# *Sustainability in Insolvency and Restructuring Procedures*

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## I. Introduction

September 25, 2015, is a date to remember: That was when the 193 member states of the United Nations General Assembly adopted a program of action entitled *Transforming our World*. *The 2030 Agenda for Sustainable Development*.[1]

The program laid out a plan to develop sustainable systems, the result of more than 40 years of work by organizations around the world, and it led to increasing awareness of the need for sustainable and responsible development.

The ambitious and transformative vision identified 17 goals and 169 sustainable development targets in three dimensions—economic, social, and environmental—and it reaffirmed the need for global cooperation to address common challenges.

The 2030 Agenda crystallizes the values and concepts developed over decades in every public and private sector. Together, they form the base of the pyramid of rules, regulations, organizational models, investment and financing techniques that have come to be categorized as ESG: ***Environmental**, **Social***, and ***Governance.***

These three concerns continue to influence entrepreneurs today and help determine a company's “sustainability.” In this sense, there are two ways to define the term in the business context:

**(i)** "internal" sustainability, as measured by financial markers over a long period, akin to the concepts of "stability" and business continuity;

**(ii)** "external" sustainability, which looks at a company’s characteristics in terms of the environment, climate, or social equity.

Considering the evolution of the concept of sustainability in the business world, it is natural to extend the concept to corporate restructuring and insolvency—a sector that until recently based its fundamental principles on a fair balance between the development of business continuity and the satisfaction of creditors. Little attention was paid to external aspects like social justice and environmental impact.

But that has changed. We now increasingly ask ourselves questions about the primary interest of a company, and what is its actual value, not only in economic terms, but also in social terms.

[1] https://sustainabledevelopment.un.org/post2015/transformingourworld/publication

This paper aims to analyze insolvency in the European Union, Italy, the United States, Brazil, and India to determine the impact of sustainability across the sector.

## II. European Union and Italy

Members of the European Union are beholden to the EU in two ways:

(i) The EU lays down rules that—directly through regulations and decisions and indirectly through directives—impose on the member states the objectives to be achieved through their own regulatory instruments; and

(ii) Each member's national legislation must take into account the regulations and principles set out in EU directives.[2]

### A. EU Regulations No. 1346 and No. 848/2015

EU Regulation 1346/2000 and, subsequently, Regulation no. 848/2015 (the "Recast") are aimed at coordinating crisis and insolvency proceedings. In the EU, such coordination is complicated: parties include the member states and third-party countries, with their own liquidation proceedings and corporate restructuring processes. With this legislation, and the Recast in particular, European legislators sought to make the management of assets more "sustainable"—in economic, financial, and social terms—while promoting business recovery. That said, there are no direct references to "sustainability" in ESG terms in the new regulations.

### B. EU Directive No. 2019/1023

The spirit of Directive No. 2019/1023 is to encourage member states to favor business continuity.[3] The directive not only contemplates "internal" sustainability—promoting the company's continuity—but also looks at "external" sustainability, emphasizing the value of human capital.[4]

[2] "The European Union: What it is and what it does" https://op.europa.eu/en/publication-detail/-/publication/c47b22 96-b71a-11ed-8912-01aa75ed71a1/language-en

[3] Whereas n. 16, EU Directive 2019/1023: "Removing the barriers to effective preventive restructuring of viable debtors in financial difficulties contributes to minimising job losses and losses of value for creditors in the supply chain, preserves know-how and skills and hence benefits the wider economy. Facilitating a discharge of debt for entrepreneurs would help to avoid their exclusion from the labour market and enable them to restart entrepreneurial activities, drawing lessons from past experience. Moreover, reducing the length of restructuring procedures would result in higher recovery rates for creditors as the passing of time would normally only result in a further loss of value of the debtor or the debtor's business. Finally, efficient preventive restructuring, insolvency and discharge procedures would enable a better assessment of the risks involved in lending and borrowing decisions and facilitate the adjustment for insolvent or over-indebted debtors, minimising the economic and social costs involved in their deleveraging process."

[4] Linna T., 2020, "Business Sustainability and Insolvency Proceedings – The EU Perspective", Journal of sustainability research, vol. 2, no. 2, e20019, 9. https://doi.org/10.20900/jsr20200019

Over the years, in the EU, the concept of "Corporate Social Responsibility"[5] has come to include social and environmental factors. Those efforts have resulted in a number of directives and regulations.

### C. EU Directive No. 95/2014—*Non-Financial Reporting Directive* (NFRD)

With this directive, the EU aims to establish laws and regulations to obligate companies to disclose non-financial reports regarding their performance in ESG sectors.[6]

According to the NFRD, large companies, banks, and insurance companies ("public-interest entities")[7] with more than 500 employees are required to publish reports on the policies they implement in relation to social responsibility and the treatment of employees, respect for human rights, the fight against corruption and bribery, and diversity on boards of directors (in terms of age, gender, educational, and professional background).

### D. EU Regulation No. 2019/2088—*Sustainable Finance Disclosure Regulation* (SFDR)

This regulation lays down the fundamental principles for regulating disclosures by financial market participants on the integration of sustainability risks[8] inherent in

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[5] The term corporate social responsibility (CSR) was born in 1953, when the American economist Howard Bowen included it in his publication "Social Responsibilities of the Businessman". In 1991, Donna J. Wood, of the University of Pittsburgh, published "Corporate Social Performance Revisited". The term has since become increasingly important for many companies, so much so that in 2001 the European Commission included a definition of CSR in its Green Paper: "*the voluntary integration by companies of social and environmental concerns into their operations and relationships with stakeholders*". The definition was expanded by the EU Commission in the "*Renewed EU Strategy for the period 2011-14 on Corporate Social Responsibility*" and then in the "*Entrepreneurship 2020 Action Plan*" published in 2013.

[6] Venturelli, A., Caputo, F., Leopizzi, R. and Pizzi, S. (2019), "The state of art of corporate social disclosure before the introduction of non-financial reporting directive: a cross country analysis", *Social Responsibility Journal*, Vol. 15 No. 4, pp. 409-423. https://doi.org/10.1108/SRJ-12-2017-0275. NFRD applies to approximately 11,700 companies and groups across the European Union, including those that meet two out of three criteria for two consecutive accounting periods: either a balance sheet total of EUR 20 million, a net turnover of EUR 40 million, or an average number of employees of 500. Additionally, it encompasses public-interest entities, such as those trading transferable securities on regulated markets, credit institutions, insurance undertakings, or entities designated as such by Member States. The non-financial report should comprise a brief description of the undertaking's business model, its ESG (Environment, Social, Governance) policies.

[7] According to Article 16 of the Italian Legislative Decree, the following are "public interest entities": a) Italian companies issuing transferable securities admitted to trading on Italian and European Union regulated markets; (b) banks; (c) insurance undertakings; (d) reinsurance undertakings having their registered office in Italy or the Italian branch offices of non-EU reinsurance undertakings.

[8] Article 3(2) of the SFDR Regulation: "Financial market participants shall publish and update on their websites: (a) where they take into account principal adverse impacts of investment decisions on sustainability factors, a statement of due diligence policies with respect to those effects, taking due account of their size, the nature and breadth of their activities and the type of financial products that they make available; or (b) where they do not take into account the adverse impacts of investment decisions on sustainability factors, a clear justification for such non-consideration including, where appropriate, information on whether and when they intend to take those adverse effects into account. 2. Financial market participants shall include in the information provided in accordance with point (a) of paragraph 1 at

investments. The regulation states: "the Union is increasingly facing the catastrophic and unpredictable consequences of climate change, resource depletion and other sustainability-related issues. Urgent action is needed to mobilize capital not only through public policies, but also from the financial services sector. Therefore, financial market participants and financial advisers should be required to disclose specific information about their approaches to the integration of sustainability risks and the consideration of adverse sustainability impacts."[9]

The regulation, though not directly related to business restructuring or insolvency, reveals the EU's principles: mobilize financial capital while opening up to "green" investments. Companies are encouraged to adapt their business and financial structures towards activities that are less damaging to the environment and more socially responsible.[10]

A greener corporate restructuring plan is not necessarily better in terms of business continuity, of course. In fact, adopting greener or more socially responsible policies, intended to ensure external sustainability, may affect internal financial sustainability, and could create conflicts that could compromise the success of the plan.[11]

There are two other recent EU directives to note:

- The **Corporate Sustainability Reporting Directive**[12] (CSRD), No. 2022/2464, which obliges companies to disclose non-financial data on the impact that their activities have on people and the environment and any sustainability-related risks the company is exposed to; and

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least the following: (a) information on their policies related to the identification and prioritisation of principal adverse sustainability impacts and related indicators; (b) a description of the principal adverse sustainability impacts and any action taken in relation thereto or, where applicable, planned; (c) brief summaries of engagement policies pursuant to Article 3g of Directive 2007/36/EC, where applicable; (d) a reference to their compliance with codes of conduct for responsible business and internationally recognised due diligence and reporting standards and, where applicable, the degree to which they comply with the objectives of the Paris Agreement."

[9] Recital 8 of the SFDR Regulation.

[10] SFDR Regulation provides for a classification of investment funds and related disclosures: "*Grey Green*" (art. 6 SFDR Regulation), i.e. those investment funds that are less virtuous from a sustainability point of view, which essentially invest in activities that are harmful to the environment, health and society; "*Light Green"* (art. 8 of the SFDR Regulation), i.e. those funds that take ESG factors into account in their investment *policies*; "*Dark Green*" (Art. 9 SFDR Regulation), *i.e*. those funds that, making environmental and social sustainability their "manifesto", invest essentially in ESG.

[11] M. Stella Richter Jr., Long-Termism, Rivista di diritto societario, 2021.

[12] CSRD enters into force on 5 January 2023 and will be applicable from financial years starting on 1 January 2024. From this date, all European states have 18 months to implement the CSRD in their legislation. The Directive is aimed at large companies (listed or not) with a turnover of more than €50 million or a balance sheet of more than €43 million and employees of more than 250 people, small and medium-sized enterprises, non-complex credit institutions and captive insurance companies, and companies from non-EU countries that achieve net revenues of more than €150 million in the EU with at least one company or branch in the EU exceeding certain thresholds.

- the **Corporate Sustainability Due Diligence Directive** (CSDD), No. 2022/2464, which has not been approved. The CSDD will apply to companies with more than 1000 employees and a total turnover of more than €450 million. It would require companies to implement comprehensive due diligence processes aimed at identifying, assessing, preventing and mitigating negative impacts on human rights and the environment. The due diligence must extend beyond the company's direct operations to include the entire supply chain, both upstream and downstream. The aspects to be addressed in the process include child labor, forced labor, greenhouse gas emissions, and deforestation.

## III. Italy

Italy has followed EU Directive 2019/1023 with its own Corporate Crisis and Insolvency Code[13] (CCII) to manage corporate restructuring and liquidation procedures. The Code can be divided into three areas.

### A. Crisis Prevention

#### 1. Early warning tools:

To prevent corporate crises and encourage their early detection, Art. 3 of the CCII and Art. 2086 of the Civil Code include a set of rules aimed at requiring companies to adopt specific organizational, administrative, and accounting structures. Budget and industrial planning are essential, designed to allow companies to detect financial instability, assess the sustainability of their debt, and evaluate the prospects for business continuity for at least the following year. The rules also call for corporate bodies to be vigilant about detecting warning signs so they can quickly intervene to avoid a financial crisis.[14]

#### 2. Composition with creditors

In the event of a potential crisis, any entrepreneur or company—no matter the size or nature of the business—can access the local Chamber of Commerce online to initiate a Negotiated Settlement. In doing so, entrepreneurs and business directors are required to prioritize the interests of creditors.

### B. Restructuring

The CCII includes details for restructuring agreements and recovery plans.

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[13] Legislative Decree no. 14 of 12 January 2019. This decree has undergone several amendments, the last of which was made on June 15, 2022 to implement EU Directive 2019/1023.

[14] Art. 3 CCII: (a) wage liabilities overdue for at least 30 days equal to more than half of the total monthly salary liabilities; (b) liabilities to suppliers that are at least 90 days past due in an amount greater than the liabilities that are not overdue; (c) exposures to banks and intermediaries that are more than 60 days past due equal to at least 5% of exposures and (d) late payments that trigger the reporting obligations of so-called "qualified public creditors."

(i) 'Simplified' Restructuring Agreements require the consent of 30% of creditors, while Restructuring Agreements with the possibility of Cram Down allow the provisions to be extended to other creditors.

(ii) Recovery plans include the option to use the restructuring plan subject to approval, which does not require compliance with absolute priority rules.

(iii) The “concordato preventivo”: allows companies to propose a plan to creditors, with company management remaining intact but under supervision, and acts of extraordinary administration subject to court approval. There are two types of concordato preventivos: for business continuance or for liquidation.[15]

### C. **Liquidation**

Judicial liquidation replaces bankruptcy, with a focus on maintaining business continuity. The curator plays a central role, with new requirements for transparency and the ability to act autonomously.

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The CCII is not very different from the European regulations, remaining anchored to crisis management models and mostly leaving sustainability in environmental and social terms to more general regulations. The only Italian rule that differs from the European one is Art. 87, F, of the CCII. This calls for a restructuring plan that ensures that business activity continues, but it also must take “into account the costs necessary to ensure compliance with the legislation on safety at work and environmental protection.”

This rule acknowledges that plans can, and must, include sections relating to social and environmental profiles.

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While the EU and Italian restructuring and liquidation regulations do not refer particularly to the "E" and "S" of ESG, the EU’s general regulatory approach today is strongly linked to protecting the environmental and social aspects of any operation. The practical application of any restructuring plan, as authoritatively argued,[16] will inevitably include ESG considerations.

In this regard, here are some reflections:

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[15] In the case of concordato with liquidation purpose, this procedure is admissible only if the available assets increase by 10% compared to a judicial liquidation.

[16] Linna T., 2020, “Business Sustainability and Insolvency Proceedings – The EU Perspective”, Journal of sustainability research, vol. 2, no. 2, e20019, 9. https://doi.org/10.20900/jsr20200019

a) Environmental and social goals may conflict: for example, an ecologically sustainable plan may be counterproductive to job preservation—which may prevent it from being accepted;

b) The economic and financial costs of adapting companies in crisis to the environmental and social profiles of the EU regulations will affect governance choices in continuing business activities; and

c) Environmental and social factors could affect the methods and "ratios" of satisfying creditors, risking jeopardizing the "best possible result" for creditors, in favor of the "greater common good."

With this said, given the importance and strategic nature of environmental values (as interpreted in the Bruntlnad report and as referred to in the Italian Environmental Code), ESG will be increasingly taken into account in the development of business continuance plans. They may even be considered as parameters and elements to be evaluated in liquidation alternatives.

## IV. United States

In the United States, the main legal framework governing the restructuring of debts is the U.S. Bankruptcy Code, which is federal legislation.[17] Restructuring processes, including liquidations and reorganizations, are handled in federal courts.[18] The Bankruptcy Code is organized by chapter, each addressing different scenarios such as Chapter 11 for business reorganizations and Chapter 7 for liquidations. Chapter 11, for example, is designed to be flexible enough to help preserve the going concern value of a business, offering various strategic options to restructure its affairs while keeping existing management generally in control under court supervision.[19]

The intersection of environmental responsibilities and bankruptcy in the U.S. can be complex, since the objectives of environmental laws and the Bankruptcy Code often conflict. Environmental laws aim to hold parties accountable for contamination and other environmental damages, while the Bankruptcy Code can allow for the restructuring or discharge of these obligations.[20] In the United States, a crucial part of a bankrupt debtor's "fresh start" is a debtor's ability to discharge certain claims once a reorganization plan is approved.[21] Because typically only claims that emerged before the bankruptcy filing can be discharged, an important concern for environmental liabilities is determining if a claim originated before or after the filing. For example, environmental cleanup obligations related to pre-petition contamination are generally

[17] Codified in 11 U.S.C. §§ 101–1532.
[18] The district courts have original and exclusive jurisdiction over bankruptcy matters in the United States, but such courts refer bankruptcy cases to specialized bankruptcy courts. 28 U.S.C. § 1334(a); 28 U.S.C. § 157(a).
[19] *See* 11 U.S.C. §§ 1101–1195.
[20] Some debts cannot be discharged, such as domestic support obligations, those resulting from fraud, and specific environmental obligations. 11 U.S.C. § 523(a).
[21] *See* 11 U.S.C. § 524.

considered claims that may be discharged under the Bankruptcy Code—which reflects their significant public and environmental health implications.[22] But, certain obligations might not be dischargeable. For instance, while a debtor might have an ongoing obligation to comply with environmental laws and consent orders, this obligation, if it is not a debt, might not be dischargeable in bankruptcy.[23]

The paramount importance of public health is clear elsewhere in the bankruptcy code too. The "automatic stay"[24] halts pre-petition claims against debtors but allows for an exception in cases where public health and safety are at risk. This special case is often referred to as the "police and regulatory power" exception.[25] Actions related to environmental claims often fall within this exception. For example, governmental actions under the Comprehensive Environmental Response, Compensation, and Liability Act (knows as "CERCLA") to recover costs for environmental violations fall within this exception.[26] This scheme illustrates a balance between financial restructuring and ongoing environmental compliance in the United States.

When it comes to social, the restructuring process under Chapter 11 of the Bankruptcy Code not only addresses the financial sustainability of a business but also allows for social aspects. It offers a centralized forum to resolve massive tort liabilities, such as products liability and asbestos claims. For example, section 524(g) of the Bankruptcy Code provides for a channeling injunction that allows asbestos-related claims to be redirected from the debtor to a trust.[27] The aim of this injunction is to ensure equal treatment of present and future asbestos injury claims and the prompt payment of those claims without the expense of a trial. This centralized approach ensures that all claims, including future ones, are dealt with equitably. Provisions like the automatic stay also prevent actions against the debtor, extending protections to related third parties (such as company directors and officers), which helps maintain workplace stability and safeguards employee interests during restructuring.[28]

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[22] *In re Oldco M Corp.*, 438 B.R. 775, 781 (Bankr. S.D.N.Y. 2010) ("clean up costs for contamination arising from prepetition conduct—even if those costs have not yet been incurred—meet the definition of claims under section 101(5) and could be discharged as part of a bankruptcy case.")

[23] *Torwico Elec., Inc. v. State of New Jersey, Dep't of Envtl. Protection (In re Torwico Elec., Inc.)*, 8 F.3d 146, 151 (3d Cir.1993) (holding that that a state agency's attempt to enforce an order it issued directing the debtor to cleanup up contamination which posed an ongoing hazard is not a "claim" within the meaning of the Bankruptcy Code and, therefore, not subject to discharge).

[24] 11 U.S.C. § 362.

[25] *See* 11 U.S.C. § 362(b)(4).

[26] *In re New York Trap Rock Corp.*, 153 B.R. 642, 645 (Bankr. S.D.N.Y. 1993) ("governmental actions under CERCLA to recover costs in response to completed environmental violations are not stayed when an alleged responsible party files a bankruptcy case.").

[27] *See*, *e.g*., *In re Maremont Corp.*, 601 B.R. 1, 27–32 (Bankr. D. Del. 2019); *In re W.R. Grace & Co.*, No. 01-1139 (JKF), 2011 WL 381942, at *28 (Bankr. D. Del. Jan. 31, 2011), *report and recommendation adopted*, 468 B.R. 81 (D. Del. 2012), *withdrawn from bound volume*, *opinion amended and superseded*, 475 B.R. 34 (D. Del. 2012), *aff'd sub nom. In re WR Grace & Co.*, 729 F.3d 332 (3d Cir. 2013), *and aff'd*, 532 Fed. Appx. 264 (3d Cir. 2013)(unpublished), *and aff'd sub nom. In re WR Grace & Co.*, 729 F.3d 332 (3d Cir. 2013), *and aff'd*, 729 F.3d 311 (3d Cir. 2013), *and report and recommendation adopted*, 475 B.R. 34 (D. Del. 2012), *and aff'd sub nom. In re WR Grace & Co.*, 729 F.3d 332 (3d Cir. 2013).

[28] *See* 11 U.S.C. § 362.

And, in an attempt to ensure that victims are compensated even after the restructuring process concludes, section 524(g) of the Bankruptcy Code provides for the creation of trusts funded under reorganization plans to assume the liabilities of a debtor when the debtor is a “defendant in personal injury, wrongful death, or property-damage actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products.”

The Bankruptcy Code prioritizes employee wages and benefits, as well, underlining the importance of protecting workers’ rights throughout the restructuring process.[29] These provisions underscore the role of bankruptcy law not just in financial restructuring but also in upholding significant social responsibilities toward employees and affected communities.

In the context of governance, the U.S. bankruptcy process emphasizes the accountability of management and boards of directors. The decisions and conduct of directors and officers are scrutinized, particularly concerning their roles in a company’s financial distress. For example, under the Bankruptcy Code, statutory creditors’ committees can investigate a debtor’s acts, conduct, assets, liabilities, and financial conditions.[30] Their findings can influence the approval of restructuring plans, as courts assess whether management acted in the best interests of creditors and other stakeholders.

Also, with regard to governance, transparency is a critical aspect of the restructuring process, particularly in how the bankruptcy case is handled and communicated to stakeholders. A debtor is required to complete a detailed disclosure statement, to include history, financials, and future plans.[31] This transparency is vital for creditors and investors to make informed decisions, particularly when voting on reorganization proposals. The restructuring process under Chapter 11, in particular, actively involves various stakeholders, including creditors, employees, and regulatory bodies. This inclusive approach not only facilitates more sustainable restructuring outcomes but also reinforces the importance of diverse stakeholder engagement in achieving these outcomes.

## V. Brazil

In Brazil, bankruptcy proceedings are governed by Law No. 11,101/2005, the Brazilian Bankruptcy Law (BBL). This legislation contemplates three proceedings designed to address insolvencies: (a) out-of-court reorganization (*recuperação extrajudicial*), which is similar to a prepackaged reorganization process under chapter 11 of the US Bankruptcy Code; (b) judicial reorganization (*recuperação judicial*), comparable to a conventional reorganization proceeding under chapter 11; and (c) bankruptcy liquidation (*falência*), which is analogous to a liquidation process under chapter 7 of the US Bankruptcy Code. Here, we address judicial reorganizations.

[29] 11 U.S.C. §§ 507(a)(4), 507(a)(5), 507(a)(6).
[30] 11 U.S.C. § 1103.
[31] 11 U.S.C. § 1125.

The judicial reorganization proceeding is designed to enable a debtor to overcome a momentaneous economic and financial crisis while continuing its activities—provided it can demonstrate its economic viability and ability to restructure its obligations. The debtor and the creditors negotiate a plan that then must be approved by a majority of creditors and confirmed by the respective Bankruptcy Court.

During the judicial reorganization proceeding, shareholders and managers retain their rights to control and manage the company, though they may be subject to some restrictions. Failure to comply with any obligation set forth under the plan of reorganization may result in the conversion of judicial reorganization into a bankruptcy liquidation proceeding, so all the plan's provisions must be observed.

Generally, companies file judicial reorganization proceedings when they find themselves in a financial crisis. When such a crisis is caused by the lack of compliance with governance, environmental and/or social issues—as it often is—it is clear that ESG policies have a dual impact on business recovery. They can both precipitate financial distress and serve as a pivotal element in effective restructuring.

Take the reorganization of Samarco Mineração, one of Brazil's major mining companies.[32] A main cause of Samarco's financial crisis was the failure of the Fundão tailings dam,[33] one of the most significant environmental disasters in Brazilian history. The event caused Samarco to have to suspend all its business activities. The company could no longer generate cash or repay existing outstanding obligations, notably some bonds held by foreign investors.

As a result, Samarco eventually turned to a judicial reorganization proceeding. The resulting judicial reorganization plan allowed Samarco to fulfill its environment-related obligations, including the need to properly repair the damage caused by the dam's failure.[34] The reorganization plan, which was ultimately confirmed by the bankruptcy

[32] Samarco Mineração S/A filed for Judicial Reorganization on April 9, 2021, which was granted on April 12, 2021, by the 2nd Business Court of the District of Belo Horizonte, in Case No. 5046520-86.2021.8.13.0024.

[33] Samarco Mineração S/A attributed the failure of the Fundão tailings dam as a primary cause of its crisis. This is reflected in the following excerpt from its initial petition, filed on April 9, 2021:"On November 5, 2015, the failure of the Fundão tailings dam in the municipality of Mariana, in the state of Minas Gerais, resulted in damage to the affected areas and their inhabitants in the states of Minas Gerais and Espírito Santo. Immediately after the collapse, Samarco's mining operations were affected and suspended, leading to the loss of the company's primary source of revenue. As of August 2016, payments on its financial debt were suspended. (…) The dam collapse led to the suspension of Samarco's operating licenses, severely compromising the company's revenue generation since November 2015, as product sales ceased with the depletion of inventories. Furthermore, reparation measures, lawsuits (including bank account blockages and obligations to provide guarantees), compliance with agreements, and other factors have significantly impaired the company's cash flow, necessitating substantial expenditures. Consequently, the Plaintiff has been unable to meet its obligations and has been compelled to seek new financing for both ordinary and extraordinary expenses."

[34] "The Judicial Approval of the Plan aims, among other objectives, to ensure compliance with Samarco's social and environmental obligations. The obligations arising from the failure of the Fundão tailings dam, whether specified in the TTAC or in any other agreements between Samarco, its shareholders, and public

court,[35] was a tool that enabled Samarco to raise the funds to continuously comply with the socio-environmental obligations assumed under the terms of the Conduct Adjustment Agreement signed in 2018 with the public authorities.[36]

The social dimension within the Brazilian insolvency framework is exemplified by the judicial reorganizations of Manikraft Guaiansses Industries and the João Santos Group.[37] In these cases, the companies were granted tax concessions (only because of the judicial reorganization proceedings) in exchange for undertaking social obligations, including covering school expenses for children, medical expenses for drug addicts, food expenses for low-income families, as well as maintaining two public squares.[38] Given that tax claims are often relevant in major judicial reorganization processes, granting discounts in exchange for social actions should be encouraged; it incentivizes financially distressed companies to embrace and fulfill these commitments.

Finally, internal governance failures may be one of the main reasons for a company's insolvency. This was the case in the judicial reorganization of Americanas S.A., which eventually filed for claims in excess of ~USD 8.5 billion.[39] The main cause of the company's financial distress was an accounting fraud (which ultimately demonstrated that Americanas held an undisclosed ~USD 4 billion in additional liability) and a lack of transparency in the company's financial operations.[40]

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authorities, will remain unaffected by this Plan. Samarco reaffirms its commitment to fully repair the damages caused by the dam failure, irrespective of the Judicial Reorganization, in accordance with Clause 5.10 of this Plan." (excerpt from Samarco's judicial reorganization plan, as confirmed).

[35] On August 31, 2023, the Bankruptcy Court confirmed Samarco's reorganization plan.

[36] On 2 March 2016, Samarco, Vale S.A. and BHP Brasil executed with several governmental authorities an Instrument of Settlement and Conduct Adjustment (TTAC), providing for several socio-environmental and socio-economic measures to remedy the several impacts caused by the Event. Pursuant to the TTAC, the remediation will occur through the establishment of a foundation governed by private law to which contribution of funds shall be made pursuant to the TTAC.

[37] Manikraft Guaiansses Industries filed for Judicial Reorganization on September 30, 2022, which was granted by the 2nd Bankruptcy Court of the District of São Paulo, in Case No. 1107466-61.2022.8.26.0100.

[38] The tax transaction was signed by Manikraft Guaiansses Industries on August 28, 2023.

[39] Americanas S/A filed for Judicial Reorganization on January 19, 2023, which was granted by the 4th Business Court of the District of Rio de Janeiro, in Case No. 0803087-20.2023.8.19.0001.

[40] Americanas attributed the accounting fraud as a primary cause of its crisis. This is reflected in the following excerpt from its initial petition, filed on January 19, 2023: "The Americanas Group's operations have historically been healthy and were perceived as sustainable and promising until recently. However, unexpected events have drastically impacted the group's financial structure, causing the Plaintiffs' cash flow and revenue expectations to collapse rapidly. This disruption resulted from the company's unusually transparent and courageous disclosure of accounting inconsistencies in the 'Suppliers' account from previous financial years, including 2022. The precise nature and responsibility for these discrepancies remain unclear. To address this, the Board of Directors of Americanas has established an independent committee comprising highly reputable professionals to investigate and report their findings to shareholders, the market, and society. According to a preliminary analysis in the management report, the company's accounting department estimates that these inconsistencies amount to approximately R$ 20 billion as of September 30, 2022, potentially increasing the Group's financial indebtedness to around R$ 40 billion."

To address concerns about its governance and to restore credibility in the company, Americanas' judicial reorganization plan included as one of its obligations the observance of best corporate governance practices.[41] Failure to adhere to ESG principles was a cause of Americanas' trouble in the first place; now the judicial reorganization plan allowed the creditor to force the company to adhere to relevant ESG principles.

As in the Americanas case, a plan of reorganization sometimes imposes on a debtor the obligation to strictly comply with certain ESG guidelines. In general, a debtor's failure to comply with a plan of reorganization causes its reorganization proceeding to be converted into a bankruptcy liquidation. So, a judicial reorganization proceeding—which generally imposes debtor's obligation to strictly comply with obligations called for in a plan under penalty of an imposed liquidation—can be seen as an important tool to force an entity to comply with relevant ESG guidelines.

Adhering to ESG policies guides companies toward adopting optimal management practices—which may someday prevent the need for judicial reorganization. If not, Brazilian precedents demonstrate that judicial reorganization plans may force it to adhere to relevant ESG principles anyway.

## VI. India

In India, restructuring proceedings can be initiated under either the Insolvency and Bankruptcy Code, 2016 (IBC) or the Companies Act, 2013. The IBC serves as a comprehensive framework governing insolvency and bankruptcy proceedings. A significant legislative milestone, the IBC has revolutionized the approach to insolvency and bankruptcy in India, providing a more effective and efficient means of restructuring distressed companies by allowing any creditor to initiate proceedings and establishing a structured resolution process. The IBC enhances the chances of reviving debtor companies, contributing to the stability and growth of the Indian economy.

The IBC provides a streamlined process for resolving corporate insolvency, but integrating ESG factors into the methodology remains in its nascent stages.

### A. The Intersection of Environmental Claims and Insolvency

The IBC does not explicitly prioritize environmental claims, which leads to conflicts between environmental obligations and creditor interests. Although no environmental claims have been received in the corporate insolvency resolution process (CIRP), the potential classification and prioritization of such claims have significant legal and

[41] "The management of the Americanas Group must adhere to the best corporate governance practices in conducting its activities, in addition to complying with all terms, conditions, and limitations set forth in this Plan and other instruments related to the Judicial Reorganization. The Americanas Group's bylaws must be updated as needed to align with the best governance practices mandated by law, proposed by the Brazilian Institute of Corporate Governance, required by the stock exchanges where Americanas Group's securities are traded, or recommended by the Securities and Exchange Commission" (excerpt from Americana´s judicial reorganization plan, as confirmed).

practical implications. Environmental liabilities (fines and penalties) can be restructured as a statutory liability of a debtor company.[42]

Environmental claims can be broadly divided into contingent environmental claimants and environmental decree holders. Contingent environmental claimants are those claims which have not been adjudicated but where the ongoing cases have been halted due to a moratorium imposed during CIRP. Environmental decree holders are the claimants in whose favor any court order or decree has been passed.

The Tripura High Court[43] has classified decree holders as “other creditors,” placing them in the “other debts and dues” category. This classification effectively makes environmental decree holders low-priority unsecured creditors within the CIRP framework. Similarly, contingent environmental claimants are classified under “any remaining debts and dues,”[44] further diminishing the priority of environmental claims compared to financial and operational creditors. The environmental claims under a resolution plan can be extinguished at the discretion of the successful Resolution Applicant.

An environmental claim may also be a court order or an order by the Collector under the Public Liability Insurance Act of 1991 (PLI Act), which was enacted in India to ensure that companies handling hazardous substances are adequately insured to protect the public from the risk of accidents. Companies owning or controlling hazardous substances must obtain public liability insurance to cover potential damages resulting from accidents. While the law is aimed at safeguarding public health and the environment, companies often seek respite from its stringent requirements.

### B. **Social Factors**

The IBC not only addresses the resolution of distressed assets but also protects the rights and interests of workers and employees.

The IBC prioritizes payment to workers under the waterfall mechanism specified in section 53. This section outlines the order in which the proceeds from the liquidation of a corporate debtor are distributed to stakeholders. Under this mechanism, workers’ dues are given priority along with secured financial creditors for 24 months preceding the liquidation commencement. This is a significant step toward ensuring that workers’ rights and livelihoods are protected during insolvency proceedings.

In addition to section 53, the IBC also strengthens the protection afforded to workers and employees in Section 36(4)(a)(iii), which excludes “all sums due to any workman or employee from the provident fund, the pension fund, and the gratuity fund” from the liquidation estate of the corporate debtor. This safeguards these funds—crucial for the

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[42] Section 53(1)(e) of the IBC.

[43] MANU/TR/0270/2022.

[44] The Insolvency and Bankruptcy Code, 2016, 53(f) covers "any remaining debts and dues[,]" which includes all dues not covered by the earlier mechanisms.

social security and financial stability of employees—from being used to satisfy other creditors' claims.

The importance of protecting these funds was reiterated in the recent judgement in *State Bank of India vs Moser Baer Karamchari Union*.[45] There, the Supreme Court upheld the legal position that the gratuity fund, the provident fund, and the pension fund are not part of the "liquidation estate" of the corporate debtor, and do not fall within the ambit of the waterfall mechanism prescribed under Section 53 of IBC.

By protecting workers' dues and excluding social security funds from the liquidation estate signal, lawmakers and the courts are signaling to businesses the importance of treating employee rights as integral to their operational responsibilities.

### C. Governance Factors

During the CIRP and liquidation, the corporate debtor's board of directors and management are suspended. The resolution professional assumes control, acting under the supervision of the Committee of Creditors (COC) and the National Company Law Tribunal (NCLT). This arrangement is designed to ensure that the resolution process is managed by an impartial professional whose primary duty is to maximize the value of the debtor's assets and protect the interests of the creditors. This mechanism prevents any potential conflicts of interest and ensures that those who may have contributed to the financial distress of the company—the board and management—do not interfere with the resolution process.

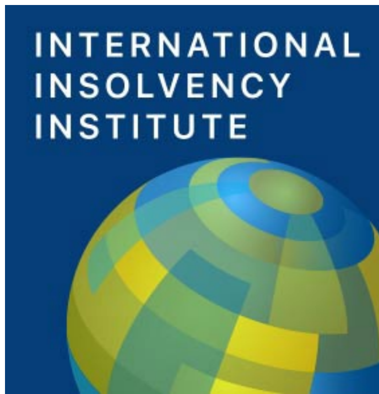
Section 29A of the IBC further strengthens this governance structure by explicitly prohibiting the former administration from managing or controlling the corporate debtor under a resolution plan.

## VII. Conclusion

In conclusion, the integration of sustainability principles within insolvency and restructuring procedures across various jurisdictions reveals a dynamic interplay between financial recovery and adherence to ESG criteria. The European Union and Italy have progressively incorporated social and environmental considerations into their frameworks, albeit with differing emphasis and application. The United States demonstrates a complex but evolving landscape where environmental responsibilities are balanced against bankruptcy provisions, ensuring public health remains paramount. Brazil and India, while still in nascent stages, highlight the potential for ESG principles to influence restructuring processes significantly. The Brazilian experience, particularly with cases like Samarco, underscores the critical role of environmental obligations in judicial reorganization. Meanwhile, India's legislative advancements offer a promising

[45] Writ Petitions Civil Nos. 421/2019.

avenue for incorporating ESG factors in future insolvency resolutions. Collectively, these developments illustrate a growing recognition that sustainable restructuring not only aids in financial recovery but also promotes long-term resilience and social equity, positioning ESG considerations as pivotal in shaping the future of corporate restructuring and insolvency practices.




# *Sustainability in Insolvency and Restructuring Procedures*

By: *Carlo Ghia, Thiago Braga Junqueira, Mariam Zaidi, and Gabriel L. Olivera*

*June 9, 2024*

# *United States*

- **U.S. Bankruptcy Code Framework**
  - Federal legislation governing debt restructuring.
  - Federal courts exclusively handle liquidations and reorganizations.
  - Chapters address different scenarios: Chapter 11 for business reorganizations, Chapter 7 for liquidations.
- **Chapter 11: Business Reorganization**
  - Designed for flexibility and preservation of business value.
  - Allows restructuring under court supervision while keeping management generally in control.
- **Environmental Liabilities in Bankruptcy**
  - Conflict between environmental laws (accountability for damages) and Bankruptcy Code (debt restructuring/discharge).
  - Discharge of claims typically limited to pre-bankruptcy filing liabilities.
  - Pre-petition environmental cleanup obligations may be discharged; ongoing compliance may not.
- **Automatic Stay and Public Health Exception**
  - Halts pre-petition claims against debtors.
  - Exception for public health and safety risks (*e.g.*, environmental claims under CERCLA).

# United States (cont.)

- **Social Aspects in Chapter 11**
  - Addresses financial and social sustainability.
  - Centralized forum for resolving tort liabilities (*e.g.*, asbestos claims).
  - Section 524(g): channeling injunction directs asbestos claims to a trust for equitable treatment.
- **Employee Protections and Prioritization**
  - Prioritizes employee wages and benefits.
  - Protects workers' rights and community interests during restructuring.
- **Governance and Accountability**
  - Management and board actions scrutinized for roles in financial distress.
  - Creditors' committees investigate debtor's conduct and financial condition.
  - Ethical execution of reorganization plans is essential.
- **Transparency and Stakeholder Involvement**
  - Detailed disclosure statements required for informed stakeholder decisions.
  - Chapter 11 involves creditors, employees, and regulatory bodies in reorganization plans.
  - Bankruptcy Code § 1129(a)(6) ensures regulatory approval of rate changes in reorganization plans.

# *India*

- **Insolvency and Bankruptcy Code, 2016 (“IBC”)**
  - Comprehensive framework governing insolvency and bankruptcy proceedings aimed at resolving distressed debts and focusing on the revival of debtor companies before considering liquidation.
  - Time bound resolution process aiming at maximizing the value of assets, ensuring the availability of credit, and balancing the interests of all stakeholders.

- **Sustainable Development and IBC**
  - ESG factors help in accessing the sustainability and societal impact of an investment of a debtor company; determining the future performance of a company
  - IBC provides a streamlined process for resolving the companies in financial distress and try to address the integration of ESG factors in the code to enhance rights of the creditors and all other stakeholders involved.



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# *India (cont.)*

- **Environmental Factors**
  - Environmental liabilities can be restructured under the IBC as statutory liabilities under section 53 (1)(e) of the IBC
  - Environmental claims can be broadly divided into two types – contingent claims and decree holders

- **Social Factors**
  - Rights and interests of workmen and employees are acknowledged and protected under the IBC
  - Prioritization of payment to workmen equivalent to secured creditors under the waterfall mechanism specified in section 53 of the IBC
  - Inclusion of Section 36(4)(a)(iii) of the IBC which further strengthens the protection afforded to workmen and employees

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# India (cont.)

- **Governance Factors**
  - IBC is designed by the legislature to ensure that those who may have contributed to the financial distress of the company to not interfere with the resolution process
  - Section 29A of the IBC strengthens this factor by explicitly prohibiting the erstwhile management or promoters of the debtor company from participating in the CIRP

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# Brazil

- Existing Insolvency regimes: (i) Judicial Reorganization; (ii) Extrajudicial Reorganization; and (iii) Bankruptcy Liquidation
- Lack of ESG notions and relevant rules in the context of the legal framework. No relevant case law to date.
- ESG, however, is part of the reality of the restructurings (cause and means of Restructuring):
  - **E**: The Samarco case. ~USD $10b (USD) Restructuring. Failure of a Dam. Major environmental impact. Plan of reorganization that contemplates obligations to continue to support the remediation efforts.
  - **S**: João Santos Group. Restructuring of tax claims (only recently allowed under local Insolvency regime) available only if relevant social impact acts were implemented by the debtor.
  - **G**: Lojas Americanas. ~$8b (USD) Restructuring. Caused by a fraud of ~$4b (USD) in the accounting records. Crash landing restructuring. Adherence to governance standards as part of the restructuring plan.
- Potential threat of a liquidation – additional (and relevant) stick to compel the debtor to comply with ESG principles.



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# *European Union*

- Sustainability in EU Insolvency regulation 848/2015 (the recast of EU Insolvency Regulation 1346/2000) and EU Directive 1023/2019 (preventive restructuring frameworks).

- Is sustainability an insolvency/restructuring issue or does it come from a wider framework.

- Corporate Social Responsibility notion in the EU:

"*the voluntary integration by companies of social and environmental concerns into their operations and relationships with stakeholders*" (Green Book, EU Commission 2001).

- Voluntary?? Really?



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# European Union (cont.)

a) *European Green Deal (2020)*

b) *EU Regulation 2019/2088 (SFDR Sustainable Finance Disclosure Regulation.*

c) Corporate Sustainability Reporting Directive – CSRD no. 2022/2464;

d) Corporate Sustainability Due Diligence Directive – CSDD (proposal no. 2022/0051(COD)

e) Directive 2003/87/EC EU Emission trading system, recently modified by Regulation (if a company produced less CO2 than expected, and therefore has not used all his allowances, there is the possibility of selling them toother companies or keep them for the future)

f) CBAM (Carbon Border Adjustment mechanism), EU Regulation 956/2023: aims to prevent the European Union's emission reduction efforts from being offset by an increase in emissions outside its borders due to the relocation of production to third countries with less stringent environmental standards than those of the Union or an increase in imports of high-carbon products.

g) Fit for 55 package

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# *Italy*

- Italy's restructuring and insolvency regimes: the new Crisis of enterprises and Insolvency Code (entered into force with Legislative Decree 224/2023).

- Early warning tools and composition with creditors.

- Restructuring agreements and Concordato Preventivo.

- Lack of ESG elements: the only recall to environment is art. 87 of the code where it is provided that restructuring plans must aim at ensuring the continuation of the business activity in a direct form and must also indicate "*the analytical identification of the expected costs and revenues, the financial needs and the relative methods of coverage, also taking into account the costs necessary to ensure compliance with the legislation on safety at work and environmental protection.*"

- Liquidation or restructuring? ESG impacts.

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