LEGAL INSIGHTS OF NOBOA, PEÑA & TORRES, ABOGADOS

RESTRUCTURING LIABILITY – EFFECTS OF COVID-19

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ABSTRACT: The situation we are currently undergoing because of COVID-19 has affected, in one way or another, the operation of companies; this circumstance leads us to consider the need to implement measures in the financial restructuring of businesses. This article summarizes several ways through which such restructuring can be achieved. Among them, we highlight, as examples, the revision of credit conditions, innovation in the provision of services, the implementation of strategies and internal agreements that best suit each company, and that, in short, ensure mutually winning solutions.

A situation like the one we are going through means that the cash flow of many companies are affected in a conjunctural manner, derived from the impossibility of sales due to the declaration of exception that prevails in the country; others, given the nature of their activity, have been able to work under complex circumstances, or may have produced sustained incremental revenue, cash or receivables, or less than the usual average. All of them have faced operating costs, or fixed costs that have had to assume or to which they have been committed. On the other hand, other companies are starting to try to project what their future will be and try to adjust budgets they probably made at the end of the previous year, and some do so with great concern due to the field in which they operate.

In fact, probably the vast majority of companies will resume their activities, starting slowly until reaching the usual levels, without knowing how long it would

take for this to take place. These companies, which are qualified as viable, and we are sure it will be the majority of them, probably will have to make adjustments, some transient with the consequent increase in costs, for example, health implements, protective masks for customer service, etc., while achieving that recovery; others will have to make reduction decisions due to their new reality; but there will also be those who will be victims of the effects of the fact that society will have to live with an unknown virus, which will imply the adoption of measures such as social distancing, which probably will severely affect their operations: meaning the sector of activities where there are important congregations of people without enough space between them.

In any case the above may mean that companies are indebted both, with respect to its suppliers (regardless of financial resources, raw materials, or other) as well as having the status of creditors, having their cash flow affected which would prevent them to assume their economic commitments. Others, on the other hand, may present more structural problems that go beyond the simple inconvenience of delays in the fulfillment of their obligations, and perhaps consider a total restructuring of their strategy or its reconsideration. Scenarios like the previous ones will possibly lead to considering the need for creative measures of financial restructuring of businesses, so that they remain healthy and profitable.

The situation described above could generate, as a natural first reaction, disagreements derived from nervousness; and with this, it may proliferate judicial litigation aimed at trying to collect debts, beyond defensive arguments such as those indicated above due to force majeure or others. But even within the framework of the existence of a process, it is likely that we should learn to see mediation or conciliation systems as a focus of interest, to find a negotiated solution to the problem that arises.

In addition, a debtor within the conditions of articles 1 and 4 of the Preventive Bankruptcy Law, who achieves that the bankruptcy process is carried out (either by impulse of the debtor or the creditor), could observe or obtain the restructuring of its obligations as a bankruptcy decision adopted by the majority of creditors.

However, litigation should not be the only alternative to the potential problems that have been alluded to. In general, the idea of

restructuring or renegotiation of obligations will probably come among the menu of alternatives that the parties will have, and this knowing that, with the exception of the provisions for the Preventive Tenders regime or the recent Entrepreneurship Law (and, leaving aside decision-making in bankruptcy proceedings arising from judicial enforcement proceedings), there is no rule that imposes the duty to carry out an act of renegotiation and, if they are held, they must take into account the rules related to the legal phenomenon of novation, particularly regarding the maintenance of guarantees. That said, we know, on the other hand, that regarding monetary activities of the country, the regulations that are most adjusted to the situation will be dictated, and for this, they will probably take into account the financial and regulatory circumstances existing at the time of granting of the operation, and for them, we will have to stick to that matter. But in any case, it is important to keep in mind that a financial restructuring is a process of changing the circumstances of an outstanding loan in order to obtain a different profile that adapts to the new circumstances that must be considered with seriousness and responsibility.

Seen in this way, restructure must combine a legal analysis of the type of business or credit in question, together with an economic study of the general situation of the business and a financial study of it, in such a way that financially, flexibility is allowed to help reduce identifiable pressures, trying to make decisions regarding these that include the flattening of commitments, and the adjustment of rates, in order to ultimately seek to recover profit margins to some extent. In this process, one cannot ignore, economically, the structural problems or situations of the market in which the company operates, for which it will be necessary to pay close attention to what the market is determining.

The forms of restructuring go through various topics within the company and depending on the sector in which the company operates; it may be via restructuring liabilities, giving them, as previously stated, a longer-term enforceability profile. But they can also include a review of certain internal company processes in order to make them less cumbersome. The foregoing does not exclude among the possible, changes in strategy, adapting to new forms of service provision which probably means new investments, and this will require showing the resource provider (who will be a new creditor, or who will increase its credit) the viabilities or incremental gains generated

with that investment. Restructuring, under normal conditions, is not a right that the debtor has, so that he can invoke it before its creditor and force him to accept the terms. A restructuring, unless it is imposed by a general and exceptional legal norm (leaving aside constitutional aspects related to these), must be agreed between the parties.

However, it should not be forgotten that the possibility that a debtor may claim an external force, such as force majeure or fortuitous event, or other legal figures, may be potentially facing the possibility of at least, deferring the fulfillment of their commitments (we are not referring to other types of decisions such as seeking the resolution or termination of contracts).

In general, as a Firm, we have intervened in renegotiation or liability restructuring processes, and we have found that there are several methods to try to lead the parties (it will always depend on their will) to mutually favorable solutions. On occasions we have resorted to reviewing, suggesting, and developing schemes to extend terms, establish grace periods on the payment of capital, including deferral of payment of interests. In others, we have observed as possibilities, corporate mechanisms such as the independence of activities through the division or concentration of these through mergers and other forms of mergers or company acquisitions; we have also analyzed and managed to translate into adequate agreements the strengthening of cost centers or their incorporation into the rest of the company process. In short, the options are varied, and it depends on what each company agrees on, taking into account its situation, environment and circumstances.

And in all cases, it has been possible to start from plans and budgets that have tried to be as close as possible to potential generations of income flows, as well as payment flows, trying to make them as fair as possible also for the creditor. In this role, different options must be sought to determine the adequate profitability; it is not ruled out, among them, that the shareholders capitalize the company with the purpose of reducing liabilities with respect to third parties, if that is the most convenient, which is done by way of capital increase. It is important to consider that saving a company on many occasions can generate greater value than liquidating it, and that when it is observed that the current cash flow leads a company to a cliff, while a renegotiated flow can lead to a viability situation under serious and mutually defined parameters, then the possibility of a restructuring appears as important. The restructuring processes are not set in stone, they require skilled negotiators, but above all

sensitive to the needs of both the creditor and the debtor, who understand that, like any negotiation, in the end it will depend on the will of the parties involved, but that they do all the effort to make valid criteria available to those involved, and, as far as possible, transparent and objective, so that the analysis by the recipients is adequate.

With all the information that can be had, and with the interaction of the financial directorates and with the decision-makers of the companies, it is possible, if there is the will of the agents, to try to reach duly written agreements with their details that make them valid and enforceable, that allow a healthy solution even within the harsh situation.

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