Europe, Middle East and Africa Restructuring Review 2020

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EUROPE, MIDDLE EAST AND AFRICA

RESTRUCTURING REVIEW 2020

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Preface

Welcome to the *Europe, Middle East and Africa Restructuring Review 2020* – a Global Restructuring Review special report.

Global Restructuring Review is the online home for all those who specialise in cross-border restructuring and insolvency, telling them all they need to know about everything that matters.

Throughout the year, the GRR editorial team delivers daily news, surveys and features; organises the liveliest events ('GRR Live') – covid-19, etc, allowing; and provides our readers with innovative tools and know-how products. In addition, assisted by external contributors, we curate a range of comprehensive regional reviews – online and in print – that delve deeper into developments than the exigencies of journalism allow.

The *Europe, Middle East and Africa Restructuring Review 2020*, which you are reading, is part of that series. It contains insight and thought leadership from 23 pre-eminent practitioners from those regions.

Across 10 chapters and 122 pages, it is part invaluable retrospective and part primer on restructuring practice in different markets, with a little crystal ball gazing thrown in from time to time. All contributors are vetted for their standing and knowledge before being invited to take part.

Together, these contributors discuss recent changes and what they mean, supported by footnotes and relevant statistics.

This edition covers England and Wales, France, Ireland, Luxembourg, the Middle East, the Netherlands, Portugal, Spain and Switzerland, and it also has a fascinating overview on aviation, in particular how the United Kingdom's new Corporate Insolvency and Governance Act may circumvent protections in an international treaty.

Among the discoveries for the reader:

- valuation evidence may be much, much more important to schemes in London, going forwards;
- more than 50 per cent of the world's leased aircraft are leased from Ireland; and

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- Campari-Milano, Fiat Crysler, and Cementir are all now 'Dutch' companies, having relocated their legal domiciles recently.

There's also a cracking table breaking down the key aspects of restructuring and insolvency regimes in three gulf states: Bahrain, Saudi Arabia and the United Arab Emirates.

We are indebted to our wonderful contributors, including our editor and GRR editorial board member Céline Domenget Morin, for their efforts. If you have any suggestions for future editions or want to take part – the review is put out annually – my colleagues and I would love to hear from you.

Please write to insight@globalrestructuringreview.com.

David Samuels
Publisher
November 2020

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New Swiss Insolvency Rules and Lenders' Rights Pre-Insolvency

Luc Defferrard and Tervel Stoyanov
Walder Wyss Ltd

In summary

On 19 June 2020, the Swiss parliament adopted a project to revise numerous provisions of the Code of Obligations pertaining to stock companies. The first part of this article focuses on summarising these new insolvency rules and, particularly, the importance of the lack of liquidity as triggering insolvency proceedings. The second part recapitulates the rights that lenders may have shortly before insolvency when asking for the repayment of a loan and for new security interests or when enforcing existing security interests.

Discussion points

- New insolvency rules
- Lenders' rights before insolvency

Referenced in this article

- Swiss Code of Obligations of 30 March 1911
- Swiss Debt Enforcement and Bankruptcy Act of 11 April 1889

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Introduction

On 19 June 2020, the Swiss parliament adopted a project to revise numerous provisions of the Code of Obligations pertaining to stock companies. Although the Federal Council is yet to decide when the bill will come into force, it is worth considering the changes it will bring to restructuring and reorganisation rules.

In addition to the currently prevailing capital-related components of insolvency (capital loss and over-indebtedness), the company's liquidity situation will also be taken into account with the new provisions, which recognise the importance of illiquidity leading to bankruptcy and, although not fundamentally amending the existing provisions on insolvency. The new provisions provide for a major reorganisation and addition through the codification of existing rules or practice, establishing the measures that must be taken in the event of impending insolvency, capital loss and over-indebtedness.

The first part of this article will focus on summarising these new insolvency rules. The second part will recapitulate certain alternatives that lenders have shortly before insolvency.

New insolvency rules

Liquidity focus: impending insolvency

The revision introduces an explicit duty of the board of directors to monitor the company's liquidity and to take appropriate action in the event of impending insolvency. Although insolvency is not defined as such in the new provisions, the Federal Council indicates in its message that insolvency may be deemed to be impending if it is likely that a company does not have the means to pay its debts when they fall due within the forthcoming 12 months (six months for companies that are not subject to the requirement to be audited) and do not have the creditworthiness to obtain these funds if necessary.

Accordingly, the mere risk of becoming unable to pay debts as they fall due (which is highly relevant in practice) has expressly become a trigger that requires the board to take action, which includes a duty to convene a general meeting of the shareholders if proposed actions are to be resolved by the general meeting or to file for a debt restructuring moratorium if necessary.

These new provisions specify the otherwise existing general rule according to which the board of directors must ensure appropriate financial planning. However, contrary to the Federal Council's proposal in its draft bill, the legislator has refrained from introducing a duty to draw up a liquidity plan in the event of impending insolvency. Whereas the newly introduced focus on the company's liquidity and the extensive flexibility with regard to the measures to be taken are generally to be welcomed, it is regrettable that neither the precautions to be taken by the board of directors nor for what period of time are specified. This leaves room and requires time for corresponding practice to develop.

Furthermore, the focus on the liquidity side is solely on the impending insolvency, and going concern is effectively neglected. In practice, insolvency is often threatening, especially in the case of uncertain business prospects or risky business activities; a focus on solvency may affect those activities or result in potential overfunding.

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Capital loss and over-indebtedness

In addition to the newly introduced explicit duties about liquidity monitoring, the existing balance sheet-based duties of the board of directors in the event of capital loss (ie, if the last annual balance sheet shows that half of the share capital and the legal reserves are no longer covered by the assets) or over-indebtedness (ie, the balance sheet shows that the claims of the company's creditors are no longer covered by its assets) remain in place with certain clarifications and amendments.

Capital loss

If the latest annual financial statements show a capital loss, the financial statements must be reviewed by an auditor before they are approved by the general meeting (except if the board of directors files for a debt restructuring moratorium), even if the company has opted out of the audit requirement. This requirement aims to prevent the board of directors from presenting the financial situation of the company under a better light than it is. The current obligation to immediately convene a general meeting if the latest annual financial statements show a capital loss has been abolished.

In practice, those mandatory general meetings often result in an unnecessary delay and show limited added value; therefore, this change seems reasonable, leaving it at the board of directors' discretion to decide to convene a general meeting if it wants to submit the company to restructuring measures.

Over-indebtedness

In the event of a justified concern of over-indebtedness, the board still has duties to prepare interim financial statements and to notify the bankruptcy court. In line with the existing regime, it will still be possible for the notification of the bankruptcy court to be deferred if sufficient subordinations of claims by creditors are obtained. In that respect, whereas the new provisions do not require a waiver of interest payments, they expressly provide that the subordination must also extend to interest payments, which consequently must be stayed as long as the company is over-indebted.

Furthermore, the new provisions expressly stipulate that the notification may be deferred if there is a reasonable prospect that the over-indebtedness will be rectified within a reasonable period of time, but no later than 90 days after the audited interim financial statements are available, and that the creditors' claims are not additionally jeopardised by the deferral.

Whether the fixed 90-day period proves to be a good solution remains to be seen as it brings more legal certainty, although it will certainly prove to be too short in practice in some cases. According to the wording of this regulation, after 90 days – and under certain circumstances even earlier – all reorganisation efforts must be stopped and the bankruptcy court notified, regardless of whether timely reorganisation success is foreseeable. It is not certain whether this consequence is intentional. In any case, it would have contributed to legal security if the 90-day period had been explicitly designed as a safe harbour to give the board of directors time and security to plan the restructuring.

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Corporate law stay of bankruptcy

The revision also abolishes the corporate law stay of bankruptcy proceedings that remained largely unused in German-speaking Switzerland but was of some practical relevance in western Switzerland. The Federal Act on Debt Enforcement and Bankruptcy (DEBA) will be amended to consolidate all bankruptcy stays.

Relief from avoidance actions for restructuring loans

DEBA will be amended and will expressly provide that debts assumed with the approval of the composition administrator are not subject to avoidance actions, which should facilitate access to new sources of funding from creditors, thus enjoying some benefits of the equivalent of debtor-in-possession financings once composition proceedings have started.

Position of the lenders shortly before insolvency

Avoidance actions

The change on avoidance actions for restructuring loans offers a good opportunity to summarise what lenders can do shortly before insolvency and which recommendations they should follow during this period. If waivers have already been granted by lenders, standstill periods have elapsed, and implementations of restructuring measures have not been successful, the question arises whether lenders can still request the repayment of their loans, ask for new security interests or enforce existing security interests.

Repayment of loan before insolvency

DEBA lists several specific avoidance actions against measures taken one year before bankruptcy and, in the case of 'recognisable' intention to favour certain creditors (avoidance for intent), five years before bankruptcy. The repayment of a loan in cash shortly before insolvency is not listed in the one-year avoidance period but is to be reviewed based on the five-year rule of avoidance for intent.

There are three conditions to fulfil an avoidance for intent:

- the existence of damage to other creditors that have not been repaid;
- the (recognisable) intent of the debtor; and
- the recognition of damage by the favoured person.

As a rule, there is no damage if an action is made based on an exchange for a service or goods of the same value. The repayment of a loan is, however, not to the consideration for the granting of the loan but for the fulfilment of a contractual obligation. Therefore, a repayment made shortly before insolvency may result in damage to the other creditors of the same class in bankruptcy, since those creditors will share less of the bankruptcy estate. This view on the existence of damage has been confirmed by the Swiss Supreme Court in its most recent decisions.

Intent of the debtor exists when it could or should have foreseen that the repayment may favour certain creditors over others, even if the repayment was not made for that specific purpose; it is sufficient that the debtor should logically have taken into account that its action

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may result in damage to the other creditors. The Swiss Supreme Court confirmed that a debtor in financial distress must, before repaying a loan, consider whether it may create damage to other creditors if bankruptcy proceedings are initiated shortly thereafter.

The recognition of damage by the favoured creditor is given when the creditor should have realised that the damage may occur after having used the attention commanded under the specific circumstances. An unlimited undertaking of the lender to request a complete set of financial information, including on all the other creditors, before asking for repayment is not a prerequisite. However, if clear signs exist that damage is foreseeable, it is expected that the creditor make an appropriate analysis. The Swiss Supreme Court stated in this regard that when information is publicly known on a company that starts selling parts of its business for restructuring purposes and asks for the financial support of the state, a creditor should have assumed that other creditors will suffer damage if it is repaid in the context of the distressed financial situation.

In summary, the repayment of an unsecured loan by a distressed company implies a high risk of avoidance. The repayment of a secured loan is, however, possible to the extent that the secured lender would be fully repaid in the insolvency proceedings based on the expected value of the security interests.

The Swiss Supreme Court has developed only one exception to the avoidance rules for unsecured loans: the restructuring loan. The avoidance actions have not been enacted to limit possibilities for a debtor to find financial restructuring solutions. It is in the interest of all creditors that lenders try to help borrowers by granting new credit without immediately losing the amount disbursed.

For this purpose, the Swiss courts have developed the concept of restructuring loans as an exception to the avoidance of a repayment. A restructuring loan exists if the loan is granted for the purpose of helping the company to implement restructuring measures. This precondition is only fulfilled based on a restructuring concept that shows positive restructuring forecasts. In a restructuring loan, the granting of the loan and its repayment is construed as a unity or an adequate consideration and, as a rule, the repayment of a restructuring loan is admitted even before the opening of bankruptcy.

Finally, as general recommendations to be mentioned in relation to the repayment of a loan before bankruptcy, banks should:

- review their regulatory duties with the supervisory authority, if needed, in this regard;
- avoid any risk of participating in a criminal action by being deemed to be an instigator or accomplice of the avoided repayment; and
- consider that declaring a loan due and payable may trigger the duty of the board of directors to file for bankruptcy (see the above-mentioned rules), which could be counterproductive for the banks.

New security interests before insolvency

Rather than ask for repayment of the loan, lenders may wish to obtain new or additional security interests to secure the loan. The granting of new or additional security interests to cover an existing loan is prohibited under Swiss law one year before the insolvency of a company,

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provided that the company was over-indebted at that time (avoidance for over-indebtedness). The granting of new or additional security interests is expressly referred to in the list of one-year avoidance actions.

The renewal of a credit by way of repaying a former loan and disbursing a new one is not deemed to be a new credit. Further, if before the one-year period a binding and enforceable undertaking was already given by the borrower to grant a security interest over specific assets in the future, this undertaking remains binding, and a security interest granted before bankruptcy on this basis is as a rule not subject to avoidance actions.

Two further conditions must be met to make the granting of a security interest subject to an avoidance action:

- the debtor is over-indebted at the time of the perfection of the security interest; and
- the lender does not provide evidence that it did not know that the company was over-indebted and that it could have not known it.

To be complete, the granting of new or additional security interests, with the intent to favour one creditor, is also subject to the rules of avoidance for intent.

As a general recommendation, banks should request security interests very early in the restructuring process, for example, at the time of the first waiver of covenants. Especially in case of unsecured loans, it is useful not only to have a negative pledge clause in the loan agreement, but also to obtain a binding and enforceable undertaking of the borrower to perfect security interests over certain material assets at a later stage.

Enforcement of existing security interests before insolvency

The enforcement of existing security interests before insolvency proceedings is less of an issue and is not subject to avoidance for intent or avoidance for over-indebtedness. The main risk is linked to the fact that enforcement on important operational assets may force the board of directors of the borrower to file for bankruptcy proceedings.

In the case of bankruptcy, a private sale of the assets subject to the security interests is no longer possible, which may have an impact on the level of enforcement proceeds. Another issue relates to the time period required to enforce a security interest: a lender may not have enough time to enforce the security interest, especially by way of enforcement proceedings pursuant to the DEBA.

A private realisation that includes, to the extent legally permitted, self-sale of the assets can be completed in a quicker manner, but the lenders must respect their fiduciary duty of care when enforcing the security interest, which must be sold or transferred as close as possible to its fair market value. As a result, private realisations on long-term assets (shares, IP and real estate) are often organised by way of private auctions, which may also take time. Private realisation on short-term assets (cash and receivables) is quicker but may trigger the opening of bankruptcy.

As a general recommendation, banks should review the alternative of composition proceedings before starting with the enforcement of security interests shortly before bankruptcy, especially to retain the opportunity of private realisation after the period of the composition moratorium.

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Luc Defferrard
Walder Wyss Ltd

Luc Defferrard, partner at Walder Wyss since 2001, has been active in the finance and legal industry for many years. He mainly advises clients in domestic and cross-border mergers and acquisitions and financing, as well as in restructuring, real estate and capital markets. He is regularly recommended by *Chambers*, *The Legal* 500 and *IFLR1000*. A client quoted by Chambers mentions him as having 'a very good eye for what is feasible yet always fights to get the best result for his client'.

Luc was educated at the University of Geneva (lic iur 1987) and registered as attorney-at-law with the Geneva Bar Registry in 1990. Before joining Walder Wyss, he worked with UBS in Geneva, Zurich and New York for seven years as client manager and project manager in corporate and structured finance. In this position, he developed the bank's structured finance offerings to clients in the French part of Switzerland.

Luc speaks French, German and English. He is registered with the Zurich Bar Registry and admitted to practice in the whole of Switzerland.

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Tervel Stoyanov
Walder Wyss Ltd

Tervel Stoyanov is counsel in the banking and finance team. His expertise includes financing transactions (corporate debt finance, leveraged finance, asset finance (including real estate finance), acquisition finance and structured finance, factoring and securitisation), financial restructuring (including reorganisation measures and insolvency) and commodities related matters (eg, structured commodity trade finance and international trade). He also advises on regulatory and commercial law aspects related to financial services.

Tervel graduated with a Bachelor of Laws in 2005 and obtained a Master of Laws in 2006 from the University of Fribourg. He was admitted to the bar in 2009 and was awarded a Master of Laws in Corporate Law (LLM) from New York University the following year. In 2014, he further obtained a certificate of advanced studies for commodity professionals from the University of Lucerne, in association with the Zug Commodity Association and the Lugano Commodity Trading Association. Before joining Walder Wyss, Tervel was an associate with another major law firm in Geneva and Zurich. His work experience also includes a secondment with the legal department of one of Switzerland's leading banks in Zurich.

Tervel practises in English and French and has a good command of German. He is registered with the Zurich Bar Registry and admitted to practice in the whole of Switzerland.

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Seefeldstrasse 123
PO Box 8034 Zurich
Switzerland
Tel: +41 58 658 58 58
www.walderwyss.com

Luc Defferrard
luc.defferrard@walderwyss.com

Tervel Stoyanov
tervel.stoyanov@walderwyss.com

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