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Insolvency

Second Edition

Introduction
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Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates has approximately 1,700 attorneys on four continents, and serves clients in every major financial centre globally. Skadden brings in-depth knowledge of the markets in which it operates and numerous local law capabilities to multi-jurisdictional, cross-border and domestic legal matters. In both the US and internationally, Skadden provides representation, strategic advice, innovative and practical legal solutions, and litigation assistance to financially troubled public and private companies and their major lenders, creditors, investors and transaction counterparties. In the US, Skadden focuses on Chapter 11 and 15 proceedings, out-of-court restructurings and related litigations in a variety of situations including "prepackaged" and "prearranged" bankruptcies.

Contributing Editors

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This second edition of the 2019 Insolvency Global Practice Guide is a guide for legal and non-legal professionals to the differing legal regimes that apply to business restructurings, reorganisations, rehabilitations, insolvencies and liquidations in the 49 countries covered by this publication. The contributing firms and authors are well-versed in the restructuring and insolvency practices and laws of their respective jurisdictions. They provide concise, high-level summaries of country-specific debtor and creditor rights and legal alternatives (statutory and non-statutory) for the restructuring and resolution of financially distressed and insolvent businesses. The contributors also provide all-important professional insights into current trends and developments in their local markets.

The information and summaries in the Guide are not provided as legal advice or opinions of any kind, and should not be relied upon as such. Readers should consult the contributors or other qualified legal and non-legal advisers when seeking to identify and understand what rules and practices might apply in particular situations and jurisdictions.

Evolution and State of Financial Restructuring Markets

The Guide summarises legal regimes that often reflect an evolution towards current best restructuring and insolvency practices. Local laws and related practices that apply to creditor rights, financial restructurings and business insolvencies are typically unique, complex and jurisdiction-specific. Such laws and practices may be long-standing or reflect recent changes and global trends. While it is difficult to generalise about global trends, the following observations may be of interest.

Globalisation of Practice

Best practices in financial restructuring and insolvency-related practices have evolved over several decades to address the globalisation of business, financial markets and debt-trading. Legal regimes in many jurisdictions have adapted and changed in response to: cross-border M&A activity and private equity investments; the immense growth in distressed investing and secondary loan trading in international debt markets; and the development of cross-border and international restructuring and insolvency laws, treaties, regulations, organisations and best practices.

The international nature of today's capital markets and business enterprises requires that legal, judicial and professional practices recognise and resolve cross-border issues arising when a company's domestic and foreign investors, creditors and operations are impacted by an insolvency or financial restructuring. Differing foreign legal rules, regimes and policies may apply simultaneously and must be harmonised.

Thirty years ago, few restructuring professionals and firms were known to have significant international restructuring contacts, capabilities and expertise needed to navigate cross-border insolvency situations. Since then, the cross-border restructuring and insolvency practice has grown and matured. The International Association of Restructuring, Insolvency & Bankruptcy Professionals (INSOL) and the Turnaround Management Association (TMA) both are worldwide associations of thousands of restructuring professionals focused on international capabilities and best practices for cross-border situations.

Uniform laws and practices for cross-border insolvencies and financial restructurings have been advocated by professional associations and enacted in various jurisdictions. INSOL formulated the INSOL Global Principles for Multi-Creditor Workouts. In 1997, the United Nations Commission on International Trade Law (UNCITRAL) established the Model Law on Cross-Border Insolvency (Model Law). The Model Law has been enacted in many countries. It provides that a country's national courts must recognise insolvency proceedings that have been commenced in another country. For instance, in Europe, the Model Law was originally enacted by Council Regulation (EC) 1346/2000 on insolvency proceedings (Insolvency Regulation), which automatically applied to all EU Member States in the European Union, excluding Denmark. The Insolvency Regulation of 2000 was replaced by Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings that, as recast, provides for recognition of pre-insolvency rescue proceedings.

There is a continuing need for laws that foster business rehabilitations rather than liquidations, because rehabilitative and "rescue" regimes preserve jobs and the going-concern value of insolvent companies. For instance, after nearly 100 years of only permitting liquidations, in 2017 Panama enacted legislation that allows for companies to reorganise. The Dominican Republic similarly shifted from a liquidation-based regime to one that permits restructuring and reorganisation in 2018. In 2017, Singapore enacted new corporate bankruptcy laws to promote international debt restructurings. The Singapore Companies (Amendment) Act 2017 enacted the UNCITRAL Model Law on Cross Border Insolvency into Singapore law. The Act also makes significant changes to Singapore's schemes of arrangement and judicial management processes by borrowing from some of the prominent features of Chapter 11 of the US Bankruptcy Code. Saudi Arabia also moved in early 2018 to bring its restructuring regime closer to US Chapter 11.

New Participants and Competition

Over the last two decades, there has been fundamental change in who typically holds "debt for borrowed money" in financially distressed company situations: traditional, institutional commercial bank lenders have been replaced by hedge funds and other strategic, private distressed debt investors.

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In years past, the senior creditors of an insolvent company often were its relationship bank lenders. Banks predictably continued to hold distressed debt through work-out or other restructuring or insolvency negotiations and proceedings. Over time, new and different types of strategic and opportunistic investors, including hedge funds, entered restructuring markets to acquire distressed company debt from banks and other traditional lenders.

The impact of hedge funds and other non-traditional investors on financial restructuring and insolvency processes was mixed. On the one hand, they often made restructurings more complicated and litigious as well as unpredictable and sometimes more difficult because such investors often sell and assign (or acquire) their debt positions during a pending restructuring, thereby potentially upsetting restructuring negotiations and agreements between a company and its creditors. The practice of using "restructuring support agreements" and "lock-up agreements" was developed to manage risks posed by debt trading; such agreements bind a debtholder and its successors and assigns to restructuring terms agreed to by the debtholder, thereby providing certainty to those who negotiate and reach restructuring agreements, and flexibility for debtholders who may want to trade their claims freely.

On the other hand, hedge funds and other non-traditional investors brought money, speed and sophistication to the restructuring landscape. They are creative investors, particularly well-suited to driving restructurings to conclusions, and have the wherewithal to invest new money to expand the solutions to a distressed company. They provide liquidity to a market that may otherwise be constrained.

Sophisticated US hedge funds and other strategic investors who previously focused primarily on distressed US company debt (using the US Chapter 11 process to achieve outsized returns and debt-to-equity conversions giving them equity control of reorganised companies) have expanded the scope of their investment activities and strategies to target financially distressed foreign companies worldwide. While many non-traditional investors remain focused on debt of North American companies because distressed debt markets there are more developed than in other jurisdictions, opportunistic investors are now active in non-US jurisdictions where distressed debt markets are less mature. In recent years, major debt funds have been raising significant capital earmarked for deployment in Europe and elsewhere globally in anticipation of expected economic changes and foreign financial distress situations that will present opportunities for such investors.

It is important to note that the increased numbers of non-traditional restructuring and distressed debt-market participants have increased competition for sometimes limited investment opportunities. As a result of such competition, risk is sometimes underpriced when distressed debt is acquired.

Pre-Negotiated Processes

Thirty years ago, in the US, distressed companies often commenced traditional Chapter 11 bankruptcy cases under the supervision of a federal bankruptcy court without any pre-negotiated outcomes or reorganisation plan terms in mind at the outset of a case. In traditional Chapter 11 cases, it typically took a year or much longer to negotiate and confirm a reorganisation plan. Over the past three decades, more efficient, speedy and less expensive Chapter 11 bankruptcy case strategies have developed. There is now a general trend in favour of consensual strategies negotiated out of court for efficient in-court resolution of financial distress, in place of lengthy, formal, non-consensual judicial proceedings. A company and its lenders and other major stakeholders may employ a "prepackaged" or "pre-negotiated" Chapter 11 case strategy to achieve relatively rapid case progress milestones and deadlines, and outcomes that in the past might have taken several years to accomplish in a traditional Chapter 11 case. Restructuring professionals, companies and major financial stakeholders often prefer out-of-court workouts and prepackaged or pre-negotiated restructurings - instead of disorderly, uncertain and often litigious bankruptcies, liquidations or receivership-type insolvency proceedings that may result in high professional fees, delay, unnecessary litigation and loss of going-concern values.

Increased Litigation

With the entry of non-traditional distressed debt investors and other opportunistic participants, litigation has become a much more common strategy for achieving or negotiating recoveries in insolvency and restructuring proceedings. When there is uncertainty about available value or who is entitled to it, valuation litigation and inter-creditor disputes may dominate insolvency proceedings, as they have in the litigious Puerto Rico insolvency cases. Likewise, avoidance actions and litigation claims against third parties (including former owners, management, directors, officers and auditors) may represent meaningful sources of recovery. The settlement or assignment of complex litigation claims during a proceeding may be the basis of a plan of reorganisation or liquidation. Moreover, creditor litigations against governmental authorities and regulators may materialise in connection with regulated financial institution insolvencies, as has happened in the wake of Santander's acquisition of the assets and senior liabilities of Banco Popular Espanol. The frequency of litigation may increase as specialised investment funds who are focused on insolvency-related litigations become more active; they invest in and fund litigations in return for a share of litigation proceeds.

Sales of Financially Troubled Businesses More Common

Sales of all or substantially all of an insolvent business's assets as a going concern "free and clear" of liens, claims

and encumbrances are now common in Chapter 11 cases and other formal proceedings when a standalone reorganisation or rehabilitation of a business is impractical or impossible. Proposed sale transactions may be market-tested and negotiated before formal insolvency proceedings are commenced. In the US, a pre-negotiated sale process for an insolvent business may be proposed and effectuated quickly with court approval following commencement of a Chapter 11 case, especially when a sale has affirmative support of senior secured creditors. Senior creditors often provide funding for a pre-planned Chapter 11 sale case in order to preserve a business's going-concern value that may be lost in the absence of such funding. After a court-approved sale, a Chapter 11 company and its creditors may negotiate and seek bankruptcy court approval of a Chapter 11 plan of liquidation that distributes sale proceeds to creditors.

What May Lie Ahead

As reported by many Guide contributors, the first half of 2019 has seen a higher incidence of business restructurings and insolvencies in many jurisdictions. The higher incidence of filings reflects a slowing global economy.

The risk of recession, both domestically and globally, has led to a drop in interest rates. In the USA, where interest rates had been steadily rising since 2016, the Federal Reserve has decreased the federal funds rate from 2.5% at the beginning of the year to 1.75% as of October 2019. Similarly, the European Central Bank (ECB) cut the deposit facility rate by 10 basis points to -0.5% in September 2019 and restarted a program of quantitative easing with a plan to buy EUR20 billion of debt on a monthly basis starting as of 1 November 2019. The Bank of England's main policy rate, after reaching an historic low of 0.25% in 2016, has remained at 0.75% since August 2018. In Japan, yields on ten-year government bonds fell below 0% in January 2019, and were hovering at around –0.2% at time of writing, as inflation continues to stagnate in Japan.

Despite continuing low interest rates, the global economy slowed in the second half of 2018 and remained sluggish in the first three quarters of 2019. The slowdown is attributable to several factors, including the escalating trade war between the United States and China, the uncertainty associated with Britain's exit from the EU, and fluctuating energy prices. The International Monetary Fund reports that global growth is projected to slow from 3.6% in 2018 to 3.0% in 2019.

After an unexpectedly strong Q1 where the US economy grew 3.1%, well above the predicted 2.5%, growth slowed to an estimated 2.0% in Q2 2019 and 1.9% in Q3 2019. US growth has been impacted by several factors, including the fading impact of the 2017 tax code reforms and economic hostilities with China. The US job market remains strong but hiring has slowed, and wage growth continues to lag, as it has for years despite strong unemployment numbers. The Eurozone grew at 0.4% in Q1 2019 and 0.2% in each of Q2 and Q3 2019, and the unemployment rate dropped to 7.5%, the lowest rate since July 2008. The slow growth prompted the ECB to launch a new package of stimulus measures in September 2019, described briefly above. The EU recently agreed to extend Britain's deadline for exiting the union until January 31, 2020, after the October 31, 2019, deadline passed without the required agreement regarding Britain's continuing relations with the union having been reached. The OECD predicts that, without free access to European markets, Britain will fall into a recession in 2020. Growth in Britain has been strangled by the threat of a no-deal "Brexit", and growth contracted in Q2 2019 by 0.2%, the first no-growth quarter in Britain in over six years. This global slowdown in economic growth may be a sign that the next cycle of financial restructurings is approaching.

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