexibility by reserving the ability to capitalize ("PIK") interest payments on the new bonds during the first 24 months. The offers also provided for a nominal par-for par exchange, which was a critical commercial component of the transaction.

Pre-Restructuring Capital Structure

$700MM Sr. Unsecured Bonds

Common Stock
- 99% owned by original shareholder

1. Sr. Unsecured Bonds exchanged for: (i) Newly issued Secured Bonds; (ii) Preferred Stock; and (iii) 39% of post reorganization equity
2. Original shareholder's equity position reduced from 99% to 61%

Post-Restructuring Capital Structure

~$422MM New Secured Bonds

~$40 MM Residual Sr. Unsecured Bonds

$273MM Callable Preferred Stock[1]
- Automatically convertible into 99% of company's fully diluted common stock upon the occurrence of certain events or if not redeemed before a specified date

Common Stock[2]
- 61% owned by original shareholder
- 39% owned by former holders of original bonds that participated in the restructuring

[1] 273,000 shares with a nominal value of $1,000 per share, redeemable at the company's option.
[2] On a fully diluted basis, assuming exercise of all outstanding warrants.

On February 24, 2016, Gildemeister announced the successful completion of its exchange offer, featuring the tender of over 94% of its original bonds, or approximately $659 million. As a result of the restructuring, Gildemeister was able to reduce the debt on its balance sheet by approximately 30% and successfully renewed its vehicle distribution agreement with Hyundai Motor Company, its key supplier. The transaction represented one of the largest restructurings and debt exchange offers for a Chilean company and was exceptional for, among other things, the continuation of control of the company by its original owners and management.

Certain Novel Features of the Restructuring

Preferred Stock
Hybrid-like stock, redeemable at the company's option at a price linked to LIBOR and automatically convertible into common stock upon the occurrence of certain events or if not redeemed before a specified date. This stock type was essential in satisfying the commercially-desired par-for-par condition.

Distribution Mechanism
To facilitate the distribution the preferred stock and warrants to bondholders that participated in the exchange, voting trusts were created for holders receiving small amounts of these securities. This mechanism ensured compliance with applicable securities laws while allowing such holders to effectively exercise their economic and voting rights.

Collateral
It was important for the structure to grant Gildemeister the financial and operational flexibility necessary to maintain access to liquidity and favorable relationships with suppliers while simultaneously providing adequate protection to participating bondholders. To this effect, receivables warehousing vehicles were created in Chile and Peru and versatile collateral trusts and similar entities were set up in Chile, Peru and Uruguay to secure the new bonds.

Singapore: A Restructuring Entrepôt

By **MANOJ SANDRASEGARA PILLAY, SMITHA MENON** *and* **HAROLD FOO**

Singapore was founded as a trading post of the British East India Company in 1819 and achieved initial success as an entrepôt due to its strategic location and free port status. While modern Singapore has moved rapidly from its humble beginnings, it nevertheless seeks to become an entrepôt in a different field altogether, namely, debt restructuring.

A debt restructuring not only provides distressed companies with an opportunity to restructure financially, but more fundamentally, operationally; neither of which are priorities when times are good. In this regard, Singapore has two main regimes that provide distressed companies with restructuring opportunities:

1. **Schemes of Arrangement:** The first is a scheme of arrangement, which is a court-approved agreement between a company and its members or creditors. Section 210 of the Companies Act provides the statutory framework for schemes of arrangement. The Section 210 framework allows the debtor to bind different classes of creditors and/or shareholders to a scheme of arrangement, provided that a majority in number representing three-fourths in value of the class of creditors present and voting (either by person or in proxy) at the meeting votes in favour of the scheme.

2. **Judicial Management:** The second is judicial management, which is a temporary court-supervised recovery plan that aims to give viable companies in financial trouble a more even chance to rehabilitate themselves and be restored to profitability, or at the very least, trade as a going concern. The Singapore judicial management regime is similar to the United Kingdom's administration regime.

In July 2016, the Ministry of Law accepted the recommendations of a specially constituted Committee to Strengthen Singapore as an International Centre for Debt Restructuring. The proposed measures (the "**Measures**") draw from the best aspects of the insolvency regimes globally, including those of the United Kingdom (traditionally perceived as a creditor friendly jurisdiction) and the United States (traditionally perceived as a debtor friendly jurisdiction), and are customised to fit our regional practices and conditions.

The Measures, which will be formally introduced as part of the larger Companies (Amendment) Bill in 2017, enhance the current restructuring ecosystem, injecting greater certainty and flexibility to respond to the complex restructurings of this age, while retaining safeguards in respect of creditor rights. The revised restructuring regime will, among other things, (i) open the Singapore courts' jurisdiction to a greater number of companies that may wish to restructure in Singapore, regardless of where they are incorporated; (ii) provide breathing room to such companies and their related entities attempting, in good faith, to formulate a restructuring plan; and (iii) facilitate easier access to rescue financing.

Welcoming foreign debtor companies—Clarifying and extending the restructuring jurisdiction

The new restructuring regime will open up Singapore as a restructuring venue to considerably more foreign debtor companies.

The central criteria for Singapore courts to assume jurisdiction for the purposes of a restructuring is that of a clear connection or nexus of the company to Singapore.

Currently, schemes of arrangements can only be invoked by foreign corporations that are "*liable to be wound up*" under the Companies Act. In other words, for schemes of arrangements, the test of whether jurisdiction is established boils down to a test of whether the court's insolvency jurisdiction can be invoked in respect of a foreign corporate debtor. In practice, that would require the courts to determine if a sufficient nexus exists by looking to the factors establishing a connection with Singapore (which are not statutorily specified) as applied to the case before the court. This includes for example, the presence of assets (bank accounts, property) or creditors in Singapore (whether local of foreign).

In order to give greater clarity to foreign companies that wish to restructure in Singapore, the Measures set out a non-exhaustive list of factors that will be taken into account by the courts to determine if a sufficient nexus exists.

The factors are:

a. where the foreign corporate debtor has established or moved its head office to Singapore or has been registered as a foreign company in Singapore;

b. where the foreign corporate debtor has opened a bank account in Singapore and transferred funds into it;

c. where the foreign corporate debtor has chosen Singapore law as the governing law in its transaction documents; and/or

d. where the foreign corporate debtor has chosen the Singapore courts as the forum for dispute resolution in its transaction documents. This is in turn bolstered by Singapore's implementation of the 2005 Hague Convention on Choice of Courts Agreements, which strengthens enforcement of agreements which specify Singapore courts as the exclusive dispute resolution forum.

The Measures will also make judicial management (which did not extend to foreign companies previously) available to foreign companies and thereby effectively open up one of Singapore's major rehabilitative regimes to foreign debtor companies. Unlike the English administration regime, judicial management offers an automatic statutory moratorium upon filing of the judicial management application, which is helpful to prevent sudden disruptions to the business arising from creditor enforcement actions.

The promulgation of specific but non-exhaustive factors to establish the requisite connection or nexus injects greater certainty and clarity as to whether and when the restructuring jurisdiction of the Singapore courts can be invoked in respect of a foreign corporate debtor. Nevertheless, these non-exhaustive factors still provide the courts with the flexibility and discretion to make a case by case determination of novel facts or factors establishing a connection or nexus in more complex scenarios.

A further point to note is that the Measures will allow for a holistic restructuring of a corporate group's debts (see also the automatic stays for related entities below). This is because the connecting factors are potentially very wide ranging. For instance, supposing that the factor of Singapore law being

the governing law of a loan document is sufficient in a particular factual scenario to establish a nexus, then that would mean that in respect of a cross border financing transaction, third party security grantors whose security documents are governed by Singapore law may invoke the restructuring jurisdiction of the Singapore courts. Effectively, the Measures may open up the restructuring regime to holding companies and subsidiaries, being entities that often offer third party guarantees or securities for loans that their subsidiaries or, as the case may be, holding companies, take up.

More breathing space for debtors—Automatic stays on creditor actions

Extending automatic stays to schemes of arrangements
Foreign corporate debtors coming into Singapore to conduct their restructurings will be provided swift respite from creditors, allowing a safe harbour to focus on formulating a cohesive rehabilitative plan.

Under the current framework, an automatic moratorium arises only when a judicial management application is made. However, no such automatic moratorium exists in respect of a scheme of arrangement, in which case a moratorium has to be applied for. Thus, there is potentially a period during which the value of the distressed entity may be eroded by way of creditor enforcement actions.

Consistent with Chapter 11 proceedings in the United States (where an automatic stay is granted upon the filing of a petition), the new restructuring regime will grant an automatic stay of creditor actions in respect of schemes of arrangements upon filing of an application under Section 210 of the Companies Act.

That said, Singapore is not adopting an absolute debtor friendly position as the grant of a moratorium on application is subject to the twin safeguards of (i) disclosing the scheme to relevant interested parties, such as certain unsecured creditors (who may apply to lift the moratorium if necessary), and (ii) the limited duration of the moratorium (one month from the filing of the application, which may be extended by the courts if required).

Extending automatic stays to related entities
Separately, the Measures will also extend moratoriums in restructurings to related entities of a debtor in appropriate cases. As a safeguard, such extension would not be granted as a matter of course, but instead would only be granted when it is shown that (i) the related entity or entities are relevant to the restructuring and (ii) including such entity or entities in the moratorium would contribute to the success of the restructuring.

The new restructuring regime will likely make Singapore a more attractive jurisdiction for debt restructurings, and the Singapore courts' facilitative and commercially sensitive approach bodes well for stakeholders looking for practical solutions in their restructurings.

Extraterritorial reach

While the United States takes the approach of a global stay of creditor action, the Measures adopt a more targeted approach, albeit with extraterritorial effect. Thus, the Singapore courts will only be able to grant injunctions against creditors (whether local or foreign) who are subject to the *in personam* jurisdiction of the Singapore courts. In this regard, Singapore's adoption of the UNCITRAL Model Law on Cross Border-Insolvency is also timely.

Potential application

The potential application of the enhanced moratorium will be wide-ranging and significant in cross-border restructurings. As Singapore is a key financial and commercial hub in Asia, Singapore is frequently a significant jurisdiction in a cross-border restructuring and conducting a restructuring in Singapore allows for orderly regulation of on-shore and off-shore debt.

Due to the lack of clarity under the current framework for restructuring of foreign corporate debtors, foreign companies frequently resorted to a parallel scheme of arrangement in Singapore, which mirrors the on-shore debt restructuring plan in its home jurisdiction.

With the new framework focusing on the cross-border aspects of restructuring, including the enhanced moratorium that automatically comes into effect and can extend to related entities of the debtor (whether local or foreign), Singapore is poised to deliver a streamlined and expedient process for global restructurings.

Significantly increasing the prospect of new money—Priority in rescue finance

Additionally, the new restructuring regime in Singapore will also encourage greater availability of rescue financing to corporate debtors attempting a restructuring in Singapore.

A crucial determinant of the success of a restructuring is often whether fresh financing can be obtained and on what terms. New money is frequently needed to tide the distressed company over and provide working capital to turn the distressed company around.

Under the current regime, as it is in the United Kingdom, there is no priority accorded to rescue financing vis-a-vis existing creditors.

The Measures adopt the United States' approach and will grant "super priority" status in respect of rescue financing. This allows rescue financing to be paid ahead of other administrative expense claims.

In the case where the rescue financing is extended on a secured basis, the Measures also provide that the courts may grant a super-priority lien in respect of the secured assets. A super priority-lien is a security that is ranked either *pari passu* or senior to existing security interests.

Acknowledging that the adoption of super-priority liens represents an intrusion into existing contractually negotiated proprietary rights, the courts will only allow such super-priority liens to be granted if it can be shown that (i) no other rescue financing is available and (ii) the existing secured creditors are adequately protected, for instance by requiring the value of the overlapping security to be such that it is significantly over-collateralised in respect of the existing secured debts.

With the advent of super priority financing and super priority liens, lenders are encouraged to extend much needed rescue financings. These proposed changes alleviate the current difficulties faced in raising new capital. This is a significant and helpful departure from the current regime, which currently requires the surrender of security by existing security holders in order to provide collateral for rescue financings, and where rescue financing is often only disbursed after a scheme of arrangement is sanctioned by the courts, since priority is expressly provided as a term of the scheme of arrangement and only becomes binding following court approval of the scheme of arrangement.

What lies ahead

The new restructuring regime will likely make Singapore a more attractive jurisdiction for debt restructurings, and the Singapore courts' facilitative and commercially sensitive approach bodes well for stakeholders looking for practical solutions in their restructurings. The progressive nature of the Singapore courts is illustrated in recent case law:

— The Singapore High Court granted recognition of a Japanese bankruptcy trustee's powers over a BVI company with operations in Japan and assets in Singapore based on the application of COMI principles (even though no winding up order made in BVI or recognition of Japanese bankruptcy order obtained in BVI) (*Re Opti-Medix Ltd* [2016] SGHC 108).

— The Singapore High Court exercised its inherent jurisdiction to grant an interim stay of proceedings against Hanjin Shipping and its Singaporean subsidiaries in support of Korean rehabilitative proceedings (*Re Taisoo Suk (as foreign representative of Hanjin Shipping Co Ltd)* [2016] SGHC 195).

— The Singapore High Court granted a moratorium to a company, prior to the application to convene a meeting of scheme creditors, provided there was a sufficiently detailed proposal (*Re Conchubar Aromatics Ltd* [2015] SGHC 322).

Indeed these are exciting times for restructuring professionals as Singapore positions itself as a restructuring entrepôt. Much opportunity abounds for restructuring in or connected to Singapore and the restructuring community has much to look forward to once the new restructuring regime takes effect. ■

▼ **Manoj Sandrasegara Pillay** is Joint Head of the Restructuring & Insolvency Practice and Joint Head of the Indonesia Practice at Wong-Partnership LLP. Manoj has extensive experience in complex cross-border debt restructurings, advising borrowers, court-appointed administrators and special situation investors. Manoj has advised on high-profile restructurings, including Jurong Aromatics' US$1.5 billion and Bilcare Singapore's US$0.3 billion debt restructuring and the judicial management of Altus Shipping & Logistics. He is ranked in the top tier of *Chambers Global*, *Chambers Asia-Pacific*, *IFLR1000* and *The Legal 500* for his restructuring expertise. *Chambers Asia-Pacific 2015* commended his depth of experience in advising Chinese companies. Manoj is the Vice Chairman of the Insolvency Association of Singapore and was appointed as a committee member to overhaul Singapore's insolvency legislation. Manoj received an LL.B (Honors) from the National University of Singapore.

▼ **Smitha Menon** is Partner in the Restructuring & Insolvency Practice and Banking & Financial Disputes Practice at WongPartnership LLP. Smitha is cited in Global Restructuring Review's 40 under 40 list (2016) of the world's leading restructuring lawyers. Smitha is an Asia representative on the Young Arbitrators Forum of the International Chamber of Commerce and the Treasurer of the Singapore network of the International Women's Insolvency and Restructuring Confederation (IWIRC). A former Council member of the Singapore Law Society, she is active on several working committees and currently serves on the Professional Affairs Committee of the Singapore Academy of Law as well as chairs the Young Members Chapter. She teaches advocacy training and regularly speaks at local and regional seminars and conferences. Smitha received an LL.B (Honors) from King's College, London.

▼ **Harold Foo** is an Associate in the Restructuring & Insolvency Practice and Banking & Financial Disputes Practice at WongPartnership LLP. Harold has a keen passion in insolvency law and has been involved in a variety of restructuring and insolvency matters. These include restructuring the debts of a Singapore listed company and its wholly owned subsidiary via a scheme of arrangement and legal proceedings in connection with clawback actions in the Singapore Court of Appeal. Harold has also attained distinctions in insolvency law courses at the Singapore Bar Examinations and the National University of Singapore. Harold received an LL.B (Honors) from National University of Singapore.

Is Debtor-In-Possession Financing Even Possible in Peru?

By **JOSÉ JIMÉNEZ** *and* **DANIEL GONZÁLES**

In Peru, providing financing to companies undergoing insolvency proceedings ("DIP financing") is highly uncommon. In most cases, this lack of financing makes it difficult to continue operating what makes up the core value of many insolvent companies. As a result a debtor is often forced to liquidate and subsequently exit from the market.

Indeed, for more than a decade, insolvency proceedings in Peru have been characterized as being more prone to liquidate rather than to reorganise. Liquidations are the most common fate of insolvent debtors, and therefore creditors have usually no interest in participate actively in insolvency proceedings in Peru.

According to 2014-2015 statistics published by the National Institute for the Defense of the Free Competition and the Protection of Intellectual Property (*Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual* or INDECOPI),[1] 92 creditors' meetings (*junta de acreedores*)[2] were held in 2015 in order to determine the fate of insolvent debtors. In all of these meetings, the creditors agreed to liquidate the insolvent debtor. Similarly, in 2014, creditors decided to liquidate the relevant debtor in 136 out of 145 cases, and only in nine cases creditors opted to restructure the insolvent company. Liquidation is in fact the most common alternative for creditors when it comes to determine the fate of insolvent companies.

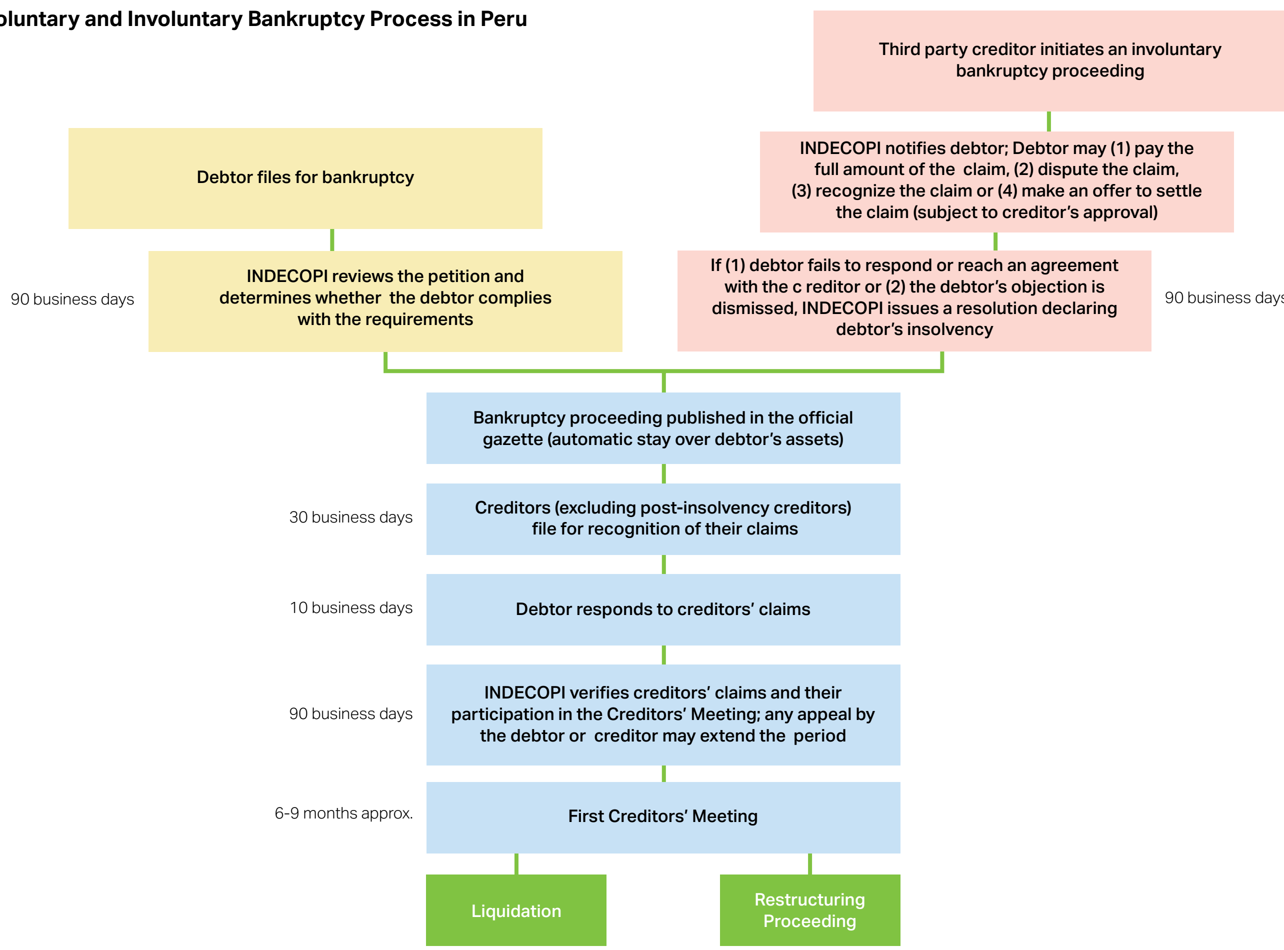
It is reasonable to assume that creditors would decide to liquidate the debtor if the market value of the debtor's assets was higher than the value of the cash flows that the debtor (as an ongoing business) could generate. Nevertheless, if that was the case, one would assume that creditors should prefer the debtor to continue running the business and preserve the value of such business in order to recover their claims.

In light of the INDECOPI statistics, we could assume that in Peru the market value of the debtor's assets is (almost always) higher than the value of the insolvent debtor as a going concern. It would seem that the losses suffered by creditors involved in an insolvency proceeding would always be less in a liquidation scenario rather than in a reorganization.

However, in our experience, creditors are usually not interested in analyzing the pros and cons of restructuring or liquidating an insolvent company in Peru. In fact, there are very few cases in which creditors hire independent consultants to assess the possibility of restructuring the business and, therefore, the future of the debtor is focused entirely on the prompt recovery of the business' remaining value (even if only partially) rather than in identifying an alternative strategy that could offer more value for all creditors, even if such value were to be obtained in the long run. Peruvian insolvency laws do not require creditors to hire independent consultants to decide about the fate of the debtor and, for the reasons explained further below, creditors are not willing to incur in the costs of hiring these specialists, even though they may provide with a more accurate assessment of what the best economic option is (liquidation vs. reorganization).

One of the reasons that could explain the massive liquidations of insolvent debtors is that reorganizing an insolvent business could be considered by creditors as an expensive and risky decision given the features of the Peruvian insolvency regime. In fact, such features usually prevent insolvent companies from obtaining the financing and working capital they need to keep carrying their business, as further explained below.

Voluntary and Involuntary Bankruptcy Process in Peru



Financing Insolvent Companies in Peru

Under Peruvian insolvency laws,[3] the financing granted to a company once the beginning of its insolvency proceeding has been published in the Peruvian official gazette does not require the approval of creditors or the INDECOPI and is not subject to rules governing payment of claims part of an insolvency proceeding. This means that such financing is repaid per the terms agreed between the debtor and the lender (i.e., post-insolvency financing is not affected by the automatic stay enforced over the debtor's assets once the proceeding has commenced).

Peruvian insolvency laws do not expressly prohibit insolvent debtors to grant security interests over their assets in order to secure post-insolvency financings such as DIP financings. As such, if the debtor does not pay the amount due, a DIP lender should be able to enforce the security interest and get paid with the proceedings obtained therefrom.

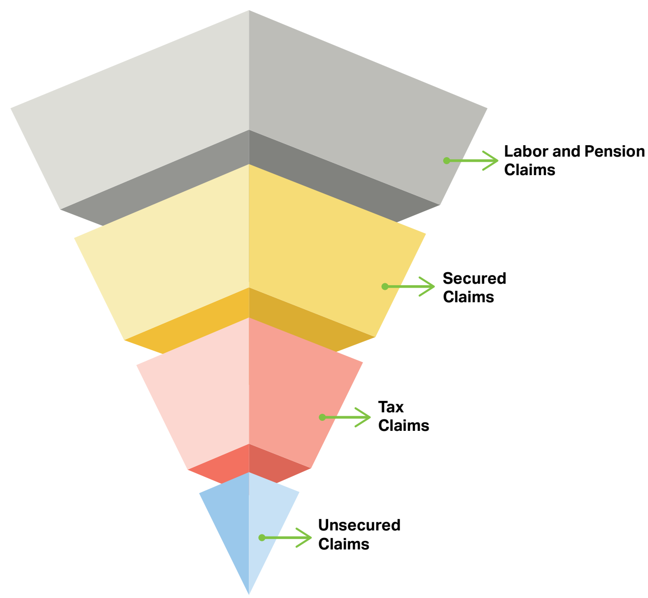
Given these features, one would think that post-insolvency financing benefits from favorable treatment under Peruvian insolvency laws and therefore the Peruvian DIP financing system is effective. Nonetheless, the situation is not as flexible as it appears to be. Peruvian insolvency laws provide that if the creditors' meeting decided with a two-thirds majority vote to liquidate the debtor, all claims against the debtor will be subject to the insolvency proceeding and paid off pursuant to the priority rules set forth by law. This provision applies to all claims regardless of whether such claims originated before or after an insolvency proceeding was published in the Peruvian official gazette. Therefore, post-insolvency creditors will have to verify their claims before INDECOPI in order to take part of the creditors' meeting and approve the corresponding liquidation agreement.

In this context, post-insolvency financing is risky given that creditors have the right to liquidate the insolvent company at any moment during the insolvency proceeding. Moreover, only creditors have the right to determine whether or not the debtor will liquidate the business, which means the creditors can choose to liquidate even if they had initially decided to restructure the business.

Hence, if creditors decide to liquidate the debtor, any post-insolvency claims will be subject to the insolvency proceeding. This means that the automatic stay will apply to these liabilities; therefore, post-insolvency creditors will no longer be paid pursuant to the original terms, and the collateral granted to secure these claims could no longer be enforced. Instead, post-insolvency indebtedness will be treated as any other claims subject to the rules of the insolvency proceeding, and creditors would be paid pursuant to the mandatory provisions set forth in Peruvian insolvency laws and in the liquidation agreement approved by the creditors' meeting.

Pursuant to Article 42 of the Peruvian Bankruptcy Law (*Ley No. 27809*), secured debt ranks second in priority of payment in a liquidation scenario—right after labor and pension debts. Unsecured debts rank fourth (and last) in said priority—after labor and pension debts, secured debts, and tax claims. Consequently, post-insolvency creditors benefitting from collateral securing their debt may believe they will rank second in the recovery waterfall; however, Peruvian insolvency laws require that the security interest be registered in the relevant Public Registry office by the time the insolvency proceeding is published in the Peruvian official gazette in order to benefit from the second rank priority. Given that post-insolvency indebtedness is issued after the insolvency proceeding is announced, in most cases, these types of claims will be ranked by INDECOPI last in the priority payments under a liquidation scenario, regardless as to whether they were secured or not.

Recovery Waterfall



All things considered, DIP lenders will likely think twice before granting any financing to insolvent debtors: financing the business of a company undergoing an insolvency proceeding may be very risky given that the likelihood of payment depends entirely on whether the creditors' meeting decides to liquidate the debtor or not. Consequently, DIP lenders may prefer not to enter into a financing agreement with the insolvent company, even if they could obtain higher interest rates, disbursement commissions or other benefits.

Peru's insolvency system, unlike other insolvency regimes of countries like the U.S. or Canada (which have a super priority rule under which DIP financing is preferred over all other existing debt, equity and other claims), does not protect or incentivize the financing of companies undergoing insolvency proceedings. The Peruvian regime unfairly penalizes investors willing to finance the activities of insolvent companies by putting them in an equal or worse situation than those creditors who granted financing before the declaration of insolvency, and who decided to remain safe during the insolvency proceeding by not providing any additional financing to the debtor.

If the justification for the Peruvian current system is to prevent post-insolvency creditors such as DIP lenders from affecting pre-insolvency creditors, then Peruvian insolvency laws may well be amended to grant the creditors' meeting the authority to approve or reject any new financing by the insolvent debtor, along with the preferred payment provisions applicable to such new financing. In fact, some limitations and other specific provisions may be included when such new financing is granted by a related company or by a lender who already holds the majority of the verified claims in the creditors' meeting.

As explained above, insolvent companies in Peru seeking to restructure face several difficulties in getting new financing and, therefore, need legal mechanisms to mitigate the risks of a liquidation scenario.

However, Peruvian insolvency laws are not the only factor causing to the lack of DIP financing in Peru. Banking regulations contribute as well to this situation by imposing higher costs on banks that are willing to finance insolvent companies.

Worst Case Scenario for a DIP Lender

1. Company undergoes an insolvency proceeding
2. At the Creditors' Meeting, creditors decide to reorganize the debtor
3. DIP lender grants new financing to the company with expectation to be paid before all other creditors with attractive interest
4. Creditors subsequently decide that the reorganization plan is no longer feasible and will not succeed and to liquidate the business
5. The DIP financing granted to the company under the terms of the failed reorganization plan becomes subject to the liquidation proceeding and will most likely be last in line for recovery

Post-Insolvency Financing under Peruvian Banking Regulations

Peruvian banking regulations consider loans to an insolvent company in the risk category of (i) "potential problems" (*peligro potencial*) only if the previous risk category was "normal" (*normal*) and (ii) "deficient" (*deficiente*) if the previous risk category was "doubtful" (*dudosa*) or a "credit loss" (*perdida*). Consequently, banks providing financing to insolvent companies may have to record general provisions (*provisiones por cobranza dudosa*) in order to cover the risk of default of such financing. This means banks are required to set aside reserves to pay for the anticipated losses coming from these loans.

This means that banks face additional costs for funding companies undergoing a restructuring proceeding. Hence, banks avoid these costs and simply do not grant financing to insolvent companies. These additional costs may be linked to how post-insolvency loans are treated in the event of liquidation. If the Peruvian insolvency laws were amended to allow preferences for authorized post-insolvency financing (such as DIP financing), banking regulations would likely be amended accordingly in order to reflect the lower risk involved in this type of financing.

Liquidation of Companies as "Going Concerns"

Peruvian insolvency laws allow companies to liquidate at their "going concern" value. This occurs when creditors believe they will obtain a higher value by selling the assets of the debtor altogether as an operating business to a single buyer rather than selling the assets individually to different buyers.

Usually, these liquidations have to be completed within two years from the date the creditors' meeting decided to liquidate the debtor as a "going concern." Nevertheless, Peru's Congress recently enacted a law extending such two year term for up to two additional years for the specific case of Doe Run Peru[4] (one year with the approval of the creditors forming part of the creditors' meeting, and one more year with the approval of the President of Peru).

Liquidations of companies as going concerns are rare in Peru. Mostly due to the lack of clear rules for the treatment of financing obtained by the debtor during the sale process. This situation is worsened by the fact that Peruvian insolvency laws provide that if the sale of the business is not completed within the time limit described above, then the debtor has to cease activities and the liquidation has to be performed through the default sale of individual assets.

Nevertheless, Peruvian insolvency laws have provisions dealing with the indebtedness issued by the debtor in order to implement the liquidation as a going concern. Pursuant to these provisions, this type of indebtedness is not pooled into the insolvency proceeding and, therefore, shall be paid when due pursuant to the terms agreed with the relevant lender. However, there remains some uncertainty in the interpretation of the laws about what claims qualify as "debt assumed by the debtor in order to implement the liquidation as the sale of a going concern."

INDECOPI issued a binding administrative resolution in 2016 interpreting the scope of these provisions.[5] Resolution No. 0226 clarifies that not all indebtedness issued during the liquidation proceeding is excluded from the insolvency proceeding, but only debt that was necessary to keep the business running during the sale process. If the post-insolvency claims comply with such purpose, then they are not pooled into the insolvency proceeding and have to be paid when due and with priority over the claims subject to the insolvency proceeding.

In our opinion, new financing of working capital or financing granted by suppliers of goods and services should fit within the definition of this binding precedent. Conversely, unpaid fines and financing obtained to acquire a new line of business would not be regarded as claims excluded from the insolvency proceeding.

Resolution No. 0226 is a step forward in clarifying the rules governing the financing of companies undergoing insolvency proceedings. With such rules, creditors will be able to better assess the true risk of providing financing to insolvent companies by determining whether such financing would qualify or not as an "excluded credit" from the insolvency proceeding.

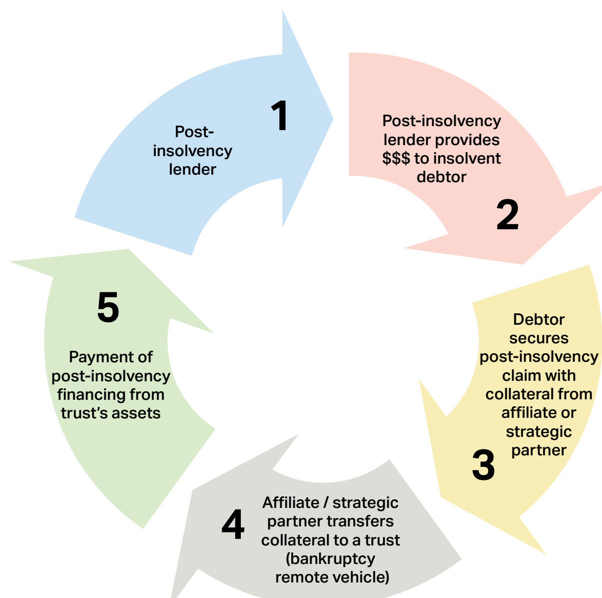
Furthermore, we believe the liquidation agreement may set forth further details about the specific claims that will qualify as "excluded debts" so that it is clear that there will be two types of claims to be paid out with the proceedings coming from the liquidation: (i) claims assumed by the insolvent debtor for the continuance of the business during the liquidation, which will be paid on their due date, and (ii) claims which are included within the scope of the insolvency proceeding (i.e., indebtedness assumed by the debtor before the filing of the insolvency proceeding along with claims assumed by the debtor thereafter which do not qualify as necessary for the continuance of the business during the liquidation), which will be paid pursuant to Peruvian insolvency laws and as set forth in the liquidation agreement.

Creation of Alternative Structures to Ensure Post-Insolvency Financing

Given that Peruvian insolvency laws do not incentivize the financing of companies undergoing insolvency proceedings, investors may have to use alternative structures to protect DIP financing and preserve the operating value of the insolvent company.

For example, companies affiliated to the debtor or strategic partners that are interested in preserving the business of the debtor as a going concern may provide collateral for securing any post-insolvency financing to be provided to the debtor. Alternatively, affiliates and strategic partners may be able to obtain the financing directly in order to redirect these funds to the insolvent debtor's business through joint ventures or other modality of business association.

Alternative structure to protect post-insolvency financing



These structures aim to mitigate the risk of liquidation that any lender willing to provide financing to an insolvent debtor faces in Peru. As such, these structures provide these lenders with a different recourse entity for any claim for payment of the post-insolvency financing in the event the debtor is liquidated.

The collateral to be posted in order to secure this financing may be structured through the incorporation of trusts (*fideicomisos*) to provide lenders with a bankruptcy remote vehicle in the event that these related companies and strategic partners face insolvency as well. Indeed, once the statute of limitations of the avoidance actions (*accion revocatoria*)[6] have expired, the trust estate is isolated from any risk affecting the debtor and/or any third party.

Conclusions

While there are some provisions regulating DIP financing in Peruvian insolvency laws, lenders face several risks which may deter them from providing such financing. In fact, if the creditors vote to liquidate the debtor, all claims outstanding at the moment the creditors take such decision are brought into the proceeding, the original terms governing the post-insolvency financing are no longer binding on the parties, and such financing will be paid pursuant to the mandatory provisions set forth by law and the rules agreed on the liquidation agreement. As shown by INDECOPI statistics, these risks have led to a situation in which restructurings are very rare and liquidations are the rule when creditors have to determine the fate of the insolvent debtor.

Lenders face a somewhat better scenario if the debtor is liquidated as a "going concern." In this case, post-insolvency financing which qualifies as "debts required for the continuance of the business during the liquidation" are excluded from the insolvency proceeding and, therefore, they are paid when due pursuant to the terms agreed on by the debtor and the lender.

Peruvian insolvency laws should be amended in order to provide DIP (post-insolvency) financing with a super priority similar to the priority granted to DIP financing under U.S. rules. In most cases, the restructuring of the debtor depends on the ability of the debtor to obtain further financing in order to continue running its business. In Peru, restructurings are not an option most likely because of the costs and risks involved in granting financing to a company undergoing an insolvency proceeding. As such, we believe that this new feature (super priority of post-insolvency financing) will allow creditors to have a real choice when deciding whether to liquidate or restructure an insolvent debtor.

Super-priority should be granted to any post-insolvency claims that is duly approved by the creditors meeting (in the absence of a judicial insolvency authority in Peru), in order to avoid this new feature to be abused by investors acting in collusion with insolvent debtors. ■

1. "*Anuario de Estadísticas Institucionales 2015*" and "*Anuario de Estadísticas Institucionales 2014*" both published by INDECOPI. INDECOPI, which began in November 1992, is the governmental (administrative) agency in charge of monitoring insolvency proceedings in Peru.
2. The meeting of creditors is comprised of all creditors of the insolvent debtor who have had their claims verified by the administrative court. In order to take part in the meeting, creditors must verify their claims before INDECOPI within 30 days after the insolvency proceeding is published in the Peruvian official gazette (*El Peruano*). This creditors' meeting replaces the shareholders meeting for all decision-making purposes and decides whether to liquidate an insolvent company or not. Usually, the first creditor's meeting takes place approximately 9 to 12 months after the insolvency proceeding is published in the Peruvian official gazette. All the creditors hold the same voting and preferential rights in each meeting. However, the voting threshold may vary depending on the representation of creditors affiliated with the insolvent company.
3. Law No. 27809 (the General Bankruptcy Law), enacted in August 2002 and related amendments including Law No. 28709, enacted in April 2006, Legislative Decree No. 1050, enacted in June, 2008, Legislative Decree No. 1170, enacted in December 2013, Legislative Decree No. 1189, enacted in August, 2015 and Law No. 30502, enacted in August 2016.
4. This law was enacted in connection with the liquidation of Doe Ron Peru SRL, a smelting company located in La Oroya. DRP is a company undergoing a liquidation proceeding (as a going concern) that owns a metallurgic center in the town of La Oroya, Peru. Currently, the liquidation proceeding of DRP is suspended because no binding offers for the acquisition of DRP were submitted. This law aims to give more time for this liquidation to be completed successfully in order to avoid social unrest in La Oroya - most of La Oroya's population work or are in some other way dependable on the continuation of DRP' business.
5. Resolution N°0226-2016/SCO-INDECOPI, published in the Peruvian Gazette "El Peruano" on May 25, 2016. This is binding administrative resolution that was issued in connection with the Doe Run Perú SRL proceeding.
6. Avoidance actions grant creditors of a company the right to revoke the transfer of assets made to a trust if such transfer was made by the company with the intention to hinder the rights of said creditors. The statute of limitations for avoidance actions is six months from the date the incorporation of the trust was last published in the Peruvian official gazette.

▼ **José Jiménez** is a Partner in the Bankruptcy Department of Rebaza, Alcazar & de las Casas. Jose is a graduate lawyer from Universidad Católica de Santa María (Arequipa), where he graduated with honors. Jose holds a Master's Degree (LLM) in Corporate Reorganization, Insolvency and Corporate Finance from the University of Toronto, Canada, and Masters' Degrees in Corporate and Tax Law from Universidad de Lima. He also has a degree in Corporate Management and Business Organization from ESAN, where he graduated first in his class.

▼ **Daniel Gonzáles** is an Associate in the M&A and Bankruptcy Departments of Rebaza, Alcazar & de las Casas. Gonzales is a graduate lawyer, magna cum laude, from Pontificia Universidad Católica del Perú. He holds a Master's Degree in Law (LLM) from The University of Chicago. He was an International Associate at the New York office of Cleary, Gottlieb, Steen & Hamilton LLP (2013—2014).

DEALNEWS / MULTI-JURISDICTION

China Fishery Bankruptcy Saga Continues between Peru, Hong Kong and U.S.: Shareholder Conflict of Interest, Chapter 11 Filing and Appointment of Independent Trustee

By **MATTHEW J. LIVINGSTON** *(mlivingston@cgsh.com)*

A tense summer and fall for creditors of China Fishery Group Limited ("CFG")—the Hong Kong-based global fishing company with significant operations in Peru—has culminated in the appointment by the Bankruptcy Court for the Southern District of New York of an independent Chapter 11 trustee to oversee the group's sale or reorganization. The appointment of the trustee—a rare occurrence in U.S. bankruptcy courts—was made at the request of a subset of CFG's lenders (the "Club Lenders") and over the objection of members of the Ng family—the controlling shareholders of CFG who had previously been managing CFG through its global insolvency proceedings.

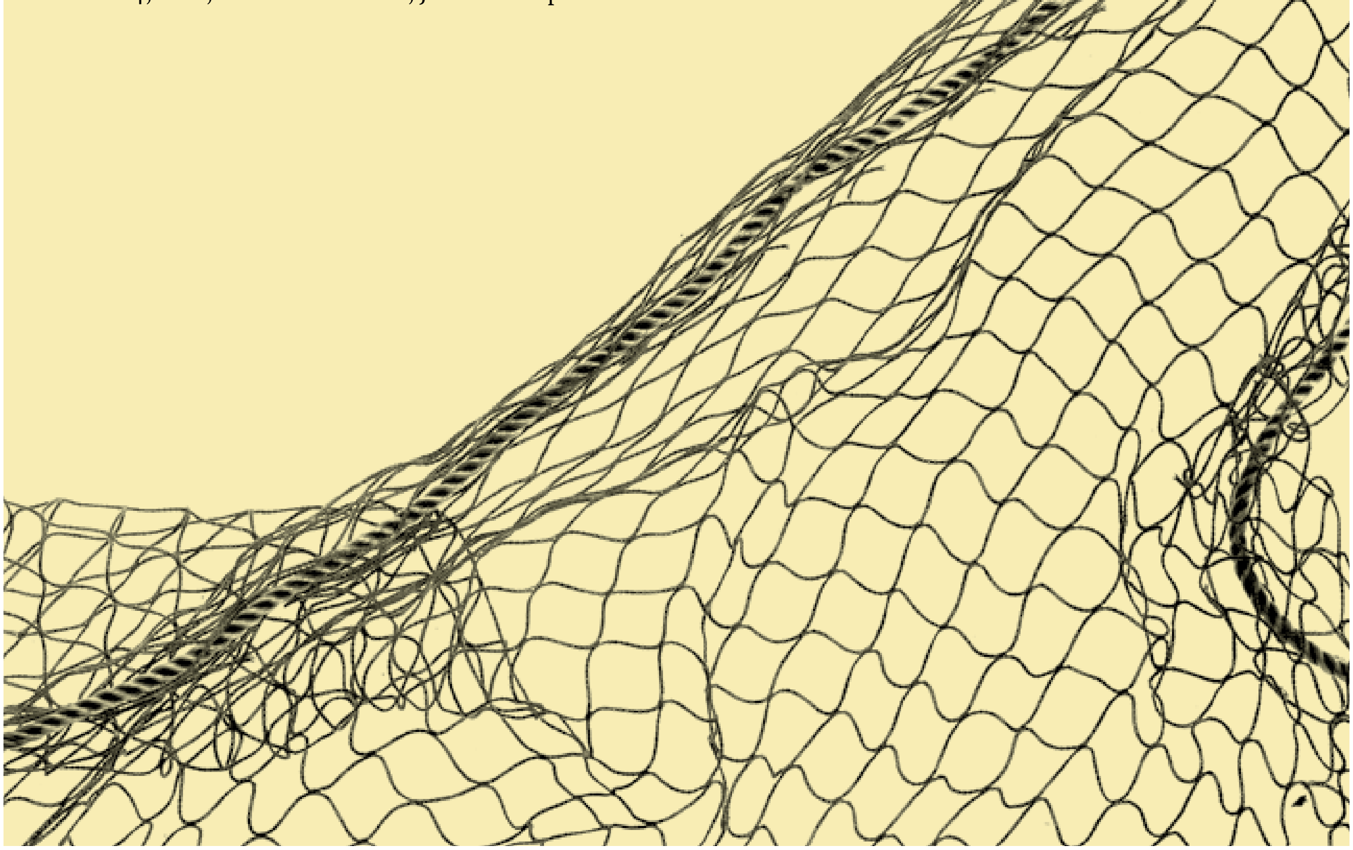
CFG, a wholly-owned subsidiary of the Pacific Andes Group, the 12th largest seafood and fishing company in the world, filed for Chapter 11 protection on June 30, 2016 and has simultaneous insolvency proceedings pending in Peru, Singapore and the British Virgin Islands. This bankruptcy filing surprised many of CFG's lenders, who had previously entered into deeds of undertaking with CFG through which the parties had provisionally agreed to take certain steps to effectuate a sale of CFG's most valuable asset—its equity interest in certain valuable fishing companies in Peru—outside of an insolvency process.

The crux of the disagreement between CFG's lenders and the Ng family is over the timing of a potential sale of the Peruvian fishing business. When previously contemplating a sale, CFG had received bids for the Peruvian fishing businesses in amounts up to approximately $1.5 billion. The Club Lenders—collectively owed more than $700 million—pushed for a sale of the assets while the Ng family, asserting that the Peruvian fishing businesses were worth far more than the bids indicated, wanted to wait to sell the company. Although estimates varied, the Club Lender parties believe that any sale of the Peruvian businesses for an amount less than $2 billion (and potentially significantly more, depending on certain intercompany liabilities) would leave the Ng

family's equity position out of the money. The filing of the Chapter 11 cases and the Peruvian insolvency proceedings delayed the potential sale of the Peruvian businesses, to the consternation of the Club Lenders.

In arguing for the appointment of an independent Chapter 11 trustee, the Club Lenders alleged that the Ng family was conflicted by their equity interest in the company and were refusing to sell the business so as to maintain control of the company, to the detriment of creditors. In agreeing to appoint the trustee, Judge Garrity of the Southern District of New York agreed that the Ng family, as both managers and controlling equity holders, were "plainly disincentivized" from selling the Peruvian business so long as equity would be out of the money. However, Judge Garrity also noted that the trustee would not necessarily be required to work towards a sale of the Peruvian business, but would rather be tasked with independently assessing the "highest and best use of [the] assets." On November 14, 2016, William A. Brandt, Jr. of Development Specialists, Inc. was appointed as the Chapter 11 trustee.

Only time will tell whether Mr. Brandt determines that a sale of the Peruvian business will constitute the "highest and best use of the assets." Either way, the Ng family does not appear willing to let go of the business easily and we expect this is not the final chapter in the global insolvency of China Fishery Group.



Reframing The Picture: Debt Restructuring Options For Local Players In The Nigerian Oil And Gas Industry

By DAMILOLA SALAWU *and* MARYAM OLAWUNMI OYEBODE

Partly in response to sustained low oil prices, global economic growth has slowed and different countries have adopted varying measures to deal with the crises they currently face as a result. Nigeria, for whom oil revenue earnings form up to 70% of government revenues, is now faced with the challenge of trying to stabilize its economy by diversifying its revenue sources. Compounding the situation, the unrest in the oil rich Niger-Delta region[1] and ensuing production shut-ins have further reduced earnings by the Nigerian government and this has in turn contributed to the continued pressure on the Nigerian Naira and created a tightened foreign exchange market in the country.

Between 2013 and 2014, the oil and gas industry in Nigeria experienced a flurry of activity, with the International Oil Companies ("IOCs") divesting their interests in onshore assets to independent local companies and the emergence of a new class of local players that were largely new to the upstream oil and gas space and without the benefit of balance sheets as robust as those of the IOCs. These local players (which are heavily leveraged after having approached the Nigerian banking community to finance the acquisition of onshore assets) are now faced with increasing uncertainty in relation to their production output and their revenue stream and are now forced to find innovative ways to stay afloat and to continue servicing their debt obligations to their lenders.

As a possible way out for some of these leveraged companies, debt restructuring options that are available in Nigeria can be explored by companies in the Nigerian oil and gas space as a means to continue meeting their debt obligations and to remain a going concern.

Some Methods of Debt Restructuring Available to Oil and Gas Companies Under Nigerian Law

The debt restructuring options open to any local oil and gas companies in any given circumstance will ultimately be determined by various considerations. These considerations for a company facing a restructuring may be further influenced and affected by the current economic climate, as well as the unique challenges facing the oil and gas industry. Several of these options, and the key issues that should be considered by Nigeria's local oil and gas players in exploring them, are discussed below.

Debt- Equity Swap

Debt equity swap is a method of restructuring which entails a reorganization of the capital of the debtor where its debt to a lender is converted into equity in the debtor. It is mostly employed where a lender looks beyond the present financial challenges and instead to the viability of the debtor's business and the potential long term value of the debtor company and elects to take a position in the debtor company. It may also entail the lender providing, where agreed by all parties, a change of management in the debtor. For the debtor, this option will free its balance sheet from the weight of the debt liability, free up its cash flow and enhance its financials. As may be expected, there will be a dilution of the existing shareholders, possibly resulting in a change of control. Given that most onshore petroleum assets are exploited under joint venture and production sharing arrangements with the government, an ensuing change of control could trigger certain default-type provisions under the relevant joint operating agreements and production sharing contracts between the debtor company (with funding obligations) and its co-venturer. Careful thought must therefore be given to these triggers in executing a debt- equity swap arrangement.

Debt-Asset Swap

This approach involves the transfer of identified assets in part or full satisfaction of the debt obligations of a debtor. This option is possible where the debtor has a portfolio of valuable assets which may not be significant or otherwise fundamental to its primary business but which are of sufficient value to offset part or the whole of its debt to a lender. Issues around an independent valuation of the asset will need to be considered here. The specific asset to be transferred to the lender will usually by agreed by both parties. It should be noted that this process is quite different from a scenario where a lender will be enforcing security over an asset which it holds a security interest over.

Between 2013 and 2014, the oil and gas industry in Nigeria experienced a flurry of activity, with the International Oil Companies ("IOCs") divesting their interests in onshore assets to independent local companies and the emergence of a new class of local players that were largely new to the upstream oil and gas space.

As a general point to note though, there is no widely documented instance where the Debt-Asset Swap has been employed by an oil and gas company in Nigeria. Although this has been utilized by Nigeria's asset management corporation, AMCON as a restructuring option in the pursuit of its statutory mandate to recover bad loans purchased from Nigerian banks. Similarly, the latter case of enforcement by a lender of a security interest over a petroleum asset remains largely unseen in Nigeria.

Standstill and Rescheduling Arrangements

Here, the objective is to delay the repayment obligations of the debtor whilst protecting the rights of the creditors and keeping the debtor as a going concern.

Standstill agreements generally predate the execution of rescheduling/restructuring agreements and the objective is to "*freeze*" the current position of all parties to allow for negotiations and discussions as to how best to address the challenges facing the debtor with respect to its debt obligations. This approach is usually employed in multiparty financings such as under a syndicated lending arrangement or where the debtor is indebted to several creditors under several bilateral loan arrangements which for example may hold security over varying assets of the debtor. It is used to prevent a scenario where different lenders exercise their enforcement rights which may trigger cross default provisions under their loan documents, which in turn, may cause the debtor to become insolvent.

Typically, the standstill agreement will articulate the standstill period, the obligations of the lender(s) and the debtor in the interim period during which negotiations of a path to repayment by the debtor will be held and concluded. Additionally, the standstill agreement may also include restrictions on the debtor from taking additional debt from any new lenders.

For its part, the debt rescheduling involves the renegotiation of the terms of an existing debt obligation, usually to extend the maturity or amortization provisions and sometimes as a result of a default or capital reconstruction. It involves the extension of the repayment period or a modification of the repayment plan with a view to making it easier for a debtor to repay and discharge its debt obligations by affording it more time and more flexible terms in paying off the debt. It is often used where the lender takes the view that the debtor is experiencing a short term liquidity squeeze and just requires some time to stabilize its cash flow.

Recently, a leading Nigerian marginal field operator with strong production volumes faced with difficulties in meeting its obligations (owing mostly to reasons prevailing in the industry issues i.e drop in oil prices and the production shut ins owing to the restiveness in the Nigeria Delta affected the production volumes and the revenue of this operator), occasioning default on its existing loan obligations with a Nigerian lender. Following discussions with the creditor, the parties entered into a debt rescheduling agreement. The agreement (a) extended the repayment tenure for an additional period of 6 years; (b) with an additional moratorium period of 6 months on principal repayments and (c) a grace period of 7 days for late payments.

Broadly however, some other agreements which may be necessary to implement this arrangement include a Standstill Agreement, Restructuring Agreement, Security Sharing Agreements, Equity Injection or Share Retention Agreements etc.

Corporate Restructurings

A corporate restructuring involves an arrangement where a creditor acquires equity and/or assumes management and control of the debtor, usually with a view to improving the efficiency of the debtor's management, governance and the conduct of its business.

Section 537 of Nigeria's Companies and Allied Matters Act ("CAMA") contemplates the restructuring of companies and defines an "arrangement" as any change in the rights or liabilities of members, debenture holders or creditors of the company, other than a change effected under any other provision of CAMA or by the unanimous agreement of all parties. This provision very clearly envisages an agreement between the company and its creditors.

Specifically related to an arrangement between creditors and the company, Section 539 of CAMA provides for three quarters of the creditors to vote and agree to a compromise or an arrangement, which may then be referred by the courts to the Nigerian Securities and Exchange Commission ("SEC") to investigate the fairness of the terms of the compromise or arrangement, following which a written report shall be provided by SEC to the courts. On the courts satisfaction of the fairness of the arrangement or compromise, the court sanctions the arrangement and it becomes binding on all parties.

Some Issues to Consider

— *The risk of shadow directorship:* Where the restructuring option employed is a debt for equity swap or even a corporate restructuring, there is often the concern that the creditor may be liable as a shadow director of the debtor company[2]. Given that Nigerian law effectively treats a shadow director as a director of a company, a creditor regarded as a shadow director will bear the full weight of the duties of care and skill as well as other statutory and fiduciary duties borne by directors to companies under CAMA. Consequently, a creditor must be careful to ensure that the right balance is struck and that its random acts and occasional interventions in the management of the debtor do not make it a shadow director of the debtor company.

— *Past Consideration Issues:* The terms of a restructuring may involve the grant of additional funding by a creditor to a debtor or the provision of additional security over an asset. As required, these if given must be for good and valuable consideration otherwise it may be regarded as being invalid as past consideration. Past consideration arises where an act has already been performed and as such cannot be induced by the other party's subsequent promise or act. In the strict sense, where new obligations are created by the restructuring agreement, new consideration must be provided. Where none is provided, the new obligation (promise) made by the debtor subsequent to the independent and underlying transaction fails as an enforceable contract. Careful attention must therefore be given to the terms of the restructuring especially where additional funding is passing from the lender or additional security from the debtor.

CASE STUDY 0N OANDO PLC. DEBT REFINANCING AND RESTRUCTURING

Oando Plc.

To illustrate how some of the restructuring options discussed have been applied recently, Oando Plc, a local integrated oil and gas company in Nigeria, recently concluded a fairly complex transaction which involved a refinancing and restructuring of a medium term loan with the objective to improve its overall debt portfolio and concentrate on its upstream activities. The transaction involved (a) the sale of its entire downstream business comprising of a number of key subsidiaries to strategic investors and the use of the sale proceeds to pay down some of its existing debt to the syndicate of lenders and (b) the release of security held by a couple of individual lenders and the accession by those individual lenders to the security held by the security trustee on behalf of the syndicate of lenders.

A condition for the sale of one of the key downstream subsidiaries was its sale without any debt liabilities. Accordingly, the purchase price from the sale of that particular subsidiary was used to pay down the intercompany loan of that subsidiary to the parent company.

In relation to another key subsidiary (in the downstream oil and gas petroleum distribution business) which itself was indebted to a small group of lenders, a corporate restructuring through a reorganization of its entire share capital was necessary as a condition for the sale of that subsidiary to a strategic investor. Consequently, the security held by the lenders on the shares of the subsidiary had to be released. The share capital of the company was reorganized into different classes with varying economic rights, with those holding the most economic rights issued to the strategic investor, the security was recreated and most pertinently, the debt by the lenders to the subsidiary was restructured on terms which gave the company an additional moratorium period, and the rescheduling of the first repayment date.

Alternative Financing Options

Beyond considering debt restructuring options, local oil and gas companies may also consider other options as a means of meeting their funding requirements.

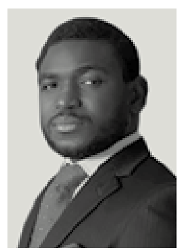
For example, the use of funding arrangements such as financial and technical service agreements (FTSAs) or strategic alliance agreements (SAAs) under which a local E&P company receives funding and/or the provision of technical services or assistance from another party in consideration for a predetermined portion of the debtor's entitlement of hydrocarbons produced from the asset. In this way, the debtor is able to meet its obligations to its creditor.

Other commonplace funding options include prepayment arrangements where the local E&P company receives advances of cash to fund operations and debt servicing in consideration of agreeing to sell crude volumes to the financier[3] up till the value of the advances received.

Conclusion

Whichever option is adopted, it is clear that the local players in the upstream oil and gas industry in Nigeria need to give careful consideration to their continued funding requirements and should not hesitate to approach their current creditors with a view to restructuring their debt positions to ensure they are able to weather the period of depressed prices. In so doing, the key issues identified above must be considered and borne in mind to prevent any liabilities on the part of the lenders. ■

1. Since the 1990's, there has persistent restiveness and unrest through violent militia activity by minority ethnic groups in the NIger Delta region where oil and gas assets are concentrated (Niger Delta).
2. Under CAMA a shadow director is a person on whose instructions and directions the directors of the company are accustomed to act.
3. Typically, an international trading company such as Mecuria, Vitol, Trafigura and the like.



▼ **Damilola Salawu** is is a Senior Associate with the Oil and Gas Practice of Olaniwun Ajayi LP, where he advises on upstream asset acquisitions, re-entry operations into field developments, financing the development of petroleum assets and advising on local content compliance issues, Damilola also advises on a wide range of finance matters including corporate finance, project finance and security arrangements. Recently, he advised on the USD 3.2 Billion Financing for the development of an integrated refinery and petrochemical complex by the Dangote Group. Mr. Salawu received an LL.B. from the University of Lagos in 2005, a BL. from the Nigerian Law School in 2006 and an LL.M. from the University College of London in 2008.

▼ **Maryam Olawunmi Oyebode** is a member of the Dispute Resolution Practice of Olaniwun Ajayi LP. She has a background in corporate commercial practice and litigation. Specifically, she has provided advice on compliance and regulatory issues pertaining to companies seeking to be established in Nigeria, she has assisted in the establishment of foreign entities within Nigeria and has advised on security arrangements. Ms. Olawunmi Oyebode received an LL.B. from the University of Reading in 2009, an LL.M. from Kings College London in 2010 and a B.L. from the Nigerian Law School in 2012. She was admitted to the New York Bar in 2014.

CROSS BORDER-PROCEEDINGS

S.D.N.Y. Court Watch: Out-Of-Court Deals Post-Marblegate & Caesars

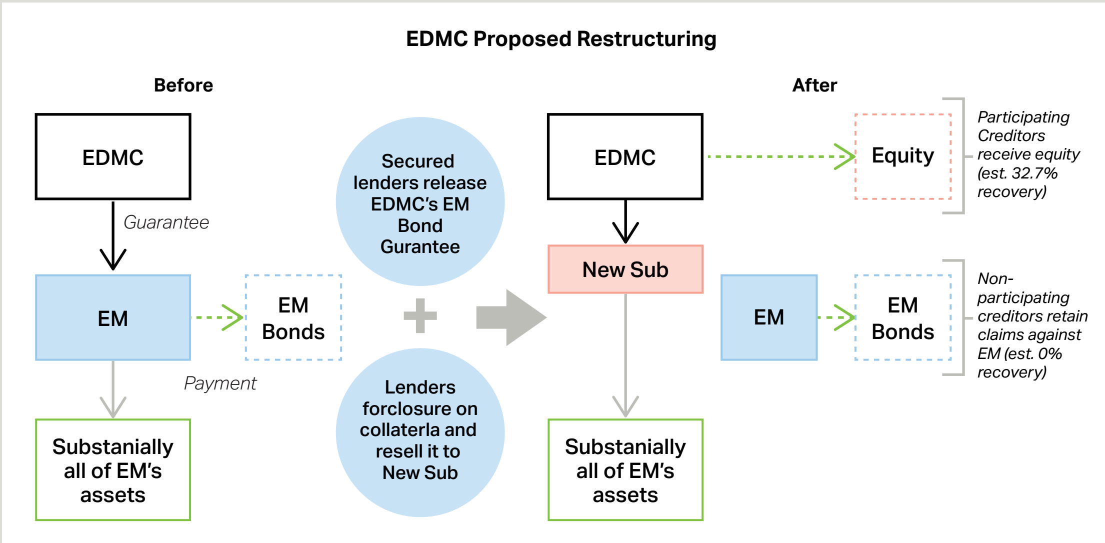
By **LEV BREYDO** *(lbreydo@cgsh.com)*

A popular and potent tool to execute out-of-court restructurings—the "exit consent"—has been mired in considerable uncertainty following recent SDNY decisions in *Marblegate Asset Mgmt. v. Education Mgmt. Corp.* ("*Marblegate*") and *Meehan Global Credit Opportunities Funds, LP v. Caesars Entertainment Corp.* ("*Caesars*"). Both cases interpret §316(b) of the Trust Indenture Act of 1939 ("TIA"), a Depression-era law intended to prevent insider transactions that "demolish retail bondholders." The TIA generally applies to debt securities sold through SEC-registered transactions—irrespective of the issuer's domicile.

Under §316(b), a bond's so-called "core terms"—the right to payment of principal and interest—cannot be "impaired or affected" without consent of the bondholder (thus, requiring 100% consent for an out-of-court restructuring). However, indentures typically include auxiliary, "non-core," provisions nevertheless essential to a bondholder's ability to receive payments—for instance, parent company guarantees and restrictions on asset sales or transfers.

In highly simplified terms, exit consents facilitate out-of-court deals by allowing participating bondholders to modify "non-core" terms prior to exchanging their bonds through the transaction. This incentivizes participation, since non-consenting bondholders will be left without the protections of the modified "non-core" terms (albeit while maintaining un-modified claims to principal and interest). While not *per se* invalidating this structure, *Marblegate* and *Caesars* suggested that the TIA's prohibition on "impairing" core terms also extends to modifications of non-core terms that have the practical effect of impairing the bondholder's core right to payment.

Marblegate stemmed from the 2014 restructuring of Education Management Corporation ("EDMC"), a for-profit education provider which could not file for Chapter 11 without losing access to federal education funding. The capital structure was relatively straight forward—$1.3 billion in secured debt and $217 million of unsecured bonds, issued by Education Management LLC ("EM") and guaranteed by EDMC (the "EM Bonds").



The proposed restructuring provided holders of EM Bonds with an estimated 32.7% recovery in post-reorganization equity and sought to ensure 100% voluntary participation through, as the Court put it, "a stick that would come into effect if any creditors did not consent." As illustrated below, the "stick" worked as follows: first, participating secured creditors would consent to releasing EDMC's guarantee of the EM bonds; then, the secured creditors would foreclose on EM's collateral and transfer it to a new subsidiary that would issue equity to participating creditors. Putting all this together, EM would be left effectively asset-less. Correspondingly, as noted in the offering circular, EDMC "anticipate[d]" that, as a result of the transaction, non-participating bondholders would not receive payment (and would not have recourse against any entity with assets).

A distressed debt-focused hedge fund, Marblegate, held out, refusing to exchange its $14 million of EM Bonds in what it argued to be a coercive transaction. The Court broadly agreed, finding EDMC's proposed restructuring to violate §316(b) by forcing Marblegate to make "a Hobson's choice: take the common stock, or take nothing."

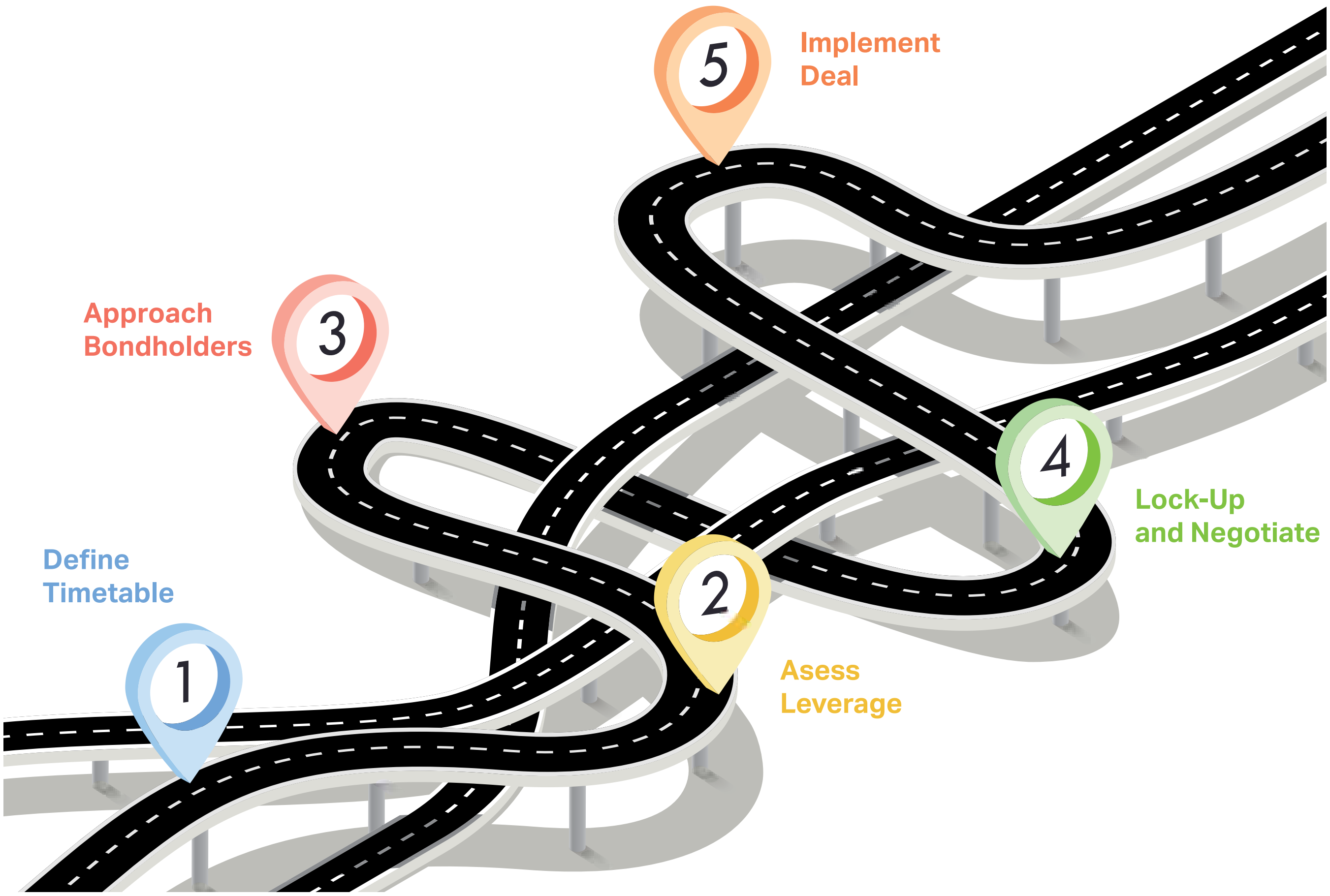
Shortly after *Marblegate*, the SDNY Court reprised its broad reading of the TIA through two opinions in the hotly-contested *Caesars* bankruptcy. In short, the transaction at issue involved stripping a parent company's guarantees of a subsidiary's bonds. Consenting holders of the subsidiary's bonds would receive a par claim against a creditworthy entity (valued significantly above the bonds' trading prices) in exchange for participating in the transaction and promising to support Caesar's restructuring; in contrast, non-consenting creditors would retain claims against a subsidiary with substantially reduced assets. Broadly tracking the reasoning in *Marblegate*, the Court also adopted an expansive interpretation of §316(b)'s protections for minority bondholders.

Prior to *Marblegate* and *Caesars*, it was largely accepted that §316(b) protected a bondholder's legal rights to payment, but not the practical ability to recover. This key distinction allowed modification of non-core terms without 100% consent, facilitating integrative transactions.

Although these decisions remain under appeal—and may potentially be the target of legislative action to reverse their holdings—as they currently stand, *Marblegate* and *Caesars* raise questions about whether exit consents can continue to be part of the toolkit to successfully effectuate out-of-court restructurings.

Restructuring Emerging Markets High Yield Bonds: An Issuer's Roadmap

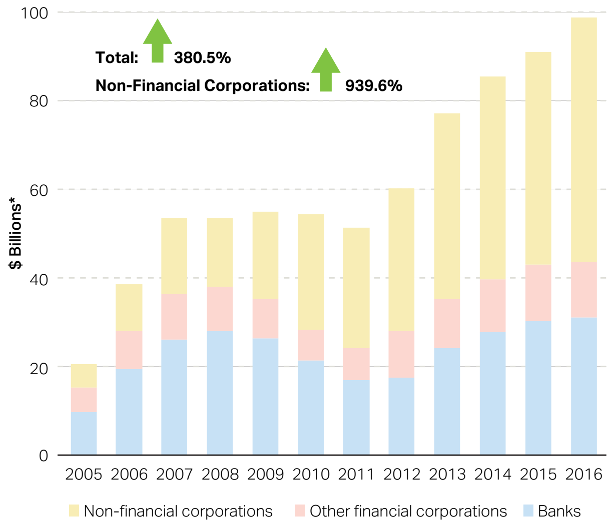
By DAVID BILLINGTON *and* CARLO DE VITO PISCICELLI



European high yield bond issuance over the last 10 years has grown enormously, maturing into a market that has proved more resilient to volatility than many expected. There are a number of reasons for this, not least the ECB's bond buying programme which has driven yields down and encouraged investors to look at riskier asset groups in the search for returns.

The maturation of the European high yield market in a low-yield macro environment has, in turn, encouraged large numbers of overseas companies to sell bonds in Europe. Many of those companies are based in (or have businesses in) emerging market jurisdictions. Many issued bonds when the commodities boom seemed set to continue indefinitely.

Developing Markets Private Sector Aggregate Euro-Denominated Bonds Outstanding: 2005-2016



Source: Bank for International Settlements. Data reflects total Euro-denominated bond debt outstanding as of Q4, except 2016 for which data is only available as of Q2.

*Figures reflect total Euro-denominated bonds, expressed in $USD based on prevailing exchange rate.

The slowdown in China at the start of 2016 has led the issuers of many of these bonds to look at their terms in a new light. How can the issuer negotiate a restructuring with a disparate group of creditors whose identity can often be difficult to establish, when cash reserves may be getting low? This article sets out the key challenges of restructuring emerging market high yield bonds from an issuer's perspective.

Timing is everything

One of the great advantages of a high yield bond over a syndicated loan is that high yield bonds don't typically contain 'maintenance' financial covenants. That means the financial performance of the issuer's business is not subject to any minimum or maximum levels below or above which the bondholders can call a default. The financial covenants in a high yield bond are only tested at the time the issuer takes certain steps (for example, paying a dividend or incurring more debt). Assuming the issuer doesn't need or want to take any of the steps that would trigger the covenant test, when should it approach bondholders if it wants to negotiate a restructuring?

Key variables affecting timing of issuer's approach of its bondholders:

1. **If it ain't broke, don't fix it.** Absent an impending default, bondholders may be unwilling to engage in a restructuring discussion with the issuer, even if they know the capital structure is unsustainable in the long term. So there usually needs to be some impending trigger point in order to convince bondholders that action is required. That said, in most circumstances it is usually better to negotiate a restructuring before a default actually occurs[1], so discussions should ideally start whilst a default is on the horizon but not imminent.

2. **Defaults and Cross-Defaults.** Without maintenance financial covenants, the most likely trigger point under the bond terms would be either a failure by the issuer to pay the coupon when due, or (if the issuer has other debt owed to third parties) a cross default. Most high yield bonds will allow for a 30-day grace period for missed coupon payments, but that is unlikely to be a sufficient time period to identify and negotiate a deal with bondholders from scratch. Cross default provisions in high yield bonds tend to require the relevant creditor to have accelerated their debt, and will usually have fairly large 'de minimis' exceptions. But there could be a 'domino effect' if a default under a small piece of debt is sufficient to trip a cross-default in a larger piece of debt that is big enough to trip the cross default in the bonds.

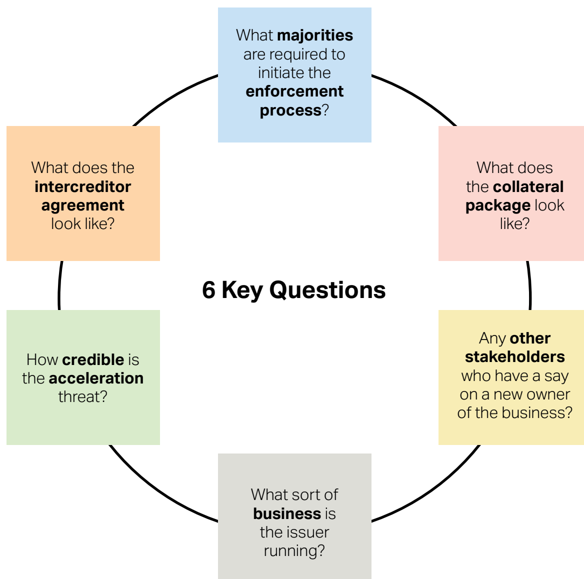
→ *Engaging with the creditors at an early stage is critical, and may well be a legal duty for the board of directors of the issuer. If distress is on the horizon, issuers should seek advice from legal and financial advisors and work out a clear timetable, working backwards from the date on which a trigger point could occur.*

What power do the bondholders really have?

Before engaging in a restructuring negotiation with bond-holders, it is important for an issuer to know the strength of its bargaining position. As noted above, there is often a perception that once an event of default has occurred, all the power lies with the bondholders and the issuer will have to take whatever deal it can get. In our experience, that is not always the case.

Before engaging with bondholders, the issuer and its advisors should conduct a thorough default analysis, to establish precisely what action can be taken, when, and by whom. Often the bondholders' position is not as strong as it initially appears. The following factors need careful examination:

— First, what are the majorities required for bondholders to initiate an enforcement process? Typically in European high yield bonds the holder of 25% of the bonds can accelerate (and more than 50% can rescind an acceleration), but often a majority is required in order to enforce security, if any. If the security is shared with other creditors (e.g. lenders under credit facilities) who is entitled to direct the enforcement? If they do, is it likely that those majorities can be brought together from the disparate group of bondholders and agree on an enforcement strategy? Will they have to indemnify the bond trustee or security trustee before action can be taken?



— Secondly, what does the collateral package, if any, look like? Invariably a creditor would want to sell the entire business as a going concern rather than pick off individual assets—is there a share pledge at the holdco level? If so, what is the law governing that pledge? Is it easy to enforce share pledges in that jurisdiction and within what period of time? Does the court need to be involved? Will the pledged shares have to be sold to a third party via an auction or other competitive process? Are there likely to be any interested bidders? Are there regulatory requirements limiting the number of possible bidders?

— Thirdly, if the bonds are unsecured, such that the only remedy of the bondholders is to accelerate the principal and sue for payment, how credible is the acceleration threat? How easily will a judgment issued by the English courts be enforced in the emerging market jurisdiction where the assets are located? Will the directors of the issuer (or any of the guarantors) feel compelled to file for insolvency? If they do, what are the consequences and how will this affect the bondholders position and security enforcement process? Are there significant contingent liabilities (e.g. performance bonds, unsubordinated intercompany debt, severance payments) that would become due in this event and, if so, how do they rank compared to the bonds?

— Fourthly, what sort of business is the issuer running? Does it require skilled and experienced management? Does the existing management have special expertise or relationships with customers, suppliers or other stakeholders (see next bullet) that are difficult to replace? What about the existing shareholder—is their involvement critical to the business?

— Fifthly, are there any other stakeholders who could make life difficult for a new owner of the business? In some jurisdictions the issuer will need a licence to conduct its business (especially if it is a mining company) and sometimes its entire business will depend on a concession it holds to exploit certain natural resources (as in the case of an oil drilling company). Would the relevant government be receptive to a change in ownership, or could it revoke the licence or concession? Does the licence or concession revoke (perhaps automatically?) if the issuer were to enter an insolvency proceeding? Are there other relationships that the existing shareholders have with the government that would make it difficult for the bondholders to enforce their security and either run or sell the business? Can capital controls be imposed which will prevent or delay repatriation of the funds? Are there restrictions on foreign investment in the relevant jurisdictions?

— Sixthly, if the bonds are junior to other debt, does the intercreditor agreement permit the reimbursement of fees of advisors to a committee of the bondholders' during negotiations (see below)?

→ *Working out the true commercial position (not just the legal position) is the key here. If the bondholders are unlikely to want to exercise their legal rights to enforce they will be much more likely to take a reasonable approach in any negotiation.*

We need to talk

Once the issuer has established the negotiating power of the bondholders, the next step is to initiate a discussion with them. That is often easier said than done.

In most cases, there will only be one 'official' or registered bondholder of a high yield bond—the common depository which holds a physical bond for the clearing systems[2]. The holders of beneficial interests in that bond will have their interests shown in individual accounts with the clearing systems (or, more often, in the accounts of intermediaries such as broker dealers etc, which may be several levels below the clearing system). There are a couple of ways of finding out who the beneficial owners are:

— have the issuer publish a press release asking the holders of beneficial interests in the bonds to make themselves known to the issuer's advisors; or

— hire an information agent, who can work with the clearing systems to identify bondholders.

Once the ultimate bondholders have identified themselves, they need to decide which of them will take an active role in negotiating the deal. Sometimes a formal committee of bondholders is appointed, with a detailed appointment letter setting out the committee's role, an indemnity and an agreement from the issuer to pay the costs of the committee's advisors. In other cases, the committee is formed ad-hoc without a formal appointment, and the issuer will enter into arrangements directly with the committee's advisors regarding payment of costs.

➔ *In both situations, the key is ensuring that the committee represents a sufficiently large proportion of the bondholders for them to be able to negotiate a deal that has a good chance of being approved by the broader bondholder group. The ability to terminate the discussions (and the obligation to pay the committee's advisors) if the committee's holdings fall below a certain level is crucial. The issuer needs to know it is talking to the right people.*

Information flows

Now that the committee has been formed and their advisors have been appointed the negotiation can start, right? When restructuring publicly listed securities, it is not as simple as that. If the bondholders receives any inside information during the course of the negotiation, they will be restricted from trading their bonds until that information is made public. But how can they negotiate a restructuring proposal without receiving inside information?

This catch 22 situation is typically resolved by having the committee's legal and financial advisors conduct due diligence and pre-negotiate a restructuring deal (based on their understanding of the interests of the bondholders and any general guidance they have received initially), at least until a short 'go-private' period during which the bondholders themselves are brought in. Each bondholder and the issuer will sign a confidentiality agreement which has a 'cleansing' mechanic.

That mechanic will require the issuer to make public (or "cleanse") any inside information that is provided to the bondholders after the 'go-private' period has ended (whether or not a restructuring deal is agreed). So care should be taken to ensure that only information which the issuer is happy to publish will be made available to the committee during the negotiation phase. If a deal is agreed, the committee and the issuer would usually sign a lock up agreement whereby they agree to support the transaction and take whatever steps the agreed implementation method requires (as to which, see below). The lock up agreement will also:

— prevent the consenting bondholders from selling their bonds, except to another bondholder that has signed the lock up agreement; and

— contain a 'standstill' provision, whereby the consenting bondholders agree not to take enforcement action in respect of any existing defaults, or any that would be caused by implementing the deal. They also agree to rescind any enforcement action taken by other bondholders (to the extent possible). This is why it is critical to ensure that the committee represents a sufficient majority of the bonds to make the standstill meaningful.

At the same time, the terms of the agreed deal are announced publicly along with the other inside information that the committee has received, and the parties move to the implementation phase of the transaction.

➔ *These procedures are typically sufficient to satisfy European and U.S. securities laws but care should be taken to ensure they do not run afoul of more stringent insider trading laws of the jurisdiction of the issuer or policies of local securities regulators who may be less familiar with international restructuring practices.*

How do you implement a deal?

There are a number of options here. Which method is chosen is entirely dependent on what the deal is and the corporate and capital structure of the issuer's group. The basic goal of any implementation method is to ensure that the agreed deal is imposed on all of the bondholders, even if they are not in favour.

Consensual Amendment	The terms of most bonds will have built in to them a cram-down procedure in the 'collective action clause'—the clause that sets out how amendments can be made to the indenture or trust deed. In most emerging markets high yield bonds the non-fundamental terms can be amended with the support of a simple majority of bondholders. But in a restructuring the changes are likely to affect the fundamental terms—principal amount, interest, maturity. Those terms are subject to a higher threshold—often **90% in New York law** governed bonds issued by a non-U.S. company, and **75% in English law** governed bonds. — English law governed bonds tend to provide for amendments to be made by bondholder meetings with quorum requirements, which can alter the voting dynamics if there is a low turnout. — New York law governed bonds often provide for a more straightforward consent solicitation process without quorum. In both cases bonds held by the issuer or its affiliates will likely not count in the vote.
Exchange offer and exit consent	This is where the issuer offers new bonds (with the amended terms) and possibly some cash in exchange for the existing bonds. Often the existing holders are encouraged to tender their bonds by a combination of carrots and sticks, where the carrots can consist of a higher interest coupon and/or a more senior ranking in the capital structure for the new bonds, and the sticks an impairment of the terms of the existing bonds (which impairment is implemented by coupling the offer with an 'exit consent', whereby tendering bondholders are deemed to vote in favour of a set of amendments to the terms of the existing bonds). Failure to tender in the exchange could thus leave a holder with a bond that has basically no covenant protection, is effectively subordinated to the new bonds, has a reduced principal amount and/or only accrues PIK interest[3]. A couple of issues: — It is unlikely that 100% of the holders will tender, so there will be a 'stub' of holders with the old bonds. Even though the covenants may have been stripped from those old bonds, the rights to interest and principal may remain in place, leading to cash leakage until the old bond matures. — If another restructuring is required at some point in the future, you would have 2 classes of creditors, which can make a scheme of arrangement (see below) more challenging.
Scheme of arrangement	A scheme is an English court-based process which allows a restructuring to be imposed on all creditors in a class if at least 75% by value and a majority in number of the creditors in that class vote in favour. Schemes can be used by English companies and, crucially, foreign companies with a 'sufficient connection' to England. Sufficient connection is not the same thing as centre of main interests (or 'COMI'), and has been established in some cases simply by having the main debt documents governed by English law. The courts have even allowed companies with foreign law governed debt documents to change the governing law to English[4] in order to establish jurisdiction for a scheme. At the time of writing the English courts seem to be stepping back somewhat from the expansive jurisdiction they have established in recent years, but it should still be viewed as a viable option for consideration in most emerging market restructurings where the laws of the jurisdiction of the issuer do not have their own cram down procedures.

Chapter 11	Chapter 11 of the U.S. Bankruptcy Code provides a robust framework to facilitate the orderly restructuring of a debtor's affairs. As a threshold matter, in order to be eligible for Chapter 11, a debtor need not be US-based or even maintain operations in the US; the Code merely requires "a domicile, a place of business, or property in the US." Courts have interpreted this standard broadly—particularly with respect to property, which has been held to include bank accounts and New York law governed debt. Chapter 11 offers a number of distinctive advantages for debtors as well as creditors: — offers significant optionality with respect to timing; for instance, if speed is the priority, a so-called "pre-packaged" plan can become effective in as little as 45-60 days. — allows management to remain in control of the debtor's operations during the process—which, for some companies, may be operationally or otherwise crucial. — facilitates financing options during the bankruptcy process through Debtor-in-Possession ("DIP") financing, which, with Bankruptcy Court approval, provides DIP lenders structural priority in exchange for the risk. — is a well-established framework that offers all stakeholders a significant amount of clarity regarding the procedural dynamics as well as their relative positions and corresponding expectations.
Chapter 15	Chapter 15 of the U.S. Bankruptcy Code provides foreign debtors an opportunity to harmonize otherwise disjointed restructurings by granting access to US Bankruptcy Courts for the purpose of recognizing and enforcing foreign restructurings through the U.S. courts. A gateway requirement with respect to chapter 15 is recognition of a foreign proceeding, which is granted to a debtor's foreign representative, rather than the debtor itself. Once the foreign proceeding is recognized, the chapter 15 proceeding serves as an ancillary proceeding to further the foreign insolvency proceeding as it relates to US-based assets and claims. U.S. courts have at times reached different conclusions regarding whether the threshold requirements for Chapter 15 should be the same as those for Chapter 11 eligibility; however, for practical purposes, the standard is quite broad.
Local insolvency proceeding	As more and more countries adopt bankruptcy laws designed to facilitate the going-concern restructuring of businesses through in-court proceedings (more or less inspired by the Chapter 11 of the U.S. Bankruptcy Code), an additional option may be to take advantage of those proceedings in order to extend the deal to non-consenting creditors. Typical issues that need to be analysed in this context include: — can the local proceedings be used to restructure the issuer group as a whole or do they need to be implemented on an entity by entity basis? — will the local proceeding be effective to restructure guarantees issued by entities outside of the issuer's home jurisdiction? — will those proceedings be recognized outside of the home jurisdiction to prevent creditors attaching assets of the issuer located elsewhere? — How will bondholders vote in those proceedings? Will their vote be taken into account individually or will the trustee vote 100% of the principal of the bonds in accordance with the instructions given by a majority of them?

1. The reason is that once a default has occurred, the balance of power tips in favour of the bondholders—they will usually have the ability to accelerate the principal amount of the bonds and enforce any security, if any. But accelerating and enforcing may not be that attractive to the bondholders in every case, which can affect the negotiating dynamics—see *'What power do the bondholders really have'* below.
2. In some cases there may be two common depositaries if the bonds have been sold into both Europe and the U.S.
3. Usually high yield bonds are governed by New York law. However if you have English law bonds, care should be taken when structuring an exit consent as the courts have raised questions about whether such coercive tactics could be deemed to infringe the rights of the dissenting minority—see 'Exit Consents in Restructurings—Still a Viable Option?' which is available at https://www.clearygottlieb.com/news-and-insights/publication-listing/exit-consents-in-restructurings-still-a-viable-option33
4. Change of governing law is often not a fundamental amendment so can be achieved with a simple majority.

▼ **David J. Billington** is a partner at Cleary Gottlieb Steen & Hamilton LLP based in the firm's London office. Mr. Billington's practice focuses on international financing transactions and restructuring transactions. He has experience across a broad range of debt financing products, advising both borrowers and lenders on bank lending, leveraged finance transactions, high yield bonds and structured debt. David also acts for a range of stakeholders in international restructuring and insolvency matters. Recent representations include Truvo, Silver Point Capital, TPG and CVC. He received a B.A. from the University of Cambridge in 1999 and a degree from Nottingham Law School in 2000.

▼ **Carlo de Vito Piscicelli** is a partner at Cleary Gottlieb Steen & Hamilton LLP based in the firm's London and Milan offices. Mr. de Vito Piscicelli's practice focuses on leveraged finance and restructuring matters and he advises clients globally on a wide variety of loan facilities, high-yield notes and related derivatives transactions. Recent representations include the Agrati Group, TPG, Warburg Pincus and Rosneft Oil Company. He received an LL.B. from the Università degli Studi di Milano in 1996 and an LL.M. from Harvard Law School in 2000.

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

Judicial Restructuring of the Year (Casas GEO restructuring)
Turnaround Atlas Awards, 2016

Restructuring Team of the Year
International Financial Law Review, 2015–2016

Restructuring Deal of the Year
Corporación GEO; Tonon Bioenergia
International Financial Law Review, 2016

Restructuring Deal of the Year
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International Financial Law Review, 2015

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Turnarounds & Workouts, 2014

Mega Company Transaction of the Year
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Turnaround Management Association, 2013

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American Roads' prepackaged bankruptcy
Turnarounds & Workouts, 2013

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