AMERICAS
RESTRUCTURING REVIEW 2024

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Edited by Richard J Cooper and Lisa M Schweitzer

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Preface

Welcome to *The Americas Restructuring Review 2024*, one of Global Restructuring Review's annual, yearbook-style reports.

Global Restructuring Review, for anyone new, is the online home for international restructuring specialists everywhere. We tell them all they need to know about everything that matters in their chosen professional niche.

Throughout the year, the GRR editorial team sends subscribers daily news about cross-border restructuring and related topics, along with surveys and longer reads; organises the liveliest events (under our GRR Live banner); and curates a series of innovative tools and know-how products, such as our GRR recognitions dataset. In addition, assisted by external contributors, we publish a set of comprehensive regional reviews that delve deeper into developments than the exigencies of journalism allow.

The Americas Restructuring Review, which you are reading, is part of that series. As its name suggests, it delivers insight and thought leadership from 43 pre-eminent practitioners from both American continents.

Its 167 pages and 12 chapters are part retrospective, part primer, part crystal ball and 100 per cent worth your time. All contributors are vetted for their standing and knowledge before being invited to participate. And contributions are all supported by abundant footnotes and relevant statistics.

This edition covers Bermuda, the British Virgin Islands, the Cayman Islands, Chile, the Dominican Republic, the European Union, Mexico and the United States.

As always with these annual reviews, a close read yields many gems. With interest rates and inflation universally high, and a number of industries struggling, that seems especially true; this book has seldom been so timely. Among the nuggets mentally filed away by this reader:

- restructuring is flavour of the month everywhere;
- the US market for debtor-in-possession finance is *so* competitive;
- that market for capital solutions is also breaking out in Europe – but not everything from the US maps across easily (there are key state-by-state differences);
- the use of 'provisional liquidators' as a restructuring tool, which became so prevalent in the offshore world for a while, in fact originated in England in the 1990s (as a workaround for insurance companies who couldn't use 'administration';
- of Europe's emerging restructuring regimes, Spain comes closest to the US on DIP finance; and

- the jury is still out on whether any EU companies have forgone Chapter 11 now there are EU options – but they may have.

And much, much more. We hope you enjoy *The Americas Restructuring Review*. If you have any suggestions for future editions, or want to take part in this annual project, my colleagues and I would love to hear from you. Please write to insight@globalrestructuringreview.com.

My thanks to all of our authors, and to Richard J Cooper and GRR editorial board member Lisa M Schweitzer, this review's editors, for steering us so well.

David Samuels
Publisher, Global Restructuring Review
November 2023

Introduction

Richard J Cooper and **Lisa M Schweitzer**

Cleary Gottlieb Steen & Hamilton LLP

Despite many predictions that the covid-19 pandemic would spark a wave of pandemic-related bankruptcies in 2021 and 2022, such a wave never fully materialised. Many companies managed through the pandemic, likely due in part, at least, to robust pandemic-era government programmes, creditors' forbearance and low-cost liquidity.

But as pandemic-era aid has waned, the tides have changed. The war in Ukraine continues to impact the cost of energy, metal and other commodities in Europe in particular, other ongoing geopolitical conflicts continue to create instability in the global economy, the widespread and persistent rise in inflation and the corresponding rise in interest rates has continued to put significant stress on companies that are highly leveraged, hold floating-rate debt, or need to raise new financing, and tightening financial conditions have made liquidity more difficult to come by. In addition, many companies have engaged in liability management transactions that have provided additional short-term liquidity, but not all have been able to avoid a subsequent bankruptcy filing.

Under these conditions, the past year has seen a significant increase in corporate bankruptcy filings. The financial sectors in particular faced distress with the failure of Silicon Valley Bank earlier this year, and many companies and individuals have been impacted by the wave of bankruptcy filings among cryptocurrency companies. Additionally, many companies in the healthcare and tech space have failed in the past year, unable to bring their new products successfully to market or to do so profitably. Other consumer businesses also continue to experience distress.

In the face of these various economic challenges, however, insolvency regimes and restructuring professionals continue to evolve to meet the changing needs of distressed companies and to craft creative solutions to novel issues arising in restructuring cases. This volume includes chapters written by experienced bankruptcy practitioners discussing insolvency regimes around the world. These chapters include, among other things, comparative analyses of different jurisdictions, an overview of new developments in domestic bankruptcy legislation, and noteworthy trends and developments in restructuring proceedings. These chapters also include insights into trends in the restructuring space that may

continue in the coming year as the global economy navigates the long-term effects of the pandemic and evolving geopolitical developments.

Insolvency regimes continue to advance and modernise to better meet the needs of companies pursuing restructuring solutions

As discussed in various chapters throughout this volume, domestic insolvency regimes continue to advance and modernise to meet the evolving needs of distressed companies. Increasing flexibility and promoting reorganisation, where possible, are the common themes among these changes, as jurisdictions recognise a benefit to providing restructuring companies with more ability to customise their proceedings to better suit their needs and preserving businesses where feasible to do so. The Mexico chapter, for example, outlines how the Concurso law allows for companies to use interim injunctions as tool that they can tailor to address their operational needs during a restructuring. Similarly, the Cayman Islands chapter discusses several discrete changes to the Cayman Islands' restructuring regime – including allowing for the appointment of a dedicated restructuring officer and providing companies the ability to present their own petition for the appointment of restructuring officers – that mark incremental improvements to and allow flexibility in the restructuring process. European Union (EU) member states have also implemented changes geared towards improving restructuring proceedings. As the chapter titled 'The EU Adaption of Important Chapter 11 Provisions' notes, EU member states have been updating their respective insolvency regimes in compliance with the EU's July 2019 Directive on Insolvency, Restructuring, and Second Chance (the Directive), which incorporates certain mechanisms of Chapter 11 to facilitate the needs of companies seeking to restructure.

Many of the modifications adopted by insolvency regimes in recent years also recognise the need to balance the at times divergent interests of both distressed companies and their stakeholders, implementing changes that provide increased protections and benefits for both. The Chile chapter, for instance, discusses the recent changes that Chile adopted to its restructuring regime, effective August 2023, which seek to provide better protections to both distressed companies and their stakeholders. To the benefit of debtors, the changes extend the automatic stay from 30 to 60 business days as a matter of default, and allow the debtor to seek to further extend the stay by up to 60 additional days with a certain level of creditor support. On the other hand, the changes allow creditors that the debtor may not identify as such and that did not file a proof of claim in the restructuring proceedings to file a motion requesting that the reorganisation plan apply to them once approved.

Even absent the formal adoption of changes to a jurisdiction's restructuring regime, practitioners and professionals working in the restructuring space move regimes forward by implementing creative solutions within the confines

of existing law. Practitioners are, after all, in a position to see trends and legal gaps as they develop through their practice, and they must be attuned and responsive to the evolving needs of their clients. The Bermuda chapter provides an example: the authors note that while Bermuda's Companies Act 1981 does not provide for expedited reorganisation proceedings, as a matter of practice, professionals may informally negotiate a pre-packaged arrangement with a liquidator prior to his or her appointment. Practitioners are often implementing practical, work-around solutions of this sort to best serve their clients' needs.

While changes and advancements to insolvency regimes are often signs of progress, implementing new rules in practice is not without its difficulties. Restructuring courts can disagree as to how to properly apply new legislation, leading to gaps or conflicts in case law and confusion among restructuring companies, a problem discussed generally in the Dominican Republic chapter. Specialised courts provide one remedy to addressing this issue. Indeed, in the Dominican Republic chapter, the authors note that specialised restructuring courts have leveraged their jurisdictional authority and have created precedents to create a more stable and consistent foundation of case law.

Restructuring regimes continue to adapt to address the unique and complex issues presented in cross-border insolvencies

As companies continue to expand their global reach, insolvency proceedings implicating the laws of multiple jurisdictions or involving parallel proceedings become increasingly common. Advancements in domestic insolvency regimes often have the benefit of creating more cohesion and consistency in insolvency legislation across jurisdictions, which can be beneficial in complex, cross-border corporate restructurings. In the case of the recent updates to insolvency regimes of EU members states, for example, 'The EU Adaption of Important Chapter 11 Provisions' chapter notes that the UK, despite having formally left the EU, still largely modelled the 2020 changes to its restructuring laws on the EU's Directive to maintain consistency with the EU's restructuring regime.

Despite the many ways in which insolvency regimes have become increasingly more consistent and cooperative across jurisdictions, tensions between the laws of different jurisdictions in which a company seeking to restructure operates of holds assets remain an issue for corporations seeking a global restructuring resolution that implicates the laws of multiple different jurisdictions. The *Gibbs* rule, a judicial doctrine in the UK providing that contracts and obligations can only be discharged pursuant to the laws governing that contract or obligation, has highlighted these tensions in recent years. The rule, in effect, means that a debtor's obligations governed by English law can generally only be extinguished through an English proceeding, which may create unwanted complications for entities that wish seek to restructure in a particular jurisdiction outside of England, but have obligations governed by English law. Among other complications, the *Gibbs* rule may require these entities to initiate parallel proceedings multiple jurisdictions to effectively discharge all of its obligations. The chapter titled 'The

Implications of the Rule in *Gibbs* on the Effectiveness of Schemes of Arrangement to Compromise US Law-Governed Debt' illustrates another such complication. Hong Kong also applies the *Gibbs* rule, and, as the chapter discusses, a Hong Kong court in the *In Re Rare Earth* case recently posited that it could refuse to recognise an offshore scheme of arrangement designed to compromise debt governed by United States law on the ground that the United States would not recognise the discharge of the debt as a matter of law through the scheme of arrangement and Chapter 15 recognition. A United States Bankruptcy Court subsequently made clear that the Hong Kong court's reasoning misinterpreted United States law in *In re Modern Land*, but the case nonetheless demonstrates how the potential tensions between the regimes in various jurisdictions may complicate or jeopardise a company's restructuring efforts.

Recent trends in restructuring cases

The chapters in this volume also highlight jurisdiction-specific practice and market trends that are impacting the landscape of corporate restructurings in those jurisdictions. Some chapters highlight in particular the role that practitioners and lenders in the restructuring space play in influencing such trends through their creative problem-solving. As discussed in the chapter titled 'Investment Fund Activity in US Debt Restructurings', for example, the increasing involvement of investment funds in US restructurings has led to an increase in fast, out-of-court 'liability management' restructurings and pre-packaged Chapter 11 cases. The increasing use of debtor-in-possession (DIP) financing structured in a non-traditional fashion, discussed in the chapter titled 'Recent Developments in DIP Financing for International and Domestic Debtors', is but another example. The chapter discusses the increasing use of 'roll-ups', whereby a DIP lenders' pre-petition debt may be repaid by the proceeds of the DIP financing or rolled into DIP obligations, and equity conversions, whereby DIP obligations remaining at the end of the debtor's Chapter 11 case convert into equity of the reorganised company rather than requiring repayment in full. These DIP structures may be particularly attractive to restructuring companies experiencing liquidity issues in the aftermath of the pandemic, for example, and provide practitioners with a wider variety of tools to use in addressing a restructuring company's need for post-petition funding. The 'Investment Fund Activity in US Debt Restructurings' chapter does the same, highlighting the increasingly prominent role that private equity and hedge funds are playing in Chapter 11 restructurings in the United States, particularly during periods of economic crises when more traditional lenders may be unwilling to invest in distressed companies, and the creative investment strategies employed by such funds. Investment funds' flexible approach to lending allows them to respond quickly to economic fluctuations and adapt to meet the needs of restructuring companies as they change in response. Similarly, the 'Capital Solutions Financings: Yield Driving Structure' chapter discusses the increasingly common and important role that credit solution transactions play in providing financing solutions to distressed companies. Other chapters focus on debtor-side trends.

The British Virgin Islands chapter, for example, discusses the increasing use of schemes of arrangement and light touch provisional liquidations following legislative changes adopted several years ago that allow for the appointment of provisional liquidators.

This volume provides an informative and interesting overview of recent developments in insolvency regimes across jurisdictions, current practice and market trends, and the present economic challenges facing companies, practitioners, and lenders. A common theme emerging from these chapters, however, is the tendency of insolvency regimes, restructuring practitioners, lenders, and debtors to adapt to meet the evolving needs of restructuring companies. As the number of companies initiating insolvency proceedings and seeking to restructure increases in the face of economic turbulence, the current climate is likely to continue demanding flexibility and adaptability from the insolvency world. Insolvency professionals, courts, debtors and lenders seem equipped to rise to the occasion.

Richard J Cooper

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Richard Cooper's practice focuses on domestic and international restructurings. He has advised clients involved in some of the most prominent and noteworthy restructurings in the United States and Latin America over the past two decades.

Rich is recognised as one of the leading restructuring lawyers in the United States and the 'go-to' person for cross-border restructurings. Rich was part of the Cleary team that represented the US Treasury in its financial assistance programme to US air carriers, and the Canadian government in connection with its financial assistance efforts to large public and private companies. He represented Garuda Airlines, the state-owned Indonesian airline, in its restructuring process and has represented the governments of Puerto Rico, Mexico, Lebanon, Indonesia and Colombia in restructuring and liability management matters.

Among others, Rich's matters include representation of LATAM Airlines as debtors, Apollo Capital as DIP lender (and various creditors) to Grupo Aeroméxico, in their respective restructurings under Chapter 11, ad hoc creditor committees in the Chapter 11 proceedings of Stoneway Capital and the DIP lenders and ad hoc creditor committee in Alphacredit, and Grupo Posados, one of the region's largest hotel and resort companies, in its pre-packaged Chapter 11 proceeding.

He received a JD from Columbia Law School, an MSc from the University of London, and a BA from Duke University.

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Lisa Schweitzer's practice focuses on financial restructuring, bankruptcy and commercial litigation, including cross-border matters.

Lisa has served as lead counsel in some of the world's most high-profile bankruptcy matters, advising corporate debtors, creditors, strategic investors and counterparties in US Chapter 11 proceedings as well as in restructurings and risk mitigation advice. Lisa regularly advises parties in financings, sales, and in-court and out-of-court restructurings, as well as multibillion-dollar litigation disputes.

Lisa's recent representations include LATAM Airlines in its voluntary reorganisation and Chapter 11 restructuring of over US$7 billion of debt; Vale in its heavily contested litigation of recognition of BSGR's Guernsey administration through a Chapter 15 proceeding; FullBeauty Brands in its acquisition of Ascena's branded e-commerce business; Total SA as a major contract counterparty in the McDermott bankruptcy; and strategic lenders, creditors and acquirers in various retail cases.

Lisa has also provided strategic advice to several Fortune 100 US and multinational companies on liquidity and restructuring advice arising from the covid-19 pandemic as well as several leading financing institutions in matters relating to their resolution plans.

Lisa received a JD from New York University School of Law and a BA, *magna cum laude*, from the University of Pennsylvania.

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Bermuda: Insolvency in a Consistently Reliable Restructuring Jurisdiction

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Appleby

In summary

This article discusses the defining features of Bermuda's insolvency landscape and the primary insolvency and rescue procedures available under Bermudian law, including compulsory liquidations and schemes of arrangements. The restructuring of Noble Group Limited is presented as a case study, to illustrate the use of provisional liquidation to facilitate a restructuring via a scheme of arrangement. The article also reviews the role of Bermuda's courts in cross-border insolvencies and the creditor-friendly nature of the insolvency regime in Bermuda.

Discussion points

- The importance of provisional liquidation
- The benefit of a statutory stay
- A creditor-friendly jurisdiction
- Cross-border cooperation and its limits

Referenced in this article

- The Companies Act 1981, Part XIII
- The Companies (Winding Up) Rules 1982
- The Bankruptcy Act 1989
- The Segregated Accounts Companies Act 2000
- *Z-OBEE Holdings Ltd*
- Noble Group Limited restructuring

Legal framework

Bermuda is an overseas territory of the United Kingdom, and its legal system is based on the English common law comprising statute and case law. Bermuda has developed its own body of common law and statutes, and this has been influenced by several jurisdictions including England, Canada, Australia and New Zealand. Decisions of the English courts are not binding on a Bermudian court, although they are highly persuasive. The decisions of the Privy Council, however, are generally binding on Bermudian courts, unless they are based on a reference from a jurisdiction with considerably different statutory provisions and policies. The Privy Council is Bermuda's highest appellate court and sits in London.

Bermuda's insolvency landscape

The principal statutory provisions[1] governing corporate insolvency and restructuring are contained in Part XIII of the Companies Act 1981 (the Companies Act) and are supported by the Companies (Winding-Up) Rules 1982 (the Winding-Up Rules). The Companies Act is based on the English Companies Act 1948 and the Companies Winding-Up Rules are based on the English Companies (Winding-Up) Rules 1949.[2] No substantive changes have been made to Part XIII of the Companies Act and the Winding-Up Rules since they were enacted, although there have been minor amendments.

At the heart of Bermuda insolvency law is the principle of *pari passu* treatment of unsecured creditors (ie, where the company does not have sufficient assets to satisfy its debts to unsecured creditors, each unsecured creditor would receive an equal distribution on a rateable basis according to the quantum of their claim).[3] Secured creditors are unaffected by insolvency proceedings in Bermuda and may enforce their security in accordance with the terms of the governing security instrument[4] (although they have standing to present winding-up petitions).

A key feature of Bermuda insolvency law is that the Companies Act provides the ability to challenge certain transactions executed by insolvent companies through avoidance or clawback provisions. This includes the avoidance of preferential payments to creditors and transactions at an undervalue. The Companies Act also provides remedies for fraudulent trading and dispositions of company property after the commencement of the winding-up.

1 Certain provisions within the Bankruptcy Act 1989 apply to companies under section 235 of the Companies Act.
2 English insolvency law has been reformed significantly since the English Companies Act 1948 and the Companies (Winding-Up) Rules 1949.
3 In certain circumstances, employees may have a preferential status.
4 The stay of proceedings that occurs when a winding-up order is made does not prevent secured creditors from exercising their rights under validly created security.

Corporate insolvency and rescue procedures

The primary insolvency and rescue procedures available under Bermudian law are:

- liquidation under the supervision of the court, commonly referenced as 'compulsory liquidation' or 'compulsory winding-up';
- provisional liquidation for the purpose of restructuring; and
- schemes of arrangement.

Bankruptcy procedures are relevant in the context of insolvent funds and individual insolvencies. The remedy of receivership is an important mechanism used when a segregated accounts company is insolvent.

Compulsory liquidation

Typically, a creditor seeking to place a debtor company into liquidation in Bermuda will apply to the court seeking such relief on the grounds the company is unable to pay its debts or that it is just and equitable for the company to be wound up. Compulsory winding-up proceedings can be commenced by any one or more of the following:

- the company itself;
- creditors, including any contingent or prospective creditors;[5]
- contributories, subject to certain restrictions; and
- the Bermuda Monetary Authority (or the applicable regulator).

Winding-up proceedings are commenced by filing a winding-up petition with the Supreme Court of Bermuda, which is supported by a standard form affidavit verifying the contents of the petition. It is common for the petitioner to annex to the petition documentary evidence of the underlying debt, although this is not strictly necessary. Once the court fixes a date for the hearing of the petition, the petition must be served on the company at its registered office. Before the hearing of the petition, the petitioner must file a certificate of compliance with the Registrar of the Supreme Court certifying that the petition has been properly filed, served and advertised in an appointed newspaper and that other procedural rules have been followed.

Anyone intending to appear at the hearing of the petition, including those who wish to oppose the petition, are required to provide advance written notice to the petitioner within a prescribed time frame, failing which they require special leave of the court to appear at the hearing.

5 However, the court will not give a hearing to a winding-up petition presented by a contingent or prospective creditor until security for costs has been given and a prima facie case for winding up has been established.

The court, when considering a winding-up petition, may grant, dismiss or adjourn the petition, or make any other order it thinks fit. If a petition is unopposed, the court may make an immediate winding-up order at the first hearing. If a petition is opposed, the court commonly adjourns the first hearing of the petition to allow the parties to prepare their respective cases. The court may also adjourn a winding-up petition to facilitate a proposed restructuring by the company with the assistance of a court-appointed insolvency practitioner known as a 'provisional liquidator'.

If the court makes a winding-up order (whether at the first hearing or a subsequent hearing), the company's operations will immediately come to an end. The management of the company is taken from the directors and is placed in the hands of a court-appointed liquidator.[6] Liquidators are equipped with a wide array of powers to ensure that the company adheres to a statutory process contained in the Winding-Up Rules. This process is intended to promote a systematic and orderly winding up of the company's affairs.

Provisional liquidation

Provisional liquidation in Bermuda is the appointment of a liquidator other than for the immediate winding up of the company. A provisional liquidator will be nominated by one or more of the parties. The court must accept the credentials of the nominees who, by custom and practice, will be insolvency practitioners.

There are two scenarios where an order for provisional liquidation will be made:

- where there is a prospect of 'rescuing' an insolvent[7] company through restructuring without the displacement of all of the board's executive functions; or
- where it is necessary for the court to appoint an officer to protect and prevent a dissipation of the company's assets in the intervening period between the filing of a petition and the making of a winding-up order.[8]

The second type of appointment given above mirrors the English jurisdiction for appointment of provisional liquidators and, like in England, is one of the most extreme tools at the court's disposal, deployed only in exceptional circumstances.

6 Technically, the liquidator appointed on the making of a winding-up order is a 'provisional' liquidator until their appointment is confirmed by a majority vote at the first meeting of creditors and contributories – which usually takes place within three months of the making of the order. Once a liquidator's appointment is confirmed, they are known as a permanent liquidator.

7 It is not a requirement that the company be insolvent within the strict definitions set out in the Companies Act 1981. A lower level of financial distress will be sufficient.

8 When a winding-up order is made, the liquidator appointed will be a 'provisional liquidator' until confirmed by the first meetings of creditors and contributories; however, in those circumstances, the company is in winding-up and is not in 'provisional liquidation' despite the, perhaps rather confusing, overlap in use of provisional liquidator as a title.

The first type of provisional liquidation is a distinct feature of Bermuda's restructuring landscape. Accordingly, where a company is insolvent, instead of making a winding-up order to liquidate the company, the Bermudian court often appoints provisional liquidators with certain, limited powers, known as 'light-touch' powers.[9] This appointment is by far the most common form of provisional liquidation in Bermuda.

In a light-touch liquidation, a company may continue its business operations as usual, pending the implementation of a restructuring plan. This would normally occur where the court is satisfied that a restructuring will produce a better result than a winding up for creditors. As explained by Kawaley CJ in *Z-OBEE Holdings Ltd* (2017) Bda LR 19:

> *[Section 170 of the Companies Act 1981 (Power of Court to appoint liquidators)] has for almost 20 years been construed as empowering this Court to appoint a provisional liquidator with powers limited to implementing a restructuring rather than displacing the management altogether pending a winding-up of the respondent company.*

The Bermudian court has used provisional liquidation as a tool to restructure the affairs of a company, preserve value in a business and provide a platform for distressed companies to recover – which together promotes the sustainability and success of cross-border business.

A key feature of provisional liquidation is the stay of proceedings against the company triggered by the appointment of provisional liquidators. Creditors are protected, given the independent oversight of provisional liquidators who, as officers of the court, are under a duty to act in the best interests of creditors.

A provisional liquidation may be commenced alone or in combination with another process in Bermuda or abroad, for example, in combination with a US bankruptcy, an English restructuring plan or a Bermudian scheme of arrangement.[10] The combination of restructuring processes in multiple jurisdictions can be a very powerful tool, as demonstrated below in the *Noble Group* case study.

Schemes of arrangement

A scheme of arrangement is the only statutory court-supervised reorganisation procedure in Bermuda, provided for in sections 99 and 100 of the Companies Act. A scheme of arrangement may be initiated by the company, any member or creditor of the company or, where applicable, a liquidator who has been appointed

9 Authority for provisional liquidators with 'light touch' powers is not found in the Companies Act or any other legislation, but rather in Bermuda common law.

10 It is said to be unprecedented for a scheme of arrangement to be promoted by an insolvent company without a concurrent provisional liquidation (per Kawaley CJ at 25 of *Re Up Energy* [2016] BDA LR 94).

in relation to the company. A proposed scheme must represent a compromise or arrangement between the company and its creditors or members, or any classes thereof.

Proceedings are started by applying to the Bermudian court for directions to convene meetings with the various classes of creditors or shareholders who will be affected by the scheme's proposals. Once the meetings have been convened, a further application is made to the court to approve or 'sanction' the scheme.

A class of creditors will be made up of creditors whose interests are sufficiently similar so that they can consult together with a view to their common interest.

Cross-class cramdown of a dissenting class of creditors or members is not permitted in a Bermuda scheme of arrangement. If any single class of affected creditors or members does not approve the scheme of arrangement, the court cannot sanction the scheme.

Each class must approve the scheme by both:

- simple majority (in number) of those present and voting; and
- 75 per cent in value of debt of those present and voting.

This double majority requirement can lead to creditors representing small amounts in value, if sufficient in number, causing the rejection of a scheme. This represents significant minority creditor protection from the imposition of a scheme they consider unfavourable.

Expedited restructurings

The Companies Act does not provide for an expedited reorganisation, such as a reorganisation by way of a pre-pack arrangement. However, as a matter of practice, a reorganisation may be informally negotiated with a liquidator prior to his or her appointment on the informal understanding that the liquidator will approve the pre-negotiated arrangement once appointed. This type of informal arrangement will have a similar effect to a pre-package deal, but the details of the arrangement will be bespoke to the particular circumstances of the case.

Receivership

Receivers are generally appointed by secured creditors pursuant to the terms of a security agreement. The function of the receiver is to realise the relevant secured assets of the company for the benefit of the security holder. Assets of a company that have been validly secured as security for a company's indebtedness are exempted from the claims of creditors in insolvency. On completion of the

receivership, therefore, there can be a winding up of the assets not realised by the receiver for the benefit of the company's unsecured creditors.

There is a separate insolvency regime that applies to segregated accounts companies incorporated in Bermuda under the Segregated Accounts Companies Act 2000 (sometimes referred to as 'protected cell companies' or 'segregated portfolio companies' in other jurisdictions). This regime provides for the appointment of receivers over the segregated accounts (or cells) of the segregated accounts company that are unable to meet their liabilities as they fall due. A liquidator may be appointed over a segregated account company's general account if it is insolvent. There are relatively few statutory rules underpinning this regime when compared to the winding-up regime that applies to limited liability companies incorporated in Bermuda. It is thought that the Bermudian court would model its approach to the winding up of a segregated accounts company on the court's established practice in relation to limited liability companies.

Bankruptcy

Corporate insolvency generally refers to the winding-up regime under Part XIII of the Companies Act and the Winding-Up Rules. Bankruptcy is a term that only applies to individual insolvency and limited partnerships, the latter being the corporate vehicle regularly used for investment funds.

Observations

Creditor-friendly jurisdiction

Each Bermudian court seeks to balance competing interests. On the one hand, the court recognises the importance of promoting a culture of rescue (where possible) and strives to assist companies in financial distress where it can. On the other hand, the court recognises that the interests of creditors are paramount, that an attempted rescue will not always maximise value to creditors and that sophisticated creditors are likely to be best placed to assess what course of action is in their commercial interests. Each Bermudian court is adept at applying the statutory regime with enough flexibility to achieve creditor-friendly results, as demonstrated by the development of the provisional liquidation regime, described above.

Bermudian courts are particularly alert to the realities and complexities of international commerce and will cooperate with courts of foreign jurisdictions where there is a Bermudian connection, for example, the company is incorporated in Bermuda, has assets in Bermuda or does business in Bermuda.

Hallmark of provisional liquidation – Noble Group Limited

The value of provisional liquidation was demonstrated in the widely publicised restructuring of Noble Group Limited in 2018. Noble Group was incorporated in Bermuda and listed on the mainboard of the Singapore Exchange. It was the ultimate holding company of a group of companies that was one of the world's largest commodity traders, with hubs in London, Hong Kong and Singapore. The group managed a portfolio of global supply chains that involved marketing, processing, financing and transporting across the world. The restructuring was highly complicated owing to the very wide range of creditors involved and the global scale of the group's business.

Noble Group experienced grave financial difficulties because of the industry-wide decline in commodity prices between 2014 and 2016. Noble Group's pre-restructuring debt exceeded US$3 billion. To avoid liquidation, the company's directors pursued a financial restructuring based on a debt-for-equity swap and provided for the transfer of Noble Group's assets to newly incorporated subsidiaries of a newly incorporated holding company, New Noble. Noble Group itself was to be dissolved. Scheme creditors were to be issued with new debt instruments and 70 per cent equity in the new group. The remaining equity was to be apportioned, with 20 per cent issued to existing shareholders and 10 per cent issued to existing management. One of the main goals of the scheme was to provide the new group with access to new hedging and trade finance facilities (US$800 million). These facilities were to be provided by a finance creditor, but also by scheme creditors who chose to guarantee the facility in exchange for senior debt instruments.

The company originally sought to achieve the restructuring solely by entering into parallel schemes of arrangement with its creditors (which were governed by both English and Bermudian law processes). Prior to presenting the English scheme of arrangement, which was regarded as the 'lead' scheme, Noble Group took steps to shift its centre of main interests from Hong Kong to England, including by relocating its main office to London from Hong Kong.

The English and Bermuda schemes of arrangement were approved by an overwhelming majority of scheme creditors and were sanctioned by the courts in both jurisdictions. The English scheme was sanctioned on 12 November 2018 and the Bermuda scheme was sanctioned two days later. The US Bankruptcy Court granted recognition of the scheme in the United States, via Chapter 15 of the US Bankruptcy Code, on 15 November 2018. Thereafter, all that remained was for the company's directors to implement the scheme.

Following sanction of the schemes, however, the Singaporean authorities blocked the transfer of Noble Group's listing on the Singapore Exchange to New Noble because of an ongoing investigation of the company and one of its subsidiaries. It was previously anticipated that Noble Group's listing status in Singapore would be transferred to New Noble and the company's directors

had received prior shareholder approvals to pursue the restructuring on this basis. For various reasons – importantly, the stance taken by the Singaporean authorities – the directors were prevented from implementing the scheme in the manner contemplated.

Noble Group's directors consequently pursued its restructuring using liquidation on a light-touch basis. On 14 December 2018, the Bermudian court appointed a provisional liquidator with light-touch powers over Noble Group. The significance of this appointment lies in the fact that the provisional liquidator was not subject to the same constraints faced by the company's directors. His mandate would be solely guided by the best interest of the creditors, while at the same time being subject to the supervision of the court and having the benefit of a stay of proceedings against the company.

In the context of Noble Group, the provisional liquidator was granted sufficient latitude to implement the transfer of the company's assets to the New Noble, provided that the scheme creditors were not prejudiced, even if that meant that the New Noble would no longer have a listing on the Singapore Stock Exchange as previously envisaged. Today, the New Noble is fully operational and the restructuring was a success. Had the Bermudian court not appointed a provisional liquidator, the company would have undergone a compulsory liquidation, its business would have come to an end and creditors would have received a significantly smaller dividend.

Recent developments in provisional liquidation – HSBC v NewOcean

NewOcean Energy Holdings Limited (NewOcean) is a Hong Kong listed, Bermuda incorporated, holding company for businesses in various sectors, including liquefied petroleum gas, real estate and shipping.

In 2020, NewOcean encountered financial difficulties. It owed in excess of US$800 million to a number of banks. NewOcean entered into negotiations with over 30 bank creditors and tried to restructure its debt by way of parallel schemes of arrangement in Hong Kong and Bermuda. Those schemes were ultimately unsuccessful, having failed to win sufficient support of creditors. On 22 October 2021, the Hong Kong and Shanghai Banking Corporation Ltd (HSBC), one of the bank's creditors, presented a petition for NewOcean's winding up.

NewOcean had failed to respond to a statutory demand served by HSBC and so was deemed insolvent. The first default to HSBC was on 2 September 2020, and petition was first heard at the end of 2021; NewOcean was clearly cash-flow insolvent as a matter of fact. NewOcean accepted this in its evidence but claimed that it was balance sheet solvent (ie, that despite its current liquidity issues, the values of its assets exceeded its liabilities).

Relying on this fact, among others, NewOcean applied to adjourn the petition and appoint joint provisional liquidators (JPLs) on a light-touch basis. The court did so, adjourning the petition. The court appointed JPLs on 14 December 2021, and the petition was adjourned on a number of occasions thereafter. The court appointed the petitioning creditor's compulsory liquidator nominees as JPLs instead of the nominees proposed by the company. By the end of March 2022, the extent to which creditor sentiment had hardened against NewOcean was very clear. A total of 64.8 per cent of bank creditors opposed any further adjournment and supported an immediate winding-up order. To secure its restructuring, NewOcean needed 75 per cent of its creditors to approve its proposed scheme.

On 9 May 2022, the petition was adjourned again for reasons given by Mussenden J in a written judgment dated 31 May 2022. In that judgment, the court held that four exceptional circumstances that were relied upon by NewOcean were still in existence:

- NewOcean had come before the court in relation to a scheme previously, showing early engagement with its financial difficulties;
- there was a restructuring plan that could be pursued by NewOcean with the JPLs' assistance;
- as a listed company with a number of licences issued by the Chinese government, an immediate winding-up order would be value destructive; and
- NewOcean was a balance-sheet solvent company praying for a short adjournment to attempt a restructuring.

The 31 May 2022 judgment, in particular the decision to adjourn, was appealed by HSBC as the petitioning creditor. The appeal was heard on 25 July 2022 and on 26 July 2022, the Court of Appeal allowed the appeal making a winding-up order against NewOcean (rather than choosing to remit the matter to the first instance court). The Court of Appeal's reasons were handed down on 30 September 2022.

The following key points of principle can be derived from the Court of Appeal's judgment:

- The interests of the creditors are paramount and it will be a truly exceptional case where the views of the majority are disregarded by the Court, although the Court will not approach this from a strictly arithmetic point of view.
- The percentage of creditors opposed or in support of the winding-up petition takes on even greater significance when the restructuring plan prayed in aid of an adjournment requires 75 per cent in favour. Where it is clearly unlikely that majority will be achieved, an adjournment should not be granted.
- The absence of creditors opposed to the winding up should be sufficient in most cases to justify an immediate winding up.
- The maintenance of a light-touch provisional liquidation calls for complete transparency and cooperation from the company and non-disclosure of material matters is a strong factor in favour of an immediate winding-up.

Sir Christopher Clarke P, delivering the judgment of the Court of Appeal, found that in the decision adjourning the petition dated 31 May 2022, the judge had failed to consider (sufficiently or at all) a number of relevant considerations including the:

- size of the majority required to restructure the company's debt. NewOcean required 75 per cent of creditors in favour but had nearly 66 per cent of creditors against. The prospect of the requisite majority being met and therefore of a restructuring succeeding was remote;
- fact that so many creditors were opposed to the adjournment. The creditors were experienced bankers and best placed to judge their own interest with no evidence that any creditors were likely to change their mind;
- absence of a majority of creditors opposing the making of a winding up order.
- proposal was an adjournment for time to liquidate assets and that liquidations should be supervised by liquidators; and
- history of the case, including the time since the defaults and previous failures to implement similar schemes.

This judgment clarifies the circumstances in which an order for provisional liquidation will be made and when the court should instead make an immediate winding-up order. The Court of Appeal has reaffirmed that the views of creditors take precedence over other considerations and made clear that those seeking to appoint provisional liquidators must cooperate with them.

The company – acting through Mr Shum, its executive director – subsequently sought and was refused leave appeal to the Judicial Committee of the Privy Council from the Court of Appeal's decision and a stay of the order that was made in May 2022, pending the final determination by the Privy Council of the appeal. The Court of Appeal formed the view that a further appeal would not raise any question of great general or public importance. In making its decision to decline the stay, the Court considered that:

- the relationship between the liquidators and Mr Shum was dysfunctional and there were repeated complaints that the company was not cooperating with the liquidators during provisional liquidation.
- the history of events, and the matters set out in the JPLs' reports, did not inspire the Court's confidence that this relationship could be repaired.
- it was apparent that any value of the company depends on the value it derives from a very large number of direct and, more importantly, indirect subsidiaries. To realise the assets of the company and derive value from the subsidiaries in the group, the liquidators are going to have to change the composition of the boards of the relevant companies and secure recognition of the status of the liquidators in China and elsewhere – which had already commenced;
- at the first creditors' meeting, bank creditors representing US$744.9 million out of some US$786 million voted to have the liquidators confirmed by the Bermudian court and a committee of inspection appointed. The fact that so

many voted in favour of confirmation showed an almost universal view that there should be a liquidation; and

- the majority of the creditors who were supportive of liquidation, were sophisticated bank creditors who were capable of forming their own judgment as to benefit and risk of asset disposals by the company in provisional liquidation as compared to assets disposals under the liquidators' control.

These decisions demonstrate the extent to which the court will respond to prevent companies from taking advantage of the light-touch regime.

Cross-border support

There are two main types of cases involving cross-border support that frequently arise in Bermuda. First, there are cases in which a winding-up proceeding is commenced in Bermuda to run parallel to, or in tandem with, an insolvency proceeding taking place elsewhere for the purpose of restructuring a Bermuda-registered company. Specifically, there have been a number of cases where Bermuda companies have been the subject of Chapter 11 proceedings in the United States, in which the Bermudian court has appointed provisional liquidators with light-touch powers to supervise the directors in the conduct of the Chapter 11 proceedings and to report to the Bermudian court. The Bermudian court will generally defer to the Chapter 11 proceedings and give effect to the Chapter 11 plan or reorganisation. As mentioned above, the advantages of this approach include independent oversight of the restructuring by court officers (ie, the provisional liquidators) focused on protecting creditors' interests and achieving a stay of proceedings against the company that is triggered by the appointment of provisional liquidators.

Second, there are cases in which a foreign office holder (eg, a liquidator) applies to the Bermudian court for relief to assist with a liquidation taking place outside Bermuda, for instance, by asking the Bermudian court to order Bermuda entities to produce information or orders compelling individuals in Bermuda to provide witness evidence. The Bermudian court may exercise its common law power to assist in these cases, and has demonstrated a general willingness to do so, provided that the foreign office holder could obtain the same relief from the court in the country where the liquidation is taking place.

In relation to the topic of cross-border support, the Bermudian court does not have jurisdiction to wind up overseas companies, except for certain statutory exceptions. In the context of a group of companies, this restriction means that the Bermudian court lacks jurisdiction to wind up a multinational group of companies, as it is not possible to obtain an ancillary winding-up order from the Bermudian court in respect of a company within the corporate group that is domiciled outside Bermuda.

On the other hand, where the Bermudian court has appointed liquidators to wind up a Bermuda company, the liquidators may commence ancillary insolvency proceedings in other jurisdictions that permit ancillary proceedings (eg, in England or Hong Kong).

The Supreme Court of Bermuda has issued practice directions relating to cross-border insolvencies, modelled on the draft guidelines adopted by the Judicial Insolvency Network in October 2016.

Looking ahead

Bermuda is a consistently reliable restructuring jurisdiction. Its well-established legal, regulatory and enforcement framework allows for continuity in its diligent approach to corporate restructurings. Bermuda takes pride in its ability to provide innovative and progressive restructuring solutions for companies with a wide and diverse global reach – in presence and industries – while providing a high degree of comfort to creditors that their interests are always been considered.

The INSOL conference in Bermuda this year raised some interesting questions, particularly in relation to the use of the provisional liquidation regime (and application of insolvency principles) in the context of insolvent segregated accounts companies as well as the continued development of cross-border cooperation where the tide of insolvency jurisprudence appears to be changing in East Asia. We have no doubt that insolvency practitioners and the Bermudian courts will have a strong focus on these two areas as 2024 unfolds.

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John Wasty is global practice group co-head of dispute resolution and head of the dispute resolution and restructuring practice in Bermuda. In his Bermuda role, he also leads the Bermuda insolvency and restructuring team and the regulatory disputes team. John also leads the insurance and reinsurance disputes practice globally.

He specialises in the areas of commercial litigation, restructuring, insolvency litigation, funds litigation and regulatory matters. He has represented clients in a wide variety of commercial disputes in Bermuda, London, the US, Europe and Asia. He is also frequently involved in major arbitrations in Bermuda and internationally in both commercial, and insurance and reinsurance matters. John is a fellow of the chartered institute of arbitrators. In addition to being

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John Riihiluoma is senior counsel in the dispute resolution department in Bermuda. He recently retired from his position as a partner at Appleby.

John's practice includes reinsurance disputes, directors' and officers' liability actions, shareholder and corporate disputes. He has also been active in insolvency and restructuring litigation. In recent years, his practice has included a number of significant contentious trust matters. He was appointed as an assistant justice of the Supreme Court of Bermuda for a one-year term on 30 July 2012 to sit from time to time as may be required in civil and commercial matters. John has also sat as an acting puisne judge on an ad hoc basis in the past few years.

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Lalita Vaswani is counsel in Appleby's dispute resolution department. She has a background in commercial and corporate litigation with a focus on restructuring and insolvency. Lalita completed her law degree at Warwick University and her LLM at the London School of Economics. She practised for seven years at a top-tier firm in Barbados and was admitted in Barbados and the Eastern Caribbean. During her tenure in Barbados, she played a pivotal role in several high-profile cross-border bankruptcy and insolvency matters, including one of the largest insolvency matters in the history of the Caribbean.

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James Batten is a senior associate in Appleby's dispute resolution department. James has considerable experience advising on and acting in corporate insolvencies. James regularly advises directors, creditors and liquidators of Bermuda companies. Before moving to Bermuda, James frequently advised and appeared in court on behalf of the UK Insolvency Service, was a legislative draftsperson on the UK Insolvency Rules and appeared for both creditors and debtors in insolvency and restructuring proceedings in the English County Court and High Court.

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British Virgin Islands: Schemes of Arrangement in China-Related Debt Restructurings

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In summary

There continues to be an upward trend in the use of schemes of arrangement, with or without the relevant company being in provisional liquidations, as a restructuring tool, particularly in relation to China-related debt. The Chinese property market continues to suffer significant challenges and points to further use of schemes of arrangement in the jurisdictions of incorporation. There continue to be coordinated approaches across offshore jurisdictions.

Discussion points

- Recent schemes of arrangement that have been approved
- The increased willingness of the judiciary to assist struggling companies that have a realistic prospect of trading their way out of difficulty

Referenced in this article

- Insolvency Act 2003
- Business Companies Act 2004
- Section 179A of the Business Companies Act 2004
- *Constellation Overseas Limited and 5 others*
- *Century Sunshine*
- *Tungshu Venus Holdings Limited v Zhang Rui KangRock International and Constellation*
- *Re: BTR Plc*
- *In re Rock Int'l Inv*
- *Rongxingda Development (BVI) Ltd*

Since the introduction of 'light touch' provisional liquidations in 2020, the British Virgin Islands has seen a considerable increase in the use of restructuring options off the back of the economic effects of covid-19 and, in particular, the financial pressure experienced in the Chinese property market. This article discusses those recent schemes of arrangement that have been approved and the increased willingness of the judiciary to assist struggling companies that have a realistic prospect of trading their way out of difficulty. It will also discuss possible reforms to the restructuring regime.

The British Virgin Islands is a self-governing overseas territory of the United Kingdom. It is a leading international finance centre that is tax neutral, politically stable and economically secure. The legal system is based on English common law, with the final appellate court being the Privy Council (comprising members of the UK Supreme Court) in London. The legal infrastructure, tight control policies and modern legislation have resulted in it being widely recognised as an ideal and stable jurisdiction for investment vehicles. Such investment vehicles have been particularly popular with Chinese, Russian and South American interests, and it is not uncommon to find British Virgin Islands companies being used to raise finance on the international markets, with British Virgin Islands companies issuing bonds in relation to operating companies in mainland China, Russia and South America.

The source of restructuring law in the British Virgin Islands is found in two statutes: the Insolvency Act 2003 and the Business Companies Act 2004, which together provide a comprehensive restructuring regime. While the Insolvency Act was largely modelled on the UK Insolvency Act 1986, there are significant differences that can trip up the unwary. For example, while the Insolvency Act 2003 provides for administration orders, the section has not been enacted. Similarly, Part 18 of the Insolvency Act 2003 sets out the UNCITRAL Model Law on Cross-Border Insolvency, which has also not been enacted. Equally, the British Virgin Islands restructuring regime includes tools that have not traditionally been part of English law, such as Canadian-style plans of arrangement.

For companies seeking to reorganise their capital or debts, there are three main routes available: a plan of arrangement, a scheme of arrangement or a creditors' arrangement. Plans and schemes are governed by the Business Companies Act 2004, and creditors' arrangements are governed by the Insolvency Act 2003.

Plans of arrangement are at the discretion of a company's directors, do not require the 75 per cent in value threshold to be satisfied, but do require court sanction. There is no statutory moratorium available in relation to plans of arrangement so a company remains vulnerable to creditors' claims.

Schemes of arrangement are governed by section 179A of the Business Companies Act between a company and its creditors and/or members or any class or classes of them. The section does not use the term 'scheme of the arrangement' specifically in the body of the text but rather refers to 'compromise

or arrangement'. There is no indication in the legislation as to the procedure for obtaining court sanction, but the British Virgin Islands follows the English court practice, first by obtaining permission to convene a meeting and second by obtaining the court sanction. The court will not merely rubber stamp the scheme but will analyse it critically to make sure it is fair, reasonable and efficacious. At the meeting, creditors holding 75 per cent in value must vote in favour of the scheme for it to be binding. As with plans of arrangement, there is no statutory moratorium available and, therefore, the scheme remains liable to upset by creditor claims until sanctioned by the court.

Creditors' arrangements are arrangements that can be entered into between the company and its unsecured creditors without court sanction provided there is a sufficient number (75 per cent by value) of creditors in favour.

A recent major development relates to the use of provisional liquidators by way of light-touch appointments. Unlike other offshore jurisdictions, such as the Cayman Islands and Bermuda, the British Virgin Islands did not have a practice of using provisional liquidators for restructuring purposes but rather used them to preserve assets at risk of dissipation pending the appointment of full liquidators.

Since 2019, the Commercial Court has developed a practice whereby provisional liquidators can be appointed in support of a subsequent restructuring plan, usually a scheme of arrangement. In those cases, the aim is to provide the company with some breathing space in order to come to an agreement with the requisite percentage of creditors.

In *Constellation Overseas Limited and 5 others*,[1] Justice Adderley, after an extensive review of the English and Commonwealth authorities, determined that the Court had 'a very wide common law jurisdiction' to appoint provisional liquidators in support of a restructuring plan. Crucially, in *Constellation* there was no evidence of over 75 per cent support from creditors at the time of making the application (the threshold for actual approval of a scheme of arrangement). In fact, the support was initially very limited, but in circumstances where there was no complaint of mismanagement of the company's affairs and there was some prospect of a forthcoming agreement with creditors, the BVI Commercial Court agreed that an appointment was appropriate. This was followed by a successful application to sanction a scheme of arrangement under section 179A as discussed further below.

Constellation was followed by a decision by Justice Jack in the 2020 case of the Chinese fertiliser group Century Sunshine. The four British Virgin Islands entities were part of a wider group of companies held by a Cayman-listed company, Century Sunshine Group Holdings Ltd. Century Sunshine Group represented the largest vertically integrated developer and producer of magnesium alloy

1 BVIHC (Com) 2018/0206 – 2012, 13, 19 December 2018, 5 February 2019.

products and ecological fertiliser business in China. While it had enjoyed several years of strong growth and profitability, Century Sunshine Group's sales and production had been negatively affected by the Chinese holiday extension and logistical delays due to covid-19 since early 2020. There had been a drop in revenue in the first four months and reduced liquidity in operating cash flow as a result. At the time of the application to appoint provisional liquidators, Century Sunshine Group was in default of an approximately US$563,563,000 Singapore bond issue that had been guaranteed by the companies. It was for this reason that the Group sought to restructure its debts in the Cayman Islands, Bermuda and the British Virgin Islands.

Justice Jack granted the appointment of provisional liquidators on the basis that there was some support from creditors and the liquidation analysis demonstrated that the return to creditors would be 0–40 per cent for unsecured creditors and 33.6–100 per cent for secured creditors, whereas the board considered that 100 per cent return would be achievable in a restructuring.

The case was noteworthy for two reasons. First, it was one of the first cases where the Court sanctioned the implementation of the JIN Guidelines across three jurisdictions – British Virgin Islands, Bermuda and the Cayman Islands – with the aim of a holistic restructuring across the group. Second, the Court addressed the issue of the moratorium under section 174(1) of the Insolvency Act 2003, which provided that where an application for appointment of a liquidator had been issued but not determined and where any action is pending against the company, an application can be made to stay such proceedings. In *Constellation,* proceedings had been issued and, therefore, the stay was granted. In *Century Sunshine,* no other proceedings had been issued. The Court, however, accepted the submission that even though no other proceedings against the companies had been commenced at the time of the application, the Court ought to grant a conditional moratorium so that in the event any actions were commenced against the companies they could obtain the benefit of the moratorium under section 174(1) of the Insolvency Act 2003 and an automatic stay would be imposed. The Bermuda Scheme of Arrangement was approved in October 2022.

The British Virgin Islands courts have also been alert to the misuse of restructuring proposals by debtor companies. In *Tungshu Venus Holdings Limited v Zhang Rui Kang,*[2] the court rejected the contention that a statutory demand ought to be set aside on the basis that the company was seeking to restructure its debts in circumstances where the evidence indicated that the company would not achieve the requisite 75 per cent of support from creditors and there was no evidence that the statutory demands per se would jeopardise the restructuring or make it more difficult for the company or group to raise financing.

2 BVIHCM 2020/ 0115 Wallbank J dated 5 November 2020.

Schemes of arrangement pursuant to section 179A of the Business Companies Act 2004 have proved a useful tool for companies in difficulty over the course of 2020 and 2021.

Section 179A(3) of the Act provides:

> *If a majority in number representing seventy five per cent in value of the creditors or class of creditors or members or class of members, as the case may be, present and voting either in person or by proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement, if sanctioned by the Court, is binding on all the creditors or class of creditors, or the members or class of members, as the case may be, and also on the company or, in the case of a company in voluntary liquidation or in liquidation under the Insolvency Act, on the liquidator and on every person liable to contribute to the assets of the company in the event of its liquidation.*

Under section 179A(2), Business Companies Act 2004 an application may be made by the company and there is nothing in the Business Companies Act 2004 that prescribes the subject matter of a compromise or arrangement.

Prior to *Rock International* and *Constellation* (discussed below) there was very little by way of authority in the British Virgin Islands by way of approach the court ought to take in relation to the sanctioning of a scheme of arrangement. The court, therefore, considered the English authorities in relation to its exercise of discretion as to whether to sanction a scheme of arrangement. In particular, the English Court of Appeal in *Re: BTR Plc* [2000] 1 BCLC 740 at 744 set out the relevant test as follows:

> *in exercising its power of sanction the court will see, first, that the provisions of the statute have been complied with, second that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.*
>
> *The court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting; but, at the same time, the court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, or some blot is found on the scheme.*

The court must also be satisfied that the resolutions have been passed by the requisite majority in accordance with the Business Companies Act in a meeting duly convened and held in accordance with the order convening the meeting.

The majority is that of those who vote, not of those entitled to vote, nor of those who are present. This means that creditors who are not present in person or by proxy, or who, although present, do not vote, may be ignored. English case law suggests that the court will ordinarily recognise that the best assessment of whether a scheme is in the interests of those to be bound by it is the vote of those present and voting at the meetings:

> *Under what circumstances is the Court to sanction a resolution which has been passed approving of a compromise or arrangement? . . . If the creditors are acting on sufficient information and with time to consider what they are about, and are acting honestly, they are, I apprehend, much better judges of what is to their commercial advantage than the Court can be. (Re English, Scottish, and Australian Chartered Bank [1893] 3 Ch 385)*

The court must be satisfied that the scheme meeting was truly representative:

> *if the court is satisfied that the meeting is unrepresentative, or that those voting in favour at the meeting have done so with a special interest to promote which differs from the interest of the ordinary independent and objective shareholder, then the vote in favour of the resolution is not to be given effect by the sanction of the court. (Re BTR plc, per Chadwick LJ)*

The central issue is whether the scheme is fair in relation to the various interests involved and so could reasonably have been approved at the scheme meetings. In this regard, the court will have regard to the relevant comparator to the scheme, namely, the terms of the scheme as against an insolvent liquidation. This is because:

> *an intelligent and honest scheme creditor would . . . give a special consideration to a comparison between the likely, or even probable, future of his debtor company should there be, on the one hand, no scheme and should there be, on the other hand, the scheme proposed. (Re Marconi plc [2003] EWHC 1083 (Ch))*

This highlights the need to have a properly prepared liquidation analysis as the basis for the comparison.

These principles were successfully applied in two cases over the course of 2020. *Rock International Investment Inc*[3] concerned a British Virgin Islands special purpose vehicle incorporated for the purpose of raising financing for the parent company and its subsidiaries through the issue of US$300 million in notes pursuant to a New York law governed indenture. The parent and its subsidiaries were in the business of research and development, production,

3 BVIHC 2020/ 184.

sales and logistics of chemical products, new energy batteries and real estate development. As a result of cross-group defaults and liabilities as guarantor for debts of other companies unrelated to the group, the parent experienced a tightened cash position and liquidity problems. The parent's creditworthiness deteriorated, affecting its ability to refinance, which contributed to the further decline in business for the parent and its subsidiaries. Business was also adversely affected by the covid-19 pandemic because of restrictions on transportation routes.

As a result, the company sought sanction from the British Virgin Islands courts to enter into a scheme of arrangement whereby there would be a cash payment of US$185 million to the scheme funded by way of an asset sale together with a consent fee and a work fee. The scheme was overwhelmingly supported by the creditors and approved by the court on 10 December 2020.

It was subsequently recognised in the United States in *In re Rock Int'l Inv*, No. 20-35623 (MI) (Bankr. S.D. Tex. Dec. 11, 2020), where the judge held that the British Virgin Islands was the main centre of interest and therefore the main foreign proceeding, that the scheme was not contrary to public policy and that the scheme and all orders of the British Virgin Islands courts were granted comity and had full force and effect in the United States.

Constellation was another major success for the British Virgin Islands during 2020, allowing a Brazilian restructuring plan and Chapter 15 recognition in the United States to proceed in parallel with a British Virgin Islands scheme of arrangement in relation to one entity that fell outside of the Brazilian plan. The court took a pragmatic approach to what was one part of the larger global restructuring of the group.

In *Rongxingda Development (BVI) Ltd*, the British Virgin Commercial Court was asked to approve a scheme of arrangement pursuant to section 179A of the Business Companies Act 2004. The company was part of a group ultimately held by RiseSun Real Estate Development Co, Ltd (the parent), a limited company incorporated under the laws of China. The key businesses of the group include developing small to mid-sized residential properties, commercial properties and large-scale urban complexes, including offices, shopping centres, recreational facilities, new industry towns, hotels, resorts and ancillary facilities across various cities in China. The company was a special purpose vehicle incorporated to raise financing for the provision of a loan to the parent to finance the operations of the group. In total, the company raised US$800 million by way of notes issued pursuant to New York-governed indentures. The notes were guaranteed by the parent and listed on Singapore Exchanges Securities Trading Limited. During the second half of 2021, Chinese property developers and the capital markets that had funded the growth and development of the sector experienced an inflection point. Reduced bank lending for real estate development resulted in reduced access by property developers to onshore capital. In addition, reduced bank lending for mortgage finance for buyers, as well as the concerns of buyers

about the ability of property developers to complete projects, resulted in reduced property sales. Adverse reaction to these onshore events by offshore capital markets limited the group's funding sources and the company failed to make payment. The court was satisfied on the basis of a liquidation analysis that in a liquidation scenario there would be insufficient realisations to settle the claim and that the scheme proposed offered the scheme creditors the prospect of a full recovery. Key matters the court had to determine included:

- whether the proposed mechanics for the holding of the scheme meeting would constitute a valid meeting; and
- whether the payment of a 1.5 per cent instruction fee to creditors committed to supporting the scheme fractured the class.

The court was entirely satisfied that the holding of the meeting in the BVI with a simulcast to Hong Kong and the ability of creditors to participate virtually would constitute a valid meeting. In determining class composition, the court was satisfied that the fee did not operate to fracture the class of creditors; and indeed noted that the English authority that suggested a fee of 2.5 per cent would not do so either. The court held by a judgment dated 13 April 2022 that 'the Court will be slow to diverge from the results of a meeting and in this case the creditors were represented and there are no grounds for going behind the vote which has been approved so overwhelmingly.' They further stated that:

> *the Notes are governed by New York law but steps are already in place to have the approval of the United States Bankruptcy Court of the Scheme of Arrangement. In those circumstances issues of international recognition it seems to me are of very little weight and certainly do not amount to a reason for refusing to recognise the Scheme of Arrangement and sanctioning it.*

Chapter 15 recognition was obtained in the United States Bankruptcy Court for the Southern District of New York.

The popularity of schemes of arrangement whether with or without provisional liquidators continues apace with the British Virgin Islands courts involved in the Evergrande US$19 billion and Redsun Properties Group Limited US$275 million restructurings. There is every indication that schemes of arrangement will continue to be used as an effective restructuring tool for the remainder of 2023 and 2024.

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Capital Solutions Financings: Yield Driving Structure

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In summary

This article will explore some of the typical deal structures for capital solutions financings (including relevance in certain non-US jurisdictions), various ways in which yield is captured in debt focused capital solutions instruments and briefly conclude with a few thoughts on the vulnerability of call protection and related concepts.

Discussion points

- Deal structures in the United States
- Fees, interest and call protection in the United States
- Deal structures and achieving yield in English, German and Italian markets
- Call protection – mitigating insolvency risk

Referenced in this article

- US Chapter 11
- *Envision*
- *In re Momentive*
- *In re Energy Future Holdings Corp*
- *In re Ultra Petroleum Corp*
- *Ultra*

Introduction

Over the past decade, the scope of 'private credit' has migrated from what historically was a limited universe of discrete investments in limited parts of the capital structure, largely in the form of junior or mezzanine debt, to investments across multiple tiers from preferred equity to senior secured debt. Its sources, most typically credit funds and pension funds, are able to invest at all points of the financing 'life cycle', ranging from financing an acquisition, to providing a bespoke liquidity or refinancing solution to an over-levered company or to backstopping out-of-court restructurings and in-court debtor-in-possession financings.

The private credit market today can broadly be characterised as a complete offering made up of two halves.

On the one hand, direct lenders are providing financings for 'performing' companies, including sponsor-backed M&A transactions in the small-, mid- and large-cap markets. This segment of the market has seen significant evolution over the years in both the mid- and large-cap markets. Originally, a private credit solution was a Plan B alternative to the traditional syndicated term loan B and high-yield market if there was insufficient investor demand or a volatile market – fast forward to the current environment, where direct lenders have become a significant part of the landscape, having developed relationships with sponsors and corporates and now often viewed as a Plan A due to certainty of pricing and speed of deal execution.

On the other hand, there are credit funds and institutional investors who now regularly provide financing solutions for companies experiencing balance sheet or market-driven stress and requiring an infusion of capital to address liquidity or refinancing needs. And importantly, the two segments are not mutually exclusive, and performing companies may require a 'capital solution' (eg, an investment-grade company seeking an off-balance sheet financing to mitigate any negative impact on credit ratings). As a result of this evolution, we are seeing some of the same players increasingly coming to the table in both segments, albeit at times with different funds with different mandates.

One of the distinguishing characteristics between the direct lending and capital solutions camps is the transaction structure and pricing. Direct lending generally follows the form for the syndicated market in that acquisitions, dividend recaps and refinancings will typically be structured as senior secured debt, either as a single-term loan tranche or as a first lien and second lien structure. Variations of this have evolved over the years, including, for example, unitranche financings.

Pricing for direct lending transactions generally competes with the syndicated market alternative other than with respect to call protection. In a syndicated term loan B deal, one often sees repricing 'soft call' protection of 101 per cent for a short period of time post-closing. This would typically only be payable if

the borrower refinances the loans with cheaper debt within the agreed period of time – but not under other circumstances. Direct lenders may be able to negotiate for a 'hard call' payable upon any prepayment or refinancing within a period of one to three years following closing at a premiums in the 3 to 1 per cent range. However, in a competitive landscape, direct lenders sometimes agree to the 'soft call' repricing construct.

Credit funds investing in capital solutions financings, on the other hand, will often have a target yield that is in the mid-teens (percentage-wise) that forces those investors to look outside of the performing sponsor-driven leveraged buyout (LBO) market. Credit funds providing a capital solution for a company typically are willing to offer a more bespoke product that is tailored for the situation at hand. A capital solutions financing may be provided at any part of the capital structure, whether as a senior secured financing, a junior secured or payment subordinated financing, a holdco payment-in-kind (PIK) financing (that would be structural senior to the equity investors) or a hybrid preferred equity investment. The list is not exhaustive and the market will continue to evolve and will also be dictated by the situation and opportunity at hand. For example, a capital solutions transaction may be structured to include a coupon with a PIK interest component to accommodate cash flow available to service the company's debt or, if a company requires incremental debt but its existing credit documents would not permit additional secured debt, the incremental capital may take the form of a junior financing or preferred equity.

Most capital solutions transactions are event-driven: a borrower may need additional liquidity to refinance upcoming debt maturities or support growth of the business, in each case where the traditional lending market may not be available. There is often a 'story' to each situation and credit funds can provide creative, speedy and nimble solutions to address these situations. However, the financing structures in these types of situations may increase the credit risk for the lender or investor in exchange for which the lender or investor would typically expect tighter terms and covenants than would be seen in the 'direct lending' market – and also be compensated through higher interest rate spreads, additional fees, hard call protection and equity upside and/or other bespoke yield-capturing instruments.

This article will explore some of the typical deal structures for capital solutions financings (including relevance in certain non-US jurisdictions), various ways in which yield is captured in debt focused capital solutions instruments and briefly conclude with a few thoughts on the vulnerability of call protection and related concepts.

Deal structures in the United States

Senior secured financings with equity kickers

Given capital solutions are most frequently utilised for under-performing companies, or fundamentally riskier situations that traditional bank lenders or direct lenders (mandated to invest in performing credits) may not be willing or able to underwrite, the preferred capital solutions financing structure in the United States is that of a senior secured loan or note. Such a structure provides the downside protections of having secured creditor status with claims against collateral in a US Chapter 11, while also providing the ability to drive the workout process. However, there may be various factors that would dictate how a financing should be structured. For example, a company may have existing debt that does not permit additional senior debt but may allow only junior secured or payment subordinated debt up to certain amounts.

If the situation requires that the incremental debt is junior – either in payment or lien priority – to existing debt that will remain in place, then an inter-creditor or subordination agreement will be required to be entered into with the existing senior lenders. In the context of a capital solutions financing, these inter-creditor agreements are typically more heavily negotiated than in a direct-lending or syndicated financing for a sponsor LBO transaction that would rely upon deal precedents that may limit the junior lenders' rights as a 'silent second lien'. From the incoming junior lender's perspective in a capital solutions financing, there should be a focus on, among other things, limiting the senior lenders' and the company's ability to amend the senior documents to increase pricing and the senior debt quantum. There will often also be a focus on ensuring that the junior lenders have an effective right to purchase the senior lenders' debt so that they can step into the shoes of the senior lenders to control critical decisions in a work-out scenario. Finally, in certain liability management 'drop-down' transactions, capital solutions financings will differ from more traditional leverage financings in that they will be secured by a small ring-fenced subset of assets rather than substantially all of the assets of the company.

The relevant credit documents in a capital solutions financing will retain the same basic features as in a direct lending or syndicated financing, typically documented in the form of a credit agreement or note purchase agreement with customary representations and warranties, covenants and events of default, as well as a customary security grant over the relevant collateral. However, capital solutions financings may diverge in pricing and have more bespoke (and less market driven) covenants and events of default. For example, a capital solutions investor financing a company dealing with the overhang of material litigation (which may have foreclosed the ability for the company to turn to more traditional financing markets) will want to ensure that the relevant definitive credit documents include customised negative covenants restricting the company's actions (including litigation settlements), tailored reporting requirements with

respect to developments in the case and significantly more robust judgement (and adverse litigation event) related events of default. While from a lenders' perspective these more enhanced covenant protections are fundamentally beneficial, lenders should be cautious not to put themselves in a position of 'controlling' the borrower and potentially opening the door for potential claims from other stakeholders.

Equity kickers provided to lenders will provide upside if the company performs in line with, or exceeds, its financial model. These may take various forms ranging from warrants for common or convertible preferred. The governance rights provided to the investor with respect to the equity piece can vary dramatically. In the most company-friendly formulation, warrants may be exercised solely in the case of an exit event. Where the relevant capital solutions provider has significant leverage – or is structuring a small portion of the financing as an actual equity co-invest – the equity rights granted may include actual board appointment rights and shareholder vetoes over certain material actions, including future fundraising and M&A activity. Again, careful consideration must be given to clearly document the debt and equity aspects of the financing as separate instruments, both for tax reasons (noting side letters will often be negotiated to ensure matching tax reporting to the Internal Revenue Service) and to provide a framework for managing the debt and equity separately, particularly where the lender has a board of direction position.

Structured equity – hybrid preferred equity instruments

While capital solutions providers will often prefer the protections afforded from structuring an investment as a traditional senior secured financing, in situations where either there is existing debt and the company is limited in its additional debt incurrence capacity or the investment thesis is fundamentally pegged to capturing equity upside, a capital solutions financing may take the form of a hybrid preferred equity investment. Although the provider of the financing will rank junior to creditors of the company in a bankruptcy, preferred equity holders will have a priority claim to any residual equity value ahead of the common stockholders. These types of hybrid preferred investments are documented in a manner similar to traditional preferred equity issuances, primarily through amendments to the company's incorporation and shareholder or governance agreements in whatever form they take (in addition to a share purchase agreement).

As compared to a traditional preferred equity solution, traditional debt instrument protections and remedies for events of default can be achieved in an equity instrument, in whole or in part, through consent rights and covenants. For example, a capital solutions oriented preferred equity structure will often incorporate more debt-like protections for the investor including covenants restricting the company's ability to incur any additional debt – which

is a critical driver in whether there may be any residual equity value for the preferred holder in a downside scenario. There may also be terms that require mandatory dividends and redemptions (subject, of course, to such dividends and redemptions being permitted in the debt documents), call protection and enhanced governance rights if certain financial or performance metrics are not met. Investors sensitive to equity versus debt treatment of their investment from an accounting and/or tax perspective may be sensitive to the inclusion of some of these rights in an equity instrument, as their inclusion could result in the investment being treated as debt.

Hybrid capital instruments

In situations in which the relevant capital solutions investor has significant leverage and an appetite for creativity, it may seek to structure the relevant investment in the form of a hybrid capital instrument that attempts to maintain the downside protections of a debt instrument coupled with the ability to capture extremely high (or, in certain cases, unlimited) upside as if it were an equity investment. Although less publicised than other capital solutions structures given their frequent utilisation in smaller capital structures of private companies – and always bespoke to the specific situation at hand – two examples that highlight these types of structures in the US market include secured royalty financings and EBITDA participation agreements.

In the former, a capital solutions provider will finance the development of the product through loan extensions that are secured by collateral, but the actual repayment amount and frequency of payment will vary depending on the performance of the underlying financed product. In the latter, in exchange for providing debt financing in the form of a more traditional secured term loan, the capital solutions provider will also be entitled to receive a quarterly fee calculated as a percentage of a company's EBITDA that crystalises into a debt claim (concurrently upon the issuance of applicable financial statements) via a payment in kind of additional loans. In each case, the investor receives an opportunity to share in upside dictated by company or product performance (similar to an equity holder) but has the downside protection of an instrument that qualifies as debt (and, if secured, the benefit of collateral). However, there is little US case law regarding the enforceability of these types of instruments as an actual debt claim. As a result, great care will often be given in the relevant documentation to ensure that the hallmarks of what constitutes debt under US law apply, such as the inclusion of interest, maturity dates, granting of security interests and a clear acknowledgement of secured creditor remedies.

Achieving target yield: fees, interest and call protection in the United States

In the pursuit of capturing greater yield, the capital solutions investor has a wide array of economic tools in its arsenal. Included among these are various types of upfront and exit fees are interest with a compounding paid-in-kind component and call protection. Certain of these have origins in more traditional debt and equity financings, while others are outgrowths of the needs of market participants in the capital solutions space. Regardless, all of these tools have been adapted in the capital solutions market to best fit the requirements and financial model of the borrower, while also reflecting the inherent greater risk associated with the transaction.

For any given investment, a credit investor will determine the appropriate pricing and how that should be structured, taking into account various factors including the company's available cash flow to pay cash interest, whether the funds that the investment is being allocated to can hold a PIK investment or equity instruments (appreciating an asset manager may manage deal allocation accordingly amongst its managed funds to address such issues), restrictions in any existing debt that may dictate the extent to which the company may make cash payments on new debt or preferred equity and, importantly, tax considerations given the yield expected to be obtained.

The combination of fees, the interest rate and call protection (or, in the case of investments structured as equity, liquidation preferences, mandatory dividends, redemption prices and other waterfall mechanics related to distributions or sales)[1] will determine the total internal rate of return for the investment. The lynchpin to many capital solutions transactions is not simply that a single economic mechanic is dramatically higher than that used in a more traditional syndicated or direct lending market, but rather the additive nature of utilising all of these tools in combination with one another – a strategy that is increasingly important as various components of these structures sometimes fall under scrutiny in insolvency proceedings.

Fees and original issue discount

Fees in their simplest form may include traditional upfront fees or original issue discount that are earned and payable upon the initial borrowing. These initial fees may be coupled with exit fees, expressed as a percentage of the principal amount of the loans and commitments that must be paid concurrently with the prepayment of the loan, noting that often parties will negotiate whether a partial prepayment of the loan triggers payment of the entire exit fee or only an

1 Note, for conciseness this section will focus on economic mechanics contained in debt instruments commonly used in capital solutions financings.

agreed-upon portion of the facility. Exit fees are less common in the traditional syndicated leverage finance space but are popular ways for capital solutions investors to ensure a certain ultimate return while allowing the more traditional economics to optically remain within market range. Exit fees may be used in lieu of a call protection using a 'make whole' construct.

Finally, with the increasing prevalence of liability management transactions (including discounted exchanges, drop down financings, priming new money financings and *Envision* style double-dip incremental financings) in the syndicated leverage finance sponsor universe, entrepreneurial capital solutions investors have been able to capture backstop fees in connection with agreements to backstop a relevant liability management transaction if existing or other lenders elect to not participate or are excluded by a majority group as may be permitted by the loan documentation. These arrangements, which are a twist on the traditional commitment fee an arranger may take in a syndicated acquisition financing, allow funds to both capture additional economics without (in most cases) having to over-extend their exposure to a specific credit while also allowing the relevant fund to be viewed by the relevant sponsor as a constructive partner.

PIK interest

With respect to interest, a common twist utilised in capital solutions transaction is to have all or a portion of each interest payment paid in kind rather than cash, meaning that on each interest payment date, the relevant interest payment is capitalised and increases the outstanding principal amount of the loan. Structuring interest payments in this manner is often a win-win in that it lowers the relevant company's cash debt service obligations over the life of the financing while at the same time allowing the relevant investor to capture increasing yield due to compound interest while the loan is outstanding. Finally, in cases where particularly aggressive returns are sought, an investor may seek to capitalise the interest more frequently than the traditional quarterly payment frequency, in certain cases reducing the time period between capitalisation to 30 days or less. There are variations of PIK payment provisions, for example, a 'pay if you can' approach where the company would be required to pay cash interest to the extent that it either has sufficient liquidity or can satisfy an interest or fixed charge coverage test – and if not, would pay in kind all or a portion of the interest amount.

Call protection and multiple on invested capital (MOIC)

Call protection in capital solutions transactions can range from traditional time-based (ie, typically a higher premium for earlier prepayment) percentage premiums and make-whole provisions to more bespoke minimum yield or MOIC mechanics. Each of these is effectively compensation for early prepayment or redemption of the loan prior to its stated maturity. Call protection migrated from high-yield bond issuances where the issuer would typically be subject to a non-call period during which it may redeem the bonds subject to payment of a make-whole amount (interest payments through the end of the non-call period and calculated on a present value basis plus a premium), which is then followed by a period of declining premiums to the par principal amount of the bonds. In the context of private credit loans, call protection is typically referred to in a loan agreement as a 'prepayment premium' and is usually a simplified version of the high-yield bond convention. It may or may not include a non-call period that is subject to a make-whole. There has been much scrutiny over the years by the US bankruptcy courts as to the enforceability of creditors' claims for make-wholes and call protection (discuss further below).

MOIC provisions differ from standard call protection or make-wholes in that the formula uses the target return on capital that the lender is looking to receive as the starting point (eg, 1.3 times the par amount of the loan as reduced by the aggregate amount of cash interest, principal payments and other cash fees paid on the loan prior to maturity or prepayment). While this provides the lender or investor with a degree of certainty on its return, it provides the borrower with some protection in a loan context and an environment of increasing interest rates. For example, where a loan would typically have a floating rate of interest pegged to a secured overnight financing rate, all interest paid would be taken into account in calculating the 1.3 times return on the initial principal amount of the loan. MOIC concepts differ from call protection and make-wholes in that the additional premium will be included regardless of the timing of payment.

Regardless of the form of the call protection, the triggers for when such premium is paid will be a key negotiated between the parties. Outside of a voluntary prepayment and payments due as the result of acceleration, call protection may also apply to certain mandatory prepayments such as asset sales, condemnation and insurance proceeds and extraordinary receipts. Finally, unlike more traditional syndicated acquisition financings or direct lending transactions, call protection in capital solutions transactions will have significantly fewer – if any – carve-outs, noting that there more traditional cousins will frequently include carve-outs for things like change of control (or, in more aggressive sponsor deals, limitations to only defined repricing transactions).

Deal structures and achieving yield in English, German and Italian markets

English market

Most of the concepts and structures for capital solutions transactions prevailing in the US market can similarly be implemented in English law governed deals, except that we note English law inter-creditor agreements often require unanimous lender consent for material amendments to the waterfall in respect of enforcement proceeds. This means 'uptiering transactions' are often unfeasible absent a formal restructuring process, such as a UK scheme of arrangement or UK restructuring plan. A number of other factors often result in stakeholders opting for a formal restructuring process in Europe including: a close-knit lender community; the flexibility of the UK restructuring plan (cramdown technology with no absolute priority rule); reduced litigation risk; and relatively manageable legal costs when compared with the US Chapter 11 process.

German market

Similarly, most of the concepts and structures for capital solutions transactions prevailing in the US market can also be implemented in German law governed deals. However, three key differences are worth noting.

First, based on the German law concept of equitable subordination, all debt claims in a German insolvency proceeding held by a holder of 10 per cent or more of the shares in a company will be subordinated to all other creditors of the insolvency company. Therefore, in any preferred equity, equity warrant or hybrid structure, care must be taken to avoid having the holder be characterised as a shareholder (of 10 per cent or more) through the use, for example, of synthetic equity warrants.

Second, to the surprise of many parties unfamiliar with the German market, by law PIK interest – essentially being compounded interest – cannot be agreed upfront. As a result, German law governed agreements will usually include a possibility (but not an obligation) for the borrower to choose to PIK the accrued interest at the end of the then current interest period (PIK toggle). Alternatively, automatic PIK arrangements are sometimes agreed in foreign law governed side letters.

Finally, call protection concepts are commonly used in German deals. However, pursuant to mandatory German law, facilities may generally be prepaid at the end of any applicable interest period, and clauses in loan agreements prohibiting or impeding such prepayments may not be given effect. It is, therefore, market practice not to include the relevant provisions in the German law governed loan documentation but in a separate fee letter that is drafted by borrower's counsel and, most importantly, governed, for example, by Luxembourg law.

Italian market

In part because of certain legal requirements under Italian law around lending activities, the Italian capital solutions market contains a number of differences from the highlighted US market. Many of these are outside the scope of this article, however a few key observations relevant to the items highlighted above include PIK interest, make-wholes and a specific form of hybrid capital instrument called 'strumento finanziario partecipativo'.

With respect to PIK interest, and noting local law limitations on the ability of banks and financial intermediaries in classic loans to allow compound interest, generally, to be permitted, compounding requires the satisfaction of two requirements: (1) frequency of compounding should be no less than six months; and (2) compounding remains subject to existence of an arrangement with the debtor to be entered into after the relevant six-month period under (1) above. Because of this, drafting of PIK interest provisions in the context of Italian deals requires great attention and careful drafting.

With respect to make-wholes, such provisions are quite typical when lending is made in the form of a bond or note, while less so in the context of a classic loan due to certain regulations (and the silence of such regulation with respect to bonds and notes). Similar to the US Fifth Circuit discussion below, make-wholes in Italy can be considered as a penalty applicable in the case of breach via early repayment by the borrower. As such, again similar to the US Fifth Circuit, under Italian law it may be possible that the amount due under the make-whole proviso can be equitably reduced by a judge where that 'penalty' is deemed to be clearly disproportionate.

Finally, in the context of Italian insolvency procedures where creditors (including banks) accept a debt-to-equity swap (in whole or in part), a hybrid capital instrument typically used is the participative financial instrument (SFP). SFPs usually qualify as quasi-equity instruments attached with monetary rights and, if so negotiated by the relevant parties, administrative and voting rights exercisable in the contest of special SFP holders' meetings (as opposed to shareholders' meetings). Very few limits apply to this kind of instrument, and they are often proven to be a valuable solution for creative investors and creditors (or also to facilitate the participation by banks in debt for equity swaps).

Call protection – mitigating insolvency risk

Overview

As one of the key components of yield for a lender, it is worth dedicating some time to focus on call protection. As a concept it received much attention a number of years ago following a Second Circuit Bankruptcy Court decision in *In re Momentive*, 874 F.3d 787 (2d. Cir. 2017), which disallowed noteholders' make-

whole claims on the basis that such claims amounted to a claim for unmatured interest, constituted a penalty for the debtor and should be set aside. The *Momentive* decision was at odds with previous Third Circuit Bankruptcy Court decisions, including *In re Energy Future Holdings Corp,* 842 F.3d 247 (3d. Cir. 2016), which generally allowed make whole claims unless there are compelling reasons to disallow them.

The loan market reacted to the *Momentive* decision with modifications to loan agreements to mitigate the risk posed by *Momentive*. However, a recent Fifth Circuit Bankruptcy Court decision in *In re Ultra Petroleum Corp,* 51 F.4th 138 (5th Cir. 2022), brought the issue back into focus by disallowing make-whole claims except in certain limited circumstances. Given the obvious conflicts among three main bankruptcy court jurisdictions, it is therefore critical for lenders to ensure that loan documents include appropriate protective provisions and to also consider other types of yield mechanisms that may be less susceptible to challenge in a restructuring scenario. And putting aside the risk that a lender's claim for call protection may actually be set aside by a court, practically speaking, if there are any questions or doubts as to how clearly the provisions in loan agreements are drafted, it will create leverage for other creditors or the debtor in negotiating a restructuring outcome that improves their own recoveries.

Addressing the issue in loan documentation.

Following the decisions in *Momentive*, the private credit market quickly adapted to clarify that call protection included in loans and notes was not intended as a penalty to compensate for unmatured interest. This developed into what is commonly referred to as either 'safety' or *Momentive* language in loan agreements. These provisions have developed to a generally uniform standard and include a number of acknowledgements and agreements by the borrower with respect to the agreement to pay the prepayment premium. This should include express acknowledgements that:

- the prepayment premium constitutes liquidates damages versus unmatured interest;
- the actual amount of damages to the lender as a result of the triggering event or prepayment would be difficult to ascertain; and
- the make-whole provision does not constitute a prepayment of debt.

Lenders also adopted provisions in loan agreement specifying when the prepayment premium would be payable, such as with voluntary and mandatory prepayments and upon acceleration whether by lender action or upon bankruptcy.[2]

2 We will also note that while the relevant lender protections have been adapted from the various courts' rulings on make wholes, such protective language is often also applied to MOICs and other yield

Finally, for the avoidance of doubt, it bears mentioning that the *Ultra* decision casts uncertainty as to whether these protections will be effective if a borrower that has agreed to call protection and make whole provision commences an insolvency proceeding in the Fifth Circuit and parties in interest challenge the enforceability of such provisions.

Conclusion and summary

Capital solutions transactions play an increasingly important role in today's credit markets by effectively matching borrowers that, for a variety of reasons, cannot access traditional credit markets with credit investors who are seeking higher level returns and have the acumen – and flexibility as non-regulated institutions – to provide bespoke and tailored credit facilities that provide for both higher returns and structural components designed to assure the higher return through various mechanics (eg, PIK interest, call protections and hybrid debt and equity instruments) and also provide some structural protections that would not normally be present in high-yield and leverage finance facilities. Capital solutions transactions are distinct from regular way private credit and sponsor leveraged finance structures in large part because they are not commoditised credit products and don't necessarily fit an institutional investor's credit profile. While the US capital solutions market is the most developed, there is robust capital solutions activity in Europe and MENA, with important differences in each jurisdiction.

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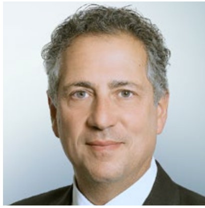
protections appreciating that courts may interpret such mechanics differently than make-wholes.



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Cayman Islands: Restructuring in the Past, Present and Future

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In summary

In this article, we explore the development of the Cayman Islands as a restructuring jurisdiction, the significant cases that demonstrate the sophistication and flexibility of the jurisdiction and our expectations for the future of restructuring and insolvency in the medium to long term.

Discussion points

- Evolution of the Cayman Islands' restructuring regime
- Schemes of arrangement
- Restructuring officers
- Funding of restructurings
- The likely impact of macroeconomic factors on insolvency and restructuring in the Cayman Islands

Referenced in this article

- *In the Matter of Ocean Rig UDW Incorporated, Drill Rigs Holdings Incorporated, Drillships Financing Holdings Incorporated and Drillships Ocean Ventures Incorporated (each in Provisional Liquidation)*
- *In the Matter of LDK Solar Co, Ltd (in Provisional Liquidation)*
- *In the Matter of Arcapita Investment Holdings Limited (in Provisional Liquidation)*
- *In the Matter of Luckin Coffee, Inc (in Provisional Liquidation)*
- *BTI 2014 LLC v Sequana SA*
- *In the Matter of Oriente Group Limited*
- Cayman Islands Companies Act (as revised)

Introduction

> *If you want to know the future, look at the past.*
>
> Albert Einstein

The Cayman Islands continues to be at the forefront of developments in restructuring and insolvency law offshore and among common law jurisdictions. Many companies have chosen the Cayman Islands as an effective and efficient jurisdiction within which to restructure their debt, but as the economic landscape has shifted towards a period of higher interest rates and higher inflation, with bearish markets, what does the future of restructuring in the Cayman Islands hold? In this article we consider what lessons can be learned from the significant restructuring cases the jurisdiction has seen previously, which might be indicative of the issues and solutions that are likely to be seen in future cases.

Past

Prior to recent reforms, the Cayman Islands had adopted a practice that first developed in the English courts in the early 1990s. Insurance companies, which were not able to take advantage of the administration process, would restructure their debt by seeking the appointment of a provisional liquidator following the presentation of a winding-up petition by the company itself, with the effect that a moratorium on claims was imposed while the company, under the supervision of the provisional liquidator, formulated a proposal for its creditors. The procedure has been regularly applied since at least *In Re Fruit of the Loom Ltd* (Grand Court, unreported, 26 September 2000). Thereafter, a well-developed body of jurisprudence has shaped the role provisional liquidators play in the process, ranging from having full control of the process to having a 'soft touch' supervisory role only, where the promulgation of the restructuring plan remains under the control of the directors of the company, with the provisional liquidators supervising the process to ensure the proper application of the company's assets.

Following the adoption of this process as a means of restructuring, the Cayman courts have gained considerable experience with the efficient management of large debt restructurings, proving the regime to be an effective and adaptive means of restructuring debt in relation to Cayman companies, as well as foreign companies that are re-domiciled to, or registered as foreign companies in, the Cayman Islands for the specific purpose of restructuring debt. For example, Ocean Rig (as discussed further below), an oil services group, transferred and shifted the centre of main interest (COMI) of four group companies from the Marshall Islands to the Cayman Islands and successfully restructured over US$3.7 billion of debt through four inter-related Cayman Islands schemes of arrangement. The COMI shift was necessary to access the Cayman Islands

scheme of arrangement process and for the successful application for Chapter 15 recognition.

The principal debt (and equity) restructuring tool in the Cayman Islands was, prior to the introduction of the restructuring officer regime (as set out below), the scheme of arrangement implemented by a provisional liquidator under section 84 of the Companies Act (as amended) (the Act). It is now the scheme of arrangement implemented by a restructuring officer under section 91 of the Act. The principles that apply to Cayman Islands schemes are based on the well-established principles of English schemes, so the law and at least some of the procedure will be familiar to practitioners experienced in the English process. The scheme process is a court process that is initiated by the filing of a scheme petition. There is then a directions hearing for the purpose of ordering the convening of scheme meetings, followed by one or more meetings where creditors consider and vote on the restructuring plan, and (if approved at all meetings) a second hearing where the court considers whether or not to sanction the scheme. If sanction is granted by the court, the scheme takes effect on the filing of the order, and the scheme terms are then implemented, usually without further reference to the court.

For group debt, each individual company with debt that needs to be restructured must be the subject of separate scheme proceedings and meetings. To streamline the process, however, the Grand Court manages the related proceedings together. Scheme terms are often inter-conditional so that one does not take effect unless all are sanctioned by the Grand Court. The restructuring can be completed quickly, but the more complex the scheme or the more vocal any dissent, the more likely it would be that the process would run its course over a longer period of time.

Examples of successful Cayman Islands restructurings

Following the 2008 global financial crisis, many companies were left with an unmanageable debt burden, with limited liquidity. To reposition themselves to take advantage of improving economic conditions through the 2010s, many companies took advantage of Cayman's restructuring regime. Some of those key cases are discussed below.

Arcapita Investment Holdings Limited (AIHL)

Arcapita was a leading global manager of shariah-compliant alternative investments and operated as an investment bank. One of its subsidiaries, AIHL, was incorporated in the Cayman Islands as an exempt company for the purpose of holding Arcapita's ownership interests in various investments.

Arcapita was adversely impacted by the 2008 global economic downturn, particularly by the debt crisis in the Eurozone. This hampered its ability to obtain liquidity through capital markets and resulted in a reduction in asset values (and concomitant difficulties in monetising certain of the illiquid and complex assets owned by its affiliated portfolio companies).

In this context, the Arcapita Group was unable to refinance a syndicated facility worth US$1.02 billion that was due on 28 March 2012. Accordingly, voluntary bankruptcy proceedings were filed under Chapter 11 of the United States Bankruptcy Code in respect of six 'debtors' of the Arcapita Group (including AIHL) and a restructuring plan was prepared.

In addition to the syndicated facility, the indebtedness of the debtors prior to implementing the plan included more than US$96 million in secured debts to a bank and more than US$1.19 billion in unsecured debt.

In effect, the plan involved restructuring the existing shariah-compliant debt and equity arrangements through the issuing of new shariah-compliant debtor-in-possession financing to fund the reorganisation and to allow operations to continue during the asset disposition process. This method: provided for the reorganisation of the existing debtors into new entities with new holding companies; provided working capital to fund the emergence from the Chapter 11 proceedings and to capitalise the new entities and holding companies; maintained control of the debtors' assets to allow value realisation; and facilitated the wind-down of the debtors' existing investments.

Proceeds from the asset dispositions were first applied to repay the new secured facility that was used to provide working capital for the plan and second to an unsecured facility subordinate to the new secured facility.

LDK Solar (LDK)

LDK is a producer of components used in the generation of solar energy.

Between 2011 and 2013, following the introduction of anti-dumping laws in the EU and a general reduction in the availability of government subsidies following the global financial crisis, the solar power industry suffered significant financial challenges associated with the reduction of the price of solar panels and the declining price of polysilicon, a key raw material used to manufacture solar panels. Already overburdened with debt taken on to fund the expansion programmes of earlier years, LDK was not able to sustain these operating losses. Accordingly, with maturity dates on debt burdens looming, LDK sought to restructure.

Prior to the restructure, LDK's debt included borrowings from Chinese institutions of approximately US$2.9 billion, secured against LDK group companies based in China, and non-Chinese based lending and security burdens of US$1.1 billion that included:

- US$293 million to senior note holders of senior notes issued by LDK;
- US$390 million worth of redeemable preferred shares issued by LDK Silicon & Chemical Technology Co, Ltd (a subsidiary of LDK); and
- inter-company creditors and unsecured creditors of LDK made up predominantly of professional advisers.

With the sanction of the Grand Court, restructuring support agreements were entered into with a majority of senior note holders and preferred shareholders, which required the promulgation of various separate but inter-conditional schemes of arrangement in the Cayman Islands and Hong Kong, as well as a related Chapter 11 plan in respect of a key trading subsidiary in the United States.

The nature of the restructuring was to extend the maturity of LDK's offshore debt by converting (to the extent agreed by the holders) the senior notes and preferred shares into convertible bonds, and exchange some of the debt arising under the senior notes and preferred shares into equity, thereby reducing the offshore debt by approximately 10 per cent.

Ocean Rig

The restructuring of the Ocean Rig Group was one of the largest successful contentious restructurings in the Cayman Islands and involved the exchange by creditors of approximately US$3.7 billion of debt for new equity, US$288 million in cash and US$450 million of new secured debt.

Ocean Rig is an international offshore drilling contractor that provides oilfield services for offshore oil and gas exploration, development and production drilling and specialises in the ultra-deep water and harsh-environment segment of the offshore drilling industry. Due primarily to the fall in the price of oil between March 2014 and February 2016 and an increasing debt burden, four companies within the Ocean Rig Group (Ocean Rig UDW Inc (UDW), the parent entity; Drillships Financial Holdings Inc (DFH); Drillships Ocean Ventures Inc (DOV); and Drill Rigs Holdings Inc (DRH)), sought sanction from the Grand Court of a compromise between each of the companies and their creditors.

Prior to the restructuring, the companies' debt comprised the following:

- UDW owed US$131 million to senior unsecured noteholders and US$3.56 billion under guarantees provided in respect of the debt of its subsidiaries. Its guarantee was secured against its shares in the subsidiaries;
- DRH owed US$459.7 million under secured notes;

- DFH owed US$1.83 billion under secured term loans; and
- DOV owed US$1.27 billion under secured loans.

Schemes were proposed (and ultimately sanctioned) in respect of each entity. The schemes in respect of UDW, DFH and DOV were inter-conditional upon each being approved. The DRH scheme was conditional upon the UDW, DFH and DOV schemes being approved.

The effect of the restructuring was to reduce the Ocean Rig Group's financial indebtedness from approximately US$3.7 billion (plus accrued interest) to US$450 million pursuant to a new credit facility (generating interest at 8 per cent per annum) provided by the existing lenders in exchange for either ordinary shares in UDW or cash.

Luckin Coffee

The Luckin Coffee restructuring is one of Cayman's most recent restructuring success stories.

Luckin Coffee was founded in 2017 by a Chinese entrepreneur, Charles Lu, with the goal of displacing Starbucks as China's largest coffee chain. By the time of its initial public offering (IPO) in 2019, it had opened 2,370 stores and with coffee consumption in China estimated to increase from 8.7 billion cups in 2018 to 15.5 billion cups by 2023, the company formulated aggressive expansion plans to open a further 2,500 stores throughout 2019. To fund this expansion, the company's 2019 IPO, secondary public offering and bond issuance raised approximately US$2.2 billion. However, by 2020, cracks had begun to show in Lu's expansion strategy. Muddy Waters Research published a report alleging that Luckin had been misreporting its sales, and an undercover research firm dispatched more than 1,000 researchers to Luckin stores, uncovering further alleged discrepancies in Luckin's reporting. Shortly after, and following an independent special committee investigation, Luckin announced that it had suspended Lu after finding that he had exaggerated the company's 2019 sales by approximately US$310 million. This resulted in the company's share price collapsing, wiping approximately 70 per cent, or US$5 billion, from its market value and the company being delisted by NASDAQ. Luckin's bonds fell as low as 10 cents on the dollar.

Litigation followed, with various direct and class action claims being asserted in the United States, a class action claim in Canada, and injunctive proceedings in both the Cayman Islands and Hong Kong. Litigation was complicated by the involvement of various individuals and institutions who were entitled to claim indemnities against Luckin. Luckin's issues also became political ammunition for US senators who argued that Chinese corporations could not be trusted, fuelling interest in Luckin's operations from the US Securities and Exchange

Commission and Department of Justice. To protect Luckin from its creditors while restructuring proposals were considered, a winding-up petition was filed by a former director as a 'friendly' creditor.[1] The company then applied for the appointment of provisional liquidators to assist with proposing a compromise or arrangement to the company's creditors, in the hope that value could be preserved and the company could continue as a going concern.

In July 2020, provisional liquidators, working collaboratively with the company and its team of advisers, addressed a number of complex practical, operational and legal issues, successfully bringing the provisional liquidation to a close in March 2022, putting Luckin in a strong position to continue as a going concern (with its share price steadily increasing post-restructuring).

Prior to implementing its restructuring, Luckin Coffee's potential liabilities included US$460 million 0.75 per cent convertible senior notes due in 2025 and claims by various of its shareholders, in the range of US$2–3 billion.

The restructuring involved the injection of US$250 million from existing shareholders, a settlement of the class action shareholder claims for US$187.5 million and cancellation of the notes in exchange for:

- US$151 million in cash;
- US$63 million in one-year notes with an enhanced interest coupon;
- US$142 million in five-year notes with an enhanced interest coupon; and
- US$9 million of new American depository shares.

These cases all involved several common themes. First, the requirement to raise new money to fund the restructuring, discharge some or all of the companies' presently due and payable liabilities, and to fund working capital requirements post-restructuring. Second, these cases tended to focus on the need to manage the relationships between competing groups of stakeholders to ensure a fair outcome for each separate stakeholder group. Third, these cases invariably involved releases of claims against management and management incentive provisions aimed at ensuring continuity and stability of management post-restructuring.

Present

The relatively recent changes to the Cayman Islands' restructuring regime for companies, which came into force on 31 August 2022, represent an evolution (rather than revolution) of the process described above. The new regime allows for the appointment of a dedicated restructuring officer, who fills a role similar

1 A well-established route to seek the protection of the Court in the Cayman Islands, as endorsed by the Grand Court in *Re CW Group Holdings Limited* (Grand Court, unreported, 3 August 2018) and in *Re CHC Group Ltd* (Grand Court, unreported, January 24, 2017).

to that of a provisional liquidator but avoids the stigma of a winding up petition, the appointment of provisional liquidators and the potential triggering of *ipso facto* clauses when restructuring a company in the Cayman Islands. The ability of the company to present its own petition for the appointment of restructuring officers also avoids the need to adopt the developed practice of working around the restriction[2] preventing the company from presenting its own petition without shareholder approval by finding a 'friendly' creditor to petition on behalf of the company. The changes were much anticipated and welcomed by legal and insolvency professionals in the Cayman Islands as representing an incremental improvement of the existing process while continuing to allow for flexible restructuring options in the Cayman Islands.

Oriente Group Limited (Oriente)

The first Cayman Islands restructuring officers were appointed in relation to Oriente in late 2022. Oriente is the parent company in a group that operates a financial technology platform providing alternative sources of credit in Southeast Asia. The Oriente group's performance was heavily impacted by a drastic increase in consumers defaulting on loans and interest rate increases by central banks during the covid-19 pandemic.

Oriente attempted to engage in discussions with its creditors, but two creditors filed a winding up petition in the Grand Court in September 2022. Shortly thereafter, in October 2022, Oriente filed a petition in the Grand Court seeking the appointment of joint restructuring officers pursuant to section 91B of the Act, on the basis that Oriente was unable to pay its debts as they fell due and intended to present a compromise or arrangement to its creditors.

The Grand Court appointed restructuring officers in relation to Oriente, and handed down a written judgment (*In re Oriente Group*, FSD 231 of 2022, unreported, 8 December 2022), which provides welcomed guidance in relation to the appointment and role of restructuring officers.

The judgment reinforces that the restructuring officer regime is an evolutionary development, which retains the majority of the aspects of the provisional liquidation regime that have worked well over many years, rather than the ground-breaking revolution some have attempted to paint it as.

The Grand Court held that, given the similarity of the legislation in relation to provisional liquidators and restructuring officers, case law relating to provisional liquidations will be persuasive in relation to the restructuring officer regime. Kawaley J said 'the cases under the former regime record valuable judicial and legal experience in essentially the same commercial sphere . . .' and went on to

2 The position at common law following *Re Emmadart Ltd* [1979] 1 Ch 540, as reapplied in the Cayman Islands following *Re China Shanshui Cement Group Limited* [2015 (2) CILR 255].

say that *In re Sun Cheong Holdings* [2020 (2) CILR 942] (a well-known judgment of Chief Justice Smellie (as he was then)) 'lucidly paints an instructive portrait of the old statutory scheme which applies with equal force to the restructuring officer regime'.

Kawaley J's judgment does emphasise a notable improvement introduced as part of the restructuring officer regime, being that the statutory moratorium on claims applies from the date of the petition to appoint restructuring officers, as opposed to the date on which the provisional liquidators were appointed (as the petitioning creditors unsuccessfully argued). Kawaley J described the change in relation to when the moratorium comes into force as a 'significant innovation . . . which might be said to turbo-charge the degree of protection filing a restructuring petition affords to the petitioning' and went on to describe the filing of a petition by the petitioning creditors in Hong Kong shortly before the appointment of restructuring officers as a 'flagrant breach' of the moratorium.

Future

Where the fundamental objective of a restructuring process is to offer a better return to stakeholders than could be achieved through a terminal liquidation of the business, certain minimal criteria must be present before a restructuring can reasonably be considered. First, the company must have a viable future as a going concern – a company whose business is no longer viable due to, for example, technological advances or cultural shifts, achieves little by restructuring where reducing demand over time means that a restructuring serves to only delay the inevitable. Second, the company must have assets of real value where the ability to realise or exploit that value over time results in a better outcome than a terminal liquidation. A company whose assets have or are about to lose significant value that is unlikely to be recovered over time, an example being intellectual property rights where patent protection is about to expire, can offer little to stakeholders through a restructuring that could not be achieved in a terminal liquidation. Contrast that situation with, for example, a mining company extracting iron ore where iron ore prices drop temporarily but are likely to recover in the medium term, where a restructuring would likely offer a better outcome for stakeholders and allow the company to trade through short-term cyclical or industry specific challenges.

Where the company can satisfy these criteria, it should have the ability to offer a better return to stakeholders through a restructuring, either by using assets of value to raise new money to discharge creditors, or alternatively by using the perceived value in the business to discharge creditors by issuing new shares in satisfaction of creditor claims (ie, a debt for equity swap). However, with rising interest rates, reduced consumer spending, soaring inflation and the withdrawal of pandemic-related government support schemes all starting to take effect, resulting in projected global economic growth for 2023 of just 1.7

per cent, current economic circumstances seem likely to impact the ability of companies to easily offer these alternatives. The cost of borrowing, particularly in circumstances of distress that often justify a funding premium, is or may become prohibitive for many companies, who must also weigh in the balance their ability to service that debt over time after emergence from a restructuring process in a more challenging economic environment. This is particularly so in the context of increasing operating costs, generally reducing consumer demand and increasing late payments by customers. These factors would also need to be carefully considered by stakeholders when contemplating an offer to accept equity in exchange for debt.

The examples of restructuring cases addressed above all involved an injection of new funding. Now, where such funding may not be affordable (or even available at all) in the short to medium term, success in restructuring cases is likely to be more difficult to achieve. This is perhaps reflected in the Allianz Global Insolvency Index suggesting that global insolvencies have increased 21 per cent in 2023, with a further 4 per cent increase in global insolvencies projected for 2024.

In this environment, insolvency practitioners are likely to have to be more cautious before recommending or supporting a restructuring plan. The restructuring process, which is often a complex exercise involving legal and financial advice in multiple jurisdictions and various competing stakeholder groups all defending their respective economic interests, can involve significant expense. Professional fees and expenses can and typically run into the millions, and that value is entirely lost to stakeholders where the restructuring does not succeed. Insolvency practitioners who support a restructuring plan with limited or no real prospect of success are likely to face criticism and potential liability for those costs if they have the effect of reducing the company's assets to no purpose. It is also likely that the liquidation analyses usually required to support a scheme of arrangement will need to be more robust and demonstrate an appropriate degree of scepticism around asset valuations and revenue or cash-flow forecasts.

Insolvency practitioners are likely to come under greater pressure to consider maximising recoveries from all available sources, including potential claims against directors and others involved in company management. The reported increase in focus on directors' conduct by the UK's Insolvency Service is unlikely to be a jurisdiction-specific trend. The recent case of *BTI 2014 LLC v Sequana SA* [2022] UKSC 25, in which the English Supreme Court said that the directors' duty to creditors modulated depending on the probability of insolvency, with the interests of creditors becoming paramount when an insolvency filing was inevitable or unavoidable, also seems likely to prove to be more of a bright-line test when it comes to the question of directors' breaches of duties to creditors.

In circumstances where many directors have been faced with difficult trading conditions arising from the impact of the global pandemic, it seems likely that there will be an increase in cases involving at least wilful neglect or default, and

even outright fraud and dishonesty, representing a potentially valuable source of recovery in a liquidation. As described above, where previous restructuring plans have typically involved management incentives and releases, it seems likely that such releases or incentive plans will be less attractive to stakeholders versus the prospect of a potential litigation recovery.

It follows from the above that directors and others involved in management will need to be conscious of these challenges as they consider the best way to manage economic distress. Company directors will need to ensure they have up to date and accurate financial information, be quick to focus on early indicators of distress, and act decisively when in circumstances of approaching or impending insolvency. Directors will need to be more proactive about seeking solutions if a liquidation is to be avoided and more philosophical about situations where a liquidation cannot.

Creditors of companies in distress are likely to be more sceptical about the benefits of accepting long positions in companies seeking to restructure. Debt for equity swaps may be less attractive where share values are likely to be suppressed and where the prospect of dividends being paid is greatly reduced by the increased operating and financing costs.

However, this heavy note of caution should not be misconstrued as despair – things could be worse. There is still greater liquidity in the market than there was in 2008, and as a result there remains significant capital available to exploit the right opportunities. The slowing of global growth, particularly in developing jurisdictions, has not yet turned to a global recession, which may be likely but is by no means inevitable. The Cayman Islands restructuring regime remains a valuable tool for those managing corporate debt and distress.

Conclusion

While the level of financial distress has certainly increased, and is reflected in increased insolvencies globally, the Cayman Islands restructuring regime may still offer solutions to those who act cautiously, take advice quickly and are prepared to be creative and pragmatic about restructuring solutions. The approaches that have worked in previous cases are instructive, but may not be as effective in a changing and more challenging economic environment.

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Chile: Recent Changes Made to Restructuring Proceedings

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In summary

This article aims to analyse the recent changes made to Chile's restructuring proceedings under Law No. 20,720, which replaced the former bankruptcy procedure of Law No. 18,175 in 2014, along with the recent enactment of Law No. 21,563, which modified some aspects of reorganisation and liquidation proceedings. This article also discusses some current Chilean cases. Finally, comments upon certain aspects that need further improvement in the Chilean system.

Discussion points

- Bankruptcy and reorganisation of debtor companies
- Changes introduced by Law No. 20,720
- Review of reorganisation proceedings
- Reform introduced by Law No. 21,563

Referenced in this article

- Law No. 20,720
- Law No. 18,175
- Law No. 21,563
- Case C-110-2023, Civil Court of Porvenir
- Case C-12.426-2023, 15th Civil Court of Santiago
- Case C-12429-2023, 6th Civil Court of Santiago
- Case C-16.059-2023, 5th Civil Court of Santiago
- Case C-497-2023, 23th Civil Court of Santiago

History of Law No. 20,720

Law No. 18,175[1] was in force in Chile until 2013 and its main objective was to promote the payment of companies' debts[2] by liquidating the bankrupt's assets. However, there was a shift of paradigm in 2014 with the enactment of Law No. 20,720 (the Law),[3] which highlights a series of factors.

First, the scarce use of the former bankruptcy system reflected its inefficiency. The former Bankruptcy Law was so unattractive for debtors that only an average of 155 companies went officially bankrupt every year, while about 2,000 companies solved their situation informally. That is, only 9 per cent of all companies going through insolvency applied for bankruptcy, although all of them could have resorted to it. This was alarming, even compared to other Latin American countries and the Organisation for Economic Co-operation and Development.[4]

Second, proceedings under Law No. 18,175 were usually time-consuming and expensive. A common bankruptcy procedure lasted 3.2 years on average, compared to 1.7 years in developed countries and 2.9 years in other countries in the region. This posed an issue because such a length of time could mean a debtor had to disburse up to 15 per cent of its assets. In addition, the probability that the company going bankrupt would reorganise afterwards was very low. And the recovery rate reached only 30 per cent, compared to 70 per cent in developed countries and 36 per cent for Chile's Latin American neighbours.[5]

With these challenges in mind, Chile adopted a new paradigm with respect to bankruptcy proceedings, which aimed to be a motor for the economy, in accordance with international standards:

> *[We see Law No. 20,720] as a tool for economic growth, business development, promotion or stimulation of entrepreneurship and as a mechanism for the elimination of legal barriers to entrepreneurship.*[6]

The objectives pursued by the Chilean legislative body when creating the Law can be summarised as follows:

- the several interests of the stakeholders: the state's objectives are enabling the effective reorganisation of viable companies and the provision of legal tools to allow companies to overcome temporary difficulties they may face; and

1 www.bcn.cl/leychile/navegar?idNorma=29597.
2 European Commission Recommendation, March 2014, found in 'Nuevo Derecho Concursal Chileno' Gonzalo Ruz, June 2017.
3 www.bcn.cl/leychile/navegar?idNorma=1058072.
4 'Insolvencia y Quiebra en Chile, Principales estadisticas desde 2018 a la fecha' Chilean Minister of Economy, June 2015.
5 'Insolvencia y Quiebra en Chile, Principales estadisticas desde 2018 a la fecha' Chilean Minister of Economy, June 2015.
6 'Nuevo Derecho Concursal Chileno' Gonzalo Ruz, June 2017.

- enabling the fast liquidation of non-viable businesses, thereby stimulating the resurgence of entrepreneurs through new initiatives.[7]

Thus, the Law provides elements to either replace or modernise the outdated roles and institutions of the former Bankruptcy Law, namely, the roles of the insolvency examiner and the insolvency trustee, the creditors' committee and the insolvency and entrepreneurship agency. All of these are now defined in section 2 of the Law, which outlines the most important terms used in this new Law. However, it is striking that a law focused on reorganisation and liquidation has not defined the word 'insolvency', a core concept in a reorganisation.

The current law ends assertively with the former unitary model, in which the same bankruptcy instruments were available for all types of debtors, and creates a hybrid model instead. The new law sets forth two separate procedures that distinguish the company from the debtor.[8] These two new procedures are reorganisation and liquidation. The pursuit of one procedure or the other depends on the debtor's objective and the company viability: it can either serve to restructure economically and financially viable companies, or to liquidate non-viable ones both quickly and effectively.[9] Both reorganisations and liquidations can be voluntary or mandatory.

The following analysis will only refer to the reorganisation procedure.

Reorganisation and its modifications

Reorganisation proceedings can be started at any time, as it is not necessary to meet any admission requirements other than the formal aspects and certificates that must be enclosed with the application. In accordance with the provisions of section 54 of the Law, companies may start proceedings filing an application with the corresponding Civil Court.

When discussing these issues, it was decided that instead of creating specialised courts, the Civil Court of the domicile in which the company is located would hear these matters. Thus, to integrate a specialisation factor in agreement with the guiding principles, it was established that courts would be trained in bankruptcy matters, which would be taught regularly by the Academia Judicial (the Judicial Academy). This probably responds to a historical rather than a legal fact, as the cost of implementing specialised courts is high, apart from a series of administrative issues that must be solved to implement them, such as their number, composition and distribution throughout the country.

7 'Nuevo Derecho Concursal Chileno' Gonzalo Ruz, June 2017.
8 'La reforma de la legislación concursal chilena' Juan Luis Goldenberg, 1-2015.
9 'Nuevo Derecho Concursal Chileno', Gonzalo Riuz, June 2017.

The reorganisation proceeding was subject to some relevant procedural modifications by the enactment of Law No. 21,563, which entered into effect in August 2023.

To start reorganisation proceedings, the appointment of an overseer must be requested before the Insolvency and Bankruptcy Office (the Office). To appoint an overseer, the following records and documents (listed in section 55 of the Law) must be submitted, and must also be filed with the civil court hearing the case:

- a copy of the petition to start the procedure; and
- a certificate issued by an independent auditor of the debtor, who must be registered with the Agency's External Auditors Register.

The overseer must be nominated in accordance with the procedure laid out in section 22 of the Law. The Office must notify the three largest creditors, who must propose an overseer and an alternate overseer. The incumbent overseer, voted by the largest majority, shall be selected. If no proposals are received, the overseer will be nominated by random selection.

With regard to notifications, to reduce costs, publications of notices in the Legal Gazette (which previously had to be paid for individually and were costly for debtors) are replaced by publication in the Bankruptcy Newsletter, an open and free electronic platform managed by the Insolvency and Bankruptcy Office.

This system has been criticised, as it requires a person to specifically search for a company to be declared insolvent, which more inexperienced creditors might find difficult, thus losing their opportunity to verify their claims in a particular proceeding.[10] However, it seems that modernisation is a vital part of the new bankruptcy system, especially if we take into account that – like any new law – its implementation may result in a period of greater uncertainty without this meaning that the change is detrimental to creditors.

Once the overseer's nomination has been approved, the court must proceed with the reorganisation procedure. To do so, the debtor company must file the documents listed in No. 1 to No. 5 of section 56 of the Law. Five days after this submission, the court will render the decision that opens the reorganisation proceedings, leading to the next step of the proceedings: determining liabilities and creditors.

The reorganisation ruling establishes a stay period of 60 business days (extended by the recent modification introduced by Law No. 21,563), which can be extended up to 60 additional days with the support of two or more creditors that represent 30 per cent of the voting rights (for an extension of 30 days) or 50 per cent of the voting rights (for an extension of 60 days).

10 'Mirada Critica a la Ley 20.720' Juan Esteban Puga, in La Ley No. 20.720, a un ano de su vigencia Eduardo Jequier May 2016.

Liabilities and creditors are determined, first, by considering the accounting certification submitted by the debtor company and, then, by means of the creditors' credit checks, which must be carried out within 15 days of the reorganisation resolution's notice. This procedure was simplified by introducing a final deadline for the insolvency reorganisation proceedings.[11] Under the procedural speed principle, the remedies applicable to the procedure are restricted to a handful of remedies previously established by law, especially regarding the appeal and bankruptcy collateral issues.

Once creditors' claims have been verified, they will be published in the Bankruptcy Newsletter, where they can be challenged by the debtor, the overseer and the creditors, within eight days. If challenges are raised, they must be remedied. If they cannot be remedied, the relevant claims and commercial appraisal shall be considered contested. The overseer must submit a list of contested claims to the court. The court shall then schedule a single oral hearing to rule on the challenges. Once the liabilities have been determined, the overseer sets a list of creditors entitled to vote at the creditors' meeting, where the proposed reorganisation agreement submitted by the debtor company is discussed and decided upon.

One of the main modifications included by Law No. 21,563 in this regard is that creditors that are not considered by the debtor and that do not file their proof of claim within the proceeding may file a motion for the plan to be applicable to them once it is approved.

Once the proposal is informed at the creditors' meeting, it is considered accepted if the debtor consents to it and there is a concurrent vote of, at least, two-thirds of the creditors present, representing at least two-thirds of the total liabilities with voting rights, as established in section 79 of the Law. If the debtor does not appear at the creditors' meeting, the court must immediately issue a liquidation resolution, ending the reorganisation procedure and thus leading to a mandatory liquidation of the debtor.

If amendments are to be made to the agreement, they must be adopted in the same way as the agreement was originally adopted, namely, in accordance with the procedure laid down in section 79 of the Law. Section 85 et seq include the possibility to contest the judicial reorganisation agreement. In this case, a single hearing will be held, at which the contest will be resolved. The agreement will be considered approved and will become effective once the term to contest it has expired, or once all challenges have been resolved.

If the creditors reject the reorganisation agreement because the necessary approval quorum has not been obtained, or because the debtor does not consent to it, the court must issue a liquidation resolution, unless the creditors' meeting

11 'Mirada Critica a la Ley 20.720' Juan Esteban Puga, in La Ley No. 20.720, a un ano de su vigencia Eduardo Jequier, May 2016.

provides otherwise by a special quorum. In this case, the debtor, through the overseer must publish a new proposal for a reorganisation agreement in the Bankruptcy Newsletter, a proposal that must also be filed with the court. If the new proposal is not submitted, the court must issue a liquidation resolution.

The latter is known as 'derived bankruptcy', whereby a company is forced to go into liquidation without the need for the creditor to request the debtor's liquidation. This is a safeguard for both the procedure as a whole and the creditor, who will not be affected even if the debtor is not complying. Therefore, it is a widely used mechanism throughout the Law.

Simplified or out-of-court reorganisation agreement

The simplified or out-of-court reorganisation agreement is an 'agreement entered into between a Debtor Company and its creditors for the purpose of restructuring its assets and liabilities, and which is submitted for court approval subject to the procedure set forth in Chapter III, Title 3 [of Law No. 20,720]'.[12]

This mechanism is rarely used because it does not adhere to the bankruptcy logic, as an individual arrangement has obvious limitations when a greater goal is sought, which can only be achieved by the creditors as a group.[13] This out-of-court agreement still needs to be approved by the court. Moreover, a single vote against it (from any of the creditors) may lead to it being entirely rejected. This hold-out right the creditors are entitled to is one of the great reasons why agreements are mostly never reached through the simplified or out-of-court reorganisation agreement.[14]

> *After the question of the need of individuals for a financial fresh start has been set aside, the remaining main role of bankruptcy law has been and should relate more to procedure rather than to substantive law. That goal is to allow the assets owner to use those assets in a way that is most productive to debtors as a group in the face of incentives by individual owners to maximize their own positions.*[15]

12 Section 2, No. 2, Law No. 20.720.
13 'El concurso desde una perspectiva procesal' Nicolas Carrasco, Vol.27, 2020.
14 See 'Extrajudicial Agreements from the Privatistic Approach of Bankruptcy Laws', Juan Luis Goldenberg, 1° semester, 2014.
15 'The Logic and limits of bankruptcy law', found in 'El concurso desde una perspectiva procesal' Nicolas Carrasco, Vol.27, 2020.

Main remarks of the reorganisation procedure of the debtor company and its recent modifications

Having already commented on the procedure in general terms, we would like to point out some innovations that are worth mentioning separately: tools created in favour of the debtor company, with the modern understanding that a reorganisation works better when they are used.

Bankruptcy financial protection

> *This is the term this law grants to the Debtor filing for Bankruptcy Reorganisation Procedure, during which its liquidation may not be requested or declared, nor may summary collection proceedings, enforcements of any kind or surrenders in lease disputes be started against it.*
>
> *The term shall be the time between the Reorganization Resolution notice and the Judicial Reorganisation Agreement, or the period fixed by law if the latter is not agreed.*[16,17,18]

Bankruptcy financial protection plays a fundamental role in the reorganisation procedure governed by the Law. It eliminates the risk of imminent enforcements, allowing adequate negotiation to take place, thus improving the possibility of reaching a better agreement, especially if we consider that the debtor company keeps managing its businesses during the procedure, though with certain restrictions, that allow it to continue developing its usual business activities.[19]

One of the main modifications introduced by Law No. 21,563, is the extension of the stay period from 30 to 60 business days, which can be extended up to 60 additional days with the support of two or more creditors that represent 30 per cent of the voting rights (for an extension of 30 days) or 50 per cent of the voting rights (for an extension of 60 days).

Supply assurance

During the reorganisation period, the debtor company must still ensure that its suppliers will keep providing the goods and services necessary to continue with the activities. To enable this, the lawmaker offers incentives to suppliers.

16 Section 2 No. 31, Law No. 20.720.
17 The period is that of the notification of the reorganisation resolution and the judicial reorganisation agreement, or the deadline set by law if no agreement has been reached.
18 See section 57, Law No. 20.720 for the effects. The same thing happens with the issuance of the liquidation decision contained in sections 130, 134 and 135.
19 'Nuevo derecho Concursal Chileno' Gonzalo Ruz, June 2017.

The first incentive is that invoices issued during reorganisation proceedings will be paid on their agreed dates, subject to the judicial reorganisation agreement being approved, without the need for creditors to verify their claims.

The second incentive implies that if the reorganisation agreement is not approved, and the liquidation of the company is declared, the credits regarding these supplies will be paid preferentially, provided that they are dated after reorganisation proceedings have started.

This concept can be clearly seen in Case No. 28256-2018 from the Chilean Supreme Court: *HDI Seguros de Garantía y Credito SA v Agrícola y frutícola San Andres del Romeral Ltda*.

This case dealt with the possibility of collecting credits that had been previously included in a reorganisation agreement under the concept of supply continuity – in accordance with section 72 of the Law. The credit consisted of a series of supplier invoices, all of them issued after the bankruptcy had been filed, but prior to the bankruptcy resolution, therefore making suppliers potential beneficiaries of the first incentive stated above. All three courts (the Civil Court, the Court of Appeals of Santiago and the Supreme Court) agreed that the credits were not enforceable because they were subject to the specific benefits of the reorganisation agreement.

Recent modifications to Chilean Insolvency Law and improvements needed

In August 2023, Law No. 21,563, which modifies Law No. 20,720, entered into effect. The modification includes some improvements to simplified insolvency proceedings for small and medium-sized companies, in addition to some procedural improvements to reorganisation and liquidation proceedings.

In summary, the modifications include:

1. the creation of a simplified reorganisation proceeding for small and medium-sized companies;
2. the possibility for creditors that did not appear in a reorganisation proceeding to demand the application of the plan to them;
3. the extension of the original stay period from 30 to 60 business days;
4. flexibility of the requirements for DIP financing with regard to the quorums needed for its approval by creditors;
5. more requirements for the initiation and termination of a liquidation procedure; and
6. restrictions to the extinctive effect of the termination of a liquidation procedure.

Although this reform includes some positive improvements, they are mostly procedural. Therefore, the reform fails to deal with some other important material aspects of this type of process, which, in our opinion, are:

- the impossibility of restructuring the debt of a group of related companies in the same process;
- an automatic stay that operates from the filing of the reorganisation request; and
- the ability to obtain financing.

Currently, in Chile, company owners and controllers, along with related companies, are the main source of financing in reorganisations.

Mechanisms must be included to allow debtor companies to acquire financing so that they can effectively implement their reorganisation plans – in particular, rules that encourage preferential financing of companies with new money or special preferences for their payment. A good measure would be to allow capital increases, favouring the entry of new external investors, similar to proceedings under Chapter 11 in the United States.

Relevant recent cases

Reorganisation proceeding of Nova Austral

Nova Austral, a Chilean salmon farmer is currently restructuring its US$560 million in debt in an in-court reorganisation proceeding, which is being held before the Civil Court of Porvernir (case C-110-2023), in the far south of Chile.

The plan proposed by Nova Austral to its creditors contemplates a US$487 million capital increase to the majority of its US$560 million debt into stock, followed by a potential sale of the company's assets. However, this proposal is still pending approval by the creditors on a hearing that was scheduled for late October 2023.

Debt restructuring of Mainstream subsidiaries in Chile

In July 2023, Mainstream Renewable Power (Mainstream) initiated two reorganisation proceedings for its energy power subsidiaries Huemul Energía SpA and Cóndor Energía SpA.

Through these proceedings, Mainstream seeks to restructure its outstanding debt and regain sustainability after the losses suffered by the renewable energy sector in Chile.

The total amount of the liabilities subject to these proceedings is approximately US$1 billion.

Debt restructuring of Winia Electronics (Daewoo)

Winia Electronics Chile, the Chilean branch of the Korean electronics company Winia (Daewoo), filed for its reorganisation before the 5th Civil Court of Santiago (Case C-16.059-2023), after X Capital, one of its main creditors, sought the liquidation of an outstanding debt of US$2 million.

In this process, Winia seeks to continue its operations in Chile by the restructuring of a total debt of approximately US$10 million. Winia's main creditors are X Capital, Cencosud and the Chilean National Treasury.

The reorganisation plan that will be proposed by Winia to its creditors will be voted on December 2023.

Liquidation proceeding of Maria Elena Solar

On 4 April 2023, the 23rd Civil Court of Santiago declared the liquidation of María Elena Solar SpA, a Chilean renewable energy Company owned by Solarpack Corporation, after a claim was filed by its main creditor, the German Bank KfW IPEX-Bank GmbH. The total debt subject to this process is approximately US$91 million.

This is the first case of an active renewable energy company entering into liquidation. However, the appointed insolvency administrator ordered the continuation of the debtors' activities to allow a sale of the company or its main assets.

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Gianfranco Lotito specialises in restructuring and insolvency, particularly in complex and cross-border insolvency proceedings.

He regularly advises banks, financial institutions, and private and public investment funds on business and financial restructuring procedures, designing pre-insolvency matters and court strategies. He has also represented national and international clients (including lenders and investors) on restructuring

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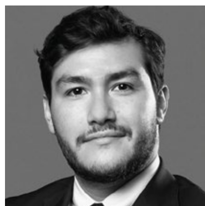
He also specialises in dispute resolution, domestic and international arbitration, and lawsuits arising from disputes over sales of shares and transferable securities, and companies (representations and warranties), construction and engineering, and agency and distribution.



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Cuatrecasas is a law firm with over 1,700 professionals present in 13 countries and well established in Spain, Portugal and Latin America, where we have offices in Bogotá, Mexico City, Lima and Santiago.

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Dominican Republic: Law 141-15's Challenges and Application

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In summary

This article discusses challenges in and updates to the application of the Dominican Republic restructuring and insolvency law (Law 141-15), which came into force in February 2017. Since then, the courts have developed criteria regarding several interesting topics, such as the payment of officers' fees and processing expenses. Furthermore, an important precedent has been established related to the capability of the insolvency jurisdiction, as a specialised jurisdiction, to suspend decisions rendered by other courts during the insolvency proceeding whenever such decisions affect the assets of the debtor. Furthermore, the courts have settled legislation contradictions with the insolvency statue, such as the abbreviated foreclosure procedure provided by Law 189-11 on trusts, regarding the effects of the insolvency law and the scope of the stay of proceedings conceived by it.

Discussion points

- Conflict between legal instruments solved by courts in relation to the stay of proceedings, the suspension of adjudication decisions in foreclosure procedures and the jurisdiction of labour courts
- Exclusive jurisdiction of the restructuring court affecting the assets of the debtor
- Non-appeal of decisions of preliminary dismissals of restructuring requests
- Challenges of restructurings through trusts
- Requirements for creditors to file restructuring requests against debtors
- Dismissal of liquidation requests

Referenced in this article

- Restructuring Law 141-15
- Executive Decree No. 20-17
- Reorganisation of Arconim Constructora, SA
- Reorganisation of Transporte Duluc, SA Servicios Petroleros, SA and AMG, SA
- Reorganisation of 33 Renova Expert SRL

Introduction

Law 141-15 regulates insolvencies and restructuring procedures in the Dominican Republic. The Law was enacted in August 2015 but came into effect on 7 February 2017, following an 18-month transitional period. Additionally, the regulations for the application of Law 141-15 were formally established by Executive Decree No. 20-17 on 13 February 2017.

The Dominican insolvency framework has been in operation for just over six years. Nevertheless, both creditors and debtors are increasingly turning to the country's restructuring provisions to safeguard their credits or assets, and there has been a rise in filings since the covid-19 pandemic.

To provide insight into insolvency practices in the Dominican Republic to date, we draw upon our firm's extensive experience, having been involved in over 80 per cent of the approved cases under local insolvency legislation. In this article, we highlight the key challenges encountered by our team in this field over the past 24 months.

Conflict of laws in the application of the insolvency regulation

The legal framework provided by Law 141-15 and its accompanying rules of application have been a subject of debate among legal practitioners and judges due to its inherent gaps. These gaps have led to significant uncertainty and disparities in the decisions issued by various courts. The insolvency courts have addressed these issues and brought clarity to the proceedings by leveraging their specialised jurisdictional authority. They have also drawn from comparative law and, through those decisions, established legal precedence to fill these legal voids and set criteria. This approach aims to resolve the contradictions within the law and provide a more stable legal foundation for the proceedings. Below, we will briefly explore some of the criteria employed by the courts when confronted with conflicting legal norms.

Concerning the commencement of stay of proceedings

In the context of the restructuring proceedings involving the corporate group consisting of Transporte Duluc (Tradulca), SA, Servicios Petroleros, SA, and AMG, SA, a debtor of the company executed a pledge over two of the company's trucks after the commencement of the restructuring proceedings. The trustee in this case filed a claim for the return of the trucks as assets of the proceedings, which was rejected by the court. The base of the court's decision was that the execution took place before the decision underwent the required publicity measures stipulated by law, which include publication for three consecutive days

in a national newspaper, on the insolvency court's website and at the relevant chamber of commerce.

This situation highlights certain contradictions between the law and the application norms. On one hand, article 54 of Law 141-15 stipulates that the restructuring request triggers an automatic and independent stay of proceedings. This stay suspends all judicial, administrative and arbitral proceedings that affect the debtor's assets, including enforcement or eviction procedures related to movable and immovable property, as well as the accrual of interest on loans and credit documents. This stay remains in effect until the restructuring plan is approved or a judicial liquidation is ordered, encompassing the negotiation and conciliation phases.

On the other hand, article 72 of the application norms clarifies that the suspensive effects outlined in article 54 of Law 141-15 come into play upon the publication of the resolution accepting the restructuring request.

Ordinarily, the law takes precedence over application norms; however, in this case, the court determined that, in line with internationally accepted doctrine and legal precedent, the provisions of the application norms should prevail when establishing the precise moment at which the stay of proceedings takes effect. The court's decision emphasised that the publication of the decision occurs once the appointed officer accepts their mandate. Consequently, in the case under consideration, where the execution of the pledge was completed on the same day the trustee accepted the appointment and 16 days before the decision was published in the local newspaper, the stay of proceedings did not apply. As a result, the trucks in question in this case could not be returned to be included as assets subject to the proceedings.

The court's ruling is logical, legally sound and well-reasoned. Nevertheless, it relies on the timely publication of the decision that initiates the restructuring process (which occurs one business day after the trustee accepts the appointment) to prevent the seizure of assets through foreclosures that could affect the list of assets. In this specific case, the decision was published eight business days after the trustee accepted the appointment. Unfortunately, the court currently lacks the resources to effectively adhere to the short time frames stipulated by the law. This case serves as an illustrative example of this predicament.

Given the widely recognised and indisputable limitations of the court's capabilities, including the severely constrained personnel and resources, as well as the significant workload and bureaucratic procedures in place for compliance with these publication requirements, we acknowledge that applying this criterion is risky. Several scenarios come to mind, each of which could cast doubt on the legitimacy and effectiveness of this criterion. For instance, it is conceivable that a situation could arise where the decision has been published on one of the platforms mandated by law, such as the court's website, but not

in the national newspaper. In such a scenario, any creditor could become aware of the debtor's situation and exploit the gap between publications to execute a pledge, potentially escaping any legal consequences, to the detriment of the restructuring procedure and all other creditors. Another example may involve a creditor obtaining information about the restructuring request from personnel within the court or even from one of the appointed trustees, regardless of whether the trustee accepts the appointment.

Considering these challenges, we believe it would be more advisable for the court to adhere to the directions of the law, thus ensuring that the application of the stay of proceedings is automatic from the moment of the acceptance of the restructuring request. This approach would provide greater legal certainty and protect the integrity of the restructuring process.

In relation to the stay of proceedings in foreclosure procedures commenced before the restructuring process

Another conflict occurred regarding the application of the stay of proceedings in the foreclosure procedure that began before the restructuring request was filed. The legal provisions in conflict in this scenario were Law 141-15 and Trust Law 189-11. Both laws are special laws with mandatory provisions that cannot be waived by the parties. The conflict arose when some questioned whether the restructuring law would prevail over the trust law when a foreclosure is initiated before a restructuring request is even filed or accepted.

On one hand, Law 189-11 envisions an expedited procedure for foreclosure with limited possibilities for appeal or counterclaim, with nullity claims before the Supreme Court of Justice being the only available recourse to challenge a foreclosure adjudication decision. Furthermore, the wording of article 54 of Law 141-15 added to the uncertainty as it expressly excludes from the application of the stay of proceedings those processes with a foreclosure judgment, if the criteria for the nullity of transactions provided for in Law 141-15 does not apply.

In the restructuring proceeding of Transporte Duluc (Tradulca), SA, Servicios Petroleros, SA, and AMG, SA, a foreclosure proceeding under Law 189-11 was initiated by a secured creditor before the commencement of the restructuring procedure. Despite being aware of the stay of proceedings mandated by Law 141-15, the creditor continued with the process until the public auction, resulting in the adjudication of the real estate to a third party. The trustee filed an urgent injunction claim to suspend the execution of the decision, which, after multiple counterclaims filed by the secured creditor and the adjudicated party, was accepted by the court.

In its decision, the court established several important criteria, including the following:

- It reinforced the jurisdictional unity of insolvency courts by establishing that an insolvency court is the only competent court to rule on a claim seeking the suspension of execution of a foreclosure judgment that involves property owned by a debtor involved in an insolvency procedure. The insolvency court has exclusive jurisdiction not only over the restructuring and liquidation procedures but also over any judicial or extrajudicial action related to the debtor and its assets, including injunctions and constitutional claims.
- It confirmed the hierarchy of insolvency law over trust law, considering the specialty of the matter and chronological order (Law 141-15 was enacted after Law 189-11).

Then, the secured creditor and adjudicated party filed an appeal, questioning, among other things:

- if the restructuring court had jurisdiction to suspend the execution of an adjudication decision;
- if the trustee complied with Law 141-15, as it did not file a stay of the foreclosure proceeding before the adjudication decision was rendered by the court; and
- if Law 141-15 prevails in a foreclosure under Law 189-11.

On 22 December 2021, the Court of Appeals of the National District issued Decision No. 026-02-2021-SCIV-00764, which rejected the appeal and upheld the decision of the Court of First Instance. The decision addressed the questions of the appellants and set out an important precedent regarding the jurisdictional unity of Law 141-15. It ratified the position that the restructuring and liquidation courts have jurisdiction to rule on any claim referring to the assets of the debtor, including the suspension of a foreclosure proceeding, if the proceeding is ongoing or initiated after the restructuring request has been approved.

Furthermore, the Court of Appeals upheld that when a debtor is subject to an insolvency proceeding under Law 141-15, this law and jurisdiction prevail over any other, including Law 189-11; therefore, the restrictions on appeals and time frames established in Law 189-11 are not applicable.

Additionally, it clarified an important question regarding the interpretation of article 23 of Law 141-15. This article indicates that after the commencement of a restructuring proceeding, any creditor, officer of the court, or any third party with a legitimate interest in the proceedings that has knowledge of any ongoing judicial or extrajudicial proceeding affecting the debtor's assets can request a stay of proceedings through the restructuring court. Many creditors misinterpreted this article, claiming that the stay of proceedings conceived in article 54 of Law 141-15 was not automatic and had to be requested to suspend any decision. The Court of Appeals clarified that it was not a condition precedent for the stay of proceedings of article 54 to apply, especially when the trustee, as an officer of the court, was not part of the foreclosure proceeding when it initiated. The court also noted that the creditor could not continue with a foreclosure

after being aware of the commencement of the insolvency proceeding and the automatic stay of proceedings, especially when that creditor participated in the insolvency proceeding and submitted the registration of its credit to the trustee.

Differing from this criteria, in Decision No. SCJ-PS-22-0159 dated 31 January 2022, the Supreme Court of Justice decided the appeal submitted by the liquidator of 33 Renova Expert SRL against the decision of the Court of First Instance of La Altagracia that approved the foreclosure of several units and adjudicated them to the creditor Distinct Investment Holdings, LLC, which had a first lien over them. In this case, the liquidator, who was very recently appointed, asked the judge of the public auction to suspend the sale and foreclosure of the assets, claiming that the stay of proceedings set forth in article 54 of Law 141-15 applied, considering that the liquidation of 33 Renova Expert was recently ordered. The Supreme Court upheld that the overstay of the proceeding was mandatory only when the restructuring court ordered so, which didn't happen in this case.

Since the recent ruling, questions have arisen regarding the applicable criteria. The two cases in question differ significantly in terms of timing and proceedings. In the *Tradulca* case, the restructuring began at an early stage of the foreclosure process, with the creditor actively participating and being aware of the restructuring proceedings, and it was initiated after the court had expressly declared the stay of proceedings in the decision that accepted the restructuring request. In contrast, in the *Renova* case, the foreclosure process was well advanced when the restructuring request was submitted. Notably, in the latter case, the stay of proceedings was claimed for the first time by the liquidator after their appointment, and it had not previously been ordered by the restructuring court.

Furthermore, while in both cases the restructuring process was initiated as a result of creditors' requests, in the *Tradulca* case, not only was the restructuring request uncontested, but the debtors later voluntarily joined the restructuring process with their other affiliated companies. This voluntary participation in the restructuring was notably absent in the *Renova* case, where the debtor contested the legitimacy of the creditor's claim and even appealed the decision that led to the initiation of the restructuring process. This critical difference in the debtors' responses to the restructuring requests, along with the nature and stage of each case, played a pivotal role in determining the legitimacy and necessity of enforcing mandatory stays. This change in criteria is, therefore, driven by the unique circumstances of each case.

Given the unquestionable differences in the facts of both cases, the effects of the stay of proceedings outlined in article 54 of Law 141-15 are evident, even in the context of foreclosure proceedings. The application of the stay of proceedings will vary depending on the phase of the foreclosure proceeding at the time of the restructuring request's acceptance.

We are awaiting the Supreme Court's decision on the *Tradulca* case to confirm the High Court's stance in this specific scenario. However, we anticipate that the High Court will uphold the criteria set by the Court of Appeals and differentiate between the two different scenarios of both cases to justify the variation in the criteria.

Exclusive jurisdiction for deciding on the assets of the debtor

Paragraph I of article 23 of Law 141-15 clearly establishes that the restructuring court has exclusive jurisdiction to handle any judicial or extrajudicial actions related to the debtor and their assets. From the moment the restructuring request is made, only the restructuring court has the authority to rule on any claim that affects these assets, including urgent measures and writs of protection.

Multiple decisions from the restructuring court in various cases have upheld and reaffirmed this jurisdictional exclusivity, including the previously mentioned *Tradulca* case, particularly concerning the decision that ordered the suspension of an adjudication decision.

One frequent challenge arises when creditors attempt to seek alternative remedies and obtain payments outside of the restructuring plan, thus jeopardising the execution of the restructuring plan and the rights of all the creditors who are part of it.

Notably, the Seventh Courtroom of the Restructuring Court of Santiago issued two significant decisions, No. 2023-0073039 and No. 2023-0073033, dated 11 September 2023. In these cases, the Court accepted the urgent measures requested by Arconim to suspend two different decisions obtained by separate creditors of the company. Despite these creditors being recognised as such in the restructuring plan of the company, they decided to pursue the collection of their debt and obtain payment of an indemnification through the ordinary court.

In clear violation of Law 141-15, the ordinary courts accepted these claims and ordered Arconim to pay both creditors the amounts due. Additionally, they authorised, in one case, the registration of a mortgage over an asset of the company, and, in the other case, the payment of punitive damages. Due to internal challenges within Arconim, they were not able to appeal these decisions in a timely manner. As a result, both decisions became final and irrevocable.

This situation creates significant concerns and challenges regarding the enforcement of Law 141-15 and the exclusive jurisdiction of the restructuring courts. Therefore, Arconim filed an injunction claim before a restructuring court to seek the suspension of both decisions based on Law 141-15.

Since the decision in question was issued by the Court of Appeals and had acquired a definitive instance, the defendant argued, among other things, that a restructuring court, being a Court of First Instance, couldn't suspend a decision issued by a higher court, such as the Court of Appeals.

The restructuring court accepted both claims and ordered the suspension of both decisions until the restructuring plan of Arconim was executed and the restructuring process was concluded, arguing, in summary the following:

- The procedures for both restructuring and liquidation, as conceived in Law 141-15, are complex and divided into stages or phases. Until these stages and procedures are completed, be it the execution of the restructuring plan or the judicial liquidation of the debtor due to the impossibility of executing the restructuring plan, the court maintains an active role. This condition prevents the court from being blacked out until the procedure is fully completed. Therefore, during the instruction and fulfilment of the various stages of these procedures, the Court of Appeals and other courts hierarchically superior to the first instance may only hear the ordinary or extraordinary appeals expressly prescribed in the law, under the conditions, forms and effects expressly regulated in Law 141-15.
- The judgment that Arconim sought to suspend included financial obligations against the debtor in restructuring – payment of sums of money as punitative damages – that would impact the assets of the restructuring process. This entails a transfer of jurisdiction to the restructuring court, since it mandates Arconim Constructora, SA, to carry out financial obligations not included in the approved restructuring plan. All credits and obligations arising from restructuring credits or subsequent to the restructuring proceeding must follow the rules and conditions dictated by the law to avoid affecting the execution of this plan. Failure to adhere to these guidelines would jeopardise the assets of the restructured entity and result in the plan's failure.

Before rendering decisions that could impact the debtor's assets, the ordinary courts are required to ascertain whether the debtor is currently undergoing a restructuring or liquidation process. If such a process is indeed in progress, as stipulated in article 23 of Law 141-15, the ordinary courts should abstain from rendering decisions on the claim and instead transfer it to the specialised jurisdiction responsible for these matters. It is crucial to understand that any actions related to the debtor's assets can significantly influence the development, execution, effectiveness and objectives of the restructuring or liquidation proceeding. Consequently, all creditors holding claims originating prior to the commencement of the judicial restructuring or liquidation process will be bound by the restructuring or liquidation plan. In these scenarios, opting for individual enforcement outside the specialised court will present considerable obstacles and delays in the collection of the credit, as the creditor will only be able to enforce a decision rendered in said conditions after the restructuring plan is fulfilled or the court orders the liquidation of the debtor. In this regard,

the court established that when a decision is issued by ordinary courts and it impacts the debtor's assets involved in the proceeding, the decision must include a condition that makes its execution dependent on the completion of the ongoing restructuring or liquidation procedure. In absence of this condition, even when a decision has the character of an enforceable title, it carries an implicit suspension arising from the application of Law 141-15 to avoid hindering the progress of the specialised procedure.

The court established that the decisions issued by ordinary courts must include a condition dependent on the completion of the ongoing restructuring or liquidation procedure if they impact the debtor's assets involved in a restructuring proceeding. It added that in the absence of such a condition and even when a decision has the character of an enforceable title, it implicitly carries a suspension due to the application of Law 141-15.

These decisions set crucial precedents in the field, which will be instrumental in ensuring the effectiveness of restructuring plans and avoid hindering the progress of insolvency proceedings. They are expected to discourage creditors from seeking payment or fulfilment of obligations through ordinary courts outside the restructuring proceeding. Furthermore, these precedents provide a level of guarantee that the restructuring plan will be executed as intended, without interference from executions or payments made outside the plan, thereby protecting the mass and the rights of all creditors involved.

Exclusive jurisdiction for ordering precautionary and conservative measures

Labour courts routinely misinterpret or even ignore the application of Law 141-15. This resulted in multiple instances where labour creditors filed precautionary and executory measures before the labour courts, which were granted despite the stay of proceedings caused by Law 141-15. In their reasoning, among other things, the labour courts indicated that a restructuring court of first instance could not suspend the decision of a labour court of appeal because it violated the judicial order. In the same line of reasoning, it established that the Labour Code, like Law 141-15, is a special law and should prevail for the protection of the labour creditors due to the specialisation of the norm doctrine.

In several cases, particularly the *Tradulca* case, the authors of this article, acting as trustee and auxiliary expert, respectively, filed injunction claims to obtain suspension of the decisions of the labour courts that ordered precautionary and executive measures over the assets of debtors based on the application of the automatic stay of proceedings.

The restructuring court stated that the labour courts retained jurisdiction to rule on labour claims, which decisions would be taken into consideration for the registration of the labour credits in the insolvency process. However, the labour court could not order any kind of precautionary or executive measure over the debtor's assets in relation to a labour claim, as the jurisdictional authority over those claims was reserved to the restructuring court.

The Supreme Court of Justice, in its decision No. SCJ-TS-22-1251 dated 16 December 2022, addressed a crucial matter concerning the conflict between Law 141-15 and the Labour Code, providing a resolution based on the principle of *lex posterior derogat priori*, which essentially means that later laws repeal earlier ones. The Supreme Court emphasised that, according to this principle, the most recent law, which in this case is Law 141-15, implicitly and partially transferred jurisdiction from the labour court, acting as the referee judge, to the First Instance Restructuring and Liquidation Court to handle requests for conservatory or precautionary measures involving the assets of an employer, once a restructuring request is submitted, as outlined in article 36 and subsequent articles of Law No. 141-15.

As a result, the Supreme Court revoked a decision enacted by the President of the Court of Appeals in Labour Matters, which had ordered conservatory and precautionary measures over the assets of the employer. This revocation was based on the lack of jurisdiction of this court to render a decision of such nature, considering that the employer in question was under a restructuring procedure as per Law 141-15. This important decision establishes a clear precedence regarding the exclusive jurisdiction of the restructuring court to handle precautionary and conservative measures related to assets of the debtor.

Non-appeal of decisions of preliminary dismissals of restructuring requests

The Supreme Court of Justice has confirmed the decisions of the courts of first instance and courts of appeal regarding the impossibility of appealing the preliminary dismissal of restructuring requests, as these decisions are considered to have an administrative nature.

In this regard, through decision No. SCJ-PS-22-2894, dated 28 October 2022, the First Chamber of the Supreme Court of Justice established that, in accordance with article 57, paragraph IV, of the Regulations for the Implementation of Law 141-15, the preliminary dismissal resolution of a restructuring request is final and cannot be appealed. This criterion is based on articles 36 and 195 of Law 141-15. The first article indicates that the process from receiving the request until its acceptance or dismissal is of an administrative nature, while the second article outlines the preliminary dismissal resolution as one of the decisions that cannot be opposed, contested or appealed.

Furthermore, the Supreme Court clarified that under article 51 of Law 141-15, the decision that accepts or dismisses the restructuring request after its preliminary admission can be appealed by any party in the process through a revision claim, and the decision made on such a claim can be appealed to the relevant appeals court.

Additionally, since the preliminary dismissal decision is rendered as a purely administrative verification, the applicant can resubmit their request after addressing or completing the essential requirements specified in articles 29 and 31 and subsequent articles of the Law.

Challenges of restructuring through trusts

One of the challenges in enforcing the law has been when restructuring is carried out through the incorporation of a trust. While the law contemplates this possibility, it does not provide specific procedures to ensure the protection of creditors' rights, compliance with the principles of the law, adherence to the established payment rules, and the necessary speed and transparency in the process. To date, only one restructuring through a trust has been approved, related to the *Arconim* case.

The tax authority has posed obstacles not only to the incorporation of the trust but also to the execution of all the sales that the trustee approved to ensure the survival of the company and the payment of creditors as per the approved restructuring plan. This includes the sale of non-essential real estate owned by the company under restructuring. The tax authority argued that the trustee did not have the authority to approve these sales before the trust was incorporated. However, the delay in trust incorporation was due to obstacles imposed by the same tax authority.

In response to this situation, the trustee filed an injunction claim before the restructuring court to obtain a decision ordering the tax authority to proceed with the incorporation of the trust and the transfer of the real estate sold with the trustee's authorisation to the buyers. The court's decision, dated 15 September 2023, ordered the tax authority to register the trust for the restructuring of Arconim Constructora, SA, issue the national tax identification number (RNC) for the trust, and remove all administrative and procedural hindrances that conflict with the execution of the restructuring plan, the purpose of the law and the principle of non-double taxation.

The decision also established an important precedent regarding the principle of non-double taxation. It emphasised that obliging Arconim to transfer assets that had already been sold with the approval of the trustee to the recently incorporated trust, which would then sell them to third parties, would lead to double taxation. This absurd requirement was seen by the court as counterproductive and illogical

for the restructuring process, which requires maximising assets to benefit the payment of obligations owed by the restructured company to its creditors. To ensure compliance with the decision, the court ordered the tax authority to pay a penalty for each day of delay in meeting the obligations set forth in the decision.

This case has underscored the need to either modify Law 141-15 or for the tax authority to issue specific regulations for the incorporation of reorganisation trusts as per Law 141-15. Clear procedures and requirements are essential to avoid discretionary powers applied by the tax authority, which primarily aim to secure and benefit the payment of tax credits, potentially violating the principles of Law 141-15.

Requirements for creditors to file reorganisation requests

Any creditor with credits representing at least 50 minimum wages (approximately US$13,550) has the right to file a restructuring request against the debtor. This request should be justified based on one or several circumstances outlined in article 29 of Law No. 141-15, which include the following:

1. failure to pay claims considered certain, due and payable under Dominican law for more than 90 days after formal notice to pay;
2. the debtor's current liabilities exceeding current assets for over six months;
3. failure to pay withheld taxes to authorities for more than six instalments;
4. failure to pay two consecutive salaries to employees on the payment date, with specific exceptions;
5. when the administration of the company is absent for a reasonable time without designating an officer to fulfil its obligations, implying the intention to deceive creditors;
6. closure of the business due to the absence of administrators or the transfer of assets to a third party;
7. use of deceitful or fraudulent practices, breach of trust, falsehood, simulation or fraud to default creditors;
8. notification to creditors of the suspension of payments by the debtor or the intent to do so;
9. commencement of a foreign insolvency proceeding in the jurisdiction of the debtor's parent company or main place of business;
10. foreclosure of over 50 per cent of the debtor's total assets; and
11. existence of enforcement procedures affecting over 50 per cent of the debtor's total assets.

Recently, a group of creditors of Promotora Los Navarros, SRL, filed a restructuring request against the entity, based on the circumstance described in (1) above. These creditors had credits originating from multiple purchase agreements with the entity to acquire units from a commercial plaza under construction in Santo Domingo. They claimed that the entity was unable to

complete the construction owing to insufficient funds, and the real estate where the construction was taking place was now under foreclosure by secured creditors with registered mortgages on the property. As established in the claim, with the restructuring request they intended to suspend the foreclosure to allow the entity to finish construction and deliver the promised units to the buyers.

However, the Ninth Courtroom of the Court of First Instance of the National District, acting as the Restructuring Court, dismissed this request through resolution No. 1531-2023-RREE-00002 dated 31 August 2023. The Court argued that the credits of the creditors did not meet the criteria required by article 29, as the obligation of the debtor was to deliver the units on the stipulated date, which does not constitute a liquid and enforceable payment obligation. Furthermore, the Court highlighted that there was no evidence that a payment notice was made by the creditors requesting the return of amounts paid as part of the sale price. Instead, they sought completion of the project, which is the main characteristic of an action for the enforcement of a contract according to article 1184 of the Civil Code. Thus, the Court established this request did not meet the conditions established in article 29 of Law No. 141-15.

As a decision that preliminarily dismisses a restructuring request is not considered final and not subject to appeal, two creditors resubmitted the request, justifying it with (1), (3) and (10) taken from article 29 of Law 141-15. The Ninth Courtroom of the Court of First Instance of the National District, acting as the Restructuring Court, was appointed for this case and also dismissed this request through resolution No. 1532-2023-SRES-00005, dated 4 October 2023. The Court ratified the criteria that the credit did not meet the requirements of being liquid and enforceable. It also noted that the requirement of a prior payment notice made to the debtor was not complied with, as the payment notice that was filed along with the claim was notified by another creditor not part of this specific claim. The Court emphasised that in doing so, the claimants were acting on behalf of another creditor without their authorization to do so, disregarding the legal principle that prevents someone from acting on behalf of another in a legal proceeding without legal authority to do so. In that sense, the Court insisted that every creditor participating in proceedings must demonstrate their status as a creditor of a liquid and enforceable credit.

Moreover, concerning (3), the Court determined that the cause of non-compliance with tax payments can only be invoked by either the Tax Authority itself or the debtor as a reason to justify a restructuring request.

Finally, in relation to (10), the Court clarified that even though the documentation filed by the claimant demonstrated an ongoing foreclosure procedure against a property owned by Promotora Los Navarros, SRL, no evidence was presented to establish that this property constitutes the entirety or at least 50 per cent of the assets of the entity, as required by law. In such cases, a restructuring request based on this scenario could only be considered if such evidence were provided.

In summary, these decisions set important criteria for creditors filing restructuring requests against their debtors. They also establish a precedent to prevent the misuse of insolvency regulations to arbitrarily suspend foreclosure proceedings, addressing one of the main criticisms against Law 141-15, as both debtors and creditors have filed irregular restructuring requests solely to suspend foreclosures.

Final remarks

Another challenge worth addressing in this issue is related to the rejection of liquidation claims filed by debtors under Law 141-15. The courts, particularly the Tenth Courtroom of the Court of First Instance of the National District, acting as the Restructuring Court, have been dismissing such petitions when the debtor's assets are insufficient to cover their debts. This dismissal is based on the argument that there are less costly procedures, such as voluntary liquidation under Company Law 479-08, which could be used instead.

However, this approach fails to consider that the voluntary liquidation procedure under Company Law 479-08 is not suitable when a company's assets are insufficient to satisfy all its creditors. Law 141-15 is specifically designed to address insolvency issues and is the primary and only legal framework for handling such cases in the Dominican Republic.

To address this challenge, we recently submitted an appeal and are awaiting the decision of the Court of Appeals. We expect that the Court of Appeals will provide clarification and resolution on this matter. This issue is critical for ensuring that debtors who are genuinely insolvent have the appropriate legal recourse to liquidate their companies while dealing with their financial difficulties within the framework of Law 141-15. The outcome of this case will likely have important implications for insolvency procedures in the country.

In conclusion, the insolvency courts in the Dominican Republic face various challenges in the application of Law 141-15. These challenges include issues related to the payment of officers' fees, conflicts between different laws, resistance from other specialised courts, and the need for further regulation on specific procedures, such as restructuring through trusts.

Efforts are being made to address these challenges. The Dominican Federation of Chambers of Commerce has recruited very experienced officers – including co-author Fabio José Guzmán Saladín – to work on a bill to modify the rules for the application of Law 141-15, with a special focus on the articles concerning officers' fees. In addition, the Federation, through its Observatory of Mercantile Restructuring, led by co-author Pamela Benzán, is collaborating with the judiciary and the restructuring courts to improve the application of the law and provide training to judges in various aspects of insolvency law.

Given the relatively short period during which Law 141-15 has been in effect, it may be too early to establish definitive criteria for addressing specific problems that have arisen. The legal system is evolving to adapt to the challenges faced in the implementation of the law, and ongoing efforts are being made to enhance the effectiveness of insolvency proceedings in the Dominican Republic.

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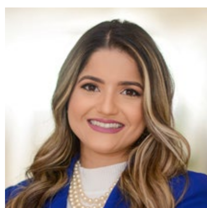
Fabio Guzmán Saladín is co-chair of the corporate practice of Guzmán Ariza. He has represented a wide range of domestic and international companies in mergers and acquisitions, banking, finance and project finance. He also focuses his practice on the areas of corporate bankruptcy, cross-border insolvency, financial investigation and asset recovery. He has represented several multinationals in complex bidding negotiations and government contracts in the country. Fabio is the leading attorney in the first major bankruptcy and restructuring case in the Dominican Republic, where he handles 90 per cent of all the restructuring procedures in the country. He has participated both as trustee and as attorney of debtors and creditors. He is also working with the restructuring committee of the Federation of Chambers of Commerce of the Dominican Republic in the preparation of a bill to modify the current restructuring legislation.



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of Chambers of Commerce of the Dominican Republic as coordinator of the Observatory of Mercantile Restructuring of the Dominican Republic. She also offers invaluable guidance to the Restructuring Committee of the Federation, especially concerning the implementation of insolvency law and the procedures for evaluating the candidates to be included in the registry of officers and appointing such officers, as stipulated by the law.

Founded in 1927, Guzmán Ariza is the largest law firm in the Dominican Republic, with seven offices strategically located to serve clients in every major business centre in the country. The firm's multilingual and multinational staff is equipped to assist international clients across a wide variety of practice areas.

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The EU Adaption of Important Chapter 11 Provisions

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In summary

For many years, Chapter 11 was both the model and the only successful restructuring option on the global level. This started to change when in 2019 the EU introduced the EU Restructuring Directive, requiring EU member states to introduce a pre-insolvency restructuring tool and mandating certain features it would need to have. The UK moved most quickly – at the time no longer required to do so given Brexit – to secure a competitive advantage. In June 2020, it enacted the Corporate Insolvency and Governance Act 2020, which introduced the restructuring plan, closely modelled on the pre-existing UK scheme of arrangement but with important bells and whistles. Now, in 2023, most EU countries have adopted the Directive, and this article focusses in particular on the Netherlands, France, Germany and Spain. Three years on from the UK introduction, and two years since the Netherlands and Germany moved (slightly more recent for France and Spain), what are the lessons we can already learn and what does this likely mean for the future?

Discussion points

- EU Restructuring Directive in 2019
- Steps the United Kingdom, Netherlands, France, Germany and Spain have taken to comply
- Comment on first use cases in the United Kingdom, Germany, Netherlands, France and Spain
- Lessons learned and trends ahead

Referenced in this article

- EU Restructuring Directive
- European Regulation on Insolvency Proceedings
- The 'Dutch Scheme'
- UK Corporate Insolvency and Governance Act
- US Bankruptcy Code
- Chapter 11

Introduction

In July 2019, the Directive on Insolvency, Restructuring and Second Chance (the Directive) came into force in the European Union. The aim of the Directive was to ensure that a statutory restructuring framework was enacted in each EU member state to maximise the chances of restructuring the debts of a company with a viable business rather than being forced into liquidation, which historically has often been the case. EU member states had until summer 2021 to implement the Directive (unless they applied for a one-year extension). At the time of writing, most EU member states have implemented the Directive with very few countries lagging behind. Although EU member states have a significant degree of flexibility in the implementation, if all aspects are fully embraced, the restructuring framework for countries in the European Union would move substantially closer to the tried and tested Chapter 11 plan available under the US Bankruptcy Code.

Germany and the Netherlands have both been model EU member states, embracing the Directive and introducing new laws well ahead of the deadline in late 2020 and early 2021.

While the UK has exited the European Union, it was first to push ahead with reforms and introduced the restructuring plan in June 2020, which was heavily influenced by the content of the Directive (which the UK had been a part of shaping while it was a member of the European Union).

Last, France and Spain pushed ahead with changes to their insolvency and restructuring regime, keen not to miss out on valuable restructuring opportunities and, of course, cognisant of the need to comply with the timelines set by the European Union. So, France moved first and promulgated Ordinance No. 2021-1193 in September 2021, which incorporated elements of the Directive not already incorporated in French insolvency law, and the reform became effective on 1 October 2021. Spain followed in September 2022 when, additional amendments to the current regime were introduced by Royal Decree-Law 16/2022 and came into force.

In terms of content, most of the individual domestic regimes have, like the Directive itself, taken significant inspiration from US Chapter 11, but none have exactly replicated it. Instead, all have adapted the Chapter 11 model to best suit their domestic insolvency history to produce:

- a court-sanctioned process;
- debtor-in-possession governance;
- classification of creditors based on similarity of rights (and sometimes interests) for the purposes of voting; and
- an ability to effect a Chapter 11-style cramdown of dissenting creditors in a particular class.

In this article, we will very briefly discuss some of key concepts of the different procedures but foremost we will take a look at some of the lessons learned from use cases to date and what this can mean for the future.

What are the gateways to establishing jurisdiction?

Some jurisdictions have long been known to be more receptive to or have been used for 'forum shopping'. The practice of forum shopping has, historically, been driven by the result that a particular process can offer, as well as the specific criteria that must be established for the local courts to accept jurisdiction. An assessment of both factors will feature heavily in the initial deal structuring phase.

One of the many attractions to Chapter 11 has always been the relatively low jurisdictional threshold needed to be established to access the process. For foreign companies to qualify as a debtor under the US Bankruptcy Code (and thereby establish jurisdiction), they need only minimal contacts, such as having retainer monies in a bank account in the United States. While none of the other jurisdictions in focus in this article have set the bar as low as the United States has, different levels apply – from the concept of sufficient connection (in the Netherlands and the United Kingdom), which can be achieved for example in the United Kingdom by showing that the underlying debt documents are governed by English law – to a more traditional centre of main interest (COMI) or registered seat concept (Spain, France, Germany and the Netherlands). Some countries have also started to play more creatively with the jurisdiction threshold – for example, the Netherlands, which provides different routes to jurisdiction (which then in turn have an impact on recognition globally).

What are the criteria for cross-border recognition?

While the initial question of jurisdiction is a key gating item to any restructuring, this should be considered in conjunction with an assessment of the other jurisdictions in which the chosen process will need to be recognised. It is clear that, to deliver an effective restructuring, there must be certainty that the chosen process will be recognised in all jurisdictions in which the company has assets, operations or creditors.

Recognition will be a matter of local law and different avenues may be open to establish this. Two avenues, however, deserve particular mention:

- the UN Model Law on Cross-Border Insolvency (the Model Law); and
- the European Insolvency Regulation (the EIR).

Where a country has adopted the Model Law, local recognition will occur where the debtor has its COMI or an establishment in the 'restructuring jurisdiction'. Where this is not the case (eg, because the debtor simply availed itself of the lower jurisdictional threshold), other avenues under domestic law may be possible.

For EU member states, if the restructuring process is listed in the Annex to the EIR (and COMI was stipulated as the jurisdictional gateway), automatic recognition of the process (eg, the New German Restructuring Regime (StaRUG) or the public version of the Court Approval of a Private Composition Act (WHOA)) will apply within the European Union.

Who can initiate the process?

The question of whether some form of financial difficulty needs to be shown to access a particular regime will also feature in the decision-making process of where to implement a restructuring. Practitioners should note that there may be an evidential threshold to be satisfied prior to entry into a process that should be analysed carefully.

This is not the place for a detailed consideration, but as a comparative base, in the United States, France, Germany and the Netherlands the debtor has some form of exclusivity to present a restructuring plan. By contrast, in Spain and the United Kingdom, creditors can propose the plan. It is notable that Spain's first big ticket restructuring using the new process (*Celsa*) was initiated by a group of creditors. In France, creditors only have a right to present a plan in case the debtor's safeguard plan is rejected.

Does the process offer a stay on enforcement?

The chances of implementing a successful restructuring are significantly heightened where creditors are prevented from taking enforcement action against the company, thereby allowing it to stabilise and, most importantly in many cases, to continue to trade while working towards implementing the restructuring. In some cases, it will be possible to agree to a consensual standstill with creditors. However, in cases where this is not possible, the presence of a statutory stay can be vital to the success of the process.

Chapter 11 is the only process discussed in this chapter that gives rise to an automatic and wide-ranging stay on enforcement. In practice, due to the wide reach of the US bankruptcy courts, coupled with the fact that many creditors of companies that file Chapter 11s will also have operations based in the United States, the automatic stay is generally respected worldwide (even in cases where there may not be formal recognition processes in place).

While different in extent to the US stay, both France and Spain do provide for an automatic stay. The Netherlands and Germany do not provide for an automatic stay, but the debtor does have the ability to request the court to impose a stay. By comparison, there is no automatic stay in the United Kingdom upon the filing of a restructuring plan.

What is the impact on operations?

In many cases, the ability of the company to continue to trade through a restructuring will be closely linked to whether it is possible to obtain protection against counterparties terminating contracts on the grounds that the debtor has proposed a restructuring (ipso facto clauses).

The United States provides companies with broad protection against ipso facto clauses. In the United Kingdom, counterparties supplying goods or services will be prevented from terminating the contract when a court summons a meeting relating to a compromise or arrangement under the restructuring plan.

In the Netherlands, upon commencement of the procedure, ipso facto clauses remain inoperative. In addition, it is possible to apply for a targeted stay against one or more suppliers. Under the German restructuring regime, if the debtor has applied to the court for a moratorium, ipso facto clauses are also invalid. In Spain, if the debtor has notified the court of the existence of negotiations with its creditors regarding a potential restructuring plan or of its intention to start them immediately, ipso facto clauses are ineffective. In France, upon the opening of a safeguard proceeding, ipso facto clauses are invalid, only the judicial administrator has a right to terminate contracts.

Is debtor-in-possession financing available?

For many companies, entering a restructuring process where forecast liquidity to completion is tight, the ability to introduce and access alternative financing during the process will be key.

In the United States, debtor-in-possession (DIP) financing is permissible with court approval in Chapter 11 to continue to operate the business and pay the costs of the restructuring process. Super-priority claim status and liens can be granted to DIP lenders if certain conditions are met. Spain comes closest among the European contenders. Here interim and new financing has priority over certain other debts. New money and interim financing will be also protected against clawback actions.

By contrast, in the United Kingdom, there are no provisions for priority financing to be introduced after a company has filed for a restructuring plan – although the restructuring plan itself can and indeed is often used to arrange and implement new super-priority funding. In the Netherlands and Germany, emergency funding (including related security) does not obtain super-priority treatment but can benefit from clawback protection (if certain court-supervised tests are met in the case of the Netherlands). France now has a DIP financing possibility allowing related security but the system has never been tested yet.

What level of support is needed to implement, and is there an ability to bind dissenting creditors or to implement a cramdown of other classes of creditors?

One of the first questions (if not the first question) that will be considered when assessing where to base a restructuring will be the level of support required to approve the proposed restructuring. The relevant consent thresholds and the presence (or absence) of a numerosity test may have a significant influence in the decision-making process. Indeed, where there is expected to be material resistance from dissenting classes of creditors, the ability to implement a cramdown (together with the conditions required to do so) will be key to the viability of the proposed restructuring.

The good news is that all procedures provide for a cross-class cramdown as mandated by the Directive for EU countries. However, as between the different jurisdictions the devil is in the detail and the test (both in terms of required majority but also in terms of denominator (ie, whose vote is counted)) varies. Most jurisdictions (the US, Germany, Spain, France and the Netherlands) have included (some form of) the (absolute) priority rule (APR), namely that a more senior class must receive payment or recovery before a more junior class can see recovery – although some provide for more exceptions than others. The United Kingdom, however has not adopted the absolute priority rule. Indeed the United Kingdom's absence of the APR has proved to be a significant attractive feature for the UK plan.

The ability to implement 'gifting' plans also differs between the jurisdictions. In Chapter 11 proceedings, gifting garners support from impaired creditor classes in order to implement a cross-class cramdown (as at least one impaired (non-insider) class must vote in favour) or a consensual plan whereby all the classes vote to accept the plan. Under US jurisprudence, a traditional gifting plan contemplates a senior creditor gifting a portion of its Chapter 11 plan distribution to a junior creditor class, while an intermediate creditor class ranking above such junior creditor class is not paid in full. These plans, in concept, circumvent the APR, such that if a creditor from a dissenting class objects, they should not theoretically be confirmable. However, if there is a strong business justification, gifts made by a senior creditor class to a junior creditor class without a

comparable gift to a similarly ranked junior creditor class (eg, a gift to unsecured trade creditors without a comparable gift to holders of unsecured notes) or a 'horizontal' gift from one similarly situated class to another may escape being deemed 'unfair discrimination' – a Chapter 11 cross-class cramdown requirement – and thereby be permissible. Gifts not deemed to be the debtor's property, via a court-approved settlement or otherwise, can also be permissible gifts. While gifting plans have long been part of the Chapter 11 toolbox, with new cross-class cramdown options in other jurisdictions, approaches to gifting are being considered. Where gifting has been relevant in the case studies discussed below, jurisdictional attitudes towards gifting has been noted.

Which cases have we seen using the new procedures?

United Kingdom

So, with three years on from the introduction of the UK restructuring plan, what cases have emerged? We have seen 23 restructuring plans to date with 15 utilising cross-class cramdown, so the choice to single out one case is large. For these purposes, the German real estate group Adler is worth highlighting. It showcases in particular the continued pull factor of the United Kingdom for international restructurings. Adler's debts were governed by German law and the group's COMI was in Germany – so on the face of it, there were no touchpoints with the United Kingdom (in particular, not the common touchpoint of English law governed debt documents that draws debtors to the United Kingdom due to the rule in *Gibbs*). Despite this, the company chose to incorporate a new English company (with COMI in England) to acceded to the debt and to propose the restructuring plan. The court sanctioned the restructuring plan using cross-class cramdown following strong opposition. The opposing creditors' main arguments were that because the plan did not collapse the existing maturities into a pari passu ranking, the later dated noteholders would lose out. Additionally, the opposing stakeholders disputed the company's evidence that the dissenting class would achieve better recoveries under the plan than in the relevant alternative. Despite the fact that there was relative scarcity of case law dealing with valuation in the United Kingdom in the context of schemes and therefore restructuring plans, the courts found themselves having to make clear valuation choices. Experts were cross-examined in a three-day hearing, but the case demonstrates that it is incredibly difficult for creditors challenging a plan to convince the court that the debtor's valuation evidence should not be accepted. This is in particular the case given that first, the debtor has had weeks if not months to prepare the evidence and, second, there will always be an information imbalance. The case also demonstrates the lack of the absolute priority rule in the United Kingdom as shareholders in Adler retained their shareholding despite creditors writing off some of their debt. A further case to highlight is the case of ED&F Man, which used the restructuring plan to rewrite the equity including shareholder agreements.

Spain

In Spain, several restructuring plans have been approved since September 2022, of which the restructuring plan of the Celsa group (a multinational group of steel companies with COMI in Spain) is the first one that has been filed and approved by creditors only.

The *Celsa* ruling relates to debt that was the subject of a prior homologation back in 2017 and includes a full takeover of the equity following a debt conversion, the sale of essential assets and a cross-class cramdown implemented in the face of opposition from shareholders and just one working capital creditor. As this was a creditor-led plan, the group had no right to oppose it.

The whole ruling is the very first helpful approach to homologate and implement a creditor-led plan without the collaboration of both the company and its shareholders.

Among others, the court replaced the compulsory list of information that the plan must include with a sufficiency test consisting of the information that is required to enable affected parties to make informed decisions and exercise their rights and provided for a more limited construction of the short-term viability test that the plan must comply with, by referring to the removal of the insolvency situation only. Finally, the court replaced certain compulsory corporate requirements to implement the plan with alternative measures that are feasible in the absence of other stakeholders and management cooperation and granted broad powers to the creditor-appointed expert to implement the plan, including the ability to access the group's premises, execute agreements on behalf of all parties and remove the group's directors.

Valuation takes up most part of the court ruling. There are four valuations that each apply the same method (cash flow discount) but with different data, the result of which showed a deficit in excess of €4 billion. The company's valuations used management's projections (verified by an audit law firm), while the creditors' valuations use external data. The court ruled that the key was not the source but the quality of the data. The court's view was that management's projections were exceptionally optimistic, not aligned with the market's expectation and lacked a proper explanation of the reasons behind the deviation. Accordingly, the court decided to go with the creditors' valuations that factored in (but ultimately disregard) management's projections and used external data only.

Additionally, the court confirmed the validity of the different treatment of secured classes on the basis that equal treatment meant equivalent and non-discriminatory treatment only. In this sense, the court ruled that both the five-year refinancing of available commitments and the capitalisation of existing (drawn) debt were ways to finance the group and that the latter was not per se a preferential treatment of the existing (drawn) debt.

The court ruling is final and not subject to appeal – this is because the creditors asked the court to open the opposition phase before the homologation was ruled out.

Germany

The restructuring of LEONI AG, a publicly listed German automotive supplier, under the StaRUG marks a significant milestone in the German legal landscape. The LEONI AG restructuring plan encompassed an A&E of existing financial liabilities, a debt to (virtual complete) equity swap as well as a delisting and disenfranchisement of existing shareholders by way of cross-class cramdown.

Following the voting meeting and the restructuring court's approval of the plan the disenfranchised shareholders contested the plan through litigation across various court levels, including the German Constitutional Court. All challenges brought by these dissenting shareholder were promptly dismissed, and the plan successfully became effective in August 2023.

The efficient court approval process and the ensuing prompt rejection of shareholder objections demonstrates that German courts are ready and willing to effectively evolve the new legal framework and provide German corporations with a reliable restructuring tool.

France

A number of cases have proven the efficiency of the system – for instance, *Pierre et Vacances*, *Orpéa* and, currently, *Casino*. All cases were strongly related to France, and no significant COMI shift has been tested. *Orpéa* was concluded in July 2023 as the first case where a cross-class cramdown was imposed on shareholders. The best interest test was based on two valuations conducted on one side at the request of the company and on the other side by a court-appointed expert. Courts have shown very careful in apprehending common interest in the classes constitution, taking into account crossholding in *Orpéa*.

The Netherlands

The Dutch WHOA is actively seeking to become a cross-border restructuring hub; it has proven to be an effective restructuring instrument not only for small to medium-sized companies, but also for large companies in more complex and international cases. Examples are the successful restructurings of Steinhoff, Diebold Nixdorf, Vroon and Royal IHC.

The restructuring of Royal IHC was the first case since the introduction of the WHOA, whereby the cramdown option was used within a syndicate of lenders to secure IHC's financial restructuring and an M&A transaction. The effectiveness and legal certainty of the WHOA was significantly increased by the case. The court permitted an amendment of (all) lenders' consent rights in credit documentation. By doing so, the court took existing case law – based on which a modification of maturity dates, interest payment obligations and covenants was possible as part of a restructuring plan – one step further. In addition, IHC used the (recently introduced) possibility under the WHOA to explicitly request the court to approve its intended transaction to sell its subsidiary as part of the restructuring, provided that such transaction is reasonable and immediately necessary for the restructuring plan and is not 'unfair' to the creditors. The court approved IHC's request and as a result, the transaction could not be challenged in a later stage. The court also decided that in principle, the WHOA may be used to force creditors to continue financing a company's working capital under existing credit facilities; it also allowed a contractual change of ranking (amendments to the waterfall in an inter-creditor agreement). The IHC restructuring was implemented in private proceedings that do not fall under the scope of the EU Insolvency Regulation (contrary to public WHOA proceedings). As a result, jurisdiction of the Dutch Court is not solely based on the debtor's COMI, but instead on the more flexible criterion 'sufficient connection to the Dutch legal sphere'. Here, the Dutch courts were comfortable to take jurisdiction over four English companies in the IHC group.

Another significant case involving a successful WHOA is the cross-border restructuring of the international Vroon Shipping group, where a restructuring was implemented in the form of an orderly disposal of certain assets and a debt-to-equity swap. The restructuring involved inter-conditional processes: the Dutch WHOA and the English scheme of arrangement were applied in such a way the restructuring could only be implemented if both the Dutch and English courts sanctioned the respective restructuring processes.

Conclusions and trends

So, drawing it all together and taking a step back, what lessons have we already learned? Speaking for all EU jurisdictions in focus here and the United Kingdom: the reform is working. While reform always takes time to implement in a meaningful way, the United Kingdom has now had more than 23 restructuring plans over the years, and each of the other jurisdictions covered in this article has had at least one large restructuring core testing the system. More are undoubtedly to follow. Despite the new options, the United Kingdom has seen more than its domestic share of restructurings, with a number of foreign companies (most notably German real estate conglomerate Adler) choosing the use the United Kingdom restructuring plan over domestic options (such as the German StaRUG).

The million (or billion) dollar question is, are we seeing any of the newcomers take over from the tried and tested US Chapter 11? Are we maybe even moving away from the United States being best in class and the model upon which others rely?

There are a few factors at play. The level of Chapter 11s is declining – the question is whether that is because companies are staying on the other side of the pond. On balance, that is probably not the case, and there are different macroeconomic reasons for the low number of Chapter 11 cases during 2021–2023, such as the preference of credit funds to effectuate balance sheet restructurings through out-of-court liability management transactions and debt for equity restructurings, only resorting to bankruptcy proceedings when unanimity cannot be achieved (in which scenario, pre-packaged Chapter 11s are fully negotiated in advance and implemented on a rapid basis). However, there is much greater choice now available to debtors and the (at least perceived) costs of a Chapter 11 case will be weighing against its use. As we are seeing more and more EU cases develop that will establish a more predictable restructuring regime and certainty of outcome, more debtors may start to choose the domestic option.

What will be the most important factor for companies to choose where to go? With a bit of planning many jurisdictions are open for foreign companies (this is particularly the case for the Netherlands and the United Kingdom). The Netherlands has had some big ticket restructuring, but for the moment is lacking a track record – but this is something that time will provide.

There is a trend of interlocking schemes emerging. Often, this is driven by the rule in *Gibbs* referred above that dictates that where English law governed debt is at stake an English process will need to be used to effectively amend or deal with such debt. Therefore, even the use of a Chapter 11 alone would not solve the problem and we have seen interlocking schemes of an Italian *concordato* or a Dutch WHOA combined with an English restructuring plan to deal with the English law debt. So, maybe the future is not in one regime that takes over from Chapter 11 but a proliferation of choice and a patchwork of different schemes used to deal with different issues at the same time.

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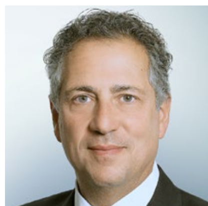

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Mexico: Interim Injunctions in Bankruptcy Proceedings

Diego Sierra and **Jessika Rocha**

Von Wobeser y Sierra

In summary

This article provides an overview of the standards that applicants for interim injunctions must meet in order to request such measures, and the limitations provided by the Mexican Bankruptcy Law (the Concursos Law). It also describes the types of interim injunctions that bankruptcy courts have granted in the most important bankruptcy proceedings in recent years. Finally, the article describes the challenges that parties in insolvency proceedings face regarding injunctions.

Discussion points

- The purposes of interim injunctions and the standards that an applicant must meet for their granting
- A brief explanation of the stages of the insolvency proceeding known as '*concurso*' and applicants of the bankruptcy proceedings
- The benefits of interim injunctions in insolvency proceedings according to the Concursos Law and its accompanying bill
- Recent insolvency proceedings in Mexico in which the courts have granted interim injunctions and their implications
- Scope and challenges of interim injunctions in Mexican insolvency proceedings

Referenced in this article

- The Concursos Law and its accompanying bill
- Federal Institute of Commercial Insolvency Proceedings Specialists (IFECOM)
- General Agreement 4/2020 of the Plenary of the Federal Judiciary Council
- Precedents issued by the federal judicial branch regarding interim injunctions

Introduction

Insolvency proceedings (*concurso* proceedings) have increased in Mexico in recent years. Although, from 1 January 2000 to 31 May 2023, only 945 insolvency proceedings were heard (an average of 39 per year), in the past three years, particularly since the beginning of the pandemic, the number of proceedings has increased.[1] In 2022, the annual average of filed bankruptcy proceedings increased to 58 motions.[2] In addition, the dismissal rate decreased, out of 41 proceedings filed in 2023, 18 cases were dismissed, while in 2021, out of 161 proceedings filed, 118 were dismissed.[3] The dismissals, the low number of cases processed over 24 years and the increasing migration of cases to the United States has been the subject of criticism, particularly because unnecessary bureaucracy and formalities are a constant practice of the bankruptcy courts, which denotes the need for judges to be more sensitive and specialised.

Part of the reason for the change in these numbers can be attributed to the specialised bankruptcy courts. On 4 March 2022, the Plenary of the Federal Judiciary Council published General Agreement 4/2020 in the Official Gazette of the Federation, through which it ordered the establishment of the First and Second District Courts in Bankruptcy Matters.[4] These specialised bankruptcy courts began functioning on 7 March 2022. They have their residence in Mexico City and jurisdiction throughout the country to hear all insolvency proceedings and *amparo indirecto* (constitutional protection) claims related to this matter.[5]

According to General Decree 4/2020, the reason behind establishing these courts is that bankruptcy proceedings are highly specialised. With the creation of specialised courts, parties in insolvency proceedings will receive prompt justice. As a result, the Mexican economy benefits through the preservation of sources of employment, companies and production chains.

The Mexican federal judicial branch is making an effort to improve insolvency proceedings, for example, through specialised courts and court clerks, the courts reduced response times and training for court personnel. Specialisation is beneficial to the parties that participate in insolvency proceedings, particularly

1 IFECOM, Semiannual Report of December 2022 – May 2023, https://www.ifecom.cjf.gob.mx/resources/PDF/informes/46.pdf.
2 id.
3 id.
4 General Agreement 4/2022 of the Plenary of the Federal Judiciary Council, regarding the creation, name and start of functions of the First and Second District Courts in matters of Commercial Bankruptcy, as well as its competence, territorial jurisdiction, domicile, rules of duty, system of reception and distribution of affairs; to the common correspondence office that will serve them; and that reforms the similar 3/2013, relative to the determination of the number and territorial limits of the judicial circuits in which the Mexican Republic is divided; and the number, territorial jurisdiction and specialisation by subject of the Circuit Courts and the District Courts, Official Gazette of the Federation [DOF], https://www.dof.gob.mx/nota_detalle.php?codigo=5644640&fecha=04/03/2022#gsc.tab=0.
5 Constitutional proceedings in which the applicant challenges the unconstitutionality of the decisions entered by the courts.

as, in addition to legal issues, insolvency proceedings involve administrative, accounting and financial matters.

The complexity of insolvency proceedings is relevant to the topic of this article. It is important that the court in charge of deciding the insolvency case has the knowledge and sensitivity to deal with the financial and administrative issues of an insolvent company, particularly when it has to grant injunctive relief to preserve the company's operations.

As explained below, the main purpose of an interim injunction is to guarantee the right to access justice. Specifically, the aim of interim injunctions in insolvency proceedings is to preserve the feasibility of companies, protect their assets and ensure that they continue with daily operations during the course of the proceedings. Hence, interim injunctions are essential in *concurso* proceedings.

Under article 1 of the Concursos Law:

> *it is in the public interest to preserve companies and to prevent generalised non-compliance with payment obligations from jeopardizing the viability of such companies and others with which they maintain a business relationship.*

Thus, the Concursos Law seeks reorganisation to achieve the conservation of insolvent companies and of those with which they do business: it seeks to avoid a domino effect in the economy.

This recognition of public interest in the preservation of companies is central to the concept of insolvency proceedings. To achieve this purpose, the Concursos Law allows all types of companies to request interim injunctions that adapt to their necessities, corporate purpose and daily operations. However, the applicant for the interim injunction must meet the doctrine's standards on injunctions and respect the Concursos Law's limitations and goals.

In recent years, companies that have initiated insolvency proceedings (including debtors, creditors and federal institutions with standing) have requested interim injunctions that allow the debtor to continue with its daily operations. These include:

- the stay of seizures over the company's assets;
- restrictions to pay that is due and payable obligations; and
- prohibition to revoke agreements that allow the company to fulfil its corporate purpose.

Purposes of the interim injunctions and standards an applicant must meet for their granting

The main purpose of an interim injunction is to protect and ensure citizens' human right to access justice (as provided in the Political Constitution of the United Mexican States and the American Convention on Human Rights).

The Political Constitution of the United Mexican States provides that federal and state laws must grant the enforcement of decisions rendered by courts. The Supreme Court of Justice has entered binding precedents defining the aspects that configure the right to access justice, which confirm that one of its fundamental characteristics is that court decisions are enforceable.[6]

Under binding precedents entered by the collegiate courts, the purpose of interim injunctions is to ensure the enforcement of decisions. Therefore, interim injunctions are intrinsically related to the right to access justice.[7]

Also, interim injunctions seek to preserve the applicant's claims during the course of judicial proceedings. Judicial proceedings must follow certain phases:

- the service of process to the defendant;
- the offering and hearing of evidence;
- the submission of closing arguments; and
- the rendering of a decision on the merits.[8]

During the course of judicial proceedings, the applicant's claims can suffer irreparable harm, in other words, the defendant has disposed of all its assets by the time the court enters a decision in which the plaintiff prevailed. Thus, the court can grant an interim injunction to preserve the applicant's claims and ensure the enforceability of the decision on the merits.

For the purposes mentioned above, the court can grant interim injunctions to preserve the status quo, modifying it to prevent irreparable harm to the parties, or to (preliminarily) satisfy the applicant's claims.

The doctrine on interim injunctions has defined four admissibility standards:

- urgency;
- reasonable probability of success on the merits of the case;

6 Right of effective access to justice. Stages and corresponding rights, Supreme Court of Justice of the Nation (SCJN), Gazette of the Judicial Weekly of the Federation, Volume I, November 2017, 1a./J. 11/2014, p. 151 (Mex.).

7 Interim injunctions or temporary injunctions in commercial proceedings. They are inherent to the right to jurisdiction, so the limitation of their granting must attend to a functional interpretation and be in accordance with article 1168 of the Commercial Code along with articles 1 and 17 of the Political Constitution of the United Mexican States, Full-Panel Circuit Courts (PC), Gazette of the Judicial Weekly of the Federation, Volume III, October 2019, p. 2,979 (Mex.).

8 Right to due process. Supreme Court of Justice of the Nation (SCJN), Gazette of the Judicial Weekly of the Federation, Volume I, February 2014, 1a./J. 11/2014, p. 396 (Mex.).

- positive balance of interests; and
- a guarantee.

Urgency

Urgency is defined as the existence of harm against the disputed interests in the proceedings. This harm arises from the period in which the court will enter a decision on the merits. Urgency consists of the risk that the final judgment may not be enforceable due to the amount of time entailed by the proceedings.

Reasonable probability of success on the merits of the case

Interim injunctions do not require a certainty test on the applicant's alleged claims and interests. For the court to grant interim injunctions, it must preliminarily consider that the plaintiff has a probability of success on the merits of the case.

Positive balance of interests

The court must weigh the interests at stake that are disputed in proceedings underlying the request for interim injunctions. The court shall analyse if the urgency that justifies the requested interim measure is more significant than the harm that the party that experiences the effects of the injunction will suffer. If the harm prevented by the interim injunction is indeed more significant, then the interim injunction will be admissible.

Guarantee

The applicant for the interim injunctions must guarantee the potential damages that the party or third parties who will experience the effects of the injunction may suffer if they prevail in the decision on the merits.

Brief explanation of the concurso stages and applicants of the insolvency proceedings

The insolvency proceedings must be filed before a specialised bankruptcy court, which will carry out the proceedings.

Under the Concursos Law, there are general commercial insolvency proceedings and four different kinds of special proceedings:

- *concurso* with a pre-pack or pre-filed restructuring plan;
- *concurso* of debtors that provide public services under a concession;
- *concurso* of financial entities; and
- *concurso* of auxiliary credit organisations.

Different insolvency experts will aid the bankruptcy court through the course of the proceedings, (ie, visitor, conciliator and receiver).

Insolvency proceedings are divided into three stages: the preliminary stage, which involves the declaration of the *concurso*, followed by the conciliation stage and the liquidation or bankruptcy stage. The Concurso Law only formally identifies the conciliation and the liquidation or bankruptcy stages.

The *concurso* declaration stage starts with a motion filed by the debtor (who is not obliged to file for *concurso*), two creditors, the Federal Attorney General's Office or the Asset Management Institute. The court will appoint a visitor to analyse the company's books and records.

The visitor then has the task of making a report for the court establishing whether the company meets insolvency standards (under Mexican law: 'general default of the company's payment obligations') for the bankruptcy court to declare the company to be in *concurso*.

After the visit, the bankruptcy court enters a decision on whether the company meets the insolvency standards. After this judgment, the proceedings finish, or the debtor enters either the conciliation stage or the liquidation stage.

The conciliation stage has the purpose of restructuring and preserving the company through a settlement agreement between the creditors and the debtor. In this phase, the court enters a decision recognising the creditors and their class. Alternatively, the liquidation stage aims to liquidate the company's assets to pay the creditors.

The benefits of interim injunctions in insolvency proceedings according to the Concursos Law and its bill

As previously mentioned, under article 1 of the Concursos Law, the objective of insolvency proceedings is to preserve the feasibility of companies and avoid their failure to meet obligations. The Concursos Law also protects companies that maintain commercial relations with the debtor.

The Concursos Law's bill[9] provides that the following objectives justify the enactment of the Law:

9 Commercial Bankruptcy Law Initiative (Concursos Law's Bill), PDF Format, http://sil.gobernacion.gob.mx/Archivos/Documentos/1999/11/asun_1310_19991123_1123263510.pdf (consulted 12 September 2023).

- maximising the value of companies;
- preserving the balance between creditors and debtors. The rights of both parties must be equally respected;
- respecting and preserving agreements that are in force;
- providing ways for debtors and creditors to enter into a voluntary settlement; and
- encouraging an extrajudicial solution.

In summary, these objectives tend to protect the parties and their interests in insolvency proceedings. Also, the Law seeks to reach a settlement.

To ensure the fulfilment of the objectives, interim injunctions are important tools, particularly to preserve the operations of the insolvent company and protect its assets – which will be used to pay creditors in the liquidation stage. Thus, interim injunctions must comply with these objectives and be consistent with the Concursos Law. In other words, they must meet the standards mentioned above. When granting interim injunctions on insolvency proceedings, bankruptcy courts must analyse and justify that the requested injunction meets the described standards.

Interim injunctions under insolvency proceedings and the standards that the applicant must meet for their granting

Under the Concursos Law, the debtor, the claimant requesting the *concurso* declaration stage and the visitor are entitled to request interim injunctions. Also, the court may grant them ex officio. The supervising authority in the *concurso* of financial entities and auxiliary credit organisations may request interim injunctions as well.

The debtor can request interim injunctions to preserve the company's feasibility, which may suffer harm due to the insolvency proceedings or the visit stage.

The claimant that files a motion requesting the *concurso* declaration stage may also request interim injunctions or their modification. Under binding precedents entered into by federal collegiate circuit courts, other creditors who did not request the *concurso* are not entitled to apply for interim injunctions until the court enters a decision declaring the debtor's failure to meet obligations – a decision declaring the debtor in *concurso*.[10]

The bankruptcy court, as leader of the *concurso* proceedings, may issue interim injunctions ex officio at any stage of the proceedings.

10 Concurso Proceedings. Moment in which the generic creditors of the bankrupt can intervene in the respective procedure, Collegiate Circuit Courts (TCC), Gazette of the Judicial Weekly of the Federation, Volume XXV, March 2007, I.3o.C. J/35, p. 1,508 (Mex.).

Regarding insolvency experts who participate in the *concurso* proceedings, the Concurso Law authorises the visitor to request interim injunctions with the aim of protecting the debtor's estate and the creditor's rights.

There is debate concerning whether the conciliator and the receiver are entitled to request interim injunctions. The Concursos Law only specifically authorises them to do so in the case of recognition of foreign bankruptcy proceedings. However, to correctly execute their functions and comply with the purposes of the Concursos Law, the conciliator and the receiver might request interim injunctions from the bankruptcy court.

Finally, the supervising authority in the *concurso* of financial entities and the auxiliary credit organisations may request interim injunctions.

Separately, the Concursos Law does not provide a catalogue of standards that the applicant must meet. However, the bankruptcy court must analyse the standards applicable to all interim injunctions defined by precedents and doctrine.[11]

The bankruptcy court must also take into account if the request for interim injunctions achieves the objectives of the Concursos Law and respects its limitations, regardless of the identity of the party that is requesting the interim injunctions. If the court grants interim injunctions ex officio, it also must analyse these standards.

Regarding the limitations provided by the Concursos Law, if the debtor requests interim injunctions, they must tend to protect the company's feasibility, which may suffer harm due to the filing of the insolvency proceedings and the visit stage. If the visitor or creditors request interim injunctions, they must have the purpose of protecting the debtor's estate and the creditor's rights.

Specifically, regarding the *concurso* of financial entities and auxiliary credit organisations, interim injunctions aim to protect the institution's employees, its facilities and the creditor's interests.

In all cases, interim injunctions granted in bankruptcy proceedings must achieve the objectives provided under article 1 of the Concursos Law, namely, preserve the companies and avoid the failure to meet obligations, and avoid any compromise to the companies' feasibility.

The Concursos Law's limitations and standards are broad. These limitations and requirements adapt to debtors' necessities and circumstances to preserve its feasibility and protect the creditor's interests.

11 Under Opinion 35/2022 issued by the Board of the Federal Institute of Specialists for Insolvency Procedures, in insolvency proceedings, the applicant for interim injunctions is not compelled to provide a guarantee. Interim injunctions in insolvency proceedings seek to preserve a public interest.

Recent bankruptcy proceedings in Mexico in which the courts have granted interim injunctions

Between 2020 and 2023, companies in the oil and gas industry, telecommunications sector, aviation field and transport industry have initiated insolvency proceedings. In these cases, bankruptcy courts have granted interim injunctions.

Two creditors of one of the most important companies in the oil and gas industry filed a motion requesting the commencement of the *concurso* declaration stage. The debtor answered the creditors' motion and requested the court for interim injunctions.

Among the granted interim injunctions were the following:

- a stay of seizures over the company's assets;
- the restriction to pay due and payable obligations –unless they are necessary for the daily transactions of the company;
- the prohibition to revoke agreements that allow the company to fulfil its corporate purpose; and
- the prohibition to retain or seize machinery that the company employs to perform its daily operations.

In a similar fashion, a creditor requested the *concurso* declaration stage of one of the most important airlines with operations in Mexico and Latin America. The court granted an injunction that ordered the stay of the enforcement over the company's assets, any guarantee or lien submitted by the debtor.

Separately, a company in the telecommunications sector filed a motion requesting the *concurso* declaration stage due to its failure to meet obligations. The debtor requested the following interim injunctions from the bankruptcy court:

- the company's suppliers should maintain the provision of services to maintain the network coverage; and
- trust funds that receive payments should continue providing them to the company.

The second interim injunctive relief is probably the most relevant as it orders the debtor's suppliers to keep providing services without the payment of overdue debts.

Another relevant example of the effects of an interim injunction comes from the insolvency proceedings of Oceanografía, SA de CV and Grupo ICA, in which the bankruptcy courts granted injunctive relief preventing the government from terminating its contracts with the debtor.

In addition, a transport company, as a debtor, requested an injunction to order a creditor to return eight vehicles – property of the creditor – to continue with its operations. To enforce the interim injunction, the court also ordered the creditor

to comply with the agreement to render maintenance services previously entered with the debtor.

Although the companies mentioned above belong to different industries, all of the interim injunctions that were requested tend to protect the assets of the companies, their corporate purpose and the performance of their daily operations.

Scope and challenges of interim injunctions in Mexican bankruptcy proceedings

Under the Concursos Law, companies under *concurso* proceedings may obtain interim injunctions that permit them to continue with their daily operations, preserve the creditors' interests and protect their assets. As explained above, the standards and limitations provided in the Concursos Law adapt to the necessities and circumstances of each company.

However, there are debatable issues regarding interim injunctions and the recognition of creditors, appeals against the order that grants them and their scope before and after the bankruptcy court declares that the debtor meets the insolvency standards.

There are two other important challenges regarding interim injunctions. The first challenge is that authorities and institutions seldom enforce them promptly. The second challenge consists of the need for the debtor to define 'daily operations' in each case.

Recognition of creditors in the concurso proceedings

Creditors who did not file a motion requesting the *concurso* declaration stage (generic creditors) are often affected by interim injunctions. For example, the court may grant an interim injunction that forbids the debtor to pay due and payable obligations. These kinds of injunctions may affect generic creditors.

In practice, Mexican courts do not recognise generic creditors as parties in *concurso* proceedings, and as a consequence they do not grant access to the case records until they enter a decision that declares that the debtor meets the insolvency standards. This logic finds its legal grounds in a binding precedent that commands that generic creditors shall only participate in *concurso* proceedings after the court has entered its decision declaring that the debtor is in *concurso*.[12] Under this precedent, only after the bankruptcy court has entered such decision

12 See footnote 7.

may the generic creditors suffer harm and be considered parties in the *concurso* proceedings.

Under the precedent mentioned above, generic creditors are only entitled to file an appeal against the order that grants an interim injunction after the debtor is declared in *concurso*.

Contradicting the first precedent, a second binding precedent orders any individual – regardless of whether they are a party in the *concurso* proceedings or not – that is affected by an interim injunction to file an appeal before the *concurso* court.[13]

The contradiction between these precedents can be an issue as it is an obstruction to the right to access justice: generic creditors are not entitled to file an appeal before the bankruptcy court until it has entered the decision declaring the debtor in *concurso*. However, bankruptcy courts may grant interim injunctions that affect generic creditors before entering such decision. What is the generic creditor's applicable appeal against such interim injunctions?

In practice, generic creditors usually challenge the bankruptcy court's denial to appeal the interim injunctions as well as the denial to grant access to the case records through *amparo indirecto* claims.

In these cases, federal district courts (which hear *amparo indirecto* claims) must weigh the human right to access justice and the generic creditor's procedural requirements to appear before the bankruptcy court.

For example, in the *concurso* proceedings of the oil and gas company mentioned above, the court did not recognise the generic creditors as parties in the proceedings until it rendered the decision declaring that the company was in *concurso*.

Scope on the interim injunctions before and after the debtor is declared to be in concurso

As explained above, the bankruptcy court can grant interim injunctions during any phase of the proceedings. However, it is debatable whether the effects of the interim injunctions are the same before and after the court issues a decision declaring the debtor in *concurso*. The Concursos Law does not clarify this matter.

13 Mercantile contest: the person affected directly and immediately in assets or rights with the *concurso* proceedings. The person affected directly and immediately in assets or rights with the notification of the interim injunctions adopted in this process does not have the status of a stranger to the trial and, therefore, to promote the indirect *amparo* proceeding against the order that grants interim injunctions, they must first file the applicable appeals before the *concurso* court. Full-Panel Circuit Courts (PC), Gazette of the Judicial Weekly of the Federation, Tenth Period, Volume II, November 2015, PC.I.C. J/19 C, p. 1,692 (Mex.).

When granting interim injunctions, bankruptcy courts must define the effects and the length thereof – in other words, if an interim injunction shall be in force until the court declares the debtor to be in *concurso* or during the whole insolvency proceedings.

The decision that declares that the debtor meets the insolvency standards has effects that often concur with the interim injunctions granted in the *concurso* declaration stage – for example, the restriction to pay due and payable obligations – unless they are necessary for the daily transactions of the company – and the stay of seizures over the company's assets.[14]

Nevertheless, there are other interim injunctions that may vary from one stage of the *concurso* to another, namely, the right of the debtor to sell assets. Thus, the bankruptcy court has to define the effects and duration of the interim injunctions to preserve the parties' right to legal certainty.

Bankruptcy courts must be aware of the concurso's stage in which interim injunctions are granted. Bankruptcy courts must consider the characteristics, objectives and procedural phases of each stage.

For example, the bankruptcy court must take into account that the debtor has lost its capacity to manage its assets when granting an injunction during the liquidation stage. The receiver will be taking possession of the assets administration.

Also, bankruptcy courts must verify if the injunction meets the objective of the current stage. During the liquidation stage, interim injunctions must aid the debtor in alienating the company's assets.

If the bankruptcy court grants the interim injunction, it must indicate the time, place and manner to enforce it.

A company's daily operations and interim injunctions

Bankruptcy courts must identify and understand the company's daily operations to grant interim injunctions that serve their purpose. This need reflects the importance of court specialisation.

In practice, courts seldom define what the parties in the *concurso* proceedings must understand by 'daily operations of the company'. This affects interim injunctions that forbid the debtor to pay due and payable obligations unless they are necessary for daily operations. Companies must define if the payments are needed for the daily operations to continue in each specific case.

14 Under article 65 of the Concursos Law, the company's employees that are entitled to an enforceable credit over the debtor's assets are exempted from the stay.

Institutions and authorities compelled by interim injunctions

Authorities and institutions, such as banks, local courts and government agencies, should recognise and comply with interim injunctions to be effective. These institutions sometimes do not comply with the order entered by the court granting the interim injunctions.

For example, in the *concurso* proceedings of the oil and gas company mentioned above, banks refused to comply with the interim injunctions until their supervising authority directly issued the order. Also, local courts required that the bankruptcy court that ordered the injunctions notified them to affected parties and the local courts. The debtor filed a motion before the bankruptcy court and requested that the local courts and the banks enforce the interim injunctions. After the debtor filed the motion, the local courts and banks enforced the interim injunctions.

The promptness with which institutions and authorities comply with the order that grants interim injunctions is essential for the company's feasibility. It is crucial that authorities comply with interim injunctions as early as possible. For example, quick enforcement is essential in the case of an order to lift a seizure on bank accounts so the debtor can continue its daily operations, (ie, pay its employees).

Conclusion

The Concursos Law allows companies to request interim injunctions that adapt to their necessities and circumstances. Interim injunctions are essential in *concurso* proceedings – proof of this is that almost every party that intervenes in the insolvency proceedings is entitled to request them. Even the bankruptcy court can grant them ex officio.

As explained above, interim injunctions aim to preserve the company and its daily operations, for example, by permitting the debtor to continue with the possession of machinery to perform such activities. These decisions may harm third parties, namely, the machinery owners who seek to recover possession. The bankruptcy court must perform a positive balance of interest analysis and consider the procedural phases of the proceedings; interim injunctions may be different from the conciliation stage to the liquidation stage.

The Concursos Law protects the debtor and provides instruments to protect its feasibility. However, the Law does not provide clear rules for appeals and remedies for third parties that are harmed by interim injunctions. The generic creditors are one of the groups most affected by interim injunctions.

Owing to population growth, globalisation and covid-19 pandemic havoc, the number of insolvency proceedings will increase. It is essential that the legal instruments that regulate insolvency proceedings contain clear standards for the granting, enforcement and appeal against interim injunctions.

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Recent Developments in DIP Financing for International and Domestic Debtors

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In summary

This article discusses the ability of foreign-domiciled debtors who pursue Chapter 11 bankruptcies to obtain debtor-in-possession (DIP) financing and recent trends in the DIP financing market, including equity conversions, roll-ups and pre-packaged bankruptcies.

Discussion points

- The types of DIP lenders
- Considerations regarding the recognition of the DIP order in foreign jurisdictions
- Trends in DIP loans including equity conversions and roll-ups
- DIP financing in pre-packaged bankruptcies

Referenced in this article

- *In re Alto Maipo Delaware LLC, et al*
- *In re Automotores Gildemeister Spa*, *et al*
- *In re Avianca Holdings SA*
- *In re Bed Bath & Beyond Inc, et al*
- *In re California Pizza Kitchen, Inc, et al*
- *In re Fairway Group Holdings Corp, et al*
- *In re Grupo Aeroméxico*, *SAB de CV*
- *In re Instant Brands Acquisition Holdings Inc, et al*
- *In re LATAM Airlines Group SA*
- *In re McDermott International, Inc, et al*
- *In re Monitronics International, Inc, et al*
- *In re Phoenix Services Topco, LLC*
- *In re Rockall Energy Holdings, LLC, et al*
- *In re RTI Holding Company, LLC*
- *In re SAS AB, et al*
- *In re SiO2 Medical Products, Inc, et al*
- *In re Yellow Corporation et al*

Chapter 11 has gained a strong foothold as a possible pathway for foreign-domiciled companies to reorganise, whether or not such companies have substantial operations in the United States. One key attraction to Chapter 11 for foreign-domiciled companies is the access Chapter 11 debtors have to a broader base of funding sources so they can finance their operations through their bankruptcy case. Known as debtor-in-possession[1] (DIP) financing, potential debtors either obtain financing from their existing secured lenders or through other third-party lenders through well-established market processes in the United States. This article provides an overview of DIP financing with a focus on international Chapter 11 debtors and discusses recent developments in DIP financing, including roll-ups of a debtor's pre-petition debt into DIP financing, conversions of DIP financing into equity upon a debtor's emergence from Chapter 11 and the use of DIP financing in pre-packaged and pre-negotiated bankruptcy plans.

DIP financing in Chapter 11 cases

DIP financing is routinely utilised in Chapter 11 cases, where the debtor seeking relief seeks to preserve its going concern operations and to emerge from bankruptcy or sell its business as a going concern. The US Bankruptcy Code (the Code) contains several provisions designed to encourage lenders to provide DIP financing in Chapter 11 cases. Due to protections provided under the Code, domestic and foreign debtors are often able to access liquidity that they would not be able to obtain outside of a US bankruptcy proceeding.[2] Under the Code, post-petition lenders are provided automatic administrative expense priority for DIP loans and related obligations, and are routinely granted super-priority administrative claim status, wherein debt must be repaid upon the emergence of the debtor from Chapter 11 prior to nearly all other administrative obligations

1 When a company files for Chapter 11 bankruptcy, the company's management and board of directors remain in possession of the business as a 'debtor-in-possession' except in the exceptional circumstance where the bankruptcy court appoints a Chapter 11 trustee, which will either occur for 'cause' such as fraud, dishonesty, incompetence or gross mismanagement, or the appointment of a trustee is found to be in the interests of 'creditors, any equity security holders and other interest of the estate'. 11 USC section 1104(a)(2).

2 Non-US incorporated debtors have been able to obtain DIP financing even where a substantial portion of their assets are located in jurisdictions outside of the United States. See, for example, Final Order Granting Debtors' Motion to (I) Authorize Debtors in Possession to Obtain Post-Petition Financing Pursuant to 11 U.S.C. §§ 105, 362, 363 and 364; (II) Grant Superiority Administrative Expense Claims to DIP Lender(s) Pursuant to 11 U.S.C. §§ 364 and 507; (III) Modify Automatic Stay Pursuant to 11 U.S.C. §§ 361, 362, 363, 364 and 507; and (IV) Granted Related Relief [ECF No. 166], *In re Alto Maipo Delaware LLC, et al,* No. 21-11507 (Bankr. Del. 2021); Order Granting Motion to Approve Debtor in Possession Financing, [ECF No. 1091], *In re LATAM Airlines Group SA*, No. 20-11254 (JLG) (Bankr. SDNY.2020) (approving LATAM's proposed US$2.45 billion DIP financing facility); Final Order (I) Authorizing the Debtors to (A) Obtain Postpetition Financing, and (B) Grant Liens and Superpriority Administrative Expense Claims, (II) Modifying the Automatic Stay, and (III) Granting Related Relief [ECF 1031], *In re Avianca Holdings SA* 20-11133 (MG) (Bankr. SDNY 2020), Order (I) Authorizing the Debtors to Obtain Senior Secured, Superpriority, Postpetition Financing, (II) Granting Liens and Superpriority Claims, and (III) Granting Related Relief, [ECF No. 331], *In re SAS AB*, No. 20-10935 (MEW) (Bankr. SDNY 2022).

incurred during the case. In addition, upon notice and a hearing, the bankruptcy court may authorise a debtor to enter into a DIP facility that is secured by a first priority lien on the unencumbered assets of its estate and by a second priority lien on collateral subject to pre-petition liens.[3] To obtain authorisation to grant such liens, the debtor must show that it is unable to obtain post-petition financing on unsecured terms, which is often relatively easy for a debtor to establish. Throughout the years, DIP financing has become increasingly attractive as DIP lenders exert considerable influence on the outcome of the Chapter 11 case through strict covenants, milestones and certain notice and consent rights.

If the debtor is still unable to obtain financing on such terms, the Code provides that a debtor can be authorised to grant liens on its assets that are senior or equal to existing liens, provided that such priming is consensual or that the pre-petition secured lender is otherwise adequately protected.[4] When DIP financing is provided by pre-petition secured lenders, this priming is generally consensual. However, when new lenders that are not creditors of the debtor (ie, 'offensive' DIP lenders, as discussed below) are seeking priming liens in pre-petition collateral, the debtor must show that it is unable to obtain such credit otherwise and that either the existing secured lenders have sufficient equity value in their collateral or that they will be 'adequately protected' against any possible diminution in the value of their security interests.[5] Adequate protection is designed to ensure the existing lender will not be worse off if the DIP loan is approved. Such protection can take on many forms, including periodic cash payments to the secured lender, payments of post-petition interest or granting of additional liens to the creditor on previously unencumbered assets or replacement liens on collateral that do not continue to attach to property post-petition. Additional protection is guaranteed under section 552 of the Bankruptcy Code as it cuts off certain pre-petition security interests over after-acquired property under a security agreement upon commencement of the bankruptcy proceeding.[6]

Once a debtor has lined up a lender to provide DIP financing, the debtor is required to obtain bankruptcy court approval for the proposed DIP financing.[7] Although typically a debtor will seek such approval at the outset of the Chapter 11 case as part of its 'first day' motions, if the debtor's liquidity needs are not as immediate, it may wait for some time after filing its bankruptcy petition to obtain such approval.[8] Creditors and other parties in interest have a right to object to the terms of a proposed DIP financing and the bankruptcy court will ultimately

3 See 11 USC section 364(c).
4 See 11 USC section 364(d).
5 See 11 USC section 364(d)(1).
6 See 11 USC Section 552(a).
7 11 USC section 364 governs bankruptcy financing. If the debtor is seeking to obtain financing in the ordinary course of business, such as for trade credit, it may do so under 11 USC section 362(a) without court approval. However, financing that is not in the ordinary course of a debtor's business, such as DIP financing, whether secured or unsecured, requires notice and a hearing. See 11 USC section 364(b)–(d).
8 This was the case, for example, in four recent Chapter 11 bankruptcies for airlines and other companies based in South and Central America. See, for example, *In re LATAM Airlines Group SA*, No. 20-11254 (JLG) (Bankr. SDNY 2020); *In re Avianca Holdings SA* 20-11133 (MG) (Bankr. SDNY 2020); *In re*

decide whether to approve the financing after a review of the relevant pleadings and objections (if any) and after conducting an evidentiary hearing if required.[9]

Types of DIP lenders

DIP financing can either be provided by a debtor's existing lenders or by new third-party lenders. Pre-petition secured lenders that provide DIP financing are termed 'defensive' DIP lenders because they are willing to make a DIP loan, in part, to mitigate the likelihood of a decline in the value of their collateral. The credit extended under the DIP facility will command higher interest rates and fees than the pre-petition credit, and the loan documents will contain tighter covenants and more detailed reporting than is required under the pre-petition facility, as well as bankruptcy case milestones and events of default. Additionally, in their capacity as DIP lenders, such pre-petition lenders will be able to exert more influence over the debtor and can help ensure that they will play a central role in the debtor's restructuring negotiations. As discussed further below, in cases where existing lenders provide the DIP loan, it is not unusual for such facilities to contain a 'roll-up' of a portion of such lenders' outstanding pre-petition debt.

If the DIP financing is provided by third parties that are not existing creditors of the debtor, the lenders are termed 'offensive' or 'new money' lenders. New money DIP lenders are often attracted by the generous economics of DIP facilities and, in some cases, are interested in extending post-petition credit because they view DIP financing as a means to pursue a loan-to-own strategy (either through credit bidding their DIP claims or through a debt-to-equity conversion, as discussed below).[10] These lenders are generally willing to finance DIP facilities where there exists sufficient unencumbered collateral to support the DIP obligations (or they believe there is little risk of a liquidation and they are willing to rely on the Code's administrative expense priority that ensures they are repaid ahead of other parties upon the emergence of the debtor from Chapter 11), where pre-petition lenders are over-secured or where the pre-petition lenders otherwise consent to having the debtor grant the DIP lender a priming lien.

Grupo Aeroméxico, SAB de CV No. 20-11563 (SCC) (Bankr. SDNY 2020); *In re Alpha Latam Management, LLC*, No. 21-11109 (JKS) (Bankr. SDNY 2021).

9 Typical objections from creditors include objections to the cost of the DIP facility, that the debtors did not conduct a sufficient market test upon entering into a proposed DIP facility, that the debtors did not use proper business judgement in obtaining the facility and that the proposed DIP is inconsistent with requirements contained in the Code.

10 As discussed further, the proposed DIP facilities of Avianca, Aeroméxico and LATAM Airlines all contained an equity conversion feature at some point in the drafting of the documentation.

Recognition of the DIP order in foreign jurisdictions

Upon the commencement of a Chapter 11 case, the debtor is protected by the Code's statutory 'automatic stay', which goes into effect immediately upon a bankruptcy filing and has purported worldwide applicability.[11] The stay operates to enjoin substantially all creditor enforcement actions during the pendency of the Chapter 11 case against the debtor and property of the debtor's estate – both within the United States and within foreign jurisdictions. Despite the purported worldwide applicability of the automatic stay, in the absence of a parallel local recognition proceeding supporting the Chapter 11, a debtor, and its prospective DIP lender, will need to assess whether the stay will be honoured by non-US parties that may hold debtor assets or hold claims against the debtor and whether non-US courts will recognise and enforce the stay against such parties if required.

A debtor's decision to seek local recognition of the DIP order involves an analysis of the particular situation including the jurisdictions involved, the composition and nature of the debtor's creditors (including, most importantly, their jurisdictional and commercial nexus to the United States) and the location of the debtor's assets. In certain jurisdictions and situations, the debtor may decide (or be required) to obtain formal recognition of the DIP order in a local proceeding to ensure that the DIP obligations and claims and liens on collateral are properly authorised under local law and will be enforced in the local jurisdiction. For example, the DIP facility in the *LATAM Airlines* Chapter 11 case included a closing condition that the debtors obtain local recognition of the DIP order by the Colombian Superintendence of Companies, authorising the incurrence of the debt and the pledge of collateral (where the local court also required such approval).[12] By contrast, in the *Alto Maipo* Chapter 11 case, the debtors, though domiciled and primarily operating in Chile, chose to not commence local recognition proceedings and did not seek recognition of the US$50 million DIP financing in Chile.

In other jurisdictions and situations, local approval of the DIP may not be feasible or it may entail additional risks that the lenders or the debtors do not want to take on. In these situations, the debtors may seek to obtain local law pledges of collateral and perfect such pledges through the requisite local law processes.[13] The debtors and DIP lenders also may take some comfort in the power of the automatic stay – even in situations where a foreign Chapter 11

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11 11 USC section 362.

12 Obtaining approval of the Colombian Superintendence of Companies was a condition precedent to closing the transaction included in the DIP Agreement itself. See Amended Motion to Approve Debtor in Possession Financing/Debtors' Supplemental Submission in Furtherance of the Debtors' Motion for Order (I) Authorizing the Debtors to (A) Obtain Postpetition Financing and (B) Grant Superpriority Administrative Expense Claims and (II) Granting Related Relief, [ECF No. 1079], Exhibit A, Superpriority Debtor-In-Possession Term Loan Agreement, Section 4.01, *In re LATAM Airlines Group SA*, No. 20-11254 (JLG) (Bankr. SDNY 2020). Section 4.01.

13 Note that with respect to the Aeroméxico DIP facility, the parties took this approach.

debtor does not commence a parallel local recognition proceeding, to the extent that the debtor's major creditors are international financial institutions or have substantial business or other interests in the United States, such creditors may nonetheless be disincentivised from violating the stay in the United States given the potential that they may have repeat interactions with United States bankruptcy courts.

Roll-ups

In the context of defensive DIP loans, DIP lenders may seek to have their pre-petition secured debt repaid with the proceeds of the new post-petition financing or otherwise 'converted' into DIP obligations. In this scenario, a certain amount of newly borrowed funds from the proposed DIP facility will be deemed to repay either all or part of the pre-petition loans or such loans will be deemed converted into post-petition loans. This transformation is termed a 'roll-up' because the existing pre-petition lender gets to roll-up its pre-petition claims and liens into post-petition administrative claims and liens via the DIP facility. Roll-up features can be structured a number of different ways – some are effectuated by a single draw on the DIP facility and some provide for a 'creeping' roll-up over time on a dollar-for-dollar, or similar, basis. While the roll-up does not provide a debtor with additional liquidity, the debtor's existing pre-petition lenders, who may already have liens on substantially all of the assets of the debtor, can be encouraged to provide new money in exchange for the ability to transform the rolled-up portion of their pre-petition debt into debt that will benefit from super-priority claims and liens, better economics and tighter controls.[14] Indeed, in negotiations with pre-petition secured lenders, it is often used as enticement to encourage all lenders to participate in post-petition financing, with debtors and the lead lenders offering the roll-up feature only to those lenders that agree to extend new money. For these same reasons, roll-ups of pre-petition obligations can be subject to challenge by unsecured creditors. Bankruptcy courts pay careful attention to the percentage of new money provided in the roll-up and whether the roll-up benefits any pre-petition lenders that are not providing DIP financing (measured most often by the ratio of new money to roll-up debt).

In more recent years, the roll-up has become a fairly standard feature of defensive DIP financings for both domestic and foreign-domiciled Chapter 11 debtors, although creditors and courts still scrutinise the terms and structure of the roll-up feature, and it is typically not approved until the final DIP hearing. On 12 June 2023, multinational kitchen appliances company Instant Brands Acquisition Holdings Inc and certain affiliates spanning the United States, Canada and Latin America initiated Chapter 11 proceedings in the Southern District of Texas, where on the first day, the company sought approval of a US$132.5 million new

14 Alan Resnick and Henry Sommer, Collier Guide to Chapter 11, Chapter 2.06[1][a][b] (2012).

money DIP facility plus a US$125 million asset-based lending (ABL) DIP facility that featured a roll up.[15] The debtors' motion noted that, in addition to addressing liquidity constraints, the DIP financing was critical to effectuate an unwinding of a pre-petition financing transactions of two unrestricted subsidiaries through a US$55 million payment to the company's pre-petition equity sponsor.[16] At the interim hearing, the United States Trustee objected to the motion, arguing that the unwinding transaction should not be indefeasible and should be subject to lien challenge by a creditors' committee. Over the objection, Judge David R Jones approved access to US$100 million in DIP financing on an interim basis.[17] At the final hearing, the DIP motion proceeded on an uncontested basis largely due to concessions the debtors made in negotiations with the creditors' committee, including release carve-outs, marshalling provisions, extended sale milestones and an increased budget for the creditors' committee's investigation.[18]

In a petition filed on 27 September 2022 by Phoenix Services Topco, LLC, an international steel-producing company with a global footprint across North America, Europe, the Middle East, South Africa and South America, the debtors' proposed roll-up of pre-petition debt came under heavy scrutiny by United States Bankruptcy Judge Mary F Walrath.[19] Here, the debtors sought to enter into a super-priority senior secured DIP facility with an aggregate amount of up to US$200 million being provided by Credit Suisse Loan Funding LLC; however, only US$50 million of the DIP facility consisted of new money – the debtor sought to convert US$150 million of pre-petition debt to a new post-petition 'roll-up facility'.[20] At the time of the bankruptcy filing, the debtors only had approximately US$6 million in cash on hand; thus, without the DIP financing, the debtors would be in a negative cash position in the early days of the case. While the debtors solicited interest from several financial institutions to assess the extent to which an offensive lender would be willing to provide post-petition financing to the debtors, the search yielded zero interest and the debtors' only

15 See Debtors' Emergency Motion for Entry of Interim and Final Orders, Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, 503, 506, 507, and 552 (I) Authorizing the Debtors to (A) Obtain Senior Secured Superpriority Postpetition Financing and (B) Use Cash Collateral, (II) Granting Liens and Superpriority Administrative Expense Claims, (III) Providing Adequate Protection to Prepetition Secured Parties, (IV) Scheduling a Final Hearing, and (V) Granting Related Relief, [ECF No. 31], *In re Instant Brands Acquisition Holdings Inc., et al.*, No. 23-90716 (Bankr. S.D. Tex. 2023).

16 *Id*.

17 Transcript, [ECF No. 163], *In re Instant Brands Acquisition Holdings Inc., et al.*, No. 23-90716 (Bankr. S.D. Tex. 2023). Following entry of the interim DIP order, the court approved an incremental US$10 million 'pull forward' of the remaining US$32.5 million final draw.

18 Final Order (I) Authorizing the Debtors to (A) Obtain Senior Secured Superpriority Post-Petition Financing and (B) Use Cash Collateral, (II) Granting Liens and Superpriority Administrative Expense Claims, (III) Providing Adequate Protection to Prepetition Secured Parties, and (IV) Granting Related Relief, [ECF No. 257], *In re Instant Brands Acquisition Holdings Inc., et al.*, No. 23-90716 (Bankr. S.D. Tex. 2023).

19 *In re Phoenix Services Topco, LLC, et al*, No. 22-10906 (Bankr. Del. 2022).

20 See Motion of Debtors for (I) Authority to (A) Obtain Postpetition Financing, (B) Use Cash Collateral, (C) Grant Liens and Provide Superpriority Administrative Expense Status, (D) Grant Adequate Protections, (E) Modify the Automatic Stay, and (F) Schedule a Final Hearing and (II) Related Relief [ECF No. 14], *In re Phoenix Services Topco, LLC, et al*, No. 22-10906 (Bankr. Del. 2022).

financing option was the roll-up facility.[21] Despite these facts, the proposed DIP financing proposal was met with resistance from Judge Walrath, who remarked that a roll-up of US$150 million of pre-petition loans while authorising interim relief for US$25 million of new money was 'a big stretch'.[22] The judge and other parties commented on the concerning 3:1 ratio of pre-petition debt as compared to new money. Judge Walrath ultimately approved the US$200 million DIP financing, which was supported by the creditors' committee following certain 'hard-fought' concessions.[23]

Similarly, though less extreme, the proposed roll-up in *In re Rockall Energy Holdings, LLC* came under scrutiny by the Office of the United States Trustee and unsecured creditors, where the oil and gas exploration debtors sought to roll up US$34 million in pre-petition debt in a DIP facility containing US$17 million in new money being provided by Goldman Sachs Bank USA.[24] The parties in interest were primarily concerned about the 2:1 ratio of pre-petition debts to new money in the US$51 million DIP financing, especially where the DIP lender could be subject to causes of action in the case. United States Bankruptcy Judge Mark X Mullin did not share the concerns of the United States Trustee and ultimately approved the DIP financing on a final basis. Subsequently, on 2 June 2022, the judge confirmed the Chapter 11 plan and approved the sale of Rockall Energy Holdings' assets to private equity fund Formentera Partners for US$85 million. Under the terms of the plan, the DIP loan would be repaid using the proceeds from the sale such that the DIP loan served as effective bridge financing to conduct and consummate a sale process.[25]

Another example is the Bed Bath & Beyond Chapter 11 case, which was filed in the District of New Jersey on 23 April 2023. The Bed Bath & Beyond US$240 million DIP facility provided by Sixth Street comprises US$40 million in new money and a US$ 200 million roll-up of pre-petition first-in last-out (FILO) secured obligations.[26] While the motion eventually proceeded on an uncontested basis at

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21 *Id*.

22 Transcript of Hearing Held on 28 September 2022 [ECF No. 72], *In re Phoenix Services Topco, LLC, et al*, No. 22-10906 (Bankr. Del. 2022).

23 Final Order (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Authorizing the Debtors to Use Cash Collateral, (III) Granting Liens and Providing Superpriority Administrative Expense Claims, (IV) Granting Adequate Protection, (V) Modifying Automatic Stay, and (VI) Granting Related Relief [ECF No. 237], *In re Phoenix Services Topco, LLC, et al*, No. 22-10906 (Bankr. Del. 2022). In a filing, the creditors' committee highlighted the favorable modifications to the DIP facility included (i) limiting extension fees, (ii) reducing the DIP liens on unencumbered property to US$150 million from US$200 million; (iii) leaving the prepetition equity sponsor's claims fully unencumbered; (iv) soft marshalling of the DIP lien collateral; and (v) certain consultation rights.

24 Emergency Motion for Entry of Interim and Final Orders (I) Authorizing Debtors to (A) Obtain Postpetition Financing Pursuant to 11 U.S.C. §§ 105, 361, 362, 364(c)(1), 364(c)(2), 364(c)(3), 364(d)(1) and 364(e) and (B) Use Cash Collateral Pursuant to 11 U.S.C. §§ 361, 362, 363 and 364 and (III) Scheduling Final Hearing, [ECF No. 21], *In re Rockall Energy Holdings, LLC, et al*, NO. 22-90000 (Bankr. N.D. Tex. 2022).

25 Findings of Fact and Conclusions of Law [ECF No. 629], *In re Rockall Energy Holdings, LLC, et al*, No. 22-90000 (Bankr. N.D. Tex. 2022).

26 See Debtors' Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to (A) Obtain Postpetition Financing and (B) Utilize Cash Collateral, (II) Granting Liens and Superpriority

the first day hearing, the United States Trustee initially asked the court to only approve the roll-up at the final hearing once a creditors' committee had been formed. The objection was withdrawn on the basis that the interim DIP order included language reserving the right to challenge.[27] At the final hearing, where the DIP was approved, the debtors, the ad hoc group of unsecured noteholders and the creditors' committee spoke to the 'hard fought' negotiations that led to various compromises, including marshalling and detailed collateral sharing provisions. Sixth Street also announced that it intended to credit bid the DIP amount in the Bed Bath & Beyond asset sale.[28] Intriguingly, less than a month following entry of the final DIP order, the ad hoc bondholder group sought to vacate the DIP orders, arguing the DIP financing was unwarranted given the debtors' cash position and described the US$200 million roll-up as 'fruit of this poisonous tree'.[29] The ad hoc group also noted that the DIP facility benefited ABL and FILO pre-petition lenders to the detriment of the unsecured creditor body, where the collateral sharing provisions contemplated unsecured creditors would receive no recovery until the FILO lenders recover their US$515 million loan principal in full.[30] Following an evidentiary hearing, Judge Vincent F Papalia lamented that vacating the DIP orders would be 'extraordinarily unjustified' and the DIP financing was appropriate based on the information available to the debtors and other parties at the time.[31]

Lastly, the Yellow Corporation and affiliates bankruptcy proceedings featured an entertaining DIP war, where following the filing of the company's DIP motion on 7 August 2023, the company received several alternative DIP financing offers from other parties with comparable financing structures but additional terms that provided the debtors with more flexibility. In the initial DIP motion, the debtors sought approval of a DIP facility provided by Apollo Capital Management, LP, comprising US$142.5 million of new money and a 3.5:1 roll-up of approximately US$502 million to take place upon entry of the interim order. The new money portion of the DIP, which carried a 17 per cent interest rate and fees near US$32 million, would become available to the debtors on a rolling basis depending on the success of the debtors' auction process.[32] The agreement also provided

Administrative Expense Claims, (III) Granting Adequate Protection, (IV) Modifying the Automatic Stay, (V) Scheduling a Final Hearing, and (VI) Granting Related Relief, [ECF No. 25], *In re Bed Bath & Beyond Inc., et al.*, No. 23-13359 (VFP) (Bankr D. N.J. 2023).

27 Transcript, [ECF No. 161], *In re Bed Bath & Beyond Inc., et al.*, No. 23-13359 (VFP) (Bankr D. N.J. 2023).

28 Transcript, [ECF No. 769], *In re Bed Bath & Beyond Inc., et al.*, No. 23-13359 (VFP) (Bankr D. N.J. 2023).

29 See Motion of the Ad Hoc Group, Pursuant to 11 U.S.C. § 105(a), Fed. R. Civ. P. 60(a), and Fed. R. Bankr. P. 4001(c) and 9024, for (A) an Order Vacating the Interim and Final Orders Authorizing the Debtors To, Among Other Things, Obtain Postpetition Financing, and (B) Other Related Relief, [ECF No. 982], *In re Bed Bath & Beyond Inc., et al.*, No. 23-13359 (VFP) (Bankr D. N.J. 2023).

30 *Id.*

31 See Transcript, [ECF No. 1196], *In re Bed Bath & Beyond Inc., et al.*, No. 23-13359 (VFP) (Bankr D. N.J. 2023); see also Order Denying Motion of the Ad Hoc Group, Pursuant to 11 U.S.C. § 105(a), Fed. R. Civ. P. 60(a), and Fed. R. Bankr. P. 4001(c) and 9024, for (A) an Order Vacating the Interim and Final Orders Authorizing the Debtors To, Among Other Things, Obtain Postpetition Financing, and (B) Other Related Relief, [ECF No. 1131], *In re Bed Bath & Beyond Inc., et al.*, No. 23-13359 (VFP) (Bankr D. N.J. 2023).

32 According to the debtors' motion, US$60 million would become available upon entry of the interim order; US$37.5 million would become available upon entry of the bidding procedures order, which

that the DIP would mature 90 days following the petition date, subject to a 15-day extension if the debtors received sufficient cash bids to pay the DIP loan in its entirety.

However, prior to the first day hearing, the debtors adjourned the DIP motion then announced at the first day hearing that the company received two competing DIP proposals. The new proposals by MFN Capital and Estes Strategic Lines contained similar economics, but a longer runway for the debtors to administer the Chapter 11 cases and also no roll-up.[33] The MFN Capital proposal contemplated the overall fees would be less than the initial DIP, provided the debtors with 180 days for the sale process and would be *pari passu* with the US$502 million pre-petition debt, while the Estes Strategic Lines DIP proposal featured a 15 per cent interest rate and a similar timeline to the MFN Capital DIP and would be junior to the pre-petition debt.[34] At the hearing, counsel for one of the pre-petition lenders, Beal Bank, protested the competing DIP proposals, noting the Estes Strategic Lines DIP financing proposal was 'junior in name only' and will likely result in a contested interim DIP financing hearing.[35] Following days of negotiations, counsel to the debtors announced at a status conference that MFN Capital had agreed to restructure its proposal to also provide the new money DIP facility on a junior basis and that the company had also received additional offers for DIP financing on a junior basis.[36] However, in an unexpected twist days following the status conference, Apollo Capital and Beal Bank announced they sold their holdings in the US$502 million pre-petition to loan to Citadel Credit Master Fund and rescinded the initial DIP proposal. The sale created a pathway for Citadel and MFN Capital to join forces to offer consensual DIP financing to the debtors, where US$100 million would be provided by Citadel on a *pari passu* basis with the US$502 million pre-petition loan, and US$42.5 million would be provided by MFN Capital on a junior basis. The DIP facility also provided for a 4 per cent interest rate on the new money portion of the DIP, 15 per cent non-default interest otherwise, a 180-day maturity and no roll-up. The DIP term sheet also included a stalking horse bidder, Old Dominion Freight Lines, with a bid of no less than US$1.5 billion for some or all of the debtors' real property.[37]

was to be accomplished within 10 days of the petition date; US$20 million upon the debtors' receipt of bids for DIP priority collateral that would generate at least US$250 million in cash proceeds; and the last US$25 million upon the debtors' receipt of bids for DIP priority collateral that would generate at least US$450 million in cash proceeds. See Motion of Debtors for Entry of Interim and Final Orders (I) Authorizing the Debtors to (A) Obtain Postpetition Financing and (B) Utilize Cash Collateral, (II) Granting Liens and Superpriority Administrative Expense Claims, (III) Modifying the Automatic Stay, (IV) Authorizing the Debtors to Use UST Cash Collateral, (V) Granting Adequate Protection, (VI) Scheduling a Final Hearing, and (VII) Granting Related Relief, [ECF No. 16], *In re Yellow Corporation, et al.*, No. 23-11069 (CTG) (Bankr. D. Del. 2023).

33 See Transcript, [ECF No. 182], *In re Yellow Corporation, et al.*, No. 23-11069 (CTG) (Bankr. D. Del. 2023).
34 *Id*.
35 *Id*.
36 See Transcript, [ECF No. 233], *In re Yellow Corporation, et al.*, No. 23-11069 (CTG) (Bankr. D. Del. 2023).
37 See Notice of DIP Financing Term Sheet and Budget, [ECF No. 297], *In re Yellow Corporation, et al.*, No. 23-11069 (CTG) (Bankr. D. Del. 2023).

The DIP was approved on an interim basis by United States Bankruptcy Judge Craig T Goldblatt on 18 August 2023.[38]

Equity conversions

Traditionally, DIP facilities are required to be repaid in full and in cash at the end of a debtor's Chapter 11 case, whether in connection with a plan of reorganisation, a 363 sale or a combination of the two. In certain situations – in particular, pre-packaged or prearranged bankruptcies – DIP facilities can be structured to provide that the outstanding DIP obligations convert into secured exit financing upon emergence from bankruptcy. Even more recently, in certain cases, DIP lenders have increasingly sought high rates of return on DIP loans, which approach equity-like rates of return, or a right to participate in an exit capital raise at a specified value approved at the start of the case.

Some DIP facilities provide for conversion of outstanding DIP obligations into equity of the reorganised debtor on emergence, most commonly at the debtor's election. These conversion features can be of great benefit to debtors that are seeking a quick exit from bankruptcy (such as in the case of a prepack) or that are looking to mitigate the risks associated with obtaining the funding necessary to repay the DIP obligations at the end of the case. Equity conversions grew increasingly popular during the covid-19 era, where the debtor's projected revenues and its relative access to international debt or equity markets at the end of the case were extremely difficult to predict. Mitigating the risk of mistiming the debtor's exit from Chapter 11 has become extremely important to certain businesses that want to avoid being in the situation where they are poised to emerge from Chapter 11 but cannot obtain attractive exit financing to do so.

Equity conversions are potentially attractive from the perspective of cash-strapped debtors and also for lenders that may recognise the underlying value of a business, even in the face of exogenous factors. When presented with a DIP facility containing an equity conversion feature, the bankruptcy court will often scrutinise which parties are provided the ability to participate in the DIP financing, the economic terms of the conversion and other conversion features (such as which entity controls the conversion election). As with roll-ups, some practitioners believe equity conversions are a feature of weak credit markets and should be less prevalent when credit markets are robust.[39] However, as

38 Interim Order (I) Authorizing the Debtors to (A) Obtain Postpetition Financing and (B) Use Cash Collateral, and (C) Grant Liens and Superpriority Administrative Expense Claims, (II) Granting Adequate Protection to Certain Prepetition Secured Parties, (III) Modifying the Automatic Stay, (IV) Scheduling a Final Hearing, and, (V) Granting Related Relief, [ECF No. 302], *In re Yellow Corporation, et al.*, No. 23-11069 (CTG) (Bankr. D. Del. 2023).

39 Practice Note, Key Developments and Trends in DIP Financing, Practical Law (19 February 2015) (http://us.practicallaw.com/6-600-9845) ('As the credit markets improve, equity conversions are likely to decline').

described further below, equity conversions have featured prominently in certain recent bankruptcies in the airline industry.

Given the additional pressures brought to bear on liquidity, especially in certain hard-hit industries, such as the airline industry during the covid-19 pandemic, the ability to convert DIP obligations into reorganised equity at the end of a case provides meaningful flexibility for debtors in situations where liquidity may not be readily available on emergence. The approved DIP facility in *Avianca*, which contains a senior Tranche A of US$1.296 billion and a junior Tranche B of US$722.3 million, contains an equity conversion option where the borrower can elect to pay the entire US$722.3 million junior Tranche B DIP facility (together with any fees) with equity of the reorganised debtors on exit.[40] The approved conversion feature has proven valuable, where the debtors have not been able to identify any financing that would pay the DIP facility in full, and have filed a plan that contemplated such conversion would occur.[41]

Similarly, the *Aeroméxico* DIP facility contains an equity conversion feature – although the conversion in *Aeroméxico* is at the lenders' option.[42] The lenders have the ability to elect to receive common stock of the reorganised debtors as repayment for their loan subject to satisfactory tax, legal and regulatory review.[43] In support of the equity conversion aspect of the DIP facility, the debtors argued that the inclusion of the equity conversion:

> *substantially increases the odds of a successful reorganization as a going concern, as it provides a potential pathway to emergence from Chapter 11 without having to raise substantial exit financing.*[44]

The debtors subsequently revised the equity conversion feature to remove drag-along rights that would have enabled the DIP lender to drag the minority investors along as part of the restructuring if it chose to convert its holdings into equity.[45] Under the revised election procedures, minority DIP lenders may

40 Final Order (I) Authorizing the Debtors to (A) Obtain Postpetition Financing, and (B) Grant Liens and Superpriority Administrative Expense Claims, (II) Modifying the Automatic Stay, and (III) Granting Related Relief [ECF 1031] *In re Avianca Holdings SA* 20-11133 (MG) (Bankr. SDNY 2020).

41 Notice of Filing of Third Amended Joint Chapter 11 Plan of Avianca Holdings S.A. and its Affiliated Debtors [ECF 2130], *In re Avianca Holdings SA* 20-11133 (MG) (Bankr. SDNY 2020).

42 Final Order Granting Debtors' Motion to (I) Authorize Certain Debtors in Possession to Obtain Post-Petition Financing; (II) Grant Liens and Superpriority Administrative Expense Claims to DIP Lenders; (III) Modify Automatic Stay; and (IV) Grant Related Relief, [ECF 527], *In re Grupo Aeroméxico, SAB de CV* No. 20-11563 (SCC) (Bankr. SDNY 2020).

43 *Id*.

44 Motion to Authorize / Motion of Debtors for Entry of Interim and Final Orders, Pursuant to 11 USC sections 105, 361, 362, 363, 364, 503, 506, 507 and 552 (I) Authorizing the Debtors to Obtain Secured Superpriority Postpetition Financing, (II) Granting Liens and Superpriority Administrative Expense Claims, (III) Scheduling a Final Hearing, and (IV) Granting Related Relief, [ECF 271], paragraph 44 *In re Grupo Aeroméxico, SAB de CV* No. 20-11563 (SCC) (Bankr. SDNY 2020).

45 Notice of Filing of Revised Debtor in Possession Loan Agreement Schedule, [ECF 525], *In re Grupo Aeroméxico, SAB de CV* No. 20-11563 (SCC) (Bankr. SDNY 2020).

choose whether to take stock or cash out after the majority DIP lender makes its own election.[46]

Although the DIP facility that was ultimately approved in the *LATAM Airlines* Chapter 11 cases did not provide for equity conversion, the initial proposed DIP facility contained such a feature.[47] The initial DIP facility provided that one of the three tranches of post-petition debt could be converted into equity on emergence (originally the conversion feature was at the DIP lenders' option, but as part of a subsequent amendment, the debtors obtained control of the election). The proposed equity conversion feature was limited to a specific tranche of the DIP facility that was provided by certain LATAM shareholders in exchange for, among other things, a commitment to approve the necessary capital increase under local Chilean law and a waiver of their pre-emptive rights as shareholders to participate in any issuance of reorganised equity of the debtors on exit.[48] The unsecured creditor's committee and ad hoc bondholder groups objected to the DIP on a number of grounds, including that the limited equity conversion feature subverted the reorganisation process and gave rise to improper *sub rosa* plan treatment with respect to those shareholder DIP lenders. The bankruptcy court ultimately found that, although the terms of the DIP financing were reasonable and proposed in good faith, it would not approve the DIP facility as proposed because the equity conversion, which was limited to those lenders that were shareholders of the company and was connected to a waiver of the exercise of such shareholders' pre-emptive rights, was a *sub rosa* plan.[49] Following further negotiations between the debtors, the DIP lenders and the unsecured creditors' committee, a revised DIP facility that did not include an equity conversion feature was approved by the bankruptcy court.[50]

Separate from the airline industry, the *Alto Maipo* Chapter 11 cases featured an equity conversion where, pursuant to the plan, the DIP lender would receive new common equity upon emergence. Debtor Alto Maipo SpA, a special purpose company that developed, constructed and operates a hydroelectric energy project in the Santiago Metropolitan Region of Chile, sought bankruptcy protection in the United States despite having primarily Chilean creditors.[51] As of the petition date, AES Andes SA, which later became the DIP lender in that case, owned 100 per cent equity interest in Norgener Renovables SpA, which owned 93 per cent

46 *Id*.
47 Motion to Approve Debtor in Possession Financing, and, Motion to Authorize Debtors to Grant Superpriority Administrative Expense Claims, [ECF No. 391], *In re LATAM Airlines Group SA*, No. 20-11254 (JLG) (Bankr. SDNY 2020).
48 *Id*.
49 *In re LATAM Airlines Grp. SA*, 2020 Bankr. LEXIS 2405 (10 September 2020).
50 Order Granting Motion to Approve Debtor in Possession Financing, [ECF No. 1091] *In re LATAM Airlines Group SA*, No. 20-11254 (JLG) (Bankr. SDNY 2020).
51 Final Order Granting Debtors' Motion to (I) Authorize Debtors in Possession to Obtain Post-Petition Financing Pursuant to 11 U.S.C. §§ 105, 362, 363 and 364; (II) Grant Superiority Administrative Expense Claims to DIP Lender(s) Pursuant to 11 U.S.C. §§ 364 and 507; (III) Modify Automatic Stay Pursuant to 11 U.S.C. §§ 361, 362, 363, 364 and 507; and (IV) Granted Related Relief [ECF No. 166], *In re Alto Maipo Delaware LLC, et al,*, No. 21-11507 (Bankr. Del. 2021).

equity interest in the Chilean debtor. Under the DIP financing agreement, AES Andes SA provided US$50 million in liquidity to the debtors, which, under the plan of reorganisation, was converted to new equity and resulted in AES Andes SA becoming the sole owner of the reorganised debtors.[52]

As previously noted, DIP lenders have sought higher, equity-like rates of return, along with additional protections. These features have not gone unscrutinised by courts. For example, the *SAS AB* DIP facility contained certain equity-linked features that were heavily scrutinised by the court. SAS AB, together with its affiliated debtors (SAS), one of Scandinavia's leading airlines, filed for Chapter 11 protection on 5 July 2022.[53] During the proceedings in connection with the court's consideration of the US$700 million SAS DIP facility, the court expressed certain reservations regarding two equity conversion features.[54] While no formal objections to the DIP were filed, the court raised these concerns *sua sponte*, ultimately granting the DIP but noting its 'significant reservations' in respect of the equity-linked features.[55]

First, the court expressed concern about a call option under the DIP, pursuant to which the DIP lenders would have the right to convert their outstanding DIP loans or pay cash to acquire equity to be issued by the debtors under a plan of reorganisation (the 'call option'). Pursuant to the DIP facility, the call option is exercisable based on a US$3.2 billion assumed total enterprise value, effectively permitting the DIP lenders to acquire equity at a discount in the event a plan was premised on a total enterprise value of US$3.2 billion.[56] The court also expressed concern about certain tag rights that would give the DIP lenders the right to subscribe to up to 30 per cent of any new money equity raise with a third party to be issued under a plan of reorganisation, on the same terms made available to such third party (the 'tag right'). Both options are terminable, subject to substantial termination fees (a US$19.52 million call option termination fee, and a US$21 million tag right termination fee).

More precisely, the court raised questions as to whether the call option and tag right constituted a *sub rosa* plan, and whether such options could only be granted as part of a plan process. The court questioned whether 'the right to participate in a plan process' is a property right that a debtor can sell under Bankruptcy

52 Findings of Fact, Conclusions of Law, and Order Confirming the Joint Chapter 11 Plan of Reorganization of Alto Maipo SpA and Alto Maipo Delaware LLC Pursuant to Chapter 11 of the Bankruptcy Code [ECF No. 614], *In re Alto Maipo Delaware LLC, et al,*, No. 21-11507 (Bankr. Del. 2021).

53 Declaration of Erno Hildén Pursuant to Rule 100-2 of Local Bankruptcy Rules for Southern District of New York, [ECF No. 3], *In re SAS AB*, No. 20-10935 (MEW) (Bankr. SDNY 2022).

54 Bench Decision (I) Authorizing the Debtors to Obtain Senior Secured, Superpriority, Postpetition Financing, (II) Granting Liens and Superpriority Claims, and (III) Granting Related Relief, [ECF No. 376], *In re SAS AB*, No. 20-10935 (MEW) (Bankr. SDNY 2022).

55 Bench Decision (I) Authorizing the Debtors to Obtain Senior Secured, Superpriority, Postpetition Financing, (II) Granting Liens and Superpriority Claims, and (III) Granting Related Relief, [ECF No. 376], *In re SAS AB*, No. 20-10935 (MEW) (Bankr. SDNY 2022).

56 Bench Decision (I) Authorizing the Debtors to Obtain Senior Secured, Superpriority, Postpetition Financing, (II) Granting Liens and Superpriority Claims, and (III) Granting Related Relief, [ECF No. 376], *In re SAS AB*, No. 20-10935 (MEW) (Bankr. SDNY 2022).

Code section 363 outside the context of a plan process. In response to the court's concerns, the debtors drew parallels between recent airline restructurings, noting that approval of equity conversions in the *Aeroméxico* and *Avianca* DIPs (and, in particular, that the debtors in *Aeroméxico* could not terminate the DIP-to-equity election right).[57] In its bench decision, the court noted that it thought the precedent was 'very clear that decisions about the issuance of equity in the reorganized debtors should be reserved for the plan process', but accepted, with noted discomfort, the SAS debtors' argument that the inclusion of termination rights did not actually lock in any particular rights to buy equity, and noted that the termination fees were unlikely to pose an impediment to the plan process given their relative magnitude to the equity that would eventually be raised.

The court also questioned the economics of the deal, noting the challenge of assessing the costs and benefits of the call option and tag right and the potential for abuse by 'insiders, large creditors or friendly buyers'. While the court approval noted the absence of objections in approving the DIP notwithstanding this reservation, the court expressed concern about opening the door to seeing such equity-linked features become more commonplace.

Viewed together, the decisions in the *LATAM Airlines* and *SAS* cases suggest that there may be limits to the ability of debtors and DIP lenders to negotiate equity conversion and equity-linked options in DIP facilities.

Pre-packaged bankruptcies

In the case of pre-packaged or prearranged bankruptcies, the provision and terms of DIP facilities, if any, may figure prominently in the negotiation and terms of the debtor's Chapter 11 plan. Pre-packaged bankruptcies reduce uncertainty and risk in the plan confirmation process, which in turn offers the same benefits in the negotiation of a DIP. The posture of negotiating a DIP together with the terms of a plan with a debtor's pre-petition lenders can allow for greater certainty in the source of repayment of the DIP, for example, through conversion into exit financing or equity, or the repayment of the DIP from the proceeds of the sale of certain of the debtor's assets.

Many pre-packaged bankruptcies make use of a DIP-to-exit financing model. For example, in a recent partially pre-packaged bankruptcy filing in the Southern District of Texas, Monitronics International, Inc, and affiliates sought approval of a US$398.6 million DIP facility as part of its suite of first day filings. Interestingly, as part of their interim relief, the debtors proposed to indefeasibly pay US$294 million in super senior first-out exit loans held by DIP lenders from the

57 Supplement to Motion of Debtors for Order (I) Authorizing the Debtors to Obtain Senior Secured, Superpriority, Postpetition Financing, (II) Granting Liens and Superpriority Claims, and (III) Granting Related Relief, [ECF No. 305], *In re SAS AB*, No. 20-10935 (MEW) (Bankr. SDNY 2022).

company's prior bankruptcy.[58] The Office of the United States Trustee objected to the relief at the hearing, noting payment of the exit loans should be subject to clawback, where a creditors' committee may be appointed and could bring a lien challenge; otherwise, the challenge period would be 'superfluous'.[59] During the hearing, one of the debtors' declarants agreed that ordering the interim relief would make the challenge period superfluous; however, the DIP was the 'best deal on the table'.[60] While sympathetic to the United States Trustee's position, Judge Christopher Lopez found the indefeasible payment was proper under the circumstances and the debtors needed the financing to operate.[61]

In a prearranged filing in the District of Delaware, life sciences company SiO2 Medical Products, Inc, featured a DIP facility supplied by Oaktree Capital Management LP (Oaktree), which comprised US$60 million in new money and US$60 million in roll-up.[62] To complement the DIP, the restructuring support agreement also contemplated Oaktree receiving all the reorganised equity of SiO2 for an existing US$225 million loan and the new money portion of the DIP facility.[63] The proposed DIP faced scrutiny from the creditors' committee, which argued, among other things, that the funding came at a high cost (14 per cent interest plus a 5 per cent facility fee and a 5 per cent exit fee), the milestones were unrealistic (plan confirmation in 78 days), the pre-petition market check was 'woefully inadequate' and the DIP stifled the creditors' committee's fiduciary duties.[64] Following a hearing on the motion, Judge John Dorsey approved the DIP facility on a final basis.[65]

58 Debtors' Emergency Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Authorizing the Use of Cash Collateral, (III) Granting Liens and Superpriority Claims, (IV) Modifying the Automatic Stay, (V) Scheduling a Final Hearing, and (VI) Granting Related Relief, [ECF No. 21], *In re Monitronics International, Inc., et al.*, 23-90332 (CML) (Bankr. S.D. Tex. 2023).

59 Transcript, [ECF No. 110], *In re Monitronics International, Inc., et al.*, 23-90332 (CML) (Bankr. S.D. Tex. 2023).

60 *Id*.

61 Interim Order (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Authorizing the Use of Cash Collateral, (III) Granting Liens and Superpriority Claims, (IV) Modifying the Automatic Stay, (V) Scheduling a Final Hearing, and (VI) Granting Related Relief, [ECF No. 70], *In re Monitronics International, Inc., et al.*, 23-90332 (CML) (Bankr. S.D. Tex 2023).

62 Motion of Debtors for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Granting Liens Superpriority Administrative Expense Status, (III) Modifying the Automatic Stay, (IV) Scheduling a Final Hearing, and (V) Granting Related Relief, [ECF No. 14], *In re SiO2 Medical Products, Inc., et al.*, 23-10366 (JTD) (Bankr. D. Del. 2023).

63 Disclosure Statement for the Joint Chapter 11 Plan of Reorganization of SiO2 Medical Products, Inc., and its Debtor Affiliates, Ex. B, [ECF No. 19], *In re SiO2 Medical Products, Inc., et al.*, 23-10366 (JTD) (Bankr. D. Del. 2023).

64 Objection of the Official Committee of Unsecured Creditors of to the Debtors Emergency Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Granting Liens Superpriority Administrative Expense Status, (III) Modifying the Automatic Stay, (IV) Scheduling a Final Hearing, and (V) Granting Related Relief, [ECF No. 162], *In re SiO2 Medical Products, Inc., et al.*, 23-10366 (JTD) (Bankr. D. Del. 2023).

65 Final Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364 and 507 (I) Authorizing the Debtors to Obtain Postpetition Financing, (II) Granting Liens Superpriority Administrative Expense Status, (III) Authorizing the Use of Cash Collateral, (IV) Granting Adequate Protection to Prepetition Secured Parties, and (V) Granting Related Relief, [ECF No. 216], *In re SiO2 Medical Products, Inc., et al.*, 23-10366 (JTD) (Bankr. D. Del. 2023).

In other examples, the case of California Pizza Kitchen, which filed for Chapter 11 in the Southern District of Texas on 30 July 2020, featured a restructuring support agreement (RSA) that included US$46.8 million in new DIP financing and was funded through a new first lien exit facility.[66] The DIP facility consisted of a roll-up of US$60.8 million in pre-petition first lien loans in addition to the US$46.8 million in new money, totalling an aggregate amount of approximately US$107.7 million.[67] Upon emergence from Chapter 11, the entirety of the DIP facility was converted into a new first lien term loan facility, which was supplemented by a second lien term facility.[68] In *Automotores Gildemeister*, a Chilean vehicle importer and distributor that filed for Chapter 11 in April 2021 in the Southern District of New York, an ad hoc group of consenting noteholders, in connection with the negotiation of a restructuring support agreement, agreed to provide a US$23.6 million DIP.[69] The plan provided that the DIP claims were to be paid, at the reorganised debtor's election dollar for dollar with new senior secured notes or in cash.[70]

In other cases, pre-packaged bankruptcy plans negotiate a DIP to be repaid through asset sales. In *Fairway Group Holdings Corp*, the debtors, a regional grocery retailer in the New York area, filed for Chapter 11 in the Southern District of New York in January 2020 to implement a strategic asset sale of substantially all of the debtor's assets pursuant to an RSA, with an ad hoc group of stakeholders holding over 91 per cent of the approximately US$227 million outstanding obligations under a pre-petition credit agreement.[71] The ad hoc group agreed to provide a US$25 million new money DIP, in addition to a roll-up of approximately US$42.8 million of pre-petition letters of credit and term loans. Following multiple auctions and the sale of substantially all of the debtor's assets, the debtor paid down substantially all of the DIP prior to commencement of solicitation of the debtor's plan.[72] Similarly, in the *McDermott* bankruptcy, an RSA with the debtor's key secured and unsecured stakeholder groups contemplated an aggregate US$2.81 billion DIP provided by the debtor's senior secured lenders, to be substantially repaid with the proceeds of the sale of the debtor's Lummus Technology Business (pursuant to a pre-petition

66 Disclosure Statement for the First Amended Joint Chapter 11 Plan of Reorganization of California Pizza Kitchen, Inc. and Its Debtor Affiliates, [ECF 434], *In re California Pizza Kitchen, Inc., et al*, No. 20-33752 (MI) (Bankr. TXSB 2020).

67 *Id*.

68 *Id*.

69 Amended Disclosure Statement for the Joint Prepackaged Plan of Reorganization of Automotores Gildemeister SpA and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code [ECF 27], *In re Automotores Gildemeister Spa, et al*, 21-10685 (LGB) (Bankr. SDNY 2021).

70 *Id*.

71 Disclosure Statement for the Joint Chapter 11 Plan of Fairway Group Holdings Corp. and Its Affiliated Debtors [ECF 679], *In re Fairway Group Holdings Corp., et al*, No. 20-10161 (JLG) (Bankr. SDNY 2020).

72 Pursuant to a stipulation with the DIP lenders, US$3 million was held back and placed in a segregated account to reserve cash for the payment of 503(b)(9) administrative expense claims. id.

stalking horse agreement that provided for the sale of the business for at least US$2.7 billion).[73]

In such pre-packaged or prearranged bankruptcies, the promise of a roll-up of pre-petition debt also may be a critical inducement for pre-petition lenders to offer pre-filing 'bridge' financing, which is later rolled up in the DIP, to provide a company sufficient liquidity to engage in pre-filing negotiation over the terms of an RSA, when the debtor might otherwise file a free-fall bankruptcy. In *McDermott*, certain of the debtor's pre-petition lenders agreed to extend an addition US$1.7 billion super-priority senior secured financing, which permitted the company to continue to engage in discussions with its key secured and unsecured stakeholder groups regarding the terms of a potential restructuring, as well as to engage in a marketing process for the sale of its Lummus Technology Business.[74] Similarly, in *Ruby Tuesday*, the debtor's pre-petition secured lenders agreed to extend US$2 million in bridge financing, giving the company sufficient liquidity to support the company's operations until the petition date, including engaging in negotiations with said secured lenders about the terms of a restructuring support agreement.[75] The US$2 million bridge loan was included as a roll-up of term loans in the DIP.[76]

Conclusion

International debtors filing for Chapter 11 in the United States are able to take advantage of an established market for DIP financing. Chapter 11 debtors are increasingly successful in including features in DIP facilities such as roll-ups and equity conversions that were previously subject to greater levels of scrutiny and that some practitioners thought were limited to times of illiquid financial markets. The recent cases discussed in this article suggest that these features may have gained a stronger foothold in the DIP financing toolkit.

73 Disclosure Statement for the Joint Prepackaged Chapter 11 Plan of Reorganization of McDermott International, Inc. and its Debtor Affiliates [ECF 4], *In re McDermott International, Inc., et al*, No. 20-30336 (Bankr. S.D. Tex. 2020).

74 Disclosure Statement for the Joint Prepackaged Chapter 11 Plan of Reorganization of McDermott International, Inc. and its Debtor Affiliates [ECF 4], *In re McDermott International, Inc., et al*, No. 20-30336 (Bankr. S.D. Tex. 2020).

75 Declaration of Shawn Lederman, Chief Executive Officer, In Support of First Day Pleadings [ECF 3], *In re RTI Holding Company LLC*, No. 20-12456 (JTD) (Bankr. D. Del. 2020); Disclosure Statement for Debtors' Chapter 11 Plan [ECF 354], *In re RTI Holding Company LLC*, No. 20-12456 (JTD) (Bankr. D. Del. 2020).

76 Final Order (I) Authorizing Debtors to (A) Obtain Postpetition Financing Pursuant to 11 USC. sections 105, 361, 362, 364(c)(1), 364(c)(2), 364(c)(3), 364(d)(1), and 364(e) and (B) Use Cash Collateral Pursuant to 11 USC section 363 and (II) Granting Adequate Protection Pursuant to 11 USC sections 361, 362, 363, and 364 [ECF 558], *In re RTI Holding Company LLC*, No. 20-12456 (JTD) (Bankr. D. Del. 2020).

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Implications of the Rule in Gibbs on the Effectiveness of Schemes of Arrangement to Compromise US Law-governed Debt

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In summary

Use of schemes of arrangement, coupled with Chapter 15 recognition, to restructure US law-governed debt has become common practice over recent years in certain jurisdictions that have a scheme of arrangement similar to that found in the United Kingdom, including Hong Kong. Recent obiter dicta comments by the Hong Kong Court in *Re Rare Earth* in relation to the applicability of the rule in *Gibbs* to such schemes of arrangement have placed this restructuring technique under scrutiny.

Discussion points

- Recent decision of the Hong Kong Court commenting on the use of schemes of arrangement to compromise US law-governed debt and Chapter 15 recognition
- The Hong Kong Court's view that the rule in *Gibbs* means certain jurisdictions (including Hong Kong) will not recognise the effect of such schemes of arrangement
- The United States Bankruptcy Court's view on the effect of Chapter 15 recognition and whether it substantively discharges US law-governed debt

Referenced in this article

- *Re Rare Earth Magnesium Technology Group Holdings Limited (Provisional Liquidators Appointed) (For Restructuring Purposes Only)* [2022] HKCFI 1686 (*Re Rare Earth*)
- *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* [1890] LR 25 QBD 399 (*Gibbs*)
- Chapter 15 of the United States Bankruptcy Code
- *In re Modern Land (China) Co Ltd, 22-10707* (MG) (Bankr. SDNY 18 July 2022) (*In re Modern Land*)

Introduction

The recent and ongoing property sector crisis in the People's Republic of China (PRC) has brought into focus how the sector has, for a long time, been financed by the Hong Kong capital markets through, among other things, the issuance of New York law-governed bonds.

Owing to the levels of consent[1] commonly required for the amendment or waiver of New York law-governed bonds, restructuring such bonds through the use of schemes of arrangement (which require lower levels of consent)[2] has become common practice in certain jurisdictions.

Comments made in the Hong Kong Court of First Instance (the Hong Kong Court) decision in *Re Rare Earth* have recently led to some scrutiny of this practice. In this article, we consider the *Re Rare Earth* decision and the implications of the rule in *Gibbs* on recognition in Hong Kong of a foreign scheme of arrangement that purports to compromise US law-governed debt.

What is the rule in Gibbs?

The rule in *Gibbs* originates from the English case *Gibbs*, where it was held by the English Court of Appeal that contracts could only be discharged in accordance with the law governing the contract (subject to certain exceptions). By extension, an English law contract can only be extinguished under an English law proceeding, and the discharge of a contract governed by the law of a foreign country would only be recognised in England to the extent the law of such foreign country recognised the discharge of such contract.

In *Gibbs*, the defendant agreed to buy copper to be delivered and paid for in England from the plaintiff. After the contracts were made, the defendant went into liquidation in France, and refused to accept delivery of the copper, arguing that the French liquidation operated as a discharge from liability on the contracts under French law. The English Court of Appeal held that the contracts were governed by English law, because they were made in and due to be performed in England. Accordingly, English law would govern the discharge of the contract, in whatever country the action was brought and the English Court of Appeal did not recognise the purported discharge of obligations under French law.

The rule in *Gibbs* is also followed in Hong Kong.

1 New York law governed bonds typically require consent from holders with 100 per cent of the outstanding principal amount to amend principal and interest payment dates or to waive a non-payment default.
2 Schemes must be approved by a majority in number and 75 per cent in value of the members of each class of scheme creditors (as defined below), present and voting.

What is a scheme of arrangement?

A scheme of arrangement (as it exists in the UK, as well as in Hong Kong and certain other jurisdictions) is an arrangement or compromise proposed by a company to be entered into with the company's creditors (the scheme creditors).[3] If the scheme creditors approve the scheme of arrangement with the requisite majorities, it can then be sanctioned by the relevant court if certain criteria are met, following which the scheme of arrangement is binding on all scheme creditors. In the UK and Hong Kong, for the court to sanction a scheme of arrangement, it must be satisfied that, among other things, there is sufficient connection with the jurisdiction and the scheme is likely to be effective in achieving its purpose. The principal way in which the English and Hong Kong courts determine the effectiveness of a scheme of arrangement in a multi-jurisdictional context is to consider whether the scheme of arrangement is likely to be recognised in the relevant foreign jurisdictions, if it is not proposed for there to be parallel schemes of arrangement in such jurisdictions.

A scheme of arrangement can be proposed by a company in one or more jurisdictions where such a procedure exists, including the company's place of incorporation or where the company otherwise has a sufficient connection (which can include its centre of main interests (COMI) being located in that jurisdiction). If there is a material risk of challenge to the effectiveness or validity of a scheme of arrangement in a relevant jurisdiction, the company may wish to consider whether it should propose a parallel scheme of arrangement in such jurisdiction (where the relevant jurisdiction also has such a procedure) or if the scheme of arrangement should be accompanied by an application for recognition.

For example, a company incorporated in the Cayman Islands with a Hong Kong COMI may consider promoting a scheme in the Cayman Islands to compromise debt governed by New York law. In deciding whether to sanction the scheme, a key question for the Grand Court of the Cayman Islands (the Cayman Court) is likely to be whether the scheme is effective in all the relevant jurisdictions, including in particular, Hong Kong (the company's COMI). In deciding whether to recognise such a scheme, the Hong Kong Court (applying the rule in *Gibbs*) will then ask whether, as a matter of New York law, the Cayman Islands scheme has effectively discharged the New York law-governed debt. To avoid any dispute as to whether such scheme is effective as a matter of New York law, especially if there is a material risk of challenge in Hong Kong by dissenting creditors (with sizeable claims), practitioners have generally in such circumstances made an

3 In the restructuring context, it is common for the debtor company to propose to enter into a scheme with its creditors. However, schemes can also be used in other situations. For example, a company can propose to enter into with a scheme with its members for the privatisation of the company. In addition to the company, creditors or members can also apply for the scheme to be sanctioned. Where a company is being wound up, only a liquidator (or provisional liquidator) can apply.

application under Chapter 15 of the United States Bankruptcy Code (Chapter 15) for the recognition of the Cayman Islands scheme.

Does recognition of a scheme of arrangement under Chapter 15 constitute a discharge of debt under New York law?

The Honourable Mr Justice Harris of the Hong Kong Court (Harris J) expressed views on this question in the recent judgment of *Re Rare Earth.*

Re Rare Earth concerned a company (Rare Earth) incorporated in Bermuda and listed on the the Stock Exchange of Hong Kong Limited (HKEx). Rare Earth has subsidiaries located in Hong Kong, the PRC and the British Virgin Islands (BVI) and is part of a group of companies (the Century Sunshine Group) ultimately held by Century Sunshine Group Holdings Limited (Century Sunshine). The Century Sunshine Group's key businesses consists of the development and production of fertilisers, with their primary production bases located in the PRC. The scheme was being proposed by Rare Earth to achieve, among other things, the discharge of its unsecured indebtedness and release of guarantees granted by Century Sunshine.

Although not applicable to Rare Earth's scheme, Harris J nevertheless took the opportunity to express his views on the use of a scheme of arrangement to compromise 'debt governed by United States law', proposed in an offshore jurisdiction (such as Bermuda or the Cayman Islands) by a debtor with its COMI in Hong Kong, where an application for recognition under Chapter 15 was also sought, stating that:

> *32. A scheme sanctioned in an offshore jurisdiction and recognised under Chapter 15 in the United States will not be treated by a Hong Kong court as compromising US$ debt. The Rule in Gibbs requires the substantive alteration of contractual rights to be sanctioned by some substantive provision of the relevant law. In the insolvency context in the United States this as I understand is achieved under Chapter 11 of United States Bankruptcy Code.*[4]

Harris J took the view that the Hong Kong Court could apply the rule in *Gibbs* to refuse to recognise the effect of an offshore scheme of arrangement proposed by a debtor with a Hong Kong COMI to compromise US law-governed debt, on the basis that the US law-governed debt would not be discharged (as a matter of US law) through the offshore scheme and Chapter 15 process. As a result, creditors who had not participated in the offshore scheme would still be entitled to take action against the debtor in the Hong Kong Court.

4 At [32] of *Re Rare Earth.*

However, Harris J also noted that a scheme of arrangement purporting to compromise US law-governed debt proposed by a debtor with a Hong Kong COMI in Hong Kong (instead of in an offshore jurisdiction) could be sanctioned by the Hong Kong Court and would (as a matter of Hong Kong law) prevent claims from being brought in Hong Kong in respect of the US law-governed debt.

Soon after Harris J's decision in *Re Rare Earth*, the question of the effect of recognition under Chapter 15 came before Glenn J of the US Bankruptcy Court in *In re Modern Land*.

In re Modern Land involved an application by Modern Land (China) Co, Limited (*Modern Land*) for the recognition of its scheme of arrangement pending before the Cayman Court. Modern Land is a company incorporated in the Cayman Islands and listed on the HKEx. Modern Land is the ultimate holding company of a group of companies (the Modern Land Group) including subsidiaries incorporated in the BVI, Hong Kong and the PRC. The Modern Land Group's main business is the investment into and development of real estate in the PRC and the United States. Modern Land's scheme proposed to compromise obligations under its bonds with a total outstanding principal amount of approximately US$1.34 billion listed on the HKEx and the Singapore Exchange Limited.

Glenn J explained that Harris J had misinterpreted US law in his comments in *Re Rare Earth* and clarified that:

> [although] *Chapter 15 limits a US bankruptcy court's authority to enjoin conduct outside the territorial jurisdiction of the United States . . . it does not make a discharge of New York law governed debt any less controlling*[5]

and

> [so long as] *the foreign court properly exercises jurisdiction over the foreign debtor in an insolvency proceeding, and the foreign court's procedures comport with broadly accepted due process principles, a decision of the foreign court approving a scheme or plan that modifies or discharges New York law governed debt is enforceable.*[6]

In, *In re Modern Land*, the US Bankruptcy Court was satisfied that it was appropriate to recognise and enforce the discharge of debt under the scheme of arrangement that had been proposed under Cayman Islands law and orders were made accordingly.

5 At page 9 of *In re Modern Land*.

6 See footnote 5, above.

What does this mean for the parties interested in a scheme?

At the time of writing, the Hong Kong Court has not made further comments regarding the use of offshore schemes of arrangement to restructure debt governed by 'United States law'. There is a high likelihood that, following the US Bankruptcy Court's decision in *In re Modern Land,* the Hong Kong Court will find an offshore scheme of arrangement recognised under Chapter 15 that purports to compromise New York law-governed debt to: (1) have effectively compromised such debt; (2) bind scheme creditors who did not participate in the relevant scheme proceedings; and (3) prevent scheme creditors from commencing proceedings to enforce their claims in connection with the compromised debt in Hong Kong.

Debtor companies proposing to use schemes to restructure debt governed by New York law should take comfort from the current state of the law – schemes of arrangement recognised under Chapter 15 should be considered to be effective by the Hong Kong court. Dissenting scheme creditors who have not participated in the scheme proceedings will find it difficult to challenge the effectiveness of the scheme of arrangement in Hong Kong.

It is likely that other jurisdictions following the rule in *Gibbs* will take a similar view given the US Bankruptcy Court's clarifications in its decision in *In re Modern Land*.

Trustees can also be confident (as a matter of New York law) in complying with the steps commonly proposed in foreign schemes of arrangement that are recognised under Chapter 15, including to modify or discharge existing debt and related guarantees governed by New York law and to issue new debt and guarantees governed by New York law. A sanction order granted by a foreign court in respect of such a scheme of arrangement, together with an order of the US Bankruptcy Court under Chapter 15, should typically be sufficient to authorise the trustee to take the steps contemplated by such orders.

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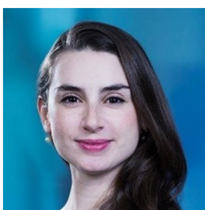

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Investment Fund Activity in US Debt Restructurings

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In summary

This article examines the role private equity and hedge funds have come to play in US debt restructurings and the variety of investment strategies they deploy in distressed situations, including in connection with pre-negotiated and pre-packaged Chapter 11 cases and out-of-court restructurings.

Discussion points

- Conditions leading to increased investment fund participation in US debt restructurings
- Overview of notable investment fund strategies
- Recent trends in investment fund tactics and the impact of such funds' roles in large Chapter 11 cases and debt restructurings

Referenced in this article

- *In re Carlson Travel, Inc*
- *In re LATAM Airlines Grp, SA*
- *Audax Credit Opportunities Offshore Ltd v TMK Hawk Parent, Corp*
- *Bayside Cap Inc v TPC Group Inc (In re TPC Group Inc)*
- *In re Deluxe Entertainment Services Group Inc*
- *In re Pioneer Energy Services Corp*

Introduction

Private equity and hedge fund participation in US debt restructurings has proliferated since the 2008 financial crisis. Funds specialising in distressed investments now appear in almost every large US debt restructuring and often play a significant role in shaping its course and outcome. This trend shows no signs of stopping, particularly in light of the growth of direct lending and private credit. Investment funds continue to be a strong force in Chapter 11, as sophisticated investors are adept at finding creative ways to maximise their returns. This article examines some of the investment strategies that funds have deployed in response to current market conditions and the impact of such funds' roles in large Chapter 11 cases and debt restructurings.

Background

The global financial crisis that began in September 2008 precipitated a huge increase in Chapter 11 filings: nearly 20 times more debt was restructured through Chapter 11 in 2008 and 2009 than in the two preceding years. Not only did the total number of bankruptcy filings increase, but the size and complexity of companies seeking bankruptcy protection also grew considerably. Yet this unprecedented upswing occurred at a time when banks and other traditional lenders were themselves struggling with the impacts of the financial crisis (and, later, with the regulatory repercussions that significantly scaled back their ability to invest in distressed situations). Non-traditional lenders, such as investment funds – both private equity and hedge funds – stepped into the resulting funding gap. Unlike traditional banks, investment funds are subject to significantly less regulatory oversight and reporting obligations. This gives them greater flexibility in their investment strategies, which has led to an explosion in private credit and direct lending since the financial crisis.[1] And during periods of increased restructuring activity, such as the months following the outbreak of the covid-19 pandemic, investment funds have had a greater appetite for and ability to invest in distressed situations.

Today, investment funds play diverse and varied roles in debt restructurings. They:

1 The direct lending market in the United States has surged since the global financial crisis, with assets under management of funds primarily involved in direct lending reportedly growing from US$31.6 billion at the end of 2008 to US$412 billion at the end of 2020. Evan Gunter, et al., 'Private Debt: A Lesser-Known Corner of Finance Finds the Spotlight', *S&P Global*, 12 Oct. 2021, https://www.spglobal.com/en/research-insights/featured/special-editorial/private-debt; David Brooke and Lisa Lee, 'Direct Lenders Suddenly Cut Risk Even With $413 Billion Warchest', *Bloomberg Law* (21 July 2022), https://news.bloomberglaw.com/banking-law/direct-lenders-suddenly-cut-risk-even-with-413-billion-warchest. Other sources estimate the direct lending market as a whole is as large as US$1.2 trillion. Paul Seligson, 'Private Credit is Eating into Junk Bonds as Competition Heats Up', *Bloomberg* (9 May 2022), https://www.bloomberg.com/news/articles/2022-05-09/private-credit-is-eating-into-junk-bonds-as-competition-heats-up?leadSource=uverify%20wall.

- invest in every level of a debtor's capital structure;
- provide financing to distressed companies out of court to help them avoid bankruptcy;
- provide financing to debtors to fund Chapter 11 cases and post-emergence operations;
- purchase assets from companies in bankruptcy through section 363 sale and Chapter 11 plan processes;
- engage in constructive negotiations with debtors to implement fully consensual restructurings in record time; and
- may stake out positions that require them to employ a full range of litigation tactics.

Of these myriad approaches, two overarching themes stand out. First, investment funds are often the key stakeholders and primary financing sources for distressed companies, providing everything from rescue loans and financing for out-of-court restructurings, to debtor-in-possession (DIP) financing to fund Chapter 11 cases and exit financing to fund operations post-bankruptcy. Distressed investment funds often acquire concentrated positions in debt of distressed companies at a discount to par. And as direct lending proliferates, future restructurings may increasingly see ownership of issuers' debt already concentrated in the hands of relatively few investment funds before the issuers become distressed. Such investment funds often stand ready to defend their existing positions, and gain leverage and control over the company's direction, by providing additional financing to distressed companies, whether in the form of rescue loans to stave off a bankruptcy filing, or DIP or exit financing to support a debt restructuring. Investing new capital in a distressed company can also yield substantial returns for a fund over a relatively short period of time, since the interest, fees and premiums that are earned on such investments tend to be significant.

Second, the strategies employed by investment funds may affect a distressed company's prospects for a speedy and successful restructuring. In many cases, the presence of well-heeled, sophisticated investment funds facilitates a quick and cost-efficient restructuring, avoiding a prolonged Chapter 11 case and the resulting administrative expenses – most notably professional fees – and delays that can materially impair the company's ability to successfully reorganise and the fund's ultimate returns. As a consequence, out-of-court 'liability management' transactions, as well as in-court 'pre-arranged' and 'pre-packaged' Chapter 11 cases, are increasingly common.[2] Through liability

2 In 2003, only 6 per cent of large companies entered Chapter 11 with a pre-negotiated plan; from 2015 to 2018, 65 per cent of Chapter 11 filings by large companies (those with liabilities greater than US$50 million at the time of filing) that emerged were pre-arranged or pre-packaged. *See* Norman Kinel, 'The Ever-Shrinking Chapter 11 Case', *Nat'l L. Rev.* (20 Aug. 2018) (discussing 7 Aug. 2018 report by Fitch Ratings); John Yozzo and Samuel Star, 'For Better or Worse, Prepackaged and Pre-Negotiated Filings Now Account for Most Reorganizations', *ABI Journal*, vol. XXXVII, No. 11, Nov. 2018. This has had a significant impact on the duration of Chapter 11 cases overall as the average duration of a Chapter 11 case fell by nearly one-half in 2016–2018 compared to 2010–2015, to 212 days from 401 days. *See* Yozzo

management transactions, investment funds work with distressed issuers to structure creative financing solutions that may provide additional liquidity, extend maturities or even deleverage an issuer's balance sheet without the need for Chapter 11 proceedings. In the case of pre-arranged or pre-packaged Chapter 11 cases, the terms of a Chapter 11 plan are fully negotiated before the case begins with an agreement among the company and its key creditor constituencies – typically, one or more ad hoc groups of investors holding majorities of the company's funded indebtedness – including the group believed to hold the fulcrum security. The company then enters Chapter 11 to implement the negotiated deal in the shortest possible time frame.[3] Pre-packaged Chapter 11 cases can often be completed in 30 to 45 days, sometimes even less. Indeed, debtors in recent pre-packaged Chapter 11 cases were able to obtain confirmation of their plans of reorganisation within one to two days of filing.[4]

The prevalence of collateralised loan obligation funds (CLOs) has also had a direct impact on several recent large restructurings. CLOs are structured investment vehicles that issue multiple tranches of securities with different risk profiles against a diversified portfolio of senior secured loans. The documents governing CLOs often contain restrictions to protect CLO investors from loss, including limits on the amount of junior and unsecured debt and equity that can be held in the portfolio. While CLOs may hold senior secured positions in capital structures of companies that become distressed, they have recently played a larger and more active role in debt restructurings as they increasingly retain ownership of troubled loans rather than selling to investment funds specialising in distressed strategies. Because CLOs are subject to unique constraints and incentives that may shape outcomes for all participants in unexpected ways, market participants have begun to develop creative strategies to accommodate CLOs' specific needs and obtain their support for restructuring transactions.

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and Star, supra. *See also* David I. Swan, 'Prepackaged Plans In 24 Hours', *Am. Bankr. Inst. J.*, vol. 38 (2019) (discussing the length of pre-packaged cases decreasing from 91 days in 2017 to 44 days in the first part of 2019).

3 In a pre-packaged case (as compared to a pre-arranged one), the parties have taken the additional step of soliciting votes on the plan before filing. In these instances, the company avoids a prolonged stay in Chapter 11 engaged in solicitation and, instead, moves straight to confirmation (ie, approval) of the plan.

4 *See In re Carlson Travel, Inc.*, Case No. 21-90017 (MI) [Dkt. No. 106] (Bankr. SD Tex. 12 Nov. 2021); *In re Belk*, Case No. 21-30630 (MI) [Dkt. No. 61] (Bankr. SD Tex. 24 Feb. 2021); *In re Mood Media Corp.*, Case No. 20-33768 (MI) [Dkt. No. 72] (Bankr. SD Tex. 31 July 2020); *In re Sheridan Holding Co. I, LLC*, Case No. 20-31884 (DRJ) [Dkt. No. 76] (Bankr. SD Tex. 24 March 2020); *In re Sungard Availability Servs. Cap., Inc*, Case No. 19-22915 (RDD) [Dkt. No. 46] (Bankr. SDNY 2 May 2019); *In re FullBeauty Brands Holdings Corp.*, Case No. 19-22185 (RDD) [Dkt. No. 39] (Bankr. SDNY 5 Feb. 2019). These single-day pre-packaged plans are not free from controversy. Recent cases have drawn objections from the Office of the United States Trustee (a component of the US Department of Justice) on the grounds that the expedited time frame violated principles of due process since parties that were not involved in pre-filing negotiations had little or no time to evaluate the company's proposed restructuring. In response, some bankruptcy courts have entered 'due process preservation orders' to partially resolve the objections by preserving the parties' rights to raise due process objections at a later date and providing that the due process preservation order would control over the bankruptcy court's order confirming the Chapter 11 plan. *See In re Carlson Travel, Inc.*, Case No. 21-90017 (MI) [Dkt. No. 105] (Bankr. SD Tex. 12 Nov. 2021); *In re Belk*, Case No. 21-30630 (MI) [Dkt. No. 62] (Bankr. SD Tex. 24 Feb. 2021).

What follows is a look at some of the more recent tactics employed by, and the unique characteristics of, investment funds in large US debt restructurings.

Recent developments and trends

Backstopped rights offerings

A fertile ground for generating returns is to offer to backstop new money investments, whether in the form of debt (eg, DIP and exit financing) or equity. The latter often takes the form of a rights offering, where investors are provided an opportunity to invest in the equity of a company about to emerge from Chapter 11, often at a discount (sometimes a substantial one) to the company's Chapter 11 plan value.

Rights offerings are attractive to companies in Chapter 11 that are otherwise capital-constrained because they offer companies access to equity capital without substantial cost. This is due, in part, to the fact that many such offerings are exempt from registration with the US Securities and Exchange Commission if certain requirements are met. Moreover, rights offerings are highly flexible financing structures that permit parties to customise both the terms and conditions of the equity issuance as well as the terms of the offering (including the allocation of the right to participate) to best serve the needs of the company or the specific circumstances of its Chapter 11 case. As a result, rights can be a valuable form of currency when negotiating creditor recoveries under a proposed plan. For these reasons, rights offerings are exceedingly popular and increasingly large. In 2022, distressed companies raised over US$10 billion through rights offerings in large Chapter 11 cases, including a single rights offering of US$4 billion in Intelsat SA's bankruptcy.[5]

In addition to providing a company with much-needed equity capital, rights offerings are attractive to creditors. A key reason is that rights are usually offered at a significant discount to the assumed value of the reorganised company to encourage participation; while the exact percentage can vary widely from case to case, recent offerings have frequently provided a discount to plan value in excess of 20 per cent, with discounts in the range of 30 to 35 per cent becoming more common.[6] That means investors can often acquire a more significant stake in the reorganised company at an implied 'in the money' valuation. These rights offerings further favour funds with capital to invest, given the dilution that typically occurs in a rights offering.[7] Thus, participation is critical to protecting

5 Catherine Corey, Qi Huang, 'Restructuring Insights - North America: Rights Offering Report 2022', *Debtwire* (19 Apr. 2023), https://www.debtwire.com/document-repository/document/5Fq7sZa6d (access required).

6 *Id.* The average discount to plan value in 2022 was 26.11 per cent, including a 40 per cent discount in Altera Infrastructure and a 35 per cent discount in TPC Group. *Id.*

7 In one recent example, a court approved a plan under which prepetition secured noteholders would receive their pro rata share of 100 per cent of the equity in the reorganised debtors on account of their

plan recoveries, with those that participate benefiting at the expense of those that do not.

Investors can further enhance the investment opportunity afforded by a rights offering by agreeing to 'backstop' the offering, which means committing to purchase any equity that remains unsubscribed following the rights offering. This guarantee of the offering's success is of enormous value to the company. As a result, acting as a backstop party can prove very lucrative. Backstop parties typically earn fees from 6 per cent to upwards of 20 per cent of the total offering in exchange for their commitments, which can be paid in cash or additional shares.[8] Backstop parties may also obtain preferred, or an over-allotment of, rights to ensure a minimum participation above their pro rata allocation. In practice, these mechanisms provide backstop parties with enhanced economics that increase the overall returns on their investment in the company. These mechanisms also afford the backstop parties the opportunity to increase their ownership stake and resulting voice in the governance of the reorganised company.

Given the substantial value at stake in a backstopped rights offering and the potential for overreach, these arrangements are often subject to challenge. Challenges are often levelled at the reasonableness of the backstop fees, though this can be difficult to establish as the market for these fees varies widely.[9] Other challenges take issue with the need and size of the preferred, or over-allotment of, shares reserved for the backstop parties.

For example, in *LATAM Airlines*' recent bankruptcy, the court approved backstop agreements that obligated the debtors to reserve (or 'hold back') 50 per cent of the US$6.816 billion in new convertible notes to be issued under the Chapter 11 plan for certain commitment parties (who were a subset of the unsecured creditors that would receive a distribution under the proposed plan of reorganisation). The unsecured creditors' committee, an unsecured notes trustee and other

claims. That recovery, however, was subject to significant dilution by new equity and direct allocation shares that were being issued through a backstopped rights offering; after giving effect to the rights offering distributions, the secured noteholders' 100 per cent equity stake on account of their claims would be diluted down to 11.1 per cent of the total equity. *In re Carlson Travel, Inc.*, Case No. 21-90017 [Dkt. Nos. 47, 106] (Bankr. SD Tex. 12 Nov. 2021).

8 James J Mazza and Zahed A Hanseeb, 'Rights Offerings in Chapter 11 Bankruptcies', *Rev. of Banking & Financial Servs*. at 77 (July 2020); Corey, Huang, supra note 5. The average backstop fees for rights offerings in 2022 was 12 per cent, including a 20 per cent backstop fee in Talen Energy Supply. *Id*.

9 For example, in the *Pacific Drilling* case, in the absence of any objections, the court initially denied the debtors authorisation to enter into an equity commitment agreement because it found the 8 per cent backstop fee to be unnecessary to incentivise the commitment. *In re Pac. Drilling SA*, Case No. 17-13193 (MEW) [Dkt. No. 622] (Bankr. SDNY 27 Sept. 2018). The court ultimately approved a revised equity commitment agreement with a backstop fee of 8 per cent for any unsubscribed portion of the rights offering and 5 per cent for the rest, despite 'a great deal of misgivings', because all stakeholders supported the agreement. *Id.* [Dkt. No. 616] (25 Sept. 2018), [Dkt. No. 634] (1 Oct. 2018). While considering backstop fees in a different context, another bankruptcy court criticised, but ultimately approved, Lumileds' proposed DIP financing participation fee in an amount equal to 36.7 per cent of new common equity (in addition to a 10.5 per cent backstop fee and 10.5 per cent exit commitment fee, each payable in new common equity), noting a lack of 'support for approving something so rich'. 30 Aug. 2022 Hr'g Tr. 147:21-22, *In re Lumileds Holding B.V.*, Case No. 22-11155 (LGB) (Bankr. SDNY 2022).

unsecured noteholders argued that the proposed restructuring plan violated the equal treatment requirements under the bankruptcy code because other unsecured creditors would not be given the same right to purchase the convertible notes as the backstop parties, which they argued would result in materially lower recoveries than the backstop parties would receive. They also argued that the aggregate consideration (including the holdback and a 20 per cent backstop fee) to be paid to the backstop parties was unreasonable.

In approving the backstop agreements, the court found that the objectors had not carried their burden to rebut the presumption that entry into the backstop agreements was a proper exercise of the debtors' business judgment.[10] In ultimately confirming the debtors' plan, the bankruptcy court held that the plan satisfied the equal treatment requirement because all unsecured creditors 'have the same opportunity for recovery' and the 50 per cent holdback was distributed to the commitment parties 'in consideration for their willingness to backstop' the rights offering, rather than on account of their claims.[11]

The creative structuring of backstop commitments and rights offering allocations that heavily favour the company's largest stakeholders – who are the parties most likely to provide a backstop commitment – is a trend that is likely to continue.

Liability management transactions

Investment funds frequently participate in out-of-court restructurings and 'liability management' transactions that may allow a distressed company to extend its liquidity runway or debt maturities, or even restructure its debt, without the need for a costly Chapter 11 proceeding. Such transactions often include, as a key component, a new-money investment in, and/or the exchange of existing debt for, 'priming' debt structured to have priority over the company's remaining existing debt with respect to some or all of the company's assets. The incurrence of this priming debt is often facilitated by nearly universal provisions in syndicated credit facilities and bonds that permit holders of a majority in principal amount to agree to amendments binding on all holders of the debt.

10 *In re LATAM Airlines Grp, S.A.*, Case No. 20-11254 (JLG) [Dkt. No. 4667] (Bankr. SDNY 15 Mar. 2022).

11 *Id.*; *see also In re CHC Group Ltd*, Case No. 16-31854 (BJH) [Dkt. No. 1794] (Bankr. ND Tex. 3 Mar. 2017) (confirming a plan over the objection of a non-participating creditor; the plan provided the noteholder class with their pro rata share of 79.5 per cent of the equity of the reorganised company, but recovery was subject to dilution down to 11.6 per cent upon conversion of convertible notes being issued under a backstopped rights offering); *In re Breitburn Energy Partners LP*, 582 BR 321, 358 (Bankr. SDNY 2018) (approving a plan that provided a particular class of creditors the opportunity to participate in a US$775 million rights offering, where parties that elected not to participate would receive no recovery, on the grounds that section 1123(a)(4) requires equality of treatment, not equality of result). Though the court denied confirmation of Breitburn Energy's plan for reasons unrelated to the rights offering in this decision, the plan was subsequently confirmed after the parties made certain technical modifications. *See In re Breitburn Energy*, Case No. 16-11390 (DSJ) [Dkt. No. 2387] (Bankr. SDNY 26 March 2018).

For example, several recent liability management transactions have attracted attention by combining a priming new-money debt investment with a roll-up of a portion of the company's existing debt held by participating creditors into additional priming debt without offering the non-participating creditors the opportunity to participate. The debt of non-participating creditors is thus subordinated not only to the new-money debt but also to existing debt that was previously of equal or even junior priority.[12] Several of these 'non-pro rata up-tier' transactions have drawn litigation challenges from the non-participating creditors, which in several cases have survived the defendants' motion to dismiss.[13]

Perhaps partly as a result, more recent iterations of this transaction structure have provided all lenders the opportunity to participate, albeit on less-advantageous terms than those available to the majority group. Rodan & Fields, the multilevel marketing cosmetics company, was able to obtain the consent of substantially all its lenders to a transaction pursuant to which the majority group provided US$30 million of new-money first-out priming loans and rolled US$105 million of their existing loans into second-out priming loans at par and the remainder of their existing loans into third-out priming loans at 82.5 per cent of par. The rest of the lenders were given the opportunity to roll their existing loans into third-out priming loans at 67.5–72.5 per cent of par.[14] But in addition to managing litigation risk, this innovation in the non-pro rata up-tier structure can be used to address impending debt maturities, where tolerance for non-participating 'holdouts' may be limited. Robertshaw, a maker of electronic switches, controls, and valves, was able to extend its debt maturities and obtain US$95 million of new-money priming first-out loans by launching an exchange offer with the support of a lender group holding 76 per cent of its first-lien loans due 2025 and 59 per cent of its second-lien loans due 2026. Lenders in the

12 *See generally* Ryan Schloessmann, 'Covenant Control: The Case for Treating Uptier Transactions as a Form of Corporate Control', *90 U. Chi. L. Rev. 1197* (2023); Diane L. Dick, 'Alliance Politics in Corporate Debt Restructurings', *39 Emory Bankr. Dev. J. 285* (2023); Stephen J. Lubben, 'Holdout Panic', *96 Am. Bankr. L.J. 1* (2022); Soma Biswas, 'Incora Recapitalization Averts Default Risk at Some Bondholders' Expense', *Wall St. J.* (31 Mar. 2022) https://www.wsj.com/articles/incora-recapitalization-averts-default-risk-at-some-bondholders-expense-11648759939; Diane L. Dick, 'Hostile Restructurings', *96 Wash. L. Rev. 1333* (2021).

13 For example, in September 2020, TriMark, a distributor of food service equipment, completed such a transaction to subordinate the first-lien debt of non-participating lenders without offering them the opportunity to participate. The non-participating lenders challenged the transaction in the New York state Supreme Court. In 2021, the court denied the defendants' motion to dismiss the lawsuit, holding that the non-participating lenders had a 'plausible argument' that the transaction violated 'sacred rights' under the credit agreement that cannot be modified without the consent of each lender. Order at 26, *Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp.*, No. 565123/2020 [Dkt. No. 171] (N.Y. Sup. Ct. 16 Aug. 2020). In January 2022, TriMark announced a settlement with the non-participating lenders, which included an exchange of all existing first-lien debt on a dollar-for-dollar basis for second-out super senior loans. Press Release, TriMark USA, TriMark USA Announces Resolution Of Litigation With Its Lenders (7 Jan. 2022), https://www.prnewswire.com/news-releases/trimark-usa-announces-resolution-of-litigation-with-its-lenders-301456561.html.

14 *See* Harvard Zhang, 'Rodan + Fields Deal Starts New Chapter of Non-Pro Rata Uptiering After Receiving Substantially All Lender Support', *Reorg Research* (28 Apr. 2023), https://app.reorg.com/v3#/items/intel/9501?item_id=214388 (access required).

group agreed to exchange 100 per cent of their first-lien loans and second-lien loans into priming second-out loans and priming third-out loans, respectively, with maturities extended to 2027. Lenders not in the group were offered the opportunity to exchange 10 per cent, 25 per cent and 65 per cent of their first-lien loans into the second-out, third-out and new priming fourth-loans, respectively, with their second-lien loans becoming fifth-out.[15]

As an alternative to priming debt, stressed and distressed borrowers have recently been issuing structurally advantaged debt using a 'double-dip' structure that gives holders of the new debt two claims, each pari passu with the borrower's existing debt.[16] In a bankruptcy, the holders of the new debt would assert both claims in the hope of obtaining a double recovery (up to a maximum of par), at the expense of the existing debt holders, whose claims against their collateral are thereby diluted. However, this double-dip structure has not yet been tested in bankruptcy and could be subject to challenge.

For example, in May 2023, At Home Group, a home décor retailer, formed a new subsidiary that issued US$200 million of senior secured notes and on-lent the proceeds back to its parent on a first-lien basis. At Home also guaranteed the new senior secured notes on a first-lien basis.[17] In a bankruptcy, the holders of the new senior secured notes would attempt to assert the guarantee claim against At Home Group while simultaneously benefiting from the notes issuer's inter-company claim against its parent. In September 2023, Wheel Pros, a designer, manufacturer and distributor of aftermarket vehicle enhancements, announced a similar transaction in which existing creditors are being offered the opportunity to exchange their debt into new double-dip term loans and notes at a discount to par.[18]

While liability management transactions will likely continue to present investment opportunities for investment funds and an attractive alternative to Chapter 11 for distressed companies, courts will scrutinise such transactions to test compliance with applicable credit documents and bankruptcy law.[19] At

15 *See* Geoff Burrows, Gaurav Sharma, and Harvard Zhang, 'Robertshaw Launches Non-Pro Rata Debt Uptiering', *Reorg Research* (11 May 2023) https://app.reorg.com/v3#/items/intel/19046?item_id=216253 (access required).

16 While creditors have asserted double-dip claims in bankruptcies dating back to at least the 2008 financial crisis, intentionally structuring double-dip claims as an alternative to issuing priming debt is an innovation in liability management transactions.

17 *See* Press Release, 'At Home Announces Completion of $200 Million Private Placement and Related Transactions', *Business Wire* (12 May 2023), https://www.businesswire.com/news/home/20230512005443/en/At-Home-Announces-Completion-of-200-Million-Private-Placement-and-Related-Transactions; Max Frumes, 'Special Situations Insight: At Home Group Transaction May be the First Intentional 'Double-Dip' Financing; It Won't Be the Last', *CreditSights* (2 June 2023).

18 *See* Press Release, 'Wheel Pros Announces Agreement With Lenders To Support Its Continued Growth and Profitability Plan', *PR Newswire* (11 Sept. 2023), https://www.prnewswire.com/news-releases/wheel-pros-announces-agreement-with-lenders-to-support-its-continued-growth-and-profitability-plan-301923753.html; Justin Forlenza, 'Wheel Pros: Another Liability Management Transaction', *Covenant Review* (12 Sept. 2023).

19 While the TriMark court allowed non-participating creditors to continue to pursue certain of their claims, the bankruptcy court considering petrochemical company TPC Group's recent priming

the same time, market participants may respond to this trend by negotiating provisions in debt documents that more clearly define the extent to which the issuance of priming debt and unequal treatment of similarly situated creditors are permitted or prohibited.

Participation of collateralised loan obligation funds in restructurings

The market for CLOs in the United States has grown significantly in recent years, with annual CLO issuance increasing from approximately US$65 billion in 2016 to approximately US$130 billion in 2022.[20] CLOs have correspondingly come to play a greater role in restructurings. But CLOs face certain restrictions and incentives that differ from those facing hedge funds and private equity funds and, as a result, their increasing role poses unique issues in the restructuring process.

CLOs raise capital from investors to acquire a portfolio of investments consisting primarily of senior secured loans issued by below-investment grade borrowers. To mitigate risk to investors, CLO fund documents include restrictions on the types of investments that can he held in the portfolio. For example, a CLO typically includes restrictions on acquiring CCC or Caa-rated debt in excess of a specified percentage cap of the aggregate portfolio. Other common restrictions include limitations on a CLO's exposure to second lien or unsecured loans and prohibitions on investing in equity securities. Further, most CLOs have tax structures that effectively limit their ability to originate loans and instead require them to purchase assets in secondary market transactions.

These restrictions may make it difficult for CLOs to participate in new-money investments, such as rights offerings, in connection with restructuring transactions, putting them at risk of dilution by hedge funds and private equity funds that are able to make such investments. CLOs also have incentives to prefer restructurings where their debt is not converted to equity, which may limit the amount of deleveraging that can be achieved in the restructuring. From a distressed borrower's perspective, the presence of CLOs in its capital structure may therefore affect the restructuring options available to it.

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transaction sided with the company and its majority noteholders and upheld the transaction by distinguishing it from TriMark since it did not involve the non-pro rata roll-up of existing debt. In reaching its opinion, the court noted that the transaction 'may have violated what the *Trimark* court (perhaps aspirationally) called the "all for one, one for all" spirit of the syndicated loan, the transactions did not violate the letter of the applicable agreements in a manner that gives rise to a claim by the objecting noteholders' and that '[t]here is nothing in the law that requires holders of syndicated debt to behave as Musketeers. To the extent such holders want to be protected against self-interested actions by borrowers or other holders, they must include such protections in the terms of their agreements.' Order at 28, *Bayside Cap. Inc.* v. *TPC Group Inc. (In re TPC Group Inc.)*, Adv. Proc. No. 22-50372 (CTG) [Dkt. No. 72] (Bankr. D. Del. 6 July 2022) (internal citations omitted).

20 'US CLO Outlook: Market Conditions Expected to Remain Rocket in Early 2023', *PitchBook* (4 Jan. 2023), https://pitchbook.com/news/articles/us-clo-outlook-market-conditions-expected-to-remain-rocky-in-early-2023.

For example, in the case of *Deluxe Entertainment*, CLOs holding the company's prepetition debt were initially willing to participate in an out-of-court restructuring or 24-hour pre-packaged Chapter 11 plan, which would have included at least US$25 million in incremental financing. However, as the consensual plan progressed, the debtor's term loan credit rating was downgraded to CCC-, and certain CLO funds were no longer willing or able to provide the incremental financing due to restrictions on their investments in CCC-rated debt. As a result, Deluxe was unable to obtain sufficient financing to complete the restructuring out of court and was instead forced to undertake a longer and more expensive in-court restructuring process.[21]

As another example, the Chapter 11 plan of Acosta Inc entirely eliminated the debtors' funded debt in exchange for equity and provided prepetition creditors with the right to participate in a US$250 million equity rights offering. Because equity interests are not considered eligible collateral obligations for CLOs, many CLOs were unable to participate in Acosta's equity rights offering and may have been forced to sell their positions rather than accept equity in exchange for their debt.[22]

In response to the CLO-specific restrictions and limitations, companies and CLOs have worked to implement creative and flexible workout structures. For example, Pioneer Energy Services' unsecured bondholders, some of whom were CLOs, exchanged their debt for convertible notes, rather than equity, in the company's restructuring. The CLOs were able to invest in the notes and obtain potential equity upside, while the convertible notes were structured to be mandatorily convertible in a variety of circumstances to give Pioneer flexibility to deleverage in the future.[23]

Some CLOs may also be permitted to make, or have made, exceptions to their investment guidelines to allow direct lending as protective investments to preserve existing portfolio investments that were not expected to default when acquired.[24] For example, investment guidelines may permit CLOs to make equity-funded or restructuring-related investments with lower penalties than those that have been historically assessed, or to more flexibly use excess cash to exercise warrants or similar options included in collateral packages, each of which may lead to greater realisation of value in distressed situations. As the role of CLOs in restructurings continues to expand, market participants will

21 *In re Deluxe Entm't Servs. Grp. Inc*, Case No. 19-23774 (RDD) (Bankr. SDNY 3 Oct. 2019); Katherine Doherty, 'We Can't Give You a Loan, CLO Managers Told Now Bankrupt Deluxe', *Bloomberg* (4 Oct. 2019) https://www.bloomberg.com/news/articles/2019-10-04/we-can-t-give-you-a-loan-clo-managers-told-now-bankrupt-deluxe.

22 Lisa Lee and Sally Blakewell, 'Hedge Funds Exploit CLO Weakness Laid Bare by Corporate Distress', *Bloomberg* (22 June 2020) https://www.bloomberg.com/news/articles/2020-06-22/hedge-funds-exploit-clo-weakness-laid-bare-by-corporate-distress.

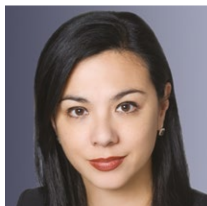
23 *In re Pioneer Energy Servs. Corp*, Case No. 20-31425 (DRJ) (Bankr. SD Tex. 11 May 2020).

24 Kristen Haunss, 'CLOs Seek Flexibility For Distressed Assets Amid Lender Competition', *Reuters* (19 Feb. 2020) https://www.reuters.com/article/clo-rescuefinancing/clos-seek-flexibility-for-distressed-assets-amid-lender-competition-idUSL1N2AJ1NB.

continue to develop creative strategies to address the unique constraints and incentives that CLOs face.

Conclusion

Investment funds continue to play a significant role in US debt restructurings. They are sophisticated investors who are able to adapt quickly to changing market conditions to find new ways to deploy capital and maximise their investments. In the most prominent of these recent trends, investment funds have found increasingly creative ways to achieve short-term gains through new investments in distressed companies while at the same time positioning themselves to obtain longer-term pay-offs. In achieving these goals, investment funds adapt existing tactics and strategies to new situations and new aspects of US restructuring practice. The new developments discussed offer excellent examples of the creativity and flexibility that can mark investment fund activity in US debt restructurings and demonstrate how borrowers and other institutional lenders are adapting their restructuring strategies in response to the participation of investment funds in restructuring transactions.



Elizabeth R McColm

Paul, Weiss, Rifkind, Wharton & Garrison LLP

A partner in the restructuring department, Elizabeth McColm specialises in the areas of corporate restructurings and bankruptcy. She has been involved in major restructurings and bankruptcies representing debtors, creditors and acquirers of assets.

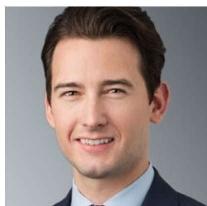
Elizabeth's recent creditor/investor matters include advising key stakeholders in the restructurings of Digicel Group, QualTek Services, California Resources Corporation, Country Fresh, Denbury Resources, Seadrill, Dean Foods, FULLBEAUTY Brands, Pacific Drilling, GenOn, Armstrong Energy, Ultra Petroleum and SquareTwo Financial.

Elizabeth's recent debtor/company representations include Westmoreland Mining, CHC Group, McGraw Hill, Pioneer Energy Services Corp, David's Bridal, The Bon-Ton Stores and Noranda.

Elizabeth also has extensive experience advising clients in cross-border matters, including the restructurings of Oro Negro, Petra Diamonds and Virgin Australia Airlines.

Elizabeth is widely recognised as a leading restructuring practitioner, including by *Chambers USA*, *Who's Who Legal* and *IFLR1000*. She is also listed as a 'Leading Lawyer' by *The Legal 500*.

In 2022 and 2021 respectively, she was awarded IFLR's Asia-Pacific 'Restructuring Deal of the Year' for her role in the restructuring of Boart Longyear and sale of Virgin Australia to Bain Capital and related US Chapter 15 cases.



Brian J Bolin

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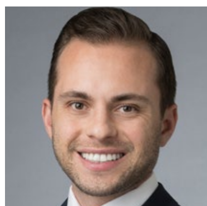
A partner in the restructuring department, Brian Bolin represents creditors, debtors, sponsors and distressed investors in a wide range of insolvency matters, including Chapter 11 cases, out-of-court workouts, bankruptcy sales and cross-border restructurings. As deputy chair of the Hybrid Capital & Special Situations Group, Brian particularly focuses on advising borrowers, lenders and sponsors on distressed financing transactions, including liability management transactions, distressed investments, rescue financings, DIP financings, exit financings and direct lending transactions.

Brian's recent restructuring experience includes advising companies/private equity sponsors in representations involving Envision Healthcare, Center for Autism and Related Disorders, Revlon, Alex and Ani and The Collected Group as well as creditors in the restructurings of Avaya Holdings, Learfield, Digicel Group, Carlson Travel and Ligado Networks.

Brian's recent financing representations include matters involving Envision Healthcare, Revlon, Pioneer Energy Services, FULLBEAUTY Brands, Carlson Travel, OTG, The Collected Group, Drive Medical, Ligado Networks and EPIC Y-Grade.

In 2023, Brian was named as one of *The American Bankruptcy Institute*'s '40 Under 40' winners as well as one of *Turnarounds & Workouts*' 'Outstanding Young Restructuring Lawyers'. Brian's work on the pre-packaged Chapter 11 cases of Carlson Travel, was awarded the 'Pre-Pack Restructuring (Large)' award by *The Turnaround Atlas Awards 2022*.



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An associate in the restructuring department, Mitchell represents debtors, creditor groups, distressed investment funds and sponsors in a wide range of restructuring matters, including Chapter 11 cases, out-of-court restructurings, liability management transactions and cross-border restructurings. Mitchell authored an article titled 'The Development of Collateral Stripping by Distressed Borrowers', which was published in the *Capital Markets Law Journal*. Prior to joining Paul, Weiss, Mitchell clerked for Chancellor Kathaleen St Jude McCormick on the Delaware Court of Chancery.

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