

CLIENT ADVISORY BULLETIN NO. 2020-004-A (Corporate Rehabilitation and Liquidation)

May 26, 2020

Gentlemen/Mesdames,

The COVID-19 outbreak, and the resulting Enhanced Community Quarantine (ECQ), which has now been modified, until May 31, 2020, has caused a considerable strain on the economy and to business owners. Most businesses have had no income during the ECQ, but still continue to incur operational expenses. The *Bayanihan To Heal As One Act*¹ and other government issuances have provided for a temporary reprieve on commercial obligations, but this may not be enough for business owners as they still face the reality of having to meet these obligations post-ECQ.

Fortunately, with the enactment of the *Financial Rehabilitation and Insolvency Act (FRIA)*², a corporate business owner that is unable to pay its liabilities as they fall due in the ordinary course of business or has liabilities greater than its assets, may undergo either **rehabilitation** or **liquidation**. The Supreme Court has held that these reliefs “ensure or maintain certainty and predictability in commercial affairs, preserve and maximize the value of the assets of these debtors, recognize creditor rights and respect priority of claims, and ensure equitable treatment of creditors who are similarly situated³”.

In this Client Advisory Bulletin, we dwell deeper into the provisions of FRIA pertaining to corporate business owners that are facing insolvency, i.e., inability to pay its liabilities as they fall due in the ordinary course of business, or has liabilities greater than its assets. Should you wish to know about how the FRIA helps individual business owners, please refer to our *Client Advisory Bulletin 2020-004*.

Rehabilitation

Rehabilitation proceedings under FRIA, may either be any of the following: (a) **court-supervised**, where either the debtor or creditor files a verified petition in court, (b) **pre-negotiated**, where a rehabilitation endorsed by creditors is submitted to court for approval, or (c) **out-of-court restructuring agreements**, where the debtor and creditors agree to implement a rehabilitation plan without need for court approval.

¹ Republic Act No. 11469.

² Republic Act No. 10142.

³ *Viva Shipping Lines vs. Keppel Philippines Mining, Inc., et al.*, G.R. No. 177382, February 17, 2016.

a. Court-Supervised

In court-supervised rehabilitation, the proceedings are initiated by the filing of a verified Petition, accompanied by a Rehabilitation Plan.

If initiated by the corporate-debtor (*voluntary rehabilitation*), it must be accompanied by a majority vote of the board of directors and authorized by the vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock.⁴ If initiated by the creditor/s (*involuntary rehabilitation*), the aggregate amount of the claim must be at least One Million Pesos (₱1,000,000.00) or at least twenty-five percent (25%) of the subscribed capital stock, whichever is higher.⁵

If the court finds the Petition sufficient in form and substance, it will issue a **Commencement Order**, which shall signify the commencement of rehabilitation proceedings and shall include a **Stay or Suspension Order**, where, among others, all actions or proceedings for the enforcement of claims, judgment, attachment or other provisional remedies against the debtor are suspended.⁶ The Commencement Order shall also result in the waiver of taxes and fees due to the national government and the local government units⁷ and be effective for the duration of the rehabilitation proceedings for as long as there is a substantial likelihood that the debtor will be successfully rehabilitated.⁸

At the initial hearing, the Rehabilitation Receiver is appointed⁹ and will be directed to prepare its report on its findings and recommendation¹⁰ on the Petition. If the court gives due course to the Petition, upon a finding that the debtor is insolvent and there is substantial likelihood for the debtor to be successfully rehabilitated¹¹, the Rehabilitation Receiver will then be required to submit a Rehabilitation Plan¹², which must be confirmed by the court¹³, and upon successful implementation, result in the termination of the rehabilitation proceedings¹⁴.

⁴ Section 12 of FRIA Law.

⁵ Section 13 of FRIA Law.

⁶ Section 16 of FRIA Law.

⁷ Section 19 of FRIA Law.

⁸ Section 21 of FRIA Law.

⁹ Section 22 of FRIA Law.

¹⁰ Section 24 of FRIA Law.

¹¹ Section 25 of FRIA Law.

¹² Section 26 of FRIA Law.

¹³ Sections 68 and 69 of FRIA Law.

¹⁴ Section 74 of FRIA Law.

b. Pre-Negotiated Rehabilitation

The insolvent debtor, by itself or jointly with any of its creditors, may also choose to file a verified Petition with the court for the approval of a pre-negotiated Rehabilitation Plan, which has been endorsed or approved by creditors holding at least two-thirds (2/3) of the total liabilities of the debtor, including secured creditors holding more than fifty percent (50%) of the total secured claims of the debtor and unsecured creditors holding more than fifty percent (50%) of the total unsecured claims of the debtor.¹⁵ The approval of the pre-negotiated Rehabilitation Plan will have the same effect as a confirmed Rehabilitation Plan in a court-supervised rehabilitation.¹⁶

c. Out-of-Court Restructuring Agreements (OCRA)

If, however, the insolvent corporate debtor and its creditors chooses to do away with court processes, the law allows for an out-of-court or informal restructuring agreements or Rehabilitation Plan¹⁷ to be entered into, provided it meets the following requirements:

- (a) The debtor must agree to the out-of-court or informal restructuring agreement or Rehabilitation Plan;
- (b) It must be approved by creditors representing at least sixty-seven percent (67%) of the secured obligations of the debtor;
- (c) It must be approved by creditors representing at least seventy-five percent (75%) of the unsecured obligations of the debtor; and
- (d) It must be approved by creditors holding at least eighty-five percent (85%) of the total liabilities, secured and unsecured, of the debtor.¹⁸

Pending negotiation and finalization of the out-of-court or informal restructuring agreement or Rehabilitation Plan, a **standstill period** may be agreed upon by the parties, which shall be effective and enforceable not only against the contracting parties but also against the other creditors, so long as: (a) such agreement is approved by creditors representing more than fifty percent (50%) of the total liabilities of the debtor; (b) notice thereof is published in a newspaper of general circulation once a week for two (2) consecutive weeks; and (c) the standstill period does not exceed one hundred twenty (120) days from the date of effectivity.¹⁹

An approved restructuring agreement or Rehabilitation Plan shall have the same legal effect as a confirmed Rehabilitation Plan in a court-supervised rehabilitation.²⁰

¹⁵ Section 76 of FRIA Law.

¹⁶ Section 82 of FRIA Law.

¹⁷ Section 83 of FRIA Law.

¹⁸ Section 84 of FRIA Law.

¹⁹ Section 85 of FRIA Law.

²⁰ Section 86 of FRIA Law.

Liquidation

The rationale in corporate rehabilitation is to resuscitate businesses in financial distress because "assets are often more valuable when so maintained than they would be when liquidated."²¹ When rehabilitation will not result in a better present value recovery for the creditors²², liquidation is the proper remedy. Liquidation allows the corporation to wind up its affairs and equitably distribute its assets among its creditors.²³ Under the law, liquidation may either be voluntary or involuntary.

Voluntary liquidation is when the insolvent debtor itself applies for liquidation by filing a Petition for Liquidation with the court, or files a verified motion during rehabilitation proceedings (except OCRA), to convert the same into liquidation proceedings. If the petition or motion is sufficient in form and substance, the court shall issue a Liquidation Order.²⁴

Involuntary liquidation, on the other hand, is when three (3) or more creditors, whose aggregate claims is either at least One Million Pesos (₱1,000,000.00) or at least twenty-five percent (25%) of the subscribed capital stock of the debtor, whichever is higher, files a Petition for Liquidation of the debtor before the court. The creditors having the same aggregate claims may also during the pendency of rehabilitation proceedings (except OCRA), move to have the same converted into liquidation proceedings. If the court finds the petition or motion to be meritorious, then a Liquidation Order shall be issued.²⁵

The **Liquidation Order** so issued shall, among others,: (a) result in legal title to and control of the assets of the insolvent debtor, except those exempt from execution, vested in the liquidator or, pending his appointment, with the court; (b) all contracts of the debtor shall be deemed terminated and/or breached; and (c) no foreclosure proceeding shall be allowed for a period of one hundred eighty (180) days.²⁶ Bear in mind, however, that the **Liquidation Order** shall not affect the right of a secured creditor to enforce his lien in accordance with the applicable contract or law.²⁷

We trust and hope that you will find the above to be helpful and of use to you. For a discussion on insolvency and liquidation for individual debtors, please refer to our Client Advisory Bulletin 2020-004.

²¹ *Viva Shipping Lines vs. Keppel Philippines Mining, Inc., et al.*, supra Note 3, citing *Bank of the Philippine Islands vs. Securities and Exchange Commission*, G.R. No. 164641, 20 December 2007.

²² *Ibid*, citing *Leonardo S. Umale vs. ASB Realty Corporation*, G.R. No. 181126, 15 June 2011.

²³ *Id.*, citing *Philippine Veterans Bank Employees Union-N.U.B.E. and Perfecto V. Hernandez vs. Honorable Benjamin Vega, et al.*, G.R. No. 105364, 28 June 2001.

²⁴ Section 90 of FRIA Law.

²⁵ Section 91 of FRIA Law.

²⁶ Section 113 of FRIA Law.

²⁷ Section 114 of FRIA Law.



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In keeping with our commitment of providing our clients and the public with the best possible service we can, we will continue to provide information relative to the actions they may consider in light of the pandemic.

Keep safe.

Thank you very much.


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