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Insolvency 2021

Introduction
Paul Leake and Carl T. Tullson
Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

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INTRODUCTION

Contributed by: *Paul Leake and Carl T. Tullson,* ***Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates***

Insolvency: An Overview

This 2021 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 jurisdictions 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) are both 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

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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 over 50 jurisdictions. It provides that a country's national courts must recognise insolvency proceedings that have been commenced in another country.

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.

New Participants and Competition

Over the last two decades, there has been a 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.

In years past, the senior creditors of an insolvent company often were its relationship bank lenders. Banks predictably continued to hold distressed debt through workout 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 finan-

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cial 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 USA, 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 rather than 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. The frequency of litigation may increase as specialised investment funds that 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 USA, 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 COVID-19 pandemic initially triggered a spike in business restructurings and insolvencies in their jurisdictions. Following the rapid rise in insolvency filings early in the pandemic, there has been a rapid plummet in insolvency filings, due largely to the expansionary fiscal and monetary policies adopted by many countries.

The virus has had a devastating impact on people and businesses across the globe. In October 2021, the World Health Organization reported that there have been more than 241 million confirmed cases of COVID-19 and the virus has killed more than 4.9 million people. The virus has impacted more than 210 countries and territories, with the USA accounting for around one fifth of all global cases. On top of the staggering loss of life, millions of people have lost their jobs and hundreds of thousands of businesses have closed. Governments implemented lockdowns, quarantines and travel restrictions in an effort to slow transmission rates.

But in response, governments and central banks around the world enacted robust stimulus policies. increased expenditures and lowered interest rates to avoid a catastrophic economic collapse. By way of example, in the USA, the Federal Reserve (the "Fed") cut interest rates to near zero and implemented aggressive quantitative easing measures. Congress enacted more than USD5 trillion in emergency legislation. Outside of the USA, the International Monetary Fund (IMF) reports that in 2020, Japan, for example, adopted fiscal packages worth JPY307.8 trillion, or 54.9% of its 2019 GDP.

Although the global economy shrank by 3.1% in 2020, the sweeping actions taken by many governments have ushered in a remarkable economic recovery. The IMF forecasts that the global economy will grow 5.9% in 2021 and 4.9% in 2022. However, the economic recovery varies widely among countries. The advanced economy countries are forecasted to return to their pre-pandemic paths, whereas the IMF predicts the economies of emerging market and developing economy countries (excluding China's) will remain 5.5% below their pre-pandemic paths into 2024. China's economy, which was able to reopen quickly due to the country's successful containment of the virus, is expected to grow 8% this year.

According to the IMF, the division in economic recovery is driven by early policy support and access to COVID-19 vaccines. Vaccines have proven to be effective against COVID-19, and nearly 60% of people in advanced economies have been vaccinated. But only 4% of people living in low-income countries have been vaccinated. Vaccine rates are also hampered by hesitancy to vaccinate in advanced economies and by access in low-income countries, leading some experts to call on the advanced economy countries to increase their efforts to ensure adequate supply of vaccine in low-income countries.

As economies have reopened, observers are increasingly concerned about inflation in some countries. For example, at the end of 2020, the Fed estimated that US inflation would average 1.8% in 2021; by September, the Fed's estimate increased to 4.2%. Economists attribute the increase in prices to a combination of labour shortages, supply-chain bottlenecks, rising costs of raw materials, and the extraordinary monetary and fiscal policies adopted to combat the economic effects of the COVID-19 pandemic.

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Many corporations entered the COVID-19 pandemic highly leveraged and during the pandemic, corporate borrowings have increased. Looking forward, observers will monitor whether lasting inflation will trigger increased interest rates and usher in the next wave of restructurings, or whether, as the IMF predicts, inflation rates prove to be transitory and return to pre-pandemic levels without a resulting increase in interest rates.

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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 global financial centre. 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 USA 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 USA, Skadden focuses on Chapter 11 and 15 proceedings, out-of-court restructurings and related litigation – including "prepackaged" and "prearranged" bankruptcies.

CONTRIBUTING EDITORS

Paul Leake is global head of Skadden's corporate restructuring practice and has led numerous large and complex US and cross-border corporate restructurings. He represents debtors, commercial banks, bank groups, distressed investment funds, noteholder committees, official creditors' committees, unsecured creditors and distressed investors in all forms of corporate restructurings. His areas of focus include advising US and transnational businesses on Chapter 11 reorganisations and liquidations, out-of-court restructurings, secured financings, distressed acquisitions and investments in troubled companies in industries such as healthcare, oil and gas, travel, retail, mining, airlines, aerospace, energy, shipping, publishing, telecom, satellite communications and real estate.

Carl T. Tullson is a partner in Skadden's corporate restructuring practice. His practice spans a variety of industries, and he has played a principal role representing sophisticated corporate debtors, purchasers and investors in complex restructuring cases and cross-border transactions. He has advised on numerous traditional Chapter 11 cases for US and international companies, debtholders, and equity sponsors, as well as on state court dissolution and receivership proceedings. He has a broad range of experience across a number of industries, including automotive, energy, real estate, financial institutions, infrastructure, manufacturing, shipping, technology, real estate, transportation, travel, healthcare, printing, and telecommunications.

Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

One Manhattan West
New York
NY 10001
USA

Tel: +1 (212) 735 3000
Fax: +1 (212) 735 2000
Email: info@skadden.com
Web: www.skadden.com