THE
RESTRUCTURING REVIEW

Seventh Edition

Editor
Christopher Mallon

Law Business Research
The Restructuring Review

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ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

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AKINWUNMI & BUSARI LEGAL PRACTITIONERS
ASTREA
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GILBERT + TOBIN
GRIMALDI STUDIO LEGALE
KIM & CHANG
KVALE ADVOKATFIRMA DA
LEONHARDT RATTUNDE
LINKLATERS LLP
Acknowledgements

MORAIS LEITÃO, GALVÃO TELES, SOARES DA SILVA & ASSOCIADOS

MOTIEKA & AUDZEVIČIUS

OPF PARTNERS

RITCH, MUELLER, HEATHER Y NICOLAUS SC

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EDITOR’S PREFACE

I am very pleased to present this seventh edition of The Restructuring Review. As with the previous editions, our intention is to help general counsel, government agencies and private practice lawyers understand the conditions prevailing in the global restructuring market in 2014 and 2015 and to highlight some of the more significant legal and commercial developments and trends that have been evident in recent years, and that are expected to be significant in the future.

In many jurisdictions the general economic trends are now more positive than they have been for many years. Against this background, the trend of diminished large-scale restructuring activity has continued in many markets. This picture may suggest a global economy in robust health after the long and difficult years of recession but it would be naïve to think that stability has returned for the long term as several warning signs remain.

First, the dramatic growth of high-yield issuances of past years may lead to unknown consequences further down the road. In the United States, 2012 and 2013 were each record years for high-yield issuance, and across the Atlantic this market is finally achieving a similar stage of development. At the time of writing, total European high-yield issuances for 2014 had already surpassed the annual totals for every year before 2013, and Credit Suisse was forecasting a record level of issuances for the year. As has happened in the past, it is inevitable that such large increases in economic activity will include inappropriate or unfortunate deals, the effects of which will need to be unpicked in future years with the help of restructuring professionals. The same will no doubt apply to the surge in M&A activity that has recently been observed in many developed economies.

A further factor to note is the continued employment of unorthodox monetary policy by many central banks. There remains considerable uncertainty as to the broader economic effects when quantitative easing is unwound and when interest rates return nearer to the long-term average; many commentators expect that when the monetary tide retreats many businesses that until now have managed to conceal their weaknesses may be left dangerously exposed.

With the above in mind, and taking into account also the stresses that continue to lie beneath the surface in the eurozone and some worrying signs of instability in the
emerging economies, only the very brave would forecast a prolonged period of calm for the global economy. As such, this work continues to be relevant and important, in particular as a result of the international nature of many corporate restructurings.

I would like to extend my gratitude to the contributors from some of the world’s leading law firms who have given such valuable support and cooperation in the preparation of this work, and to our publishers, without whom this Review would not have been possible.

Christopher Mallon
Skadden, Arps, Slate, Meagher & Flom (UK) LLP
London
August 2014
I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

The Swedish economy is expected to continue its gradual recovery, which remains sluggish because of the continued subdued state of the global economy. According to the Swedish Ministry of Finance’s July 2014 macroeconomic assessment, growth is expected to reach 2.5 per cent during 2014 and 3.1 per cent during 2015. The fact that the economy is growing despite the weak international economic environment is mainly attributable to household consumption. The risk of weaker growth still predominates, primarily because of the outlook for the eurozone. While there appears little risk of a sharp downturn, the risk of protracted stagnation remains.

Swedish banks are again open for business and some international banks have returned since their departures from the Swedish market during the crisis. The competition between the banks is once more picking up and sponsors and other borrowers are using this hardened competition to achieve the most attractive terms. In addition, a growing Swedish and Nordic high-yield bond market is taking up some competition with the banks.

Even though the economy is growing, the unemployment rate is falling, interest rates are low and the bank and capital markets offer attractive financing terms, there are still companies that are suffering from too-high leverage and certain industries are facing their own industry-specific challenges, for example, the mining industry, which has suffered due to failing iron ore prices.

In 2013, 6,483 limited liability companies entered formal bankruptcy proceedings and a mere 87 companies entered restructuring (with judicial composition). For 2012,
the figures were 6,163 and 85, respectively; and for 2011, 5,539 and 77, respectively – indicating a rising trend.

As is apparent, bankruptcy is a far more frequently used procedure than court restructuring. In practice, most restructurings are done informally, without the involvement of the courts or any public authorities. As the lenders maintain full control in out-of-court proceedings this is most often a preferred route compared with in-court proceedings. Also, the spate of bankruptcies in the early 1990s has had a permanent effect on the Swedish market as most lenders then realised that it is often economically more viable to restructure ailing firms outside formal procedures. Informal restructuring has therefore largely become the preferred solution. That said, there are circumstances in which judicial procedures are needed and can be efficiently employed to restructure and finance distressed companies.

The techniques employed in restructurings have developed and become more sophisticated. The main driver for this development has been the larger restructuring cases of recent years and the international restructuring market has also been an influence. An increase in both international groups’ insolvencies and also a growing market for distressed debt transactions has increased the awareness on the local market. In addition, the growing Nordic high-yield bond market has added layers of complexity to restructurings, not only due to the different kind of terms for bonds compared with loans, but also with respect to the different objectives of bond investors compared with bank lenders.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

In Sweden, there are two main formal proceedings available for companies in financial difficulties: company restructuring and bankruptcy. A company may also be mandatorily liquidated. Mandatory liquidation is triggered by severe overindebtedness (this is essentially a solidity test); bankruptcy is triggered by permanent illiquidity and aims at the disciplined liquidation of the company’s assets with a view to optimising creditor returns and usually ends with the liquidation of the company; restructuring is based on a ‘prospective illiquidity’ test and aims at restructuring a company’s financial position so that it can continue operations with reasonable prospects of profitability. Company restructuring takes place under the supervision of a court-appointed ‘reconstructor’ and bankruptcy is managed by a court-appointed administrator, who takes the place of the shareholders and directors in managing the company’s business.

Although Swedish insolvency law does not provide for extensively ‘pre-packed’ insolvency procedures, it is common for some element of pre-packaging to take place, usually in close cooperation with an insolvency official chosen by the company and its advisers. The courts normally accept the company’s choice of official. In recent years there have been a number of successfully ‘pre-packed’ deals within the real estate sector with sales of distressed real estate portfolios via an official auction process conducted by the Swedish Enforcement Authority. The advantage of choosing the formal auction process in these types of transactions is that any sale of real property made through a formal auction process effectively extinguishes all claims and security in relation to the
sold property. Thus, if existing junior creditors do not consensually agree to an informal debt restructuring, a formal auction process could be a way to squeeze out such creditors and sell the property free from claims and encumbrances. Obviously, such pre-pack solutions need to be carefully planned and structured in order to maximise the value of the sold assets.

i Company restructuring

A formal company restructuring aims to achieve a financial workout of financially distressed companies that are deemed to have sustainable long-term business prospects. Financially distressed companies can apply for a restructuring with the local court. An application will only be approved if the company is unable to pay its overdue debts or will be unable to do so in the near future and there are reasonable grounds to believe that the restructuring can achieve its purpose.

When approving the restructuring the court appoints a ‘reconstructor’ to manage the restructuring. The reconstructor will, *inter alia*, investigate the financial situation of the company and, together with the company, establish and implement a restructuring plan. The creditors will be afforded an opportunity at the creditors’ meeting to express opinions regarding whether the company restructuring should continue. Upon request by any of the creditors, the court appoints a creditors’ committee of no more than three to four persons from among the creditors. All creditors are permitted to stand for the committee and to participate in the discussions. The committee is purely advisory; in matters of material importance the reconstructor is obliged to consult with the committee but is not bound by any advice given.

Crucial for the success of the restructuring is often that the total unprioritised debt of the company is decreased to a manageable level in order for the company to regain its financial viability. The composition may be conducted on a voluntary basis; however, more commonly, the negotiations will aim at a mandatory judicial composition, during which claims of creditors who are entitled to participate in composition proceedings may be mandatorily reduced. The composition should provide all entitled creditors with similar rights at least 25 per cent of the amount of the claims, unless a lower composition percentage is approved by all known creditors who would be covered by the composition, or where special cause exists for a lower percentage.

Only creditors whose claims arose prior to the application for company restructuring may participate in composition proceedings. A creditor whose claim enjoys priority or can be satisfied through set-off may not participate, nor may a subordinated creditor participate in the proceedings, unless the other creditors who are participating in the proceedings so consent. There is case law to suggest that a creditor is subordinated in company restructuring only if this is clear from the relevant agreement; but subsequent statutory changes may inadvertently have changed the law in this regard, in which case a creditor contractually subordinated in bankruptcy will automatically also be subordinated in a company restructuring.

An obvious advantage of a judicial composition is that, contrary to a voluntary write-down of debts, not all (participating) creditors need agree to the write-down provided that an acceptable majority has done so. Before proposing a composition, however, the company and reconstructor should bear in mind that major trade creditors
can play a vital role in the success of the restructuring, for example, by extending credit periods or converting their trade credits into long-terms debt. Any forced compositions could therefore jeopardise the relations with important trade partners and reduce the chances of a successful restructuring.

A sometimes-useful effect is that judicial composition will effectively extinguish all subordinated claims in the company. Thus, by just achieving a smaller composition with the unprioritised creditors, all subordinated debt can be extinguished and the capital structure of the company can be significantly improved, which will also have a positive impact on the value of the remaining debt and the value of the shares in the company. For subordinated creditors, this is a rather unreasonable effect since it puts the shareholders’ interests before the subordinated creditors the claims of which are being extinguished, whereas there is no possibility to, for example, reduce the shareholders’ equity interests correspondingly.

One of the most important features of the company restructuring regime is that a new financier can be given a ‘super-priority’ right in respect of any new debt provided by it, with the consent of the reconstructor, during the restructuring. In order to facilitate a formal restructuring and for the company subject to such to regain financial stability and be able to continue its business, the Swedish Preferential Rights of Creditors Act contains a provision giving ‘super-priority rights’ to claims that are assumed and approved by the reconstructor during the restructuring. Pursuant to the Act such claims are given general priority and rank before other claims of general priority such as claims for compensation for the performance auditing functions required by law, employees’ claims for wages or other compensation arising from the employment, certain pension benefits and claims with priority connected to floating charges. Although the super-priority right is essential in finding new financiers, existing financiers (e.g. banks that hold floating charges in the company) are disadvantaged in that the super-priority claims are prioritised over the assets covered by a floating charge. This has given rise to much debate on the implications of the super-priority rights and whether it is reasonable for, for example, a financing bank to see the value of its floating charge being diminished as a result of a restructuring without being able to object to its outcome. The reconstructor is, however, responsible for procuring that the value of claims secured by floating charges does not decrease more than necessary. Further, it should be stressed that the super-priority right does not apply to claims that arise (e.g., interest) during the restructuring under agreements entered into prior to the commencement of the restructuring. Apart from the super-priority right described above, Swedish law does not provide for any further special priorities.

Restructuring also automatically imposes a moratorium on enforcements and termination of existing agreements and provides conditional protection against bankruptcy. The moratorium does not, however, apply to secured creditors that hold possessory pledges, which may be enforced if the relevant pledgee has a due and payable claim, meaning that the underlying debt must actually have been accelerated to be effective.

Unless terminated prematurely by court order, restructuring may last for no more than three months, subject to an extension for up to nine months in certain circumstances. In our experience, the court performs a fairly summary review of the application – it is usual that the application be accepted (or, exceptionally, rejected) the same day. It is customary to submit the application before – often immediately before – the court opens for business to allow the court as much time for deliberation as possible.
In practice, it has also proved relatively easy to obtain the prolongation, at least if the reconstructor supports it. The recent difficulties of Saab Automobile shows that, in some circumstances, renewed restructuring proceedings may also be granted very close to a previous failed restructuring. In the Saab case, the first restructuring was granted in 2009 and continued, unsuccessfully, through prolongation. In 2011 the company applied again for company restructuring. After having been denied at first instance, the application was granted upon appeal. Saab then carried out a second, prolonged and ultimately unsuccessful company restructuring.

At the end of the restructuring (regardless of whether it has been successful), the reconstructor resigns and the moratorium is automatically lifted. The court will not be required to make any decision if the time allocated to the company restructuring merely elapses. After an unsuccessful company restructuring, the company will usually have eaten through more of its liquidity and accumulated more debt than at the commencement of the proceedings (including a debt to the state corresponding to the state’s guarantee for staff remuneration). This creates powerful incentives for creditors caught by the moratorium to act swiftly when the moratorium has been lifted; creditors who have not been prevented by the moratorium from enforcing their security (that is, creditors with security over specific assets) will often already have enforced security leaving the company potentially without crucial business assets. Unsecured creditors – such as suppliers and other trade creditors whose continued support is absolutely necessary to the continuation of business – will often have been hard hit by the moratorium and any compulsory composition, and may therefore be reluctant to assume continued credit risk after the end of company restructuring proceedings. This is one of the contributing factors as to why company restructuring proceedings often are quickly followed by formal bankruptcy. This is also a factor making informal restructuring by contractual negotiation earlier in the life of the ailing company an often more attractive solution to creditors.

As a final reflection, treatment of the shareholders – or rather the inability to judicially involve the shareholders in the process – is thought to be a major challenge in any successful restructuring of an ailing company. A perhaps ideal solution would be for legislation to abolish the artificial distinction between insolvency law – dealing with debt – and company law – dealing with equity – by allowing insolvency proceedings to also reconstruct the equity of a company. In the absence of any such Swedish legislation, however, it is often found that neither company restructuring nor bankruptcy proceedings provide the flexibility required, which may be an important contributing factor for both the frequent failures of company restructuring proceedings and the prevalence of informal contractually negotiated arrangements. As mentioned earlier, informal restructuring proceeds often involve a restructuring of both the debt and the equity.

ii Bankruptcy

Bankruptcy proceedings are initiated as a consequence of a company becoming permanently illiquid. The relevant test is cash-flow insolvency and a company may enter bankruptcy if it cannot pay its debts as they fall due and such inability is not merely temporary.

Proceedings are aimed at winding down an insolvent company by way of selling its assets and distributing any cash received to the creditors. The normal result is a
negative balance leading to the automatic liquidation of the company. Any positive balance accrues to the shareholders, who may choose whether to liquidate the company. The proceedings can be initiated by the company as well as by a creditor by filing of a petition for bankruptcy with the local court. The company's application will normally be granted, whereas a creditor will have to prove that the conditions for bankruptcy have been met; the law presumes this to be the case in a number of explicit cases. Contested applications are litigated in full civil trial.

After the court has declared a company bankrupt it appoints an administrator that independently takes control over the company's assets with the main task of realising such assets and repaying the debts of the bankruptcy estate in accordance with the creditors' statutory ranking. Upon formal bankruptcy, the company loses its legal capacity and the administrator takes the place of the shareholders and directors in running the company.

Statute classifies claims into one of the following:

\( a \) claims with special priority (essentially security over specific assets);
\( b \) claims with general priority (including various statutory costs, transactions costs and taxes);
\( c \) claims without priority; and
\( d \) subordinated claims.

Shareholders have no claims in the ranking and are only entitled to any positive balance post-bankruptcy in accordance with normal company law principles. The priority ranking cannot be changed or amended by contractual agreement, but a creditor may agree to its claim being subordinated in relation to all other creditors of the company, whereby the repayment of such debt is conditional upon the full payment of all other claims against the company. Through intercreditor agreements, creditors may also contractually agree to an order of payment that deviates from the statutory ranking. The administrator is not legally bound by the intercreditor arrangements (regardless of whether the company is party to those arrangements) and can be expected to distribute proceeds in accordance with the statutory ranking of claims; in our experience, however, administrators tend to adhere to the intercreditor principles, albeit not being legally bound by the same. In order to mitigate the risks of the administrator not honouring the intercreditor principles, it is important to carefully consider turnover provisions that, albeit not being binding upon the administrator, are binding and enforceable among the creditors who have signed up to the agreement.\(^2\)

As regards the existing creditors of the company, neither unsecured nor secured creditors are generally free to take independent enforcement actions in bankruptcy. Secured creditors that hold possessory pledges may sell the security assets subject to such

\(^2\) An interesting and practical implication of the turnover provisions in the context of bond financing is that it is virtually impossible to enforce a traditional turnover provision against a large and often unknown collective of bond investors. The practical solution provided is instead that the a corresponding amount of any funds received by a bond investor which should have been turned over to the other creditors, will be withheld by the security agent the next time any funds are run through the payment waterfall in the intercreditor agreement.
pledges at a public auction or, in respect of certain financial assets, in any other manner (including by way of appropriation). With the exception of certain financial assets, the administrator must also be given the right of first refusal to the security assets. A valid claim against a bankrupt company – regardless of whether it is due and payable – may be set off against a claim that the bankrupt company had against the creditor when the bankruptcy commenced.

iii Clawback actions

Any pre-insolvency planning (including planning of pre-commencement financing) is arranged with a view to avoiding clawback risks, minimising upstreaming complications and maximising the value and robustness of the security package. Other aspects that need to be addressed in this context include subordination of debt layers as well as limiting potential subrogation rights of intragroup security providers. The latter aspects are usually addressed in intercreditor agreements dealing with both debt subordination and the waiver of subrogation rights by the intragroup security providers.

The clawback provisions under Swedish law are based on the Roman law concept of *actio Pauliana* (fraudulent conveyance) and therefore require a degree of fraudulent behaviour in order to be triggered. Thus, the clawback provisions will only come into play if the relevant transaction entails (1) that a particular creditor has, in an unfair manner, been favoured in preference to other creditors, (2) the property of the debtor having been concealed from its creditors, or (3) its debts being increased, and provided that such transaction (by itself or together with other transactions) led to the company becoming insolvent. Another prerequisite is that the other person party to the transaction knew, or should have known, of the insolvency of the debtor and the circumstances making the transaction improper.

Consequently, any recovery would have to be based on some degree of ‘disloyalty’ as against the relevant debtor’s general collective of creditors. As Swedish law makes a clear distinction between the contractual creation of legal arrangements *inter partes* and the perfection of those arrangements *erga omnes*, care is usually taken to ensure that all important arrangements – in particular, security arrangements – have not only been created but also perfected in circumstances that would make a recovery action unlikely to succeed. For instance, perfection would typically be sought well in advance of the likely starting date for any suspect period (usually three months prior to the borrower’s entering into formal insolvency proceedings) to avoid recoveries.

When renegotiating or providing new financing to a group facing financial difficulties, debt providers often require that new or additional security and guarantees are granted by the borrower group. The debt provider in this scenario needs to pay close attention to the risk of such security and guarantees being subject to clawback in the formal insolvency proceedings in respect of the security provider. Under these rules, a security interest granted after the security provider incurred the secured obligations may be subject to clawback unless the granting of the security nonetheless can be considered as ‘ordinary’. This exception for ‘ordinary’ transactions is sometimes referred to as a ‘safe haven’ for creditors, although it is difficult to clearly define a transaction as ordinary.

Simply put, security or guarantees will be deemed ordinary in the event (1) they were agreed no later than the incurrence of the debt or more than three months
prior to the insolvency and (2) the terms providing for security or guarantees have been implemented by the parties in a manner that does not amount to an opportunistic application of the terms with a view to a looming insolvency. However, the exception for ‘ordinary’ security has been introduced quite recently and Sweden therefore lacks court precedents on the subject. Some guidance may be found in the preparatory works to the legislation that states that in order to meet this condition (i.e. that the granting of the security is ordinary), the security should be granted in direct relation to the funding and not by reason of the security provider experiencing financial difficulties. According to the prevailing view in Swedish legal literature, on the other hand, one needs to make an overall assessment of the circumstances in which the security was taken, taking into account all circumstances of the transaction. The exception can also be considered from the view that the security transaction in any event may not diverge from what can be considered as normal and natural.

A change of creditor will not, however, affect the validity of the security provided that the underlying claim remains the same and that the relevant transfer expressly includes the existing creditor’s portion of the security securing the transferred debt. Similarly, the fact that a creditor has acquired its portion of the debt from another creditor would not generally restrict the new creditor from benefiting from the provisions under Swedish law granting a creditor the right of set-off under certain circumstances. However, the right of set off may be restricted in the event that the creditor assuming the debt had (or should have had) knowledge about the debtor’s financial difficulties and consequently has acquired the debt in order to improve its situation in any insolvency proceeding affecting the debtor.

Any security that is deemed to have been granted for ‘old’ debt will be at risk of being subject to clawback during a hardening period of three months from the time that the security is perfected. The hardening period may, however, be up to five years if the security provider was insolvent at the time that the security was perfected. The five-year hardening period applies to certain intentionally fraudulent or conniving transactions whereby a certain creditor is unduly favoured over other creditors in such a way that the debtor’s assets have become unavailable to its other creditors. The extended hardening period also applies where the effect of the fraudulent transaction is that the debtor has assumed additional debt. A general criterion for the extended hardening period is that the debtor was insolvent when the transaction took place or became insolvent through the transaction (either independently or in connection with other transactions). The hardening period may, however, be unlimited to certain connected persons who are assumed to have the required knowledge about the debtor unless they can show that it was reasonably likely that they did not have the information.

As regards third-party creditors, there is a ‘safe haven’ to the extent that they did not have any knowledge of the debtor’s insolvency and that they did not have knowledge of any circumstances that would render the transaction inappropriate.

As mentioned above, a number of clawback provisions are triggered if and to the extent the relevant debtor was or became insolvent as a result of the transaction. Pursuant to the Swedish Bankruptcy Act, a company is generally considered to be insolvent if it lacks the ability to pay its debts as they fall due and such inability is not just temporary. This definition and the interpretation of it have been subject to much debate among legal scholars and practitioners as the exact point in time when a company
is deemed insolvent has several implications. However, the prevailing view among scholars and practitioners is that a company that cannot pay its debts when they fall due could nonetheless be considered as being solvent if the company has a realistic plan for successfully restructuring the company and finding a long-term financing solution. Whether a company is solvent is therefore to be separated from it being liquid, which relates to the company’s immediate ability to service its debts rather than the company’s financial situation over a longer period. For example, a company with a strong balance sheet will likely be able to pay its long-term debt, but might at a particular time lack the liquidity to service its debt.

In addition to the clawback risks, any security or guarantees that are granted in violation of the relevant provisions may make directors of the company personally liable for losses incurred by a creditor due to the mismanagement of an insolvent company. Such mismanagement is generally considered to include the directors’ having continued the company’s business past the point when they knew, or should have known, that there was no reasonable prospect of avoiding the insolvency of the company, and did not take the required steps with a view to minimising the potential loss to the company’s creditors. In addition to the risk of incurring personal liability for losses incurred by the company’s creditors, a director may face criminal charges for crimes against creditors, as set out in the Swedish Penal Code. These offences include situations in which a director is deemed to have acted carelessly towards the company’s creditors or to have favoured a particular creditor by, for example, paying a debt that had not fallen due or providing security or guarantees that were not required under the terms of an existing agreement.

III RECENT LEGAL DEVELOPMENTS

Swedish bankruptcy law is based on longstanding principles and company restructuring, although a fairly new procedure (introduced in 1996) is largely based on older law dealing with compositions. There is currently work on a unified insolvency code designed to provide greater flexibility in primarily addressing corporate insolvencies (partly taking into account the UNCITRAL Legislative Guide on Insolvency Law). The most significant proposal is the removal of the separate bankruptcy and restructuring proceedings and the introduction of a new unified ‘insolvency proceeding’. Draft legislation was published in 2010 but the project has since largely languished in the government offices. It is unclear whether or when a reform could be launched.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

The financial distress of a group often requires that the terms of its existing financial arrangements be renegotiated in order to, *inter alia*, reset financial covenants, provide a more flexible amortisation structure, defer interest payments and allow for various restructuring measures. These actions are often sufficient for the purposes of providing a financially distressed group with a financial arrangement that allows the group sufficient flexibility to successfully restructure its business. It is not uncommon, however, that a group facing financial difficulties defers necessary acquisitions and capital expenditures
in order to temporarily improve its financial position on one hand, with the result that, on the other hand, the earnings of the group are not sustained or increased to a satisfactory level. This entails that a successful restructuring of a group will not only require a strengthening of the balance sheet by reducing the debt but also additional financing from either existing stakeholders or third parties in order to finance the necessary investments.

In the event of a balance-sheet problem where existing shareholders cannot provide sufficient equity, the improvement of the balance sheet can be supported by the lenders through a debt-to-equity swap. An example of a Swedish debt-equity swap transaction launched in recent years is the Nobina group restructuring. Nobina had issued a US high-yield bond in 2007 and was expected to fail to meet its repayment obligations under its US bonds. The solution included an exchange of the US high-yield bonds for new Swedish law-governed high-yield bonds and shares in the parent company of Nobina. The settlement of the transaction took place across Euroclear Bank and Clearstream Luxemburg for the US bonds that were exchanged against new Swedish high-yield bonds held by Euroclear Sweden. Simultaneously, a portion of the existing US bonds were used for an in-kind share issue in the parent company of Nobina. The end result was a dilution of the shareholders and a significant reduction of the debt. This was a successful out-of-court restructuring and saved Nobina from entering formal insolvency proceedings. Through this solution the debt level was decreased and the currency exposure was reduced, giving the company the necessary means to survive long term and develop its business. Another type of ‘debt to hybrid equity swap’ was recently employed in the restructuring of the Basler Fashion group, a distressed group within the fashion industry, where the senior debt providers swapped their senior claims against the operating entity against a value participating debenture in the ultimate parent company, giving the value participating lenders the right to a certain percentage of the group’s profits, instead of an outright ownership stake. In addition, a majority interest in the group was transferred to a trust vehicle with the ultimate aim of selling the group to an investor after the conclusion of the operative restructuring. From a lender’s perspective, this type of hybrid solution can be an attractive alternative as the lenders can avoid taking ownership of the group at the same time as they can benefit from the economic value or profit generated by the group.

Whether a financially distressed group requires that the terms of its existing financial arrangements be renegotiated or if it also requires additional financing will have a significant impact on the financing process. A provider of new or additional financing to a financially distressed group often requires more control and economic return as compared with the existing stakeholders. The new finance provider will usually also be in a position to elect – taking certain legal, practical and commercial aspects into consideration – the way in which the new funds will be provided. The different type of financial instruments available can be used and combined in a way to achieve the most

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3 For example, by way of debt, equity, preference shares, convertible loans, value participating loans or any other form of instruments.
feasible restructuring of the group, considering the different stakeholder positions and also the group’s need for a new capital structure.

In practice, a combination of a renegotiation of the terms of the existing debt together with the provision of new debt is often sought. As set out above, the additional financing can be provided by way of debt, common equity, preference shares, convertible loans or various other forms of hybrid debt instruments. Which financing method that is preferred varies depending on numerous factors, including whether the relevant company is in a position to take on and service additional debt and on the financing provider’s preferences. An obvious advantage with out-of-court restructurings is the flexibility that can be employed in finding viable solutions for the distressed company and the investors. As an example, Dannemora Mineral AB, a mining company financed with senior secured bonds, junior bonds and senior bank facilities, has during the past year defaulted under their senior and junior bonds and has not been able to pay interest under any of its bond debt. A major debt restructuring negotiation has been ongoing with the various creditors (senior bond holders, junior bond holders, banks, and trade creditors) for the past 12 months and Dannemora has been granted waivers and amendments to the debt terms. Dannemora has also been provided with a super-senior bridge financing from certain senior bond holders.

In April 2014 Dannemora launched a deal whereby the subsidiary of Dannemora offered an issue of US$100 million senior secured bonds, combined with penny warrants in Dannemora. The offer also included a debt-equity swap of the senior bond and the junior bonds, whereby the bonds were fully equitised. The investors in the new senior secured bonds would, through the warrants, receive a significant equity stake in Dannemora. The existing bond holders would, through the debt-equity conversion receive a minority holding in the company, but were also offered the chance to participate in the new debt-equity issue and thereby increase their holding. The shareholders of Dannemora were also offered the opportunity to protect their current holdings from dilution through participation in the new debt-equity issue.

Partly as a consequence of the failing iron ore prices, not only Dannemora but also Northland Resources and Nordic Mines have encountered financial difficulties. The mining industry has been suffering for quite some time and all three mentioned companies have been through out-of-court and in-court restructurings. The crisis is still not over and even though the different companies have different issues there is one common denominator, the iron ore price. If the price turns back up sufficiently, it will most likely be much easier for these companies to access the capital markets to obtain financing.

Another notable recent insolvency case is Panaxia, a cash-in-transit company, with an approximate market share of 20 per cent. Panaxia filed for bankruptcy in September 2012, and the case has since then been much debated partly due to concerns about the security in the cash handling system and partly due to suspicion of fraud.

It should also be noted that the growing high-yield bond market has added a layer of complexity to restructurings. Restructuring of bonds is significantly different to restructuring of bank loans. The bonds are traded freely and it is sometimes difficult to identify and convene a bondholders committee with the sufficient majority. Also, the sharing of information can be sensitive from an insider perspective, which makes restructuring negotiations more difficult. More importantly, the objectives of the bond
holders differ more than among lenders in a bank group. There are participants in
the bond market who acquire distressed debt with the aim of subsequently acquiring
control over the equity interest in the borrower. There is also an increasing number
of bond investors who target financially distressed bond issuers by acquiring corner
positions at a significantly discounted price. The corner positions are then used to
block any consensual restructuring proposals until that investor is bought out at a
higher level than its original investment or the borrower is forced into equitisation.
The restructuring strategies employed by the borrowers may also entail strategies
regarding the timing of information to the market to manage the pricing of the bonds
before restructuring proposals are launched. It may be easier to achieve a restructuring
solution if many of the bond holders have acquired their bonds significantly below par.
There are many strategic, practical and legal considerations to be taken and pitfalls to
look out for. That said, the access to the capital markets through listed bonds or equity
instruments gives a great advantage in the restructuring and opens up many interesting
possibilities.

V INTERNATIONAL

Traditionally, Swedish insolvency law has been characterised by a certain asymmetry
in respect of the international ramifications of a company’s insolvency. The basic rules
are that foreign insolvency proceedings are not recognised or enforced in Sweden, and
Swedish insolvency proceedings in respect of a Swedish entity are universal and, in
respect of a foreign entity, includes all its assets in Sweden (but not elsewhere). The first
rule has been modified by, first, treaty law in the Inter-Nordic Insolvency Treaty and,
second, by the EU Insolvency Regulation (EIR). The treaty is now only effective in
respect of Denmark, Norway and Iceland, with the effect that insolvency proceedings
in those jurisdictions will be given effect in Sweden as if they were Swedish. The treaty
does not take into account the particular challenges facing international groups of
companies. In respect of Finland, the treaty has, to all intents and purposes, been
superseded by the EIR.

The EIR amendments, insofar as they seek to encourage the cooperation among
the courts of the various Member States in respect of insolvency proceedings, would not
in principle be a novelty for Swedish courts. There have long been special arrangements
with the other Nordic countries enabling and encouraging courts and administrative
authorities in the various states to deal directly with each other and to cooperate as
appropriate. The EIR amendments would appear to extend this approach to include the
entire EU, at least. However, as the courts and authorities in the Nordic countries would
normally be able to communicate with each other in their mutually intelligible national
languages, the linguistic challenges of communicating accurately and rapidly on matters
of financial and legal complexity across borders may be more challenging.

It may also be challenging for Sweden to provide the information on Swedish
insolvency law contemplated by the EIR amendments. While it is true that the much
Swedish insolvency law is in the form of statute, much law – and much important law
– is only found in series of judicial precedents, the parliamentary history of the various
enactments, and expert legal writers. There is no institution, other than a court when
dealing with a specific matter – and then only within the scope of that matter – that could authoritatively state the fullness of the law on any one point. Judging from experience, the Swedish parliament is likely to pass various enactments to support the realisation of the intentions of the EIR amendments. The legislative process has not, however, yet commenced in this respect.

**VI FUTURE DEVELOPMENTS**

There is currently work on a unified insolvency code designed to provide greater flexibility in addressing primarily corporate insolvencies (see Section III, *supra*).

The Swedish FSA has published a memorandum in June 2014 presenting its intentions to increase transparency in the Swedish bonds market, to the effect that prices and volumes will become more transparent. The aim is to achieve a more efficient bond market. This modified practice is not directly insolvency related, but an increased transparency may have an impact in restructurings of bond-financed companies.
Appendix 1

ABOUT THE AUTHORS

JOHAN HÄGER
Roschier Advokatbyrå AB

Johan Häger is head of the firm's banking and debt capital markets practice in Sweden, within which the restructuring and insolvency practice forms a significant part.

Mr Häger works closely with the firm's private equity and corporate M&A teams, the real estate team, tax structuring team and other practices to achieve the best possible results in complex restructurings and security enforcements. He cooperates closely with financial restructuring advisers, CROs and local in-court-administrators, which enables him to efficiently coordinate a team to facilitate a restructuring of both operations and balance sheet. He has extensive experience in LBO financings and high-yield bonds and acts frequently for both bond arrangers and borrowers with the structuring and negotiation of these instruments, which experience is essential for successful restructurings of bank loans and bonds.

Mr Häger's restructuring and insolvency credentials span cross-border reorganisations in Sweden, Norway, Finland, Denmark, Lithuania, Latvia, Estonia, Germany, the United Kingdom, Canada, the Netherlands and Luxembourg. He acts for local and international banks, as well as for private equity clients and corporate borrowers. Recent engagements have included Saab Automobile, Nobina, Basler Fashion, the PMS Group, Dentutech, Centrumkompaniet, Propinvest, Ittur, Homburg and Dannemora Mineral.

Mr Häger has, in the growing high-yield bond market, been engaged both by bond holders, private equity firms and corporate borrowers in restructurings involving senior bonds, junior bonds and bank debt.

DAN HANQVIST
Roschier Advokatbyrå AB

Dan Hanqvist is a member of the firm's banking and debt capital markets practice in Sweden, within which the restructuring and insolvency practice forms a significant part.
He has more than 20 years of experience in assisting both Swedish and international banks, financial institutions, funds, corporations as well as public authorities on transactions involving regulatory matters, financial restructuring and complex financial instruments. He is also often involved in the legislative process in respect of the financial markets. His work experience includes working for market participants in London, Moscow and Sweden, including in-house work for NASDAQ OMX. He is a regular lecturer at the Universities of Stockholm and Uppsala and frequently writes for the academic and professional press.

**HAREM MAHIR**  
*Roschier Advokatbyrå AB*  
Harem Mahir is a member of the firm’s banking and debt capital markets practice in Sweden, within which the restructuring and insolvency practice forms a significant part. His experience covers various out-of-court restructurings, within various industry sectors, including media, retail, automotive and real estate. In addition, Mr Mahir has experience in various large-scale international acquisition and asset-backed financing transactions, representing international banks and financial institutions as well as private equity investors and large corporate. He also regularly advises various financial institutions and insurance companies in regulatory and derivates matters. In addition, His experience also covers working with debt capital market transactions, representing both arrangers and issuers in various high-yield bond issues.

**MATTIAS MOSKOWICZ**  
*Roschier Advokatbyrå AB*  
Mattias Moskowicz is a member of the firm’s banking and debt capital markets practice in Sweden, within which the restructuring and insolvency practice forms a significant part. His experience covers various cross-border acquisition financings, real estate financings, project financings as well as corporate restructurings and enforcements. Some of the more significant restructurings that he has worked on involve acting for the lenders in connection with the successful out-of-court restructurings of two international groups listed on NASDAQ OMX. Mr Moskowicz has also experience acting for the lenders in connection with successful out-of-court restructurings of international private equity owned groups as well as the enforcement and subsequent divestment of a large real estate portfolio.