REGULATORY FRAMEWORK FOR BUSINESS TRANSACTIONS (RFBT)

CPALE Concept Notes

FINANCIAL REHABILITATION AND INSOLVENCY ACT (FRIA)

Source: REO Live (Atty. Kris), ReSA Lecture (Atty. Nicko), CPAR Lecture (Atty. Kid)

Topics Covered:

Preliminaries and Distinctions

Nature of FRIA Proceedings

- In Rem (*Binds the Whole World – Cram Down Effect*)
- Summary (*Speedy and Efficient*)
- Jurisdiction is acquired upon publication
- Non-adversarial (*No Adverse Parties – Not A vs. B*)

DEBTORS

- Natural Persons who are PH *resident and citizen* ***(Individuals)***
- Juridical Persons ***(Business Organizations)***
    - Sole Proprietorship registered with DTI *(separate from its owner)*
    - Partnership registered with SEC
    - Corporations registered with SEC

Group of Debtors
No need of separate filing
May file even if only one is insolvent, as long as the others are also affected

- Single proprietorships owned by **the same** individual
- Partnerships of which more than 50% are owned by **the same** person
- Financially related corporations *(parents, subsidiary, affiliates)*

Excluded Debtors
Those with governing special law:

- Banks and quasi-banks
- Pre-need and insurance companies
- Government agencies or units

CONCEPT OF INSOLVENCY

a. *Actual Insolvency*
- Liabilities are greater than the assets *(A<L)*

b. *Technical Insolvency*
- Liabilities are not greater than the assets *(A>L)*
- But unable to pay liabilities as they fall due

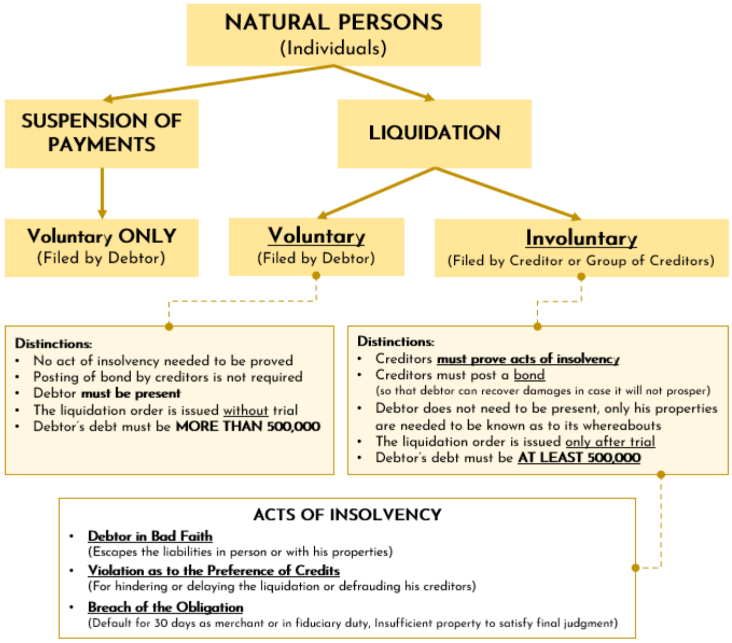
Summary of Distinction for FRIA Proceedings

	Rehabilitation	Suspension of Payment	Liquidation
Applicable Debtors	Juridical Persons only	Natural Persons only	Both Natural and Juridical Persons
Required Insolvency	Actual or Technical Insolvency	Technical Insolvency	Actual Insolvency
Voluntariness of Filing	Voluntary or Involuntary	Voluntary (Debtor) only	Voluntary or Involuntary
Who Files in Involuntary Filing?	At least *1 creditor*, where no payments were made for at least *60 days* of due and demandable debts	N/A	*As to Juridical Persons:* *3 or more creditors*, where no payments were made for at least ***180 days*** of due and demandable debts.
Possible Effect to Amount of Liability	✓	✕ *(No Effect)*	✓

Summary of Proceedings Applicable for Debtors

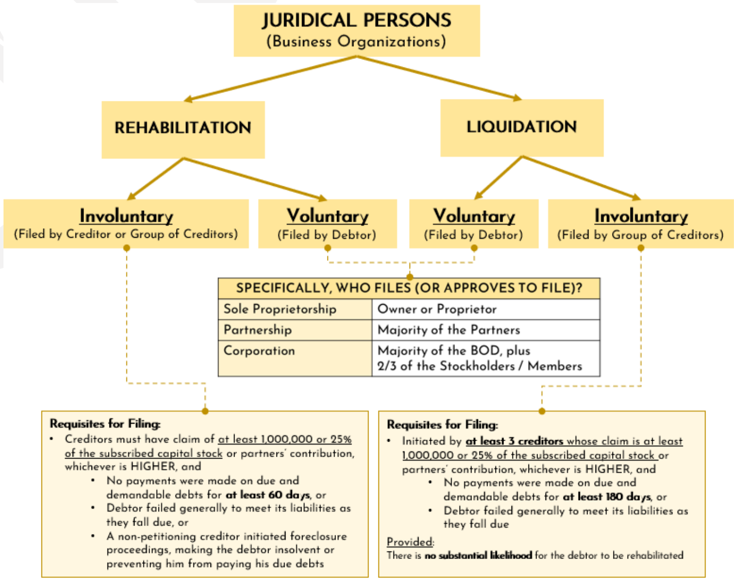
For Natural Persons:

- *Suspension of Payments and Liquidation only*



For Juridical Persons:

- *Rehabilitation and Liquidation only*



Rehabilitation

Available only to juridical persons (business organizations) who are ***either actually or technically insolvent***

Three Types of Rehabilitation

- Court-Supervised (rehabilitation in general)
- Pre-Negotiated
- Out-of-Court

Summary of Distinction as to Different Rehabilitation Types

	Court-Supervised	Pre-Negotiated	Out-of-Court
Court Involvement	- Filing - Approval of Rehab Plan - Confirmation of Rehab Plan - Implementation of Rehab Plan	- Confirmation of Rehab Plan - Implementation of Rehab Plan	No involvement

	Court-Supervised	Pre-Negotiated	Out-of-Court
Requirements for the Approval of Rehabilitation Plan	By the Creditors with ***More Than 50% of the Total Claims and*** the Court; or By the ***Court Alone*** in certain circumstances	By the ***Creditors***: *(Must meet all)* Total Claims: ≥ 2/3 Secured Credits: More Than 50% Unsecured Credits: More Than 50%	By the ***Creditors***: *(Must meet all)* Total Claims: ≥ 85% Secured Credits: ≥ 67% Unsecured Credits: ≥ 75%
Temporary Restriction as to Enforcement of the Claims	Stay Order	Stay Order *(Suspension Order)*	Standstill Period
Issuance and/or Effectivity of Order or Period	*Issued*: Within ***5 working days*** from Filing of Petition *Effectivity*: For the ***Entire Duration of the Rehabilitation Proceeding*** *(unless lifted)*	*Issued*: Within ***5 working days*** from Filing of Petition	*Effectivity*: For a ***Maximum of 120 days***
Period for Creditors' Objections	Within ***20 days from Receipt of Notice from the Court*** that a Rehabilitation Plan was submitted	Not later than ***8 days from the Second Publication*** of the Order	N/A
*Period for Approval or Confirmation of Rehabilitation Plan **by the Court***	*Confirmation*: Within ***1 year*** from the Filing of Petition ***Inaction***: Converted into Liquidation	*Approval*: Maximum of ***120 days*** from Filing the Petition ***Inaction***: Deemed Approved	N/A
Cram Down Effect	✓	✓	✓

COURT-SUPERVISED REHABILITATION

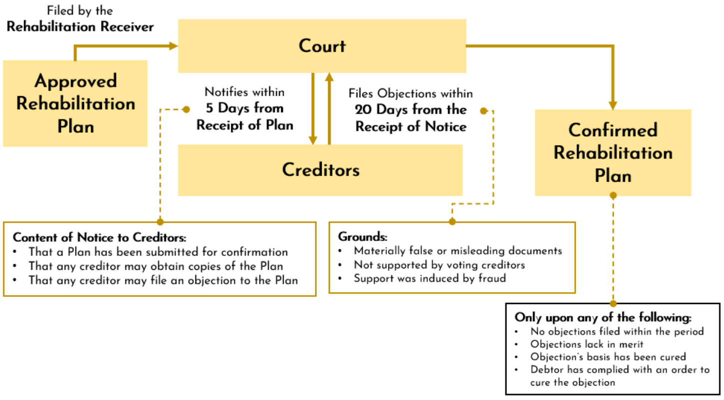
Step 1: File a Petition

- Voluntary or Involuntary
- **Indispensable Attachments to the Petition:**
  1. *Rehabilitation Plan*
     - The output plan of rehabilitation wherein the financial well-being and viability of an insolvent debtor can be restored using various means, as may be approved by the court or creditors
  2. *Inventory of Assets*
  3. *Three Nominees as Rehabilitation Receiver*

Approval of a Rehabilitation Plan
Either of the following:

- By the creditors with *more than 50%* of the total claims **AND** the court's confirmation, or
- By the *Court alone*, notwithstanding creditors' objections, in the following cases:
  - *The Plan **complies with FRIA requirements***
  - *The **Rehabilitation Receiver recommends** the confirmation of the Plan*
  - *The Juridical Debtor's Shareholders, Owners, or Partners **lose at least their controlling interest** as a result of the Plan*
  - *The Plan would likely provide the objecting creditors a **compensation with greater NPV than that of liquidation***

Rehabilitation Plan Submission, Objection, and Confirmation



I. Upon approval, the *Rehabilitation Receiver will submit the Plan to the court* for confirmation

II. Within **5 days from receipt of the Plan**, the *court will notify the creditors* as to:
   - The submission of such Plan
   - That they may obtain copies, and
   - That they may file an objection thereto

III. Within **20 days from the receipt of notice** from the court, the creditors may *file an objection* on the following grounds:
   - ***Materially false*** or misleading documents/data relied upon
   - The plan is ***not supported*** by the voting creditors
   - Creditors' ***support was induced by fraud***

- Notwithstanding any unresolved disputes over claims and if the Plan has made adequate provisions for paying such claims, the *court shall issue an order confirming the Rehabilitation Plan* upon the following instances:
  - ***No objections*** *are filed within the relevant period*
  - *Objections files are **lacking in merit***
  - *The basis for the objection has been **cured***
  - *The debtor has **complied with an order** to cure the objection*

Who Manages the Business of the Debtor?
General Rule: The Existing Board or Management
XPN:
Rehabilitation Receiver or Management Committee was appointed

REHABILITATION RECEIVER

- Appointed at the *discretion of the Court* *(may also not appoint one)*
- May be other than the nominees in the attached plan
- May be a natural or a juridical person, provided that the juridical person designates a natural person as its representative

Qualifications

- *Citizen or Resident* (6 months prior) of the Philippines
- **Knowledge** as to insolvency and commercial laws
- *No conflict of interest* (including even only apparent)

Grounds for Appointment of a Rehabilitation Receiver
Also applies to Management Committee for managing debtor's business if not its existing management or board

- *Gross mismanagement*, fraud, or other wrongful conduct to the debtor's business by the existing management
- Actual or imminent *danger or loss of assets*
- *Paralyzation* of debtor's business operation

Principal Duties of a Rehabilitation Receiver

- ***Preserve the value*** of the debtor's assets during the proceedings
- Determine the ***viability of the rehabilitation***
  Rehabilitation is viable if:
  - *Can bring the debtor to a state of solvency, and*
  - *Collections by the creditors under rehabilitation would be higher than compared to that under liquidation*
- ***Prepare and recommend*** a Rehabilitation Plan to the court
- ***Implement*** the approved Rehabilitation Plan

- ***Creditors' Committee*** – if existent, serves as the *primary liaison between the rehabilitation receiver and the creditors*

Step 2: Issuance of a Commencement and Stay Order

- A Commencement Order is ***always issued together with a Stay Order***
- Issued within *5 working days upon receipt of the petition*

Restrictions Imposed:

As to the Debtors

- **Disposing** its properties (*XPN: Those in the ordinary course of business)*
- Making any **payment** of its liabilities, except if provided for by law

As to Creditors
*Covers both secured and unsecured creditors, but **secured creditors retain their preference over the credits***

- **Enforcement of claims** against the debtor
- Enforcement of any **judgment, attachment**, or other provisional remedies against the debtor

- *Prior to Commencement Date, any transaction entered into by debtor or involving its funds or assets <u>may be rescinded or declared null and void</u> on the ground that it was executed with **intent to defraud creditor/s** or which **constitutes undue preference of creditors.***

Disputable Presumption of Transactions Entered Into with the Intent to Defraud Creditor/s or Constitutes Undue Preference

- *<u>Accelerated payment of a creditor's claim</u> within 90 days prior to the commencement date*
- *<u>Providing security or additional security</u> to a creditor's claim within 90 days prior to the commencement date*
- *A creditor obtained or <u>received benefit which is more than its pro-rata share in the debtor's assets</u>, **executed at a time when the debtor was insolvent***

Upon the issuance of a commencement order,

- *Rehabilitation Receiver is appointed*
- *<u>Taxes and fees</u> are due to the government are **waived** until the approval of the rehabilitation plan or dismissal of the petition* ***(However, administrative expenses are NOT suspended)***
- *<u>BIR</u> is required to file and serve on the debtor its <u>comment or opposition to the petition</u> or its claims against the debtor*
- *Debtor's suppliers are prohibited from withholding the supply of goods and services in the ordinary course of business as long as the debtor makes payments for such*

***Exceptions to the Stay Order** (Not Covered):*

- Those already pending to the <u>*Supreme Court*</u>
- Those already filed or pending at a <u>*Specialized Court or Quasi-Judicial Agency*</u>
- ***Criminal action*** against the debtor
- ***Clearing*** and settlement of financial transactions by a clearing agency or similar entities
- <u>*Licensed Broker or Dealer's*</u> foreclosure of pledged securities
- <u>*Securities Market Participant's clients or customers*</u> as to recover securities entrusted to it within its ordinary course of business *(acting at a fiduciary capacity)*
- Enforcement of claims ***against sureties*** and other persons solidarily liable with the debtor, a third party or ***accommodation mortgagors*** unless the property is necessary for the proceedings, and ***issuers of letters of credit***
  (Other persons can be held liable for the same transaction)

<u>***Step 3: Court Action***</u>

- **Give Due Course**
  Cram Down Effect *– <u>everyone will be bound</u>,* whether participated or not, respective claims were scheduled or not, opposed or agreed

  <u>*Requisites:*</u>
  - Debtor is ***insolvent*** *(if not, denied), and*
  - Substantial ***likelihood of successful rehabilitation*** *(if not, converted)*

- **Deny or Dismiss the Petition**
  If <u>any</u> of the following is present:
  - Debtor is ***not insolvent***
  - Debtor committed acts of misrepresentation ***in fraud of creditors***
  - ***Sham filing***, only to delay enforcement of creditors' rights
  - ***Materially false*** or misleading statements in the petition, plan, and/or attachments

- **Convert to Liquidation**
  In <u>any</u> of the following instances:
  - ***No substantial likelihood*** of successful rehabilitation
  - No confirmed plan ***within 1 year*** from filing

PRE-NEGOTIATED REHABILITATION

- Filed by the debtor alone or with the creditors
- Cram down effect also applies

Approval of the Rehabilitation Plan
Must first be approved by:

The creditors holding or representing (***ALL must be met***):
- *At least 2/3 of the total claims*
- *More than 50% of the total secured claims*
- *More than 50% of the total unsecured claims*

- If <u>*without objection*</u>, approved by the court within ***10 days from the date of the second publication***
- *Period for Approval by the Court:*
  Maximum of 120 days *from the date of filing the petition*

Issuance of an Order by the Court
Within <u>5 working days from filing</u>

What's in the Order?
- <u>*Identifies the debtor*</u>, including its principal activity and place of business
- Declares the debtor as under rehabilitation
- Summarizes the grounds for filing the petition
- Directs the <u>*publication of the order*</u> in a newspaper of general circulation in Philippines ***once a week for at least 2 consecutive weeks***
  - The <u>*first publication*</u> must be made within **7 days from the time of its issuance**
- Directs the <u>*personal delivery of a petition copy within 3 days*</u> to each non-petitioning creditors ***holding at least 10% of the total liabilities***
- States that the copies of the petition and the Plan is available for examination and copying by interested party
- States that <u>*objections or comments may be filed*</u> within 20 days *(conflict, as in practice and succeeding provisions, **8 days**)* ***from the second publication***
- <u>*Appoints a rehabilitation receiver*</u> if provided in the Plan
- Includes a suspension or stay order

<u>*Grounds for an Objection*</u>
Must be submitted ***within 8 days from the second publication***
- Allegations are <u>*materially false or misleading*</u>
- Majority of creditors <u>*do not in fact support the Plan*</u>
- Creditors' <u>*support was induced by fraud*</u>
- Plan fails to accurately account for a claim, and the claim is not categorically declared as a contested claim ***(will only result to correction)***

<u>*Hearing on Objections*</u>
Within ***20 to 30 days from the second publication***

Court Actions
- Direct the debtor to cure the defect, <u>*if feasible*</u>
- ***Convert*** into liquidation, if:
  - ***Supporting*** debtors or creditors acted <u>*in bad faith*</u>, **or**
  - Objection is <u>*non-curable*</u>
- ***Approve*** the Rehabilitation Plan, if
  - Objection has <u>*no substantial merit*</u>, **or**
  - Objection has been <u>*cured*</u>

OUT-OF-COURT REHABILITATION

- No court involvement, thus is <u>*only approved by the debtor and creditors*</u>
- Cram down effect also applies *(same legal effect)*

Approval of the Rehabilitation Plan
By the creditors holding or representing (***ALL must be met***):
- *At least 85% of the total liabilities*
- *At least 67% of the total secured obligations*
- *At least 75% of the total unsecured obligations*

Publication Requirement and Effectivity of Approved Plan
- <u>*Notice of the Plan*</u> shall be published in a newspaper of general circulation in the Philippines ***once a week for at least three consecutive weeks***
- *Effectivity of Approved Plan:*
  *Upon the **lapse of 15 days** from the **Last** Publication of the Notice*

Standstill Period or Agreement

- Agreed upon by the parties, which shall be ***effective*** against all creditors for ***a maximum of 120 days***, if:
  - *Approved by the creditors representing more than 50% of the total liabilities,* ***and***
  - *A notice thereof is published in a newspaper of general circulation in the Philippines* ***once a week for two consecutive weeks***
    - *Must invite creditors to participate in the negotiation and notify them that it will be binding to all creditors if required majority votes are met*

Suspension of Payments

- Applies only to *natural persons (individuals)* who are ***technically insolvent*** *(not actual)*

FEATURES:

- No actual insolvency, but is *technically insolvent*
- Purpose is *to delay or suspend the payment* of debts
- ***Amount*** of liability is **not affected** *(not reduced nor discharged)*
- *Secured debtors* are ***not affected***
- The number of creditors is immaterial

Step 1: File a Petition

- ***Always voluntary*** *(made by the debtor)*
- Filed in the court of the province or city in which he has resided for 6 months prior to filing his petition
- Minimum Required Attachments to the Petition
  - Inventory of Assets
  - Schedule of Liabilities
  - Proposed Agreement with Creditors

Step 2: Issuance of a Suspension Order

- Within ***5 working days upon receipt*** of the petition or motion filed by the individual debtor
- Effective for *3 months*

Effect of Suspension Order *(The same with a Stay Order)*

- Debtors are prohibited from
  - **Disposing** his properties
    (XPN: Those in the ordinary course of business)
  - Making any **payment** of its liabilities
    (XPN: Those necessary or legitimate expenses of his business/ industry)
- No creditor shall ***enforce their claims***

XPNs:

- Secured Creditors
- Creditors having claims incurred wi***thin 60 days prior to filing of petition***, *specifically* for any of the following:
  - Personal labor
  - Maintenance
  - Expense of last illness and funeral of the debtor's wife or children

Step 3: Call for Creditors' Meeting (Approval or Disapproval)

For Quorum:

- *Creditors representing at least 3/5 of total liabilities*

For Approval:

- *2/3 of the Voting Creditors (by headcount),* ***and***
- *At least 3/5 of total liabilities (by amount)*

Non-Participating Creditors

- Creditors not affected by the suspension order
  (Secured creditors and those specifically within 60 days)
  - If joined, they shall be *bound in the same manner as are other creditors*
- Creditors whose claim is incurred within 90 days prior to filing the petition *(any claim)*
  - Not entitled to vote

If Disapproved:

- Proceedings shall be *terminated*
- Creditors shall be at liberty to enforce their rights

Liquidation

- Available to *both natural (individuals) and juridical persons (business organizations)*, but only to those who are ***actually insolvent*** *(excludes technical insolvency)*

Step 1: File a Petition

May be voluntary or involuntary
Not needed if such is converted from rehabilitation

Conversion from Rehabilitation to Liquidation

- Insolvent, *but no substantial likelihood* of successful rehabilitation
- *No confirmed rehabilitation* plan within 1 year from filing of petition
- Failure of rehabilitation or dismissal of petition on *technical grounds*
- *Upon the rehabilitation receiver's recommendation that the rehabilitation is not feasible*
- Upon *debtor's verified motion (filing for liquidation)* during the pendency of a rehabilitation proceeding *(except out-of-court)*

Step 2: Issuance of Liquidation Order

- Within **5 working days** from receipt of petition

What's in a Liquidation Order?

- Declares the *natural person as* ***insolvent***, or the *juridical person as* ***dissolved***
- Order the liquidation of debtor and for the sheriff to take possession and control of all the debtor's properties, except those that may be exempt from execution
- Orders the *publication of the petition* in a newspaper of general circulation ***once a week for two consecutive weeks***
- Directs payment of any claims and conveyance of any property due to the liquidator
- Prohibits payments and property transfers by the debtor ***(only the liquidator should do so)***
- Directs all creditors to file their claims with the liquidator within the period set
- Authorizes the *payment of due administrative expenses*
- States that the non-petitioning debtor and creditors may submit the names of other nominees as liquidator
- Sets the case for ***hearing for the election and appointment of the liquidator***
  - Must be *within 30-45 days* from the ***last*** publication

Coverage of the Order

- **Debtors** *(can't dispose properties or make payments)*
- **Unsecured Creditors** *(can't enforce, must find their claims to the liquidator)*
- **Secured Creditors** *(at his option)*
  - *Waives Lien or Claim* – shares with unsecured creditors as to the debtor's assets
  - *Maintains Lien or Claim* – covered not by the liquidation order, but by a **temporary stay order** valid for a **maximum of 180 days**
    - *If there is* ***deficiency*** *– shares with unsecured creditors as to the balance*
    - *If there is* ***excess*** *– must be paid to the liquidator*

LIQUIDATOR

- Appointed by the creditors *(preferred)* who filed their claim or of the court
- Same qualifications as to that of a rehabilitation receiver
- May also be the same as the rehabilitation receiver prior to the liquidation
- May be removed at any time by the court for a cause (motu proprio or upon a voting creditor's motion)
- Submits the liquidation plan *within 3 months from his assumption into office to the court*, with the following minimum contents:
  - Inventory of Assets
  - Schedule of Liquidation of the Assets
  - Payment of the Claims

- May sell the debtor's unencumbered assets and convert such into money

  General Rule: Sale shall be made at **public auction**

  XPNs *(Private Sale is allowed)*:

  - Goods to be sold are ***perishable***, liable to ***quickly deteriorate*** in value, or are ***disproportionately expensive to keep*** or maintain
  - Private sale is *for the best interest* of the debtor and creditors

Election of a Liquidator

Elected by the voting creditors in ***open court*** *who had the highest number of votes as to the* ***amount of claims***

Voting Creditors:

- Those who have filed their claims within the period set by the court and not barred by the statute of limitations *(not prescribed)*
- Secured creditors ***only if***
  - He *waives* his lien or security, **or**
  - Security's value is *deficient to his claim*, and admitted as to the remaining balance of his claim

May also be ***appointed by the court*** *in any of the following instances:*

- Creditors did not attend on the set election date
- Attending creditors failed or refused to elect a liquidator
- After elected, the liquidator fails to qualify
- A vacancy occurs *(court sets another election instead)*

Step 3: Court Action of Approved Liquidation Plan

- Upon determining that liquidation has completed, the court issues an order approving the report and ***ordering the SEC to remove the debtor from the registry of legal entities*** *(as to partnerships and corporations)*
- Only *upon receipt of evidence* showing that ***debtor has been removed from the SEC's registry of legal entities***, the court *issues an order terminating the proceedings*