PwC International Business Reorganisations Network – Monthly Legal Update

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Welcome

Welcome to the fifth edition of the PwC International Business Reorganisations (**IBR**) Network Monthly Legal Update for 2017.

The PwC IBR Network provides legal services to assist multinational organisations with their cross-border reorganisations. We focus on post-deal integration, pre-transaction separation and carve outs, single entity projects, and legal entity rationalisation and simplification as well as general business and corporate and commercial structuring.

Each month our global legal network brings you insights and updates on key legal issues and developments relevant to multinational organisations.

We hope that you will find this publication helpful, and we look forward to hearing from you.

In this issue

In our May 2017 issue:

- Loeser e Portela Advogados (Brazil) examines corporate reorganisations involving companies under judicial recovery; and
- PricewaterhouseCoopers Tax & Legal, Sarl (Cameroon) discusses the treatment of convertible bonds issued by public limited companies under the revised OHADA Uniform Act relating to Commercial Companies and Economic Interest Groups.

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Loeser e Portela Advogados (Brazil) – Corporate Reorganisations Involving Companies under Judicial Recovery

At a glance

Amendments to Federal Law n. 11.101, 2005 have introduced a judicial recovery procedure designed to provide an alternative mechanism for companies that face financial difficulties.

The judicial recovery process encompasses two types of reorganisation, namely in-court and out-of-court procedures. These processes enable the debtor to submit, negotiate and provide a plan of reorganisation to be approved by its creditors, to which it may re-profile its debt and/or equity structure.

Such a mechanism is an effective means of enabling debtors to access creditors and open a dialog between the debtor, creditors and the court in times of financial crises.

In detail

Many companies in Brazil have sought to address pending debts as well as restrictions on access to credit and capital by entering into judicial recovery processes. The development of transactions aimed at acquiring companies or assets of companies in financial difficulties have become more feasible with the amendment to the Federal Law n. 11.101, 2005 (**Law n. 11,101**, the "Brazilian Bankruptcy Law").

The Brazilian judicial recovery regime was introduced by Federal Law n. 11.101, 2005, and modelled after the U.S. bankruptcy code's Chapter 11. It established a pre-bankruptcy restructuring process designed to recover companies by filing a judicial recovery plan, which is further submitted to creditor's approval and to judge homologation. The introduction of the judicial recovery proceeding in Brazilian legislation represents a true alternative for ailing companies.

Merger and acquisitions involving companies under a judicial recovery procedure are common, as the sale of equity or participation are ways to generate value for the creditor's payment or to reduce business costs. In addition, corporate reorganisations are also allowed to either implement more effective (and sometimes less costly) structures, as well as to prepare the group under judicial recovery for a sale or another transaction.

Brazilian law provides for two types of reorganisation: in-court and out-of-court.

The first takes place before a judicial court and the latter is entered in an out-of-court procedure and is further approved by the court. The key difference is that in a judicial reorganisation the credits are usually declared frozen during a stay-period and also involves labor, secured and unsecured credits, while the out-of-court reorganisation does not comprehend labor credits, nor are the credits deemed frozen towards the company (**debtor**). Neither of them comprehend tax credits.

Loeser e Portela Advogados (Brazil)

Corporate Reorganisations Involving Companies under Judicial Recovery

PricewaterhouseCoopers Tax & Legal, Sarl (Cameroon)

Treatment of convertible bonds issued by public limited companies in the OHADA zone

While protected against enforcement and other actions during the stay-period, the debtor, which continues with the management of the company, is entitled to submit, negotiate and provide a plan of reorganisation to be approved by its creditors, to which it may re-profile its debt and/or equity structure.

In this context, the Law n. 11,101 also regulates DIP financing (credits extended during the judicial reorganisation have high-priority rights) and the possibility of third-party investors purchasing branches or isolated productive units (**IPU's**) free of any liens and liability, including without limitation tax and labor.

From the buyer's standpoint, the attractiveness of the transaction is related to the fact that the law allows the transfer of an IPU, or specific assets, without the burden of succession, including tax and labor liabilities.

In accordance with the Law n. 11,101, the purpose of the reorganisation must take into consideration the following factors (among others):

a the recovery of the company from its economic and financial crisis;

b the interests of the creditors;

c continuance of the company.

Reorganisation proceedings must also enable debtors and creditors to discuss the future of the company's activities.

The assets of a company in judicial recovery can be sold in different ways, but depending on the nature of the asset, the sale needs court approval. In order to avoid any risk of interpretation regarding succession, many transactions are structured under an open bid process. Such alternative with the creation of an IPU is well accepted by courts as a form of sale which the buyer does not succeed the liabilities of the distressed company.

The Law n. 11,101 is an effective instrument for companies under distress to overcome their financial crises as the law provides mechanisms that allows creditors to establish an open dialog with the judge and the debtor, as well as enable the debtor to implement reorganisations and transactions with third parties without the risk of succession.

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PricewaterhouseCoopers Tax & Legal, Sarl (Cameroon) – Treatment of convertible bonds issued by public limited companies in the OHADA zone

At a glance

Bonds convertible into shares were introduced in the Organisation for the Harmonization of Business Law in Africa (**OHADA**) zone on 30 January 2014 when the provisions of the OHADA Uniform Act relating to Commercial Companies and Economic Interest Groups (**the Uniform Act**) regarding hybrid securities were revised. The revised Uniform Act outlines the legal framework applicable to hybrid securities. This new form of investment in the share capital of a company offers certain advantages for both the issuing company and investors.

In detail

Bonds are negotiable instruments issued by commercial companies or public bodies to lenders of capital and whose par value on issue corresponds with a fraction of the total amount of the loan. They can be in registered or bearer form. Convertible bonds are bonds that may, if the holder so wishes, be converted into shares of the company that issued them either during a given period (ordinary convertible bonds), or at any time, during a period corresponding to the life of the bond.

These bonds are hybrid instruments that:

a represent a liability, to the extent that the holder can be reimbursed at maturity; and

b correspond to a deferred share issue, to the extent that the subscriber can exercise a conversion right.

Bonds convertible into shares were introduced in the OHADA zone on 30 January 2014 when the provisions of the Uniform Act regarding hybrid securities were revised.

Article 822 of the Uniform Act provides:
"Public limited companies can issue securities that give access to the share capital or confer rights to the allocation of debt instruments."

The revised Uniform Act outlines the legal framework applicable to hybrid securities. This new form of investment in the share capital of a company offers certain advantages for both the issuing company and investors.

Formalities and procedures for issuing convertible bonds

Companies in the OHADA zone that wish to issue convertible bonds must comply with certain conditions and follow a special procedure.

General conditions for issuing bonds

The general conditions governing bond issues are set out in Articles 780 et seq. of the Uniform Act. According to Article 781-1 of the Uniform Act, any bonds issued in breach of these conditions shall be null and void.

Consequently, it should be noted that:

a the issue of bonds shall only be allowed for public limited companies and economic interest groups made up of public limited companies, which have existed for two (2) years and have drawn up two balance sheets duly approved by the shareholders;

b the issue of bonds shall be forbidden for companies whose capital is not fully paid up; and

c the issue of lottery bonds shall be forbidden.

According to Vocabulaire Juridique (Gérard Cornu), lottery bonds are bonds that, when drawn at random, entitle their holders to prizes of varying amounts.

Context for issuing convertible bonds

Equity financing is a means of financing without the involvement of the usual intermediaries, such as credit institutions. It is a way for companies to borrow over the long term, by issuing bonds for example. Public limited companies can issue bonds that entitle their holders to request the conversion of their bonds into shares, under conditions and at times set at the time of issue, provided the conditions imposed for the issue of ordinary bonds are met.

A bond represents a liability, which is repayable at a date and at an amount set in advance, on which interest accrues. It can be issued to the public (in the event of a public offering) or privately, to a limited number of investors (for equity financing purposes for example).

Holding of an extraordinary general Meeting

Article 822-5 of the Uniform Act provides that:
"Issues of securities giving access to the capital or the right to the allocation of debt securities governed by this Section are authorised by the extraordinary general meeting of the shareholders in compliance with Articles 562 to 572 and 588 to 618 above. Any decisions made in violation of this provision shall be null and void (...)."

According to this Article, issues of convertible bonds are decided by the extraordinary general meeting. In addition, where convertible bonds are issued between companies of the same group, the issue must, under pain of invalidity, be authorised by the extraordinary general meetings of the company issuing the transferable securities and the company within which the rights are exercised.

The extraordinary general meeting must make a decision, based on the Board of Directors' report and the auditor's special report on the bond issue. It may delegate to the Board of Directors or the managing director, as appropriate, the necessary powers to issue bonds in one or more instalments within a period of two (2) years and to lay down the conditions thereof.

Reports of the Board of Directors and the auditor to the extraordinary general meeting

The general meeting must issue an opinion on the report of the Board of Directors or managing director, as appropriate, and on the auditor's special report. Pursuant to Article 822-5, paragraph 3 of the Uniform Act:
"The reports present the characteristics of the transferable securities giving the right to the allocation of debt securities or giving access to the capital, the terms and conditions for allocating the debt or equity securities to which these securities confer the right, as well as the dates on which the allocation rights can be exercised. In the event of an issue of transferable securities conferring rights to the allocation of debt instruments or comprising debt instruments alone, the auditor's report will focus on the company's debt position but will exclude the choice of components used to calculate the issue price (....)".

The auditor's special report has specific content which is linked to the special nature of the convertible bond issue procedure. In the report, the auditor forms an opinion on the:

a proposed issue;

b items included in calculating the issue price;

c characteristics of the convertible bonds;

d conditions for the allocation of shares;

e dates on which the allocation rights may be exercised proposed issue; and f company's debt position (which warranted the bond issue).

Any decisions made in the absence of the Board of Directors' or managing directors' report, as appropriate, and of the auditor's report provided for in Article 822-5 of the Uniform Act, shall be null and void. The decisions can also be cancelled in the event that the report does not contain all of the information required by law.

The key role of the issue agreement

The issue agreement plays a key role in the convertible bond issue process. The conditions applicable to the convertible bonds are generally defined in such an agreement. In principle, the agreement must be approved by the extraordinary General meeting called to make a decision on the convertible bond issue.

It is an agreement between the company and the subscriber(s) of the convertible bonds, which provides for:

a the issue and subscription terms and conditions (number of convertible bonds issued, subscription price per bond, the bond subscription period, the conditions for paying the subscription price);

b the characteristics of the bond issue (issue price and face value, interest and term, guarantees attached to the bonds); and

c the conditions for converting the bonds into shares, etc.

Consequences of convertible bond issues

Obligations of the issuing company

In relation to the convertible bond issue, the company issuing the securities is required to comply with the obligations listed in Articles 822-7 *et seq.* of the Uniform Act:

a it cannot change its form or purpose unless authorised to do so in the issue agreement or based on the conditions outlined in the Uniform Act to issue the securities;

b it cannot change its profit sharing rules or redeem its capital;

c it cannot create preferred shares entailing a modification to the share capital allocation rules or the redemption of the capital;

d it cannot issue shares reserved for certain persons, unless authorised to so by the general meeting of the holders of the transferable securities;

e it cannot change its profit sharing rules or redeem its capital; and

f it must take the necessary measures to protect the interests of the holders of such rights.

Rights of shareholders

Shareholders of the company that issues the hybrid securities have pre-emptive subscription rights to the securities proportionate to the amount of their shares. This right is governed by Articles 573 to 587-2 and 593 to 597 of the Uniform Act.

The authorisation to issue convertible bonds entails the waiver by the shareholders of their pre-emptive Subscription rights to the shares to be issued on the conversion of the bonds in favour of the bondholders.

The adoption of paperless securities systems requires the involvement of a number of parties, which must be carefully managed.

The rights of holders of convertible Bonds

In the event of a merger, takeover or demerger of the company that issues the securities, the owners of the convertible bonds may exercise their rights in the company or companies that benefited from the contribution of assets.

Unless otherwise provided in the issue agreement, and except in cases of early winding up not resulting from a merger or demerger, the issuing company cannot impose that the rights of holders of securities giving access to its capital be redeemed or repaid. Any decision to the contrary shall be deemed null and void.

The issuing company is required by law to provide the owners of convertible bonds with access to corporate documentation; the issuing company can either send the documents to the bondholders or make them available to them by some other means.

Converting convertible bonds

The Uniform Act does not provide precise terms and conditions for converting bonds giving access to the Share capital. However, they must be converted according to the conditions and the conversion bases set in the bond issue agreement entered into between the issuing company and the bondholders. This agreement can indicate that the bonds will be converted either during a given option period(s), or at any time.

Where a holder of securities giving access to the capital is not entitled to a whole number of shares, fractional shares will be paid in cash in accordance with Article 822-17 of the Uniform Act. The payment is equal to the fraction of the share multiplied by the value of the share.

A capital increase is completed when the bondholders exercise their rights (to convert their bonds) and when subscriptions to the shares are paid up, where appropriate. Capital increases that result from conversions of bonds are not subject to the publication formalities provided for in the Uniform Act.

The advantages of issuing convertible bonds

First, a company that issues convertible bonds no longer needs to take out a loan with a credit institution. It is an alternative method of financing. However, interest may be payable when the bonds are redeemed.

Second, if the bonds are converted, the issuing company's debt towards the subscriber(s) who choose to convert their bonds may be reduced. The conversion of the bonds remains uncertain, however, as it depends on the fulfilment of the conditions set in the issue agreement.

Another advantage of convertible bonds is that the investor (obligee) has time to determine whether the conditions have been met to acquire an interest in the capital of the company issuing the bonds.

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