The International Insolvency Review

Second Edition

Editor
Donald S Bernstein

Law Business Research

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EDITOR'S PREFACE

This second edition of *The International Insolvency Review* once again offers an in-depth review of market conditions and insolvency case developments in a number of key countries. Building on the first edition, coverage has been expanded to include Belgium, Greece, Jersey, Poland, Portugal, Singapore and South Africa bringing the total number of jurisdictions covered to 31. Once again, a debt of gratitude is owed to the outstanding professionals in geographically diverse locales who have contributed to this book. Their contributions, of course, reflect their diverse viewpoints and approaches, which in turn reflect the diversity of their respective national commercial cultures and laws. These differences drive the steadily emerging pattern, described in these pages, of resistance on the national level to the universal application of a single 'home' country's law in cross-border commercial insolvency cases.

This pattern, though understandable, poses a significant challenge. While a large and increasing coterie of countries have adopted legislation based on the UNCITRAL Model Law, with its universalist vision of global recognition of a single controlling 'main' or home country insolvency proceeding, countries continue to find it difficult to allow the rules of the foreign main proceeding to control within their borders. In addition, neither the Model Law, nor other enactments, like the European Union's Regulation on insolvency,[1] provide the tools necessary for consolidated administration of insolvencies involving multiple legal entities in a corporate group, with operations, assets and stakeholders under different corporate umbrellas in different jurisdictions. It is difficult enough for local authorities and local commercial interests to relinquish local control of the treatment of a single foreign company's local assets and stakeholders. It is almost impossible for them to do so with respect to a locally organised entity with

1 Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings, 2000 O.J. (L 160) 1, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:0018:en:PDF.

local operations, employees, assets and creditors. Embedded expectations that local law, local courts, local procedures and local insolvency administrations will apply are simply too strong.

Insolvent corporate groups are obliged to initiate separate plenary insolvency proceedings for individual companies under local insolvency regimes in multiple jurisdictions (as illustrated in the cases of Nortel and Lehman Brothers, among others), and the daily conflicts among the controlling insolvency administrations destroy value and vastly increase costs. Since there seems to be no appetite for allowing a single home country's insolvency law to take precedence in such cases, alternatives that allow a single court to administer the proceedings, but make adjustments to the treatment of each entity's stakeholders reflecting applicable foreign law, are being explored. These approaches pose a complex set of questions for which there is no legal framework or consensus. Can a single court be given control over the entire corporate group and its assets and stakeholders wherever located? How and when should adjustments in treatment be made to reflect foreign substantive law? Although possible answers to these questions are beginning to emerge, they all involve a relinquishment of national sovereignty and an expansion of jurisdiction that may be difficult to accomplish, especially without greater convergence in national insolvency laws.

Aware of the issues arising out of this deficiency in current law, in 2006, UNCITRAL referred the matter of enterprise groups to its Working Group V (Insolvency Law) for further discussion.[2] The efforts of the working group led to the publication, in 2012, of Part Three of the UNCITRAL Legislative Guide on Insolvency Law, addressing the treatment of enterprise groups in insolvency.[3] Although the Guide recognises that 'it is desirable that an insolvency law recognise the existence of enterprise groups', discusses the importance of cross-border cooperation and offers various proposals to facilitate enhanced coordination,[4] there is no consensus regarding definitive proposals. Publication of Part Three of the Guide did not mark the end of Working Group V's mandate to address the issue of enterprise groups, but everyone recognises the road to a solution, if one is possible, may be long and hard.[5]

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2 United Nations Commission on International Trade Law, Report of Working Group V (Insolvency Law) on the Work of its Thirty-First Session (Vienna, 11–15 December 2006), U.N. Doc. A/CN.9/618 (8 January 2007), available at http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V07/800/89/PDF/V0780089.pdf?OpenElement.

3 United Nations Commission on International Trade Law, UNCITRAL Legislative Guide on Insolvency Law; Part Three: Treatment of Enterprise Groups in Insolvency, U.S. Sales No. E.12 V. 16 (2012), available at www.uncitral.org/pdf/english/texts/insolven/Leg-Guide-Insol-Part3-ebook-E.pdf.

4 Id.

5 See United Nations Commission on International Trade Law, Report of Working Group V (Insolvency Law) on the Work of its Forty-Fifth Session (New York, 21–25 April 2014), U.N. Doc. A/CN.9/803 (6 May 2014), available at http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V14/028/64/PDF/V1402864.pdf?OpenElement. The European Commission is also considering amending the European Union Regulation on Insolvency to better encompass

I once again want to thank each of the contributors to this book for their efforts to make *The International Insolvency Review* a valuable resource. As each of our authors, both old and new, knows, this book is a significant undertaking because of the current coverage of developments we seek to provide. My hope is that this year's volume will help all of us, authors and readers alike, reflect on the larger picture, keeping our eye on likely, as well as necessary, developments on the near and, alas, distant horizon.

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October 2014

enterprise groups. See European Commission, Proposal for a Regulation of the European Parliament and of the Counsel Amending Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings (2012), available at http://ec.europa.eu/justice/civil/files/insolvency-regulation_en.pdf.

Chapter 1

BARNET AND BEMARMARA
MUST A FOREIGN DEBTOR HAVE US ASSETS TO BE ELIGIBLE FOR RELIEF UNDER CHAPTER 15 IN THE UNITED STATES?

Donald S Bernstein, Timothy Graulich, Damon P Meyer and Christopher S Robertson[1]

In last year's edition of *The International Insolvency Review*, we discussed the tension between the 'universalist' and 'territorialist' approaches to cross-border insolvencies. Universalists believe that cross-border insolvencies should be governed by the laws of a single country[2] to increase the efficiency and predictability of cross-border insolvencies,[3] whereas territorialists dispute both the feasibility and purported benefit of a unified

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2 See, for example, Jay Lawrence Westbrook, 'Theory and Pragmatism in Global Insolvencies: Choice of Laws and Choice of Forum', 65 Am. Bankr. L.J. 457, 461 (1991) (under the universalist principle 'all of the debts of the enterprise would be administered through one central proceeding in the "home country"'); Andrew T Guzman, 'International Bankruptcy: In Defense of Universalism', 98 Mich. L. Rev. 2177, 2203 (2000) (arguing that universalism is a 'better framework for reorganisations' because of the centralisation of assets in a single court); Todd Kraft and Allison Aranson, 'Transnational Bankruptcies: The Section 304 and Beyond', 1993 Colum. Bus. L. Rev. 329, 336 (1993) (one proceeding – held in a country with great interest in the debtor or the property – minimises administrative costs and maximises judicial efficiency).

3 See, for example, Jay Lawrence Westbrook, 'A Global Solution to Multinational Default', 98 Mich. L. Rev. 2276, 2288 (2000) (because bankruptcy is a market-symmetrical law, a global market requires a global bankruptcy law); John A E Pottow, 'Procedural Incrementalism: A Model for International Bankruptcy', 45 Va. J. Int'l L. 936, 946 (2005) (arguing that a territorialist insolvency system would 'undermine the market-symmetric and orderly disposition of a debtor's assets').

approach[4] and argue that adopting a single 'home' jurisdiction for a multinational corporation would inevitably lead to 'forum shopping'.

The universalist approach received a big boost in 1997, when the United Nations Commission on International Trade Law (UNCITRAL) promulgated the Model Law on Cross-Border Insolvency (the Model Law), which, generally, endorses recognition of a 'main' insolvency proceeding in a single country with the possibility of one or more local ancillary proceedings to support the foreign main proceeding. The Model Law thus creates a unified approach that could force creditors in different countries to look to a single country's law for recovery on their claims.

Key to the Model Law (enacted in 21 jurisdictions, including as Chapter 15 to Title 11 of the United States Code (the Bankruptcy Code) in the United States)[5] is a presumption that debtors could fairly access local courts to protect local assets, defend or commence local lawsuits and otherwise maximise the assets of the estate. However, in its recent decision in *Barnet*,[6] the United States Court of Appeals for the Second Circuit surprised many observers by holding that the same eligibility standard applies to ancillary Chapter 15 cases as to plenary cases in the United States – specifically, that a foreign debtor must have at least some property in the United States to commence proceedings under Chapter 15. Unless Chapter 15 is amended, the *Barnet* decision is likely to result in continuing confusion among courts and foreign debtors, inefficiencies in administration of cross-border cases and an increasing resort to creative ways to establish that debtors have property in the United States.

I IN RE BARNET

Octaviar Administration Pty Ltd (Octaviar), an Australian investment company, was placed into 'external administration' in Australia on 3 October 2008. Less than a year later, on 31 July 2009, the Supreme Court of Queensland ordered that Octaviar be liquidated. As part of the liquidation of Octaviar, the liquidators conducted examinations of directors, officers and professionals of Octaviar to determine whether there were potential causes of action that could bring assets into the estate. Following these investigations, the liquidators of Octaviar sought to recover claims in Australia against various Australian affiliates of Drawbridge Special Opportunities Fund LP (Drawbridge), a fund affiliated

4 See, for example, Lynn M LoPucki, 'Cooperation in International Bankruptcy: A Post-Universalist Approach', 84 Cornell L. Rev. 696, 709 (1999) (the problems with universalism are overwhelming); Lynn M LoPucki, 'Universalism Unravels', 79 Am. Bankr. L.J. 143, 148 (2005) (universalists have tried to ignore the uncomfortable fact that someone must be given the power to decide what a country's courts – and thus what a country's law – will control).

5 'United Nations Commission on International Trade Law (UNCITRAL): UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment', 30 May 1997, available at www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf.

6 *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013).

with the Fortress Group. Avoidance claims and related equitable claims were brought seeking to recover A$210 million.[7]

On 13 August 2012, the liquidators of Octaviar, acting as its 'foreign representatives',[8] filed a petition for recognition under Section 1515 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. At the time, Octaviar did not transact business in the United States or have any operations in the United States; however, the foreign representatives asserted that it might have assets in the United States in the form of inchoate claims or causes of action against Drawbridge affiliates located in the United States. Indeed, one of the principal purposes for filing the Chapter 15 petition was to conduct discovery to determine if there were, in fact, any such claims. The foreign representatives sought recognition of the Australian proceeding as Octaviar's foreign main proceeding, as defined in Section 1502(4) of the Bankruptcy Code. Recognition of the foreign main proceeding would allow the bankruptcy court to authorise the requested discovery under Section 1521(a)(4) of the Bankruptcy Code.

Drawbridge objected to recognition on the grounds that Octaviar did not reside or have a domicile, a place of business, or property in the United States and thus could not be a 'debtor' under Section 109(a) of the Bankruptcy Code. The issue stems from the language of the Bankruptcy Code. Specifically, Section 109(a) provides that 'only a person[9] that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under [the Bankruptcy Code]'.[10] Section 103(a), in turn, purports to make Section 109(a) applicable in a Chapter 15 case, with one exception that is not relevant here.[11] Chapter 15, however, contains its own definition of 'debtor'. Section 1502 states that, for the purposes of Chapter 15, a 'debtor' is 'an entity that is the subject of a foreign proceeding'.[12]

Drawbridge asserted that the plain language of Section 109(a) requires that a debtor have property in the United States and Section 103(a) makes this requirement applicable in a Chapter 15 case.[13]

7 *In re Barnet*, 2012 Bankr. LEXIS 6233 at *6 (Bankr. S.D.N.Y. 28 November 2012).

8 See 11 U.S.C. §§ 101(24), 1509.

9 As per 11 U.S.C. § 101(41), '[t]he term "person" includes individual, partnership, and corporation'.

10 11 U.S.C. § 109(a).

11 11 U.S.C. § 103(a) (except as provided in Section 1161 of this Title, Chapters 1, 3, and 5 of this Title apply in a case under Chapter 7, 11, 12, or 13 of this Title, and this Chapter, Sections 307, 362 (o), 555 through 557, and 559 through 562 apply in a case under Chapter 15).

12 11 U.S.C. § 1502(1).

13 Objection of Drawbridge Special Opportunities Fund LP to Alleged Foreign Representatives' Verified Petition Under Chapter 15 for Recognition of Foreign Main Proceeding at 4, Case No. 12-13443 (Bankr. S.D.N.Y. 30 August 2012), ECF No. 13.

The foreign representatives raised a number of arguments in support of their petition. First, they argued that Section 109(a) does not apply in Chapter 15 cases.[14] 'A "debtor" as described in Section 109(a)', the foreign representatives noted, 'is an entity that commences a case to "create an estate" under Section 541 of the Bankruptcy Code'.[15] Because no estate is created in Chapter 15, there is no debtor as that term is used in Chapter 7 or Chapter 11.[16] Moreover, Section 1502 contains a unique definition of a debtor, which it defines as 'any entity that is the subject of a foreign proceeding'.[17] Octaviar certainly would qualify as a debtor under this definition. Second, the Chapter 15 venue provision in Section 1410 of the Bankruptcy Code provides for venue in a Chapter 15 case in which a debtor does not have assets or place of business in the United States, which implies that such a debtor could file for Chapter 15 in the first place.[18] Third, case law under Section 304 of the Bankruptcy Code, the predecessor to Chapter 15, supported the conclusion that the bankruptcy courts had jurisdiction over the affairs of foreign debtors with no assets or business in the United States.[19] Fourth, two recent decisions in the Southern District of New York had held that the presence of assets in the United States was not necessary to grant relief under Chapter 15.[20] In *In re Toft*, the bankruptcy court observed that '[t]he eligibility standards in Section 109 for filings under the various chapters of the Bankruptcy Code do not require that a debtor in a foreign proceeding have a place of business or property in the United States'.[21] Likewise, in *In re Fairfield Sentry Ltd*, the bankruptcy court found that 'Section 1521(a)(4) … allows for discovery in the United States whether or not a debtor has assets here'.[22]

The bankruptcy court granted recognition of Octaviar's Australian proceeding over Drawbridge's objection. In so holding, the bankruptcy court was persuaded by the *Toft* and *Fairfield Sentry* decisions[23] and by law and practice developed under former Section 304 of the Bankruptcy Code.[24] Both parties indicated an intent to appeal

14 Petitioners' Response to Objection of Drawbridge Special Opportunities Fund LP to Verified Petition Under Chapter 15 for Recognition of a Foreign Main Proceeding at 4, Case No. 12-13443 (Bankr. S.D.N.Y. 5 September 2012), ECF No. 16.

15 Id.

16 Id.

17 Id. Note that this definition is not included in the text of the Model Law. The legislative history to Chapter 15 states that the definition 'is necessary to eliminate the need to refer repeatedly to "the same debtor as in the foreign proceeding"'. H.R. Rep. No. 109-31, pt.1, at *107 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 170. This legislative history seems to indicate that had Congress adopted the Model Law without making this change, the word 'debtor' in Chapter 15 would have been replaced with 'debtor in a foreign proceeding'.

18 Id. at 5.

19 Id. at 7.

20 Id. at 7-8.

21 *In re Toft*, 453 B.R. 186, 193 (Bankr. S.D.N.Y. 2011).

22 *In re Fairfield Sentry, Ltd.*, 458 B.R. 665, 679 n.5 (Bankr. S.D.N.Y. 2011).

23 *In re Barnet*, 2012 Bankr. LEXIS 6233 at *8.

24 Id. at *10–11.

any adverse decision of the district court if it were to hear and decide an appeal of the recognition order in the first instance, which prompted the bankruptcy court to certify the matter for direct appeal to the Second Circuit Court of Appeals.[25]

The Second Circuit reversed, accepting Drawbridge's argument that the language of Section 109(a) applied in a Chapter 15 case and that Octaviar therefore could not be a debtor under Chapter 15 without a domicile, a place of business, or property in the United States.[26] The court rejected each of the foreign representatives' textual arguments. Notably, however, the opinion does not address former Section 304 of the Bankruptcy Code or the precedent cases that were persuasive in the proceeding below (but were not binding on the Court of Appeals). On appeal, the foreign representatives suggested that the purpose of Chapter 15 would be undermined by application of Section 109(a), but the court countered that none of the delineated purposes set forth in the express purpose section of Chapter 15 were dispositive to whether Section 109(a) applies, and so the clear language of the statute must control.[27] The Second Circuit nevertheless acknowledged that the Model Law contains no similar requirement,[28] and, perhaps as a result, in its order, took the rare step of directing the Clerk of the Court to forward copies of the opinion to Congress.

The foreign representatives subsequently pursued discovery against Drawbridge outside Chapter 15, under 28 U.S.C. 1782.[29] Following this discovery, Octaviar identified and filed causes of action against Drawbridge in both federal and state court in New York. In addition, Octaviar provided its US counsel with a $10,000 retainer. Following this and over 18 months after Octaviar's first Chapter 15 case was filed, the foreign representatives refiled Octaviar's Chapter 15 case (creating a 'Chapter 30', perhaps the first in US history).[30]

Drawbridge objected to the foreign representatives' request for recognition of the newly filed petition, but the bankruptcy court concluded that the particular claims and causes of action against Drawbridge (now reduced to complaints) were property in the United States within the meaning of Section 109(a) of the Bankruptcy Code.[31]

25 Id. at *14.

26 *In re Barnet*, 737 F.3d at 247. The court reached this holding after finding that Drawbridge had standing to appeal the discovery order entered in the bankruptcy case; that appeal brought up for review the recognition order. Id. at 243.

27 Id. at 250–51.

28 Id. at 251.

29 This statute is entitled 'Assistance to foreign and international tribunals and to litigants before such tribunals' and allows for district courts to order a person to give testimony, a statement or produce a document for use in a proceeding in a foreign or international tribunal.

30 *In re Octaviar Admin. Pty. Ltd.*, Case No. 14-10438 (SCC) (Bankr. S.D.N.Y. 27 February 2014), ECF No. 1.

31 *In re Octaviar Admin. Pty. Ltd.*, 511 B.R. 361, 371 (Bankr. S.D.N.Y. 2014).

This holding runs somewhat counter to the holding in *In re Fairfield Sentry Ltd*,[32] by a different bankruptcy judge in the Southern District of New York (the same court as the *Octaviar* case) the previous year. In *Fairfield Sentry*, the debtor, a Madoff feeder-fund that was situated in the British Virgin Islands, held a claim against the estate of Bernard L Madoff. The bankruptcy court found that under New York law, the claim held by the debtor was a general intangible asset of the debtor and was located in the *situs* of the debtor, the BVI.[33] Nevertheless, the *Octaviar* court found that the flexible test employed in *Fairfield Sentry*, which depended on 'a common sense appraisal of the requirements of justice and convenience', allowed for a different conclusion with respect to the foreign representatives' claims.[34] In *Octaviar*, the claims were asserted under US law, involved defendants located in the United States and included allegations that funds were wrongfully transferred in the United States. In addition, the actions in the United States involved different parties from those in related actions in Australia, and the US courts had both personal and subject matter jurisdiction.[35]

The *Octaviar* court further found that Octaviar had property in the United States within the meaning of Section 109 of the Bankruptcy Code in the form of an undrawn retainer, deposited with the foreign representatives' counsel prior to the filing of the second Chapter 15 petition.[36] Drawbridge argued that depositing the retainer constituted a 'bad-faith attempt to "manufacture eligibility"' to file for Chapter 15.[37] The court found that Octaviar had acted in good faith and that, '[i]n any event, as the Second Circuit emphasised in *Barnet*, the Court must abide by the plain meaning of the words in the statute. Section 109(a) says, simply, that the debtor must have property; it says nothing about the amount of such property'.[38] Furthermore, the imposition of a requirement that the property be 'substantial' would 'subvert the intent of Congress and the plain meaning of the statute'.[39]

The state court action is currently stayed by stipulation of both parties pending the final disposition of the federal action.[40] The substantive litigation is proceeding in the

32 *In re Fairfield Sentry Ltd.*, 484 B.R. 615 (Bankr. S.D.N.Y. 2013). This is a different *Fairfield Sentry* decision from the one that the bankruptcy court cited in the first Chapter 15 proceeding in support of recognition.

33 Id. at 623.

34 *In re Octaviar*, 511 B.R. at 371.

35 Id. at 372.

36 Id.

37 Id.

38 Id. at 373.

39 Id.

40 *Katherine Elizabeth Barnet and William John Fletcher, as Liquidators of Octaviar Admin. Pty. Ltd. (in Liquidation) v. Drawbridge Special Opportunities Fund, LP*, Sup. Ct., NY County, Index No. 650656/14 (1st Dep't 2014).

District Court for the Southern District of New York.[41] On 20 June 2014, Drawbridge filed a motion to dismiss the litigation.[42] Motion practice is ongoing as of this writing.

II BEMARMARA

Mere days after the Second Circuit's *Barnet* decision, the bankruptcy court for the District of Delaware faced the same question of whether Section 109(a) applied to eligibility for a Chapter 15 case and concluded, contrary to *Barnet*, that it did not.[43] On 22 August 2012, Bemarmara Consulting a.s. (Bemarmara), a company specialising in the manufacture of welded steel structures, facilities and machine parts, filed a voluntary insolvency petition under the Czech Insolvency Act. The County Court in Prague, Czech Republic announced the commencement of Bemarmara's insolvency proceedings the following day.

In May of 2009, more than four years before the commencement of Bemarmara's Czech insolvency proceedings, Terex USA, LLC (Terex), a customer of Bemarmara, commenced an action in the federal district court in Delaware against Bemarmara. The action sought a declaratory judgment with respect to various contract and warranty claims. Following an unsuccessful attempt at mediation, Terex filed a motion seeking sanctions (related to Bemarmara's failure to respond to requests for depositions) and entry of a default judgment against Bemarmara. Separately, Terex filed a claim in Bemarmara's Czech proceeding for $26 million.

On 15 November 2013, the foreign representatives of Bemarmara filed for Chapter 15 relief and sought provisional relief staying the Terex action.[44] Terex objected to recognition of Bemarmara's Czech insolvency proceedings on the grounds that Bemarmara had no assets, employees or operations in the United States. In fact, Bemarmara had no US creditors other than Terex and no pending litigation in the United States other than the Terex action.

The Delaware bankruptcy granted recognition to Bemarmara's Czech proceeding and stated, rather bluntly, that '[t]he decision of the Second Circuit [in *Octaviar*] is not controlling in this Court. And this Court does not agree with the decision of the Second Circuit'.[45] Rather, the Delaware bankruptcy court held that '[i]n the absence of a finding that the motion for recognition is manifestly contrary to public policy, recognition is mandatory in aid of the main proceeding'.[46] Further, the court held that this public policy exception should be 'narrowly construed' and invoked only under 'exceptional

41 See *Katherine Elizabeth Barnet and William John Fletcher, as Liquidators of Octaviar Admin. Pty. Ltd. (in Liquidation) v. Drawbridge Special Opportunities Fund, LP*, Case No. 14-1376 (PKC) (S.D.N.Y. 2014).

42 Id. ECF. No. 31 (20 June 2014).

43 *In re Bemarmara Consulting a.s.*, Case No. 13-13037 (KG) (Bankr. D. Del. 17 December 2013) ECF. No. 38.

44 *In re Bemarmara Consulting a.s.*, ECF. No. 1.

45 *In re Bemarmara Consulting a.s.*, ECF. No. 38 at *8.

46 Id. at *6-7.

circumstances'.[47] With respect to the textual argument upon which the Second Circuit based its decision in *Octaviar*, the Delaware bankruptcy court postulated that perhaps the failure to carve Chapter 15 out from Section 109(a)'s requirement that a debtor have assets in the United States was a 'scrivener's error' and that the 'intent was that 109(a) not apply'.[48] The court pointed to the language of Section 1502, which has no requirement that a Chapter 15 'debtor' have assets in the United States, and found that the Section 1502 definition of 'debtor' should apply.

III THE MODEL LAW

Because the 'assets in the United States' requirement in Section 109(a) requires only *de mimimis* assets, the perceived hurdle the *Octaviar* decision created with respect to a foreign debtor's access to a US bankruptcy court in the Second Circuit is easily overcome – as it was, ultimately, by Octaviar itself. Nevertheless, the split between the Second Circuit and the Delaware bankruptcy court (which sits in the Third Circuit) is important because it demonstrates how US courts are still grappling with integration of the Model Law into the US bankruptcy system. While it makes sense that the Bankruptcy Code would contain a requirement that a company filing a plenary bankruptcy proceeding under the Bankruptcy Code (under Chapter 7 or Chapter 11) have a property-based connection to the United States, as required by Section 109(a), such a requirement makes little sense for a foreign company seeking to use Chapter 15 merely to support its foreign main proceeding. It is also likely to be inconsistent with what the drafters of the Model Law intended, especially because an ancillary foreign proceeding could be necessary or useful to support a debtor's main proceeding even if the debtor does not have property in the non-main jurisdiction.

UNCITRAL has produced and issued a text intended to provide guidance to judges in foreign jurisdictions in interpreting the Model Law (the Judicial Perspective).[49] One of the issues recognised by UNCITRAL in the Judicial Perspective was that '[i]n some circumstances, it might be argued that a particular entity administered by a "foreign representative" is not a "debtor" for the purposes of the domestic law to be applied by the receiving court'.[50] In response to this potential issue, the Judicial Perspective points to the case of *Rubin v. Eurofinance*,[51] in which it was argued that because the debtor in the US plenary proceeding was a 'business trust', which is not a recognised entity under English law, the debtor could not be recognised as a 'debtor' under English law. The English court rejected this argument 'holding that, having regard to the international origins of the UNCITRAL Model Law, a "parochial interpretation" of the term "debtor" would

47 Id. at *7.

48 Id. at *9.

49 'UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective' (Updated 2013), available at www.uncitral.org/pdf/english/texts/insolven/V1188129-Judicial_Perspective_ebook-E.pdf.

50 Id. at 12.

51 Id. at 11.

be "perverse"'.[52] Though not a directly analogous situation, the message is similar. Once a valid plenary proceeding exists, access to the ancillary court to assist with the plenary proceeding is viewed as critical.

IV CHAPTER 15

The legislative history of Chapter 15 further supports the *Bemarmara* holding that the failure to carve Chapter 15 out of Section 109(a) may well have been a 'scrivener's error'. Chapter 15 largely adopts the Model Law verbatim, and the legislative history addresses the places where the language of Chapter 15 strays from that of the Model Law. One of these places is the addition of the definition of 'debtor' in Section 1502, which, as discussed above, appears to have been added largely for convenience.

Section 1508 of the Bankruptcy Code provides an interpretive guide to Chapter 15 and states that 'the court shall consider its international origin, and the need to promote an application of this Chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions'.[53] Further, the legislative history of Section 1508 provides that the interpretation of Chapter 15 is to be aided by the UNCITRAL Case Law on Uniform Texts because it will 'advance the crucial goal of uniformity of interpretation'.[54] With uniformity of interpretation with the Model Law as a stated goal of Chapter 15, it seems unlikely that Congress intended to exclude from Chapter 15 eligibility a whole category of foreign entities that the Model Law would otherwise protect.

V WHY THIS MATTERS

Filing an ancillary proceeding under Chapter 15 or any other insolvency law based on the Model Law may be necessary for companies even if they do not have business operations or property in the ancillary jurisdiction. This is because an ancillary proceeding can be helpful to stay local litigation, pursue claims or bind local creditors who may be outside the reach of the court overseeing the plenary proceeding. In multinational insolvencies based on the Model Law, claims are administered in the plenary proceeding, and the purpose of the ancillary proceeding is, among other things, to help enforce the treatment of local creditors as determined in the main proceedings. The ability to use an ancillary proceeding to ensure global enforcement of the outcome of the main proceeding is one of the principal purposes of the Model Law and this purpose is wholly independent of the location of the debtor's property.

52 Id., citing *Rubin v. Eurofinance*, [2009] EWHC 2129 (Eng.).

53 11 U.S.C. § 1508.

54 H.R. REP. 109-31, pt. 1, at *110 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 172-173.

Chapter 12

FRANCE

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I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

French insolvency law currently provides for seven restructuring and (pre-)insolvency proceedings, which can be classified into two subgroups: two court-assisted proceedings (*ad hoc* mandate and conciliation proceedings) and five court-controlled proceedings (judicial reorganisation, judicial liquidation and three types of safeguard proceedings). The main features of each of these proceedings are discussed below, as well as the key changes resulting from a fairly significant reform introduced in the course of 2014.[2]

The two court-assisted proceedings (*ad hoc* mandate and conciliation proceedings) are both informal, amicable proceedings where no creditor can be forced into a restructuring agreement and where the management still runs the business. Negotiations thus remain governed by the terms of the contract for the duration of the proceeding, which (unless the contract provides that certain terms can be changed with the consent of a specified majority of creditors) implies obtaining the consent of each and every creditor involved in the restructuring process. Furthermore, only the debtor can decide to enter into these kinds of non-compulsory proceedings.

These proceedings are conducted under the supervision of a court-appointed practitioner[3] (*ad hoc* agent or conciliator) to help the debtor reach an agreement with its creditors, typically to reduce or reschedule its indebtedness.

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2 Ordinance No. 2014-326 of 12 March 2014 and Decree No. 2014-736 of 30 June 2014.

3 Most of the time, court-appointed practitioners are chosen from the profession of judicial administrators, who are independent restructuring and insolvency practitioners. Judicial administrators are members of a regulated profession requiring a specific degree and

Both are confidential proceedings. The conciliation proceeding can, however, become public if the debtor seeks the approval of the commercial court, so that new money provided to the distressed debtor benefits from a legal privilege in case of future insolvency proceedings.[4] Although the conciliation and the related court decision become public, the terms and conditions of the conciliation agreement must, by law, remain confidential.

Such pre-insolvency proceedings are increasingly implemented to restructure distressed leveraged buyouts (LBOs) or to secure share capital reorganisations and spin-offs of distressed companies (see Section IV, *infra*).

All five court-controlled proceedings are public and share the following common features:

a All pre-filing claims (with very few exceptions) are automatically stayed.[5]

b All creditors (except employees) must file proof of their claim within two months after the opening judgment has been published. The period is extended to four months for creditors located outside France. Fortunately, the 2014 reform has simplified this proof of creditors' claim process, bringing it closer to the one applying to US Chapter 11 proceedings. In particular, the list of creditors' claims prepared by the debtor at the outset of the proceeding is now deemed a valid proof of claim made on behalf of the relevant creditors, except for those creditors who decide to file their own proof of claim.

c Debts arising after the commencement of the proceedings[6] will be given priority over debts incurred prior to their commencement (other than certain employment claims and, as noted above, claims of creditors who provided new money as part of a previous conciliation proceeding).

d In judicial reorganisation and judicial liquidation proceedings, certain types of transactions may be set aside by the court (fraudulent conveyances) if they were entered into by the debtor during a hardening period before a judgment opening a judicial reorganisation or a judicial liquidation. This period runs from the date on which the company is deemed insolvent; such date is fixed by the court and may predate the judgment commencing the relevant insolvency proceedings by up to 18 months.

However, court-controlled proceedings vary in terms of the involvement of the court-appointed practitioner in running the business. The safeguard, accelerated safeguard (AS) and accelerated financial safeguard (AFS) (see Section I.iii, *infra*) are debtor-in-possession proceedings. In a judicial reorganisation proceeding, the court has discretion to decide

appropriate qualifications, dedicated exclusively to the assistance or representation of debtors subject to pre-insolvency or insolvency proceedings.

4 This privilege is useful mainly in liquidation proceedings.

5 In an AFS proceeding, the automatic stay only applies to financial creditors (see Section I.iii, *infra*, for further details).

6 Provided such debts are incurred for the purposes of the proceedings or in consideration of services provided to the debtor.

whether to set aside the managers. The role of management is particularly reduced in a judicial liquidation proceeding because the debtor generally ceases to conduct any business. Nevertheless, the court can decide that the business will continue under the supervision of a court-appointed liquidator who is in charge of liquidating the debtor's assets to pay its creditors.

Further, the safeguard, AS and AFS, introduced in 2005, 2014 and 2010 respectively, can only be opened as long as the debtor remains solvent (i.e., when the debtor is still able to pay its debts as they fall due out of its available assets (taking into account any waiver or moratorium to which its creditors may have consented)) or, with respect to AS and AFS proceedings, provided it has not been insolvent for more than 45 days, whereas only the other two court-controlled proceedings (the judicial reorganisation and judicial liquidation) are available to insolvent debtors.

In practice, some meaningful restructuring cases are first handled via some of those court-assisted proceedings, then implemented through a court-controlled proceeding, typically through an AFS, AS or safeguard.

ii Policy

French insolvency legislation has long been seen, generally, as favouring the debtor and the continuation of a business over the payment of creditors: French law explicitly sets the preservation of the business and the safeguarding of employment as the primary goal of a restructuring over the payment of the creditors (while the payment of the creditors becomes the primary goal only in a judicial liquidation, where all prospects of continuing the business have vanished). However, a fairly significant reform was introduced in 2014, whose stated objective was to shift the balance in favour of creditors. The key changes introduced by the reform were, first, to facilitate the process for creditors to file proof of their claims: in principle, creditors no longer have to go through that process if their claim is mentioned in the filing made by the debtor itself at the outset of the proceeding. Creditors can elect to make that filing themselves if there was an omission in the debtor's filing, or if they dispute the amount mentioned by the debtor. Second, in a safeguard proceeding, creditors (but, surprisingly, not bondholders) are now entitled to submit their own restructuring plan, effectively as a counterproposal to the plan prepared by the debtor. Third, the 'nuisance capacity' of minority shareholders is reduced in safeguard proceedings since the court may decide to reduce the majority required for the shareholders' approval of debt-for-equity swaps from 66.33 per cent down to 50 per cent. Finally, in a judicial reorganisation proceeding, the shareholders' approval of a debt-for-equity swap may be forced on dissenting shareholders, in certain circumstances (see Section I.iii, *infra*).

Furthermore, French law heavily favours voluntary arrangements reached in *ad hoc* mandates and conciliation proceedings. It is often held that the potentially drastic measures that can be imposed on creditors in court-controlled proceedings is a strong incentive for them to reach a voluntary out-of-court arrangement. As a matter of fact, these informal court-assisted proceedings play a key role in most restructuring situations.

Another characteristic feature of French insolvency law is the very favourable treatment of the debtor's employees in insolvency, who are granted first-rank privilege over all the assets for the payment of their wage claims. In practice, employees' claims are also paid upfront by a quasi-public collective body, the Wage Guarantee Scheme (AGS), which will then benefit from the employees' first-rank privilege.

iii Restructuring and (pre-)insolvency procedures

Ad hoc mandate proceedings

Ad hoc mandate proceedings are straightforward and very flexible. It does not take more than a few days to obtain a court order appointing an *ad hoc* agent, who plays the role of an ombudsman and is in charge of facilitating and supervising discussions between the debtor and its main creditors. There is no statutory time limit within which the *ad hoc* agent must complete his or her tasks. The task of the *ad hoc* agent is set by the president of the commercial court according to the debtor's needs.

Conciliation proceedings

A debtor facing 'legal, economic or financial difficulties' may request the appointment of a conciliator to assist it in reaching an agreement with its main creditors and contractual partners provided it has not been insolvent for more than 45 days. At the end of the process, if an agreement has been found, it may be either acknowledged by the president of the competent commercial court or approved by the commercial court. Acknowledgment gives the agreement the legal force of an enforceable court decision. Approval of the agreement allows new financing provided to the distressed debtor (new money) to be granted a legal privilege in case of future liquidation. The court cannot appoint the conciliator for longer than four months, extendable at the conciliator's request provided that the total duration of the conciliation proceedings cannot exceed five months. The task of the conciliator may include the total or partial sale of the business (pre-pack disposal), to be implemented as necessary through court-controlled proceedings.

Safeguard proceedings

The safeguard proceeding was introduced in 2005 and was (in part) modelled on the US Chapter 11 proceedings. The debtor may not apply for safeguard if it is insolvent. Safeguard proceedings are public.

One of the main features of safeguard proceedings is the creation of two creditors' committees (one consisting of credit institutions and other creditors holding bank debt and the other of the main trade creditors) and, where applicable, a bondholders' committee (comprising all holders of bonds issued by the company). Each committee votes on the proposed restructuring plans, and the required majority in each committee is two-thirds of the voting creditors. Creditors whose repayment terms are not affected by the plan are not permitted to take part in the vote. The plans submitted to the committees may include a debt rescheduling, a debt write-off, a debt-for-equity swap, or a combination of the three. The plan can also provide for a partial sale of the business or certain assets (akin to Section 363 sales in the US). In addition to the approval of the creditor and bondholders' committees, debt-for-equity swaps require the approval of shareholders.

Provided that the plan is approved by the committees (and the shareholders if there is a debt-for-equity swap), and that creditors' interests are adequately preserved, the court approves the plan, which becomes binding on all parties, including dissenting committee members and shareholders.

If the plan is not approved by one of the committees, the court may, as a fall-back plan, impose a rescheduling of debt repayments over a maximum period of 10 years, but cannot impose a write-off of claim.

Accelerated safeguard and accelerated financial safeguard proceedings

The AS was introduced by the 2014 reform, as a specific type of safeguard proceeding intended to be implemented on an accelerated basis. This proceeding is only available to companies that have first been through a conciliation proceeding and failed to reach a unanimous restructuring agreement with their creditors.[7] The court will open an AS proceeding if the outcome of the conciliation suggests that the restructuring plan negotiated during the conciliation has sufficient support from the creditors such that it is reasonably likely to be adopted on an expedited basis (three months maximum). In other words, if there is a consensus among creditors on the plan proposed by the debtor in out-of-court negotiations, the AS proceeding is just a tool to cram down dissenting creditors.

The AFS proceeding is very similar to the AS and is intended for situations where the restructuring only involves financial debt. As a result, the AFS only affects financial creditors (and shareholders, to the extent there is a debt-for-equity swap) and does not entail any automatic stay of trade payables and other non-financial liabilities of the debtor, to limit the disruption to the business.

Judicial reorganisation proceedings

Judicial reorganisation proceedings apply to insolvent debtors (i.e., those that cannot pay their due debts out of their available assets). Most of the rules applicable to safeguard proceedings also apply to judicial reorganisation proceedings: pre-filing claims are automatically stayed, the reorganisation plan must be adopted by the creditors' committees and can provide for reschedulings, debt write-offs and debt-for-equity swaps, and the partial sale of the business.

The court may also order a total or partial sale of the business at the request of the court-appointed administrator.

Since the 2014 reform, a debt-for-equity swap may be forced on dissenting shareholders under certain circumstances. This is a significant change in the law that was welcomed by most commentators and practitioners, although it only applies to judicial reorganisation proceedings and is not available in safeguard. Overall, this change is viewed as a step in the right direction, reducing the damaging 'nuisance capacity' of shareholders.

7 AS proceedings are only available to debtors that draw up consolidated accounts or that exceed at least one of the following thresholds: (1) 20 employees, (2) €3 million of turnover or (3) a balance sheet of €1.5 million.

Judicial liquidation

The aim of these proceedings is to liquidate a company by selling its business when there is no prospect of recovery, be it as a whole or by branch of activity, or by each of its assets individually.

Liquidation proceedings last until no more proceeds can be expected from the sale of the company's business or assets. After two years (from the judgment ordering liquidation), any creditor can request that the court order the liquidator to close the liquidation. There is a simplified form of liquidation proceedings available for small businesses, which lasts for a maximum of one year.

iv Starting proceedings

Pre-insolvency proceedings (*ad hoc* mandates and conciliation proceedings) and safeguard proceedings may only be started by the debtor. Judicial reorganisations and judicial liquidations may be initiated by the debtors themselves, creditors or the state prosecutor. The debtor is required to petition for insolvency proceedings within 45 days of becoming insolvent unless it has initiated a conciliation proceeding within the same period. If it does not, directors and, as the case may be, *de facto* managers, may be subject to personal liability.

Only a few persons may appeal the opening of an insolvency proceeding: the debtor, a creditor that is party to the proceeding, the state prosecutor and, in respect of judicial liquidations, the workers' council. The appeal must be filed within 10 days of the judgment being notified to the parties. Third parties (including creditors that were not party to the proceeding) may also contest a judgment opening an insolvency proceeding or approving a conciliation agreement through third-party proceedings within 10 days of the opening judgment being published.

v Special regimes

Banks

The general insolvency regime described above applies generally to the vast majority of companies, with slight adjustments made to account for regulated entities such as insurance companies. However, France recently adopted new banking legislation[8] introducing an enhanced supervisory framework, including, critically, bail-in and other resolution powers in advance of the implementation of the European Recovery and Resolution Directive.[9] The French banking regulator, ACPR, is given very broad resolution tools with respect to failing banks,[10] including:

8 Law No. 2013-672 on the separation and regulation of banking activities dated 26 July 2013.

9 Directive 2014/59/EU of the European Parliament and of the Council dated 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms shall be implemented by Member States from 1 January 2015, except with respect to the bail-in tool for senior debt, which will apply from 1 January 2016 at the latest.

10 Failing banks are defined as those that, currently or in the near future: (1) no longer comply with regulatory capital requirements; (2) are not able to make payments that are, or will be imminently, due; or (3) require extraordinary public financial support.

a bail-in (i.e., the power to cancel or write-off shareholders' equity and then cancel, write-off or convert subordinated debt into equity, in accordance with their seniority);[11]

b the power to transfer all or part of the bank's assets and activities;

c the power to force a bank to issue new equity; and

d the power to terminate the contracts of executives or appoint a temporary administrator.

In cases determined by the French regulator, at its sole discretion, to be presenting urgent risks, it may adopt resolution measures unilaterally, without affording a hearing to interested parties.

Corporate groups

The French insolvency regime does not yet include specific rules tailored for corporate groups. Therefore, a separate insolvency proceeding must be opened with respect to each distressed company of the group and conflicts of jurisdiction (even within France among different local courts) may arise as a result.[12] Practitioners have attempted to avoid such conflicts and centralise all proceedings of the group companies using concepts such as the 'centre of main interests' (COMI)[13] (stemming from EC Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings (the EU Insolvency Regulation) – see Section I.vi, *infra*) or 'merger of the assets and liabilities'.[14] None of these concepts are, however, ideal for the (albeit common) situation where a corporate group is affected by financial difficulties.

vi Cross-border issues

Recognition of foreign insolvency proceedings differs largely depending on whether the debtor has its COMI located within the European Union (except Denmark).

In a case where the debtor's COMI is located in the EU, the EU Insolvency Regulation allows insolvency proceedings carried out in EU Member States to be automatically recognised in France. Alternatively, if a debtor's COMI is in France, the main proceeding can be commenced before the French courts and will be automatically recognised throughout the EU. The EU Insolvency Regulation also provides that secondary proceedings can subsequently be commenced to liquidate an establishment's assets located in another EU Member State.

11 As yet, senior debt is not subject to this bail-in power, contrary to the provisions of the EU Recovery and Resolution Directive.

12 As a step in the right direction, the 2014 reform has at least authorised the use of one single court-appointed practitioner for the proceedings of all companies within a group.

13 A company's COMI is presumed to be the place of its registered office.

14 A merger of the assets and liabilities entails the extension of an insolvency proceeding to an affiliate and is characterised when the following applies to companies in the group: commingling of the accounts, abnormal financial flows or interference in the affiliate's activities and management.

The recognition and enforcement in France of insolvency proceedings commenced in another country (outside the EU) requires an enforcement procedure during which, although the merits will not be reviewed, the French court will verify certain conditions pertaining to the jurisdiction of the foreign court in accordance with French rules of international conflicts of jurisdiction, compliance with French international public policy, absence of fraud, and absence of conflict with a French judgment (or a foreign judgment that has become effective in France). Although this would greatly simplify this burdensome process, France has not adopted the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency, as the United States did through Chapter 15 of the federal Bankruptcy Code.

II INSOLVENCY METRICS

With an unemployment rate of 10.7 per cent in 2013 and no growth (GDP in 2013/2014 is about flat),[15] France has been severely affected by the economic downturn of 2008.

In 2013, 63,101 insolvency proceedings were opened in France, compared with 61,278 in 2012 (i.e., an increase of 3 per cent following a similar increase in 2012 and small decreases of insolvency proceedings in 2010 and 2011).[16]

These official figures are unfortunately not representative of the restructuring market in France, first, because they do not include confidential amicable court-assisted proceedings (*ad hoc* mandates and conciliations), although these are more commonly used than public court-controlled proceedings in France in the case of large restructurings.[17] Second, the bulk of the more than 60,000 insolvency proceedings opened in France each year concerns extremely small businesses, mostly with no or very few employees: in 2013, 92 per cent of insolvency proceedings concerned companies with fewer than

15 Employment and labour markets: *OECD Economic Outlook No. 95 – May 2014*, http://stats.oecd.org/index.aspx?DataSetCode=EO93_FLASHFILE_EO93.

16 Source: 2013 report *Défaillances et sauvegardes d'entreprises en France* published by Altares, 16 January 2014, www.altares.fr/wp-content/uploads/2014/01/AltaresDefaSauvBilan2013.pdf. The number of insolvency proceedings opened in 2013 is close to that of 2009, in the midst of the financial crisis.

17 The few statistics available suggest that nearly 10,000 court-assisted proceedings were opened between 2006 and 2011 (Guillonneau, Haehl and Munoz-Perez, 'La prévention des difficultés des entreprises par le mandat *ad hoc* et la conciliation devant les juridictions commerciales de 2006 à 2011'). However, this number is not a fair reflection of the economic, financial and social significance of the businesses that used such court-assisted proceedings. In the absence of nationwide statistics on this subject, the figures of co-author Hélène Bourbouloux – a single professional judicial administrator – speak for themselves: since the end of 2008, nearly 56 court-assisted proceedings have been handled, concerning about 140,000 employees, and debts amounting to €25 billion, with the consolidated turnover reaching €25 billion.

10 employees.[18] At the other end of the spectrum, only 185 companies in insolvency in 2013 (representing 0.3 per cent) had more than 100 employees. Similarly, companies with a turnover exceeding €15 million accounted for 0.4 per cent of insolvency proceedings in 2013, while companies with a turnover under €1.5 million represented 39.9 per cent.[19] Also, the number of insolvency proceedings must be compared with the number of new companies created in France – 538,185 in 2013,[20] about nine times the number of bankruptcies.

When looking at statistics, commentators note that 85 per cent of insolvency proceedings opened in France lead to a liquidation,[21] to conclude that the legal framework is inefficient. A closer examination, however, reveals that nearly half of the jobs of businesses in insolvency are saved.[22]

III PLENARY INSOLVENCY PROCEEDINGS

Ailing LBOs have continued to fuel the restructuring market in recent years, in the aftermath of the private equity bubble in 2006. In most cases, LBO restructuring cases are lender-led and are handled through informal (court-assisted but not court-controlled) proceedings.

i Saur

Saur is the third-largest water services company in France (after Veolia and Suez Environnement). Its 13,000 employees generated revenues of €1.7 billion in 2012 with 10,000 municipalities and 18 million end-consumers in France and worldwide.

Saur breached a financial covenant when it faced a 10 per cent drop in its operating profit in the first half of 2012. The group petitioned the President of the Versailles Commercial Court to appoint a conciliator to help negotiate with its lenders and shareholders under a (confidential) pre-insolvency conciliation proceeding. The key features of the restructuring plan that was negotiated under the aegis of the conciliator involve:

18 Altares report op. cit. (footnote 16). This figure includes the insolvency proceedings of companies with fewer than 10 employees or where the number of employees is unknown.

19 Altares report op. cit. (footnote 16).

20 *Key Figures of Business Creation in 2013*, published by the governmental agency for business creation (APCE) and available online at www.observatoire-creation.com/sites/default/files/actualites/pdf/APCE_chiffrescles_2013.pdf.

21 2013 statistics of French commercial courts prepared by the General Conference of Lay Judges of France in April 2014.

22 Over the 12 months before 31 March 2012, approximately 58 per cent of jobs were saved. For further detail see Bourbouloux, 'Les chiffres trompeurs: halte aux idées reçues! La boîte à outils du livre VI est performante', *Bulletin Joly: Entreprises en difficulté*, No. 4, July–August 2012.

a lenders taking over Saur, with former shareholders[23] being written off entirely;
b a write-off of more than 50 per cent of senior debt and a full write-off of junior debt (total debt halved down to €900 million with an additional €150 million tranche that can be fully written off in the event of subsequent difficulties);
c new money financing of €200 million.

Interestingly, although the restructuring was fairly drastic, it was not necessary to resort to a safeguard to proceed to a court-enforced cramdown of dissenting creditors, since the lender-led restructuring agreement negotiated under conciliation was eventually approved by the court, so that the new money financing could be afforded a legal privilege in the event of a future liquidation. As noted above, whenever possible, the parties in France tend to avoid court-controlled proceedings such as a safeguard or judicial reorganisation, to avoid the public stigma linked to bankruptcy and reduce the disruption to the debtor's business.

ii Solocal

Solocal was previously known as PagesJaunes (akin to the Yellow Pages in the UK), the group that marketed the telephone directories. Although the group transitioned to online services, its business model was challenged, in particular by web search engines such as Google or Yahoo and it was faced with a significant decline in revenue.

In 2014, Solocal negotiated with its creditors to extend the maturity of its €1.3 billion 2006 LBO debt by three to five years, in exchange for an immediate partial repayment of €400 million, financed through a share capital increase. The company was not able to achieve the contractually required majority consent of 90 per cent of its creditors, so it requested the opening of an AFS to enforce the proposed financial restructuring.

Eventually, in the AFS the creditors approved the restructuring plan and the vote did reach a 90 per cent majority (well above the two-thirds threshold mandated by safeguard proceedings rules).

The restructuring of Solocal in 2014 was the first time this new AFS proceeding was implemented with respect to a listed company. As previously mentioned, the AFS aims at limiting the disruption to the debtor's business, as it does not entail any automatic stay of trade payables and is implemented on an accelerated basis. Also, the *Solocal* case shows that the AFS forces creditors to actually take a position on the proposed restructuring: either to approve or to reject it,[24] while it is tempting for creditors to simply wait and see during informal negotiations, thus delaying implementation. Hedged creditors under a credit–default swap are a good illustration of this issue.[25]

23 Séché Environnement (a French player in environmental projects and waste management), the French sovereign investment fund FSI and private equity funds Axa PE and Cube Infrastructure.

24 If, however, creditors choose not to show up at the creditors' meeting convened to rule on the plan, their claims will be disregarded.

25 Because a hedged creditor is compensated only upon the occurrence of a 'credit event', it usually prefers to remain passive and not to approve any restructuring of the debtor so as not

iii Sequana

Sequana, also a publicly listed company, is a leader in the distribution of paper and packaging products, with €3.3 billion sales in 2013 and 10,000 employees worldwide. It underwent in 2014 its third financial restructuring in three years. Almost €1 billion of debt were restructured through a court-assisted conciliation proceeding, with a debt write-off in the amount of €164 million, a rescheduling for €320 million, a deferred debt-for-equity swap of €132 million and a new equity contribution by existing shareholders for €64 million.

An interesting feature of the Sequana restructuring was the swap of €20 million of existing debt against 'disposal proceeds notes' (DPN). The DPN, which were created for the purpose of the Technicolor restructuring in 2010, are notes that entitle their holders to a reimbursement based on the proceeds to come of disposals of certain identified non-strategic assets. Therefore, DPN are a way to buy time (about a year in the Sequana case) to organise a smooth disposal process of certain assets, in order hopefully to maximise the value and cash proceeds to be received by the company.[26]

iv Cœur Défense

Cœur Défense, named after the largest office towers in Europe, located in La Défense near Paris, was one of the incidental victims of Lehman Brothers' demise in September 2008. It is also one of the most famous (or infamous, depending on one's point of view) restructuring cases in France in recent years, attracting considerable attention from practitioners and scholars.

In June 2007, a Lehman Brothers investment funds bought the Cœur Défense towers for €2.1 billion through a special purpose vehicle called Heart Of La Défense (HOLD) incorporated in France, itself held by a Luxembourg entity named Dame Luxembourg. A €1.6 billion loan to finance the acquisition was refinanced through a securitisation structure and secured through: (1) a mortgage on the assets (the towers), (2) an assignment (by way of a *bordereau* Dailly[27]) of the rental income and (3) a pledge of HOLD shares. Under the terms of the loan, HOLD was required to hedge its interest rate exposure and Lehman was then chosen as the swap counterparty. When the bank collapsed, the borrower was compelled to find a better-rated swap counterparty, which proved impossible given the market conditions (as one recalls, there was hardly a market at all for several weeks).

to be seen as participating in any way in the characterisation of the 'credit event' triggering the unwinding of the credit–default swap. For further information on this topic, see Pérès, Perchet, Loget and Schlumberger, 'Quelle réforme du droit des faillites?' *Banque & Droit* No. HS-2013-2, October 2013, pp. 22 et seq. and Foillard, 'Les procedures collectives à l'épreuve des contrats de swap', p. 51.

26 For further details on DPNs, see Pérès and Loget, 'Les DPN émis par Technicolor : un outil sur mesure au service du recentrage de ses activités', *Bulletin Joly: Bourse & Droit*, January 2011, pp. 64 et seq.

27 Under French law, a professional or a company can transfer its receivables to a bank via a simplified mechanism known as a *bordereau* Dailly or *cession* Dailly.

To prevent an imminent default under the loan (for failure to maintain a suitable hedging protection), HOLD and its shareholder filed for safeguard in France. Various important legal issues were at stake here, including whether and under what conditions a Luxembourg entity could be eligible for safeguard in France and also if a mere holding company (holding buildings and therefore hardly a 'business' in the usual sense) was eligible for safeguard.

Both questions were much debated, gave rise to a long (several years) and complex judicial battle between the debtor or sponsor and the senior creditors. Ultimately, the French Supreme Court ruled that the answer to each question was positive: first, the determination that the Luxembourg shareholder was eligible for safeguard in France was made on the basis that, according to the court, its COMI within the meaning of the EU Insolvency Regulation was in France. On the second question, the court merely stated that the law did not provide as a condition that the debtor should also qualify as a 'business' or an 'enterprise'.

In the United States, assuming Cœur Défense would have been eligible to the protection of Chapter 11, the secured creditors would have been entitled to foreclose on their mortgage or pledge and become the new owners of the assets. This outcome contrasts with French insolvency law, pursuant to which a creditor takeover requires the shareholders' approval in safeguard proceedings (see Section IV, *infra*, for further details). Cœur Défense's sponsor was not written off.

v Vivarte

Vivarte is a footwear and clothing retailer with well-known brands such as Caroll, Kookaï, La Halle, André and San Marina – and another example of an ailing LBO. Private equity funds acquired Vivarte for €3.5 billion in 2007, but the level of debt (€2.8 billion, one of the highest level of debts among European groups under LBO) had become unsustainable given the competition from low-cost players such as Zara, H&M or Uniqlo.

The main features of the restructuring plan that was agreed to in July 2014, after a lengthy and intensive negotiation process, are the following:

a lenders will take over Vivarte, with former shareholders[28] being entirely written off (subject to a contingent claw-back provision enabling them to receive equity in the future);
b a 70 per cent debt write-off. In total, the debt is reduced by €2 billion;
c creditors agree to provide new money financing of €500 million.

Although these terms are drastic for shareholders and creditors alike, this lender-led restructuring was achieved with unanimous creditors' approval, without the need to resort to a safeguard. However, the agreement negotiated under conciliation was eventually approved by the court, to allow for new money privilege. But the most specific feature of this deal is that the key creditors (specifically, four private equity funds) were granted a seat on Vivarte's board of directors, along with Vivarte's

28 Private equity funds as well as the former management of the group.

management. In their capacity of board members, those creditors will therefore have to comply with related fiduciary duties, having regard to Vivarte's corporate interest.[29]

vi Belvédère

The Belvédère restructuring is another interminable judicial saga that started in 2008 and went on for more than five years, under the close watch of commentators. Belvédère is an alcohol and spirits business that owns Sobieski, a popular Polish vodka brand, and Marie Brizard Liqueurs. There is a lot to say on this case as it illustrates some of the most blatant shortcomings in the way certain restructuring cases are conducted in the current legal framework in France: proceedings are generally too long and unpredictable.

In five years, with virtually no respite, Belvédère first moved into safeguard, then out of safeguard, then fell into a judicial reorganisation. There were about 15 court decisions in France, the United Kingdom and Poland – although all three countries are under the same umbrella of the EU Insolvency Regulation – and, in France itself, there were conflicting decisions from various local courts, several other decisions at the appeal and Supreme Court levels.

Eventually, in March 2013 the court-approved restructuring plan provided that creditors would take over 87 per cent of the equity (through a debt-for-equity swap for approximately €500 million). Former shareholders, who include actor Bruce Willis, would be diluted to hold together the remaining 13 per cent. In a US Chapter 11 proceeding, Belvédère's shareholders would probably have been written off entirely from the outset.

Belvédère illustrates the vulnerability of insolvent companies towards competitors: the debt-for-equity swap is expected to allow rival Stock Spirits, which makes Polish Orzel vodka, to take over 38 per cent of Belvédère's equity (with voting rights limited to 19.9 per cent) through investment fund Oaktree Capital Management, Belvédère's main creditor.

IV TRENDS

The move towards the takeover of debtor companies by their creditors, which we described in the first edition of the *International Insolvency Review* (see the French chapter, at Section V) will likely continue to grow, at least to the extent permitted by French law.[30]

In this respect, certain of the groundbreaking provisions introduced by the 2014 reform will certainly foster creditors' takeover. Such is the case of the provisions intended to reduce the 'nuisance capacity' of minority shareholders in safeguard proceedings or,

29 The corporate structure of a French limited liability company with a board of directors was used for this Vivarte restructuring.

30 After a first occurrence in the restructuring of CPI Group in 2009, Europe's leading monochrome book printer, 'lender-led restructuring' has grown following the 2008, 2010 and 2014 reforms. See, for example, the Vivarte and Saur restructurings described in Section III, *supra*, or the Terreal restructuring.

under certain circumstances, force shareholders' approval of debt-for-equity swaps on dissenting shareholders, in a judicial reorganisation proceeding (see Section I.ii, *supra*).

Nevertheless, shareholders can still veto a creditor takeover approval in safeguard proceedings. This leverage can be used by the shareholders throughout the negotiation process, to have the creditors bear more losses than would otherwise be the case. And yet, the shareholders are the ones benefiting primarily from the creation of value (through dividends, capital gains following transfers, etc.) and should therefore be the ones who bear the losses in priority, before the creditors. We believe that the reform should go one step further in the recognition of this fairly fundamental principle, known in the US as the 'absolute priority rule', which should provide greater predictability as to the outcome of the restructuring and overall a shorter process.[31]

The most recent restructuring practice also shows a new trend towards the use of conciliation proceedings to prepare and secure spin-offs of distressed companies (see for example the recent spin-off to their managers of La Redoute and Relais Colis, held by the Kering group).[32] Through the court approval of the agreement negotiated under conciliation, the parties aim at avoiding the risk that the spin-off is set aside as a fraudulent conveyance.

Finally, at the European level, a proposal for a regulation of the European Parliament and of the Council amending the EU Insolvency Regulation is currently being finalised and could be adopted within the next few months.[33] The following three modifications are particularly relevant.

In addition to the codification of the previous case law on the definition of the COMI, the proposal requires that the court verifies its jurisdiction *ex officio* and states the basis of its jurisdiction in its decision. Besides, the proposal grants foreign creditors the right to challenge the decision opening the proceeding. Those changes aim at limiting the 'forum shopping' allowed by an extensive definition of the COMI.

Also, secondary proceedings are no longer necessarily winding-up proceedings. When a secondary proceeding is opened because the debtor subject to a main proceeding has an establishment in another EU Member State, the jurisdiction can choose between all the proceedings offered by local law, including restructuration or reorganisation, to avoid untoward interference with the main proceeding.

31 If the agreed order of priority among creditors (senior and junior) and shareholders is not respected, the outcome of the restructuring becomes impossible to predict. This uncertainty increases the cost of distressed debtors' credit, or even worse can prevent distressed companies from accessing new financing. See Pérès, Perchet, Loget and Schlumberger, 'Quelle réforme du droit des faillites?', *Banque & Droit* No. HS-2013-2, October 2013, pp. 22 et seq.

32 For further information, see Bourbouloux and Chatelain, 'L'accord de conciliation homologué au secours des spin off d'entreprises en difficultés', *Bulletin Joly: Entreprises en difficulté*, July 2014, No. 4, p. 225 et seq.

33 Proposal for a Regulation of the European Parliament and of the Council amending the EU Insolvency Regulation. See Section I.vi, *supra*, for further information on the EU Insolvency Regulation.

Finally, the proposal attempts to better take into account corporate groups by requiring cooperation between insolvency practitioners and courts; further, insolvency practitioners are granted the right to request a stay of the EU proceedings opened with respect to any other member of the group.

Chapter 32

UNITED STATES

Donald S Bernstein, Timothy Graulich, Damon P Meyer and Christopher S Robertson[1]

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

Although individual states in the United States have laws that govern the relationship between debtors and their creditors, insolvency law in the United States is primarily dictated by federal law because Article 1, Section 8 of the United States Constitution bestows on Congress the power to enact 'uniform Laws on the subject of Bankruptcies'.[2] While there have been several different bankruptcy statutes passed by Congress, the US bankruptcy regime is currently set forth in Title 11 of the United States Code[3] (the Bankruptcy Code), which codified the Bankruptcy Reform Act of 1978[4] and subsequent amendments. The most recent significant amendment to the Bankruptcy Code was the 2005 Bankruptcy Abuse and Consumer Protection Act.[5]

The Bankruptcy Code is broken into nine chapters.[6] Chapters 1, 3 and 5 provide the structural components that generally apply to all bankruptcy cases. Chapters 7, 9, 11, 12, 13 and 15 lay out general procedures specific to certain types of bankruptcies. Generally speaking, these specific types of bankruptcies are:

a trustee-administered liquidation (Chapter 7);

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2 US Constitution, Article I, § 8.

3 11 U.S.C. §§ 101-1532 (2012).

4 Pub. L. No. 95-598 (1978).

5 Pub. L. No. 109-8 (2005).

6 As discussed in Section V below, there is a proposal currently under consideration in Congress to add a new chapter or subchapter to the Bankruptcy Code tailored to resolving systemically important financial institutions.

b municipality bankruptcy (Chapter 9);
c debtor-in-possession (DIP) managed reorganisation or liquidation (Chapter 11);
d family farmer and fisherman bankruptcies (Chapter 12);
e individual bankruptcies (Chapter 13);[7] and
f cross-border cases (Chapter 15).

Generally speaking, with respect to plenary corporate bankruptcies, US insolvency law provides for two distinct regimes: a trustee-controlled liquidation under Chapter 7 and a DIP-controlled reorganisation or structured liquidation under Chapter 11.[8] This article focuses on Chapter 11 proceedings. Below are certain key provisions of US insolvency law:

Automatic stays

One of the most important provisions of the US insolvency regime is the 'automatic stay', which is codified in Section 362 of the Bankruptcy Code. The automatic stay is a statutory injunction that applies immediately upon the commencement of a bankruptcy proceeding. Generally, the automatic stay operates to enjoin most creditors from pursuing actions or exercising remedies to recover against a debtor's property. There are limited exceptions to the automatic stay and it can be modified by a court order upon a showing of cause. The automatic stay provides the breathing room necessary for the debtor or trustee to assess and assemble all of the property of the estate without creditors seeking remedies to protect their own self-interests. Accordingly, the automatic stay allows for the preservation of the debtor's assets and the maximisation of their value and for an equitable distribution of those assets to creditors.

Safe harbours

One important exception to the automatic stay is that it generally does not apply to contracts that are colloquially referred to as 'financial contracts'. Specifically, the automatic stay does not apply to certain delineated counterparties' ability to offset, net, liquidate, terminate or accelerate 'securities contracts',[9] 'commodities contracts',[10] 'forward contracts',[11] 'repurchase agreements',[12] 'swap agreements',[13] or 'master netting agreements'[14] with a debtor, provided that the counterparty may be required to exercise its remedies

7 Individuals can also seek relief under Chapters 7 and 11 of the Bankruptcy Code.
8 A trustee can be appointed in Chapter 11 for cause. 11 U.S.C. § 1104(a)(1).
9 11 U.S.C. § 555.
10 11 U.S.C. § 556.
11 Id.
12 11 U.S.C. § 559.
13 11 U.S.C. § 560.
14 11 U.S.C. § 561.

promptly.[15] In addition, a debtor may not avoid as a fraudulent transfer a transfer to such a counterparty under one of these contracts unless the transfer is intentionally fraudulent.

The absolute priority rule

Another key tenet of US insolvency law is the absolute priority rule. The absolute priority rule provides that creditors with higher priority must be paid in full before creditors of lower priority receive any distribution from the bankruptcy estate, and thereby ensures a 'fair and equitable' distribution of the debtor's property consistent with the priorities under applicable non-bankruptcy law. As a result, in the absence of consent, secured claims must be paid in full from collateral before general unsecured creditors receive any recovery. Similarly, because equity holders have the lowest priority, in the absence of consent, they cannot receive any distribution until all creditors have received payment in full on account of their allowed claims. Consent to the payment of a junior class can be obtained through a vote of the senior class on a plan of reorganisation.[16]

Avoidance actions

The Bankruptcy Code also provides a number of procedures that allow the debtor or trustee to avoid a pre-bankruptcy transfer of property from the bankruptcy estate. This allows the debtor to maximise the value of the bankruptcy estate and prevent a depletion of the estate prior to the commencement of the bankruptcy proceeding that may favour certain creditors over others. These protections are found in Chapter 5 of the Bankruptcy Code. The most commonly used of these actions are:

a avoidance of preferential transfers, which enables an insolvent debtor, subject to certain defences, to avoid and recover payments based on antecedent debt made to creditors within the 90 days prior to the debtor's filing for bankruptcy – up to one year for payments made to insiders of the debtor;[17]

b avoidance of fraudulent transfers, which enables the debtor to avoid and recover transfers of property that were actually fraudulent or were made while the debtor was insolvent and for less than reasonably equivalent value;[18] and

15 See *In re Lehman Brothers Holdings Inc.*, Case No. 08-13555 (JMP) (Bankr. S.D.N.Y. 15 September 2009).

16 A plan of reorganisation is approved by a class when a majority in number of the class members vote in favour of it and the class members who voted in favour hold at least two thirds of the total value of the claims in that class. 11 U.S.C. § 1126.

17 11 U.S.C. § 547.

18 11 U.S.C. §§ 544(b), 548. Under Section 548, the trustee can avoid a fraudulent transfer of an interest of the debtor in property that took place within two years before the date of the filing of the petition. Under Section 544(b), a trustee can avoid a transfer of an interest of the debtor in property under applicable state law, which can extend the look-back period beyond two years. However, a debtor might not be able to avoid and recover subsequent transfers of property received abroad by a foreign transferee from a foreign transferor. See *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Sec. LLC*, Case No. 12-00115 (S.D.N.Y. 7 July 2014).

c avoidance of unperfected security interests, which enables a debtor to avoid liens on property if such liens were not perfected under applicable non-bankruptcy law prior to the commencement of the bankruptcy case.[19]

ii Policy

The goal of US insolvency law is to provide maximum return to creditors (and, if possible, equity holders) of the debtor and, in that context, to reorganise rather than liquidate business debtors to preserve employment and to realise the 'going concern surplus' of reorganisation value over liquidation value. Generally, this is accomplished by reorganising the debtor corporation under the provisions of Chapter 11 of the Bankruptcy Code. However, if a reorganisation is not possible – or if it would not result in a maximisation of value for creditors – the debtor company can be liquidated either under Chapter 11 or Chapter 7 of the Bankruptcy Code. Chapter 7 transfers the control of the liquidation process from the debtor's management, who are likely to have greater familiarity with the assets and their value, to a trustee appointed by the United States Trustee[20] or elected by the debtor's creditors. Chapter 7 liquidations usually result in lower recoveries for creditors. Therefore, companies are more likely to be liquidated under Chapter 7 if there are not sufficient funds in the estate or available to the estate to run a Chapter 11 process.

iii Insolvency procedures

As discussed above, the Bankruptcy Code provides for two main types of insolvency proceedings available to businesses with assets in the United States: Chapter 7 and Chapter 11.

Chapter 7

Chapter 7 is a trustee-controlled liquidation. The goal of Chapter 7 is to ensure the most efficient and orderly liquidation of the debtor's assets to be distributed to the creditors and equity holders. Companies cannot reorganise under Chapter 7. The Chapter 7 liquidation procedure is administered by a Chapter 7 trustee either selected by the United States Trustee or by an election conducted by certain creditors. The Chapter 7 trustee is responsible for realising upon all of the property of the estate and coordinating the distribution of such property or proceeds of sales of such property.

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19 11 U.S.C. § 552(a).

20 The United States Trustee Program is a component of the Department of Justice that seeks to promote the efficiency and protect the integrity of the federal bankruptcy system. The Program monitors the conduct of parties in interest in bankruptcy cases, oversees related administrative functions and acts to ensure compliance with applicable laws and procedures. It also identifies and helps investigate bankruptcy fraud and abuse in coordination with various law enforcement agencies. The United States Trustee is distinct from the trustee appointed to administer Chapter 7 and certain Chapter 11 cases.

Chapter 11

Chapter 11 provides for an insolvency proceeding in which the directors and management of the debtor company remain in control (the DIP) unless a trustee is appointed for cause. Chapter 11 proceedings allow for the reorganisation of the debtor's operations and capital structure in the hope that the company will emerge from the bankruptcy process as a healthier, reorganised company. Chapter 11 gives the debtor the exclusive right to propose a plan of reorganisation for the first 120 days after commencement of the bankruptcy proceedings, and this date may be extended until 18 months after the order for relief (the petition date of a voluntary case) in the case if the debtor is making progress on a plan of reorganisation and can show cause why the court should extend the exclusivity period. The plan of reorganisation provides for how the debtor's assets will be distributed among the classes of creditors and equity holders. It is also possible for a debtor to liquidate its assets through Chapter 11, which is typically a more structured liquidation than one under Chapter 7.

The culmination of a Chapter 11 proceeding is the filing of the plan of reorganisation. The Chapter 11 plan provides how creditors' claims will be treated by the estate. Under the Chapter 11 plan creditors and shareholders are divided into classes of holders sharing substantially similar claims or interests. Chapter 11 plans must meet certain standards to be confirmed. Even if a plan is accepted by the requisite vote of all impaired classes, it must be found by the court to be in 'the best interests of creditors' (providing each dissenting class member with at least what would have been recovered in a liquidation). As to a class that rejects the plan, the plan must satisfy the Bankruptcy Code's 'fair and equitable' requirement (described above).

To be confirmed, the plan of reorganisation is submitted to a vote of the various creditor and shareholder classes. If at least one class that stands to receive less than their asserted claim (an 'impaired' class) votes in support of confirmation, excluding insider yes votes, the plan can be confirmed over the dissent of another impaired class. Dissenting classes can thus be 'crammed down' so long as the plan is fair and equitable and does not discriminate among similarly situated creditors. Once the plan is approved by the necessary stakeholders, a court can confirm a plan so long as certain other prerequisites of Section 1129 of the Bankruptcy Code are satisfied.

Chapter 15

Chapter 15 is the Bankruptcy Code's codification of the United Nations Commission on International Trade Law (UNCITRAL) Model Law and allows a foreign debtor, through its 'foreign representative' to commence an ancillary proceeding in the United States to support its foreign insolvency proceeding.

iv Starting proceedings

As set forth above, the US Bankruptcy Code provides for different types of insolvency proceedings. Not all of these proceedings are available for all types of companies. Specifically, insurance companies and banking institutions cannot file for Chapter 7 or Chapter 11 bankruptcy; a railroad can be a debtor under Chapter 11 but not Chapter 7, and stockbrokers and commodity brokers can file for bankruptcy under Chapter 7 but not Chapter 11. Regardless of the type of bankruptcy case, under Section 301(a) of the

Bankruptcy Code, a debtor voluntarily commences a plenary insolvency proceeding by filing a petition with the bankruptcy court.

A bankruptcy proceeding can also be commenced against a debtor company, which is known as an 'involuntary' bankruptcy case. An involuntary case is commenced upon the filing of a petition with the bankruptcy court by three or more holders[21] of non-contingent, undisputed claims, and such claims aggregate at least $14,425 more than the value of any lien on property of the debtor securing such claims.[22] A bankruptcy court will order relief against the debtor in an involuntary case only if the debtor is generally not paying its debts as they become due, unless such debts are the subject of a *bona fide* dispute as to liability or amount,[23] or if a custodian as described in Section 303(h)(2) of the Bankruptcy Code has been appointed.

A Chapter 15 case is commenced when the foreign representative of the debtor company files a petition for recognition of the foreign proceeding with the US bankruptcy court.[24]

v Control of insolvency proceedings

Under Chapter 7, the insolvency proceeding is controlled by a trustee who is appointed by the United States Trustee or elected by the debtor's creditors to administer the debtor's assets. The 'Chapter 7 trustee' is responsible for, among other things, 'collect[ing] and reduc[ing] to money the property of the estate for which such trustee serves, and closes such estate as expeditiously as is compatible with the best interests of parties in interest'.[25] Although the Chapter 7 trustee can continue business operations for a short period if value is maximised by doing so, generally, once a Chapter 7 trustee has been appointed, the debtor company is expeditiously liquidated.

Chapter 11 proceedings allow for the debtor's existing management and directors to stay in place and operate the business during the bankruptcy case. For this reason, a debtor in a Chapter 11 proceeding is referred to as the 'DIP'. The board of directors' primary duties in connection with an insolvency proceeding are the same as they are

21 Only a single holder is necessary to commence an involuntary case if there are fewer than 12 overall holders of claims against the debtor.

22 11 U.S.C. §§ 303(b)(1), (2).

23 11 U.S.C. § 303(h)(1).

24 11 U.S.C. §§ 1504, 1515.

25 11 U.S.C. §704(a)(1).

outside bankruptcy[26] – to maximise the value of the company.[27] The key distinction is that when a company is insolvent, the creditors, not the shareholders, are the indirect beneficiaries of the board's fiduciary duties to the corporation and are, thus, able to bring actions for breach of fiduciary duty.[28] If it is in the best interests of the estate and its creditors, a trustee may be appointed to replace the DIP and administer a Chapter 11 case.[29]

During a Chapter 7 or Chapter 11 case, the DIP or trustee may take actions that are in the ordinary course of the debtor's business without approval of the bankruptcy court. Actions after entry of the order for relief outside the ordinary course of business are subject to bankruptcy court approval.

In the United States, bankruptcy courts are courts of limited jurisdiction. This is because, unlike federal district and circuit courts, bankruptcy courts were not created under Article III of the United States Constitution. Instead, Congress created the bankruptcy courts because they were 'necessary and proper' to effectuate Congress's enumerated powers to enact bankruptcy law. For this reason, bankruptcy courts may only oversee matters that are 'core' to the bankruptcy case.[30] Matters that are not 'core' to the

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26 The Supreme Court has observed that 'the willingness of courts to leave debtors in possession "is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee"'. *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 355 (1985), *citing Wolf v. Weinstein*, 372 U.S. 633, 651 (1963). Officers and directors may therefore owe fiduciary duties to the estate even if their fiduciary duties to the company were limited under state law prior to the bankruptcy. *In re Houston Regional Sports Network, L.P.*, Case No. 13-35998 (Bankr. S.D. Tex. 12 February 2014).

27 'Even when [a] company is insolvent the board may pursue, in good faith, strategies to maximise the value of the firm.' *Trenwick America Litigation Trust v. Ernst & Young*, 906 A.2d 168, 175 (Del. Ch. 2006).

28 Marshall Huebner and Hugh McCullough, 'The Fiduciary Duties of Directors of Troubled US Companies: Emerging Clarity', in ICLG to: Corporate Recovery and Insolvency 2008 6, 7 (Global Legal Group, Ltd 2008).

29 11 U.S.C. §1104.

30 Core proceedings include:

a matters concerning the administration of the estate;

b allowance or disallowance of claims against the estate or exemptions of property of the estate;

c counterclaims by the estate against persons filing claims against the estate;

d orders in respect of obtaining credit;

e proceedings to determine, avoid or recover preferences;

f motions to terminate, annul or modify the automatic stays;

g proceedings to determine, avoid or recover fraudulent conveyances;

h determination as to the dischargeability of particular debts;

i objection to discharges;

j determination of the validity, extent or priority of liens;

insolvency proceeding must be decided by a federal district court. Appeals of bankruptcy court decisions are generally heard, in the first instance, by the federal district court sitting in the same jurisdiction as the applicable bankruptcy court.[31]

Among other things, the bankruptcy court manages filing deadlines, hears evidence on contested issues and issues orders regarding requests for relief by the parties. Nevertheless, and despite the involvement of the court, many aspects of the bankruptcy process are negotiated by the parties outside the courtroom and the DIP or trustee is free to enter into settlement agreements, which are then subject to the approval of the bankruptcy court.

vi Special regimes

Securities broker-dealers are not eligible for relief under Chapter 11. Instead, insolvent broker-dealers may liquidate under Chapter 7 of the Bankruptcy Code,[32] but are more

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k confirmation of plans;

l orders approving the use or lease of property, including the use of cash collateral;

m orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

n other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor–creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

o recognition of foreign proceedings and other matters under Chapter 15 of Title 11.

28 U.S.C. § 157. The scope of the bankruptcy court's jurisdiction is, however, a subject under active review in light of the decision of the Supreme Court of the United States in *Stern v. Marshall*, 564 U.S. 2, 131 S. Ct. 2594 (2011), in which the Supreme Court held that a 28 U.S.C. § 157(b)(2)(C) was unconstitutional and thus non-Article III bankruptcy judges do not have authority to enter a final judgment on a debtor's compulsory state law counterclaim in an adversary proceeding brought by a creditor, even if the creditor has filed a proof of claim against the debtor's bankruptcy estate. As discussed in greater detail below, the Supreme Court's subsequent decision in *Exec. Benefits Ins. Agency v. Arkison*, No. 12-1200, slip op. (U.S. 9 June 2014) further explored the extent of the bankruptcy court's constitutional jurisdiction.

31 The 1st, 6th, 8th, 9th, and 10th Circuits have established Bankruptcy Appellate Panels (BAPs), which are panels composed of three bankruptcy judges that are authorised to hear appeals of bankruptcy court decisions. These panels are units of the federal courts of appeals. BAP judges continue to serve as active bankruptcy judges in addition to fulfilling their BAP duties. If a BAP has been established in a given circuit, the BAP will hear an appeal of a bankruptcy court decision unless a party to the appeal elects to have it heard by the district court. Decisions of the BAP may be appealed to the appropriate circuit court of appeals. United States Courts, Bankruptcy Appellate Panels, available at www.uscourts.gov/FederalCourts/UnderstandingtheFederalCourts/CourtofAppeals/BankruptcyAppellatePanels.aspx.

32 11 U.S.C. §§ 741-753.

likely to be resolved in a proceeding under the Securities Investor Protection Act of 1970 (SIPA).[33] SIPA proceedings are liquidation proceedings, and upon commencement of the SIPA proceedings, the broker-dealer will cease to conduct business as a broker-dealer, subject to certain limited exceptions. In SIPA proceedings, a trustee (the SIPA Trustee) will take control of all property, premises, bank accounts, records, systems and other assets of the broker-dealer and displace management. The SIPA Trustee's primary duties will be to marshal assets, recover and return customer property (including through effectuating bulk account transfers to a solvent broker-dealer) and liquidate the broker-dealer.

In SIPA proceedings, the provisions of Chapters 1, 3 and 5 and Subchapters I and II of Chapter 7 of the Bankruptcy Code will also apply, to the extent consistent with SIPA, and the SIPA Trustee will generally be subject to the same duties as a trustee under Chapter 7 of the Bankruptcy Code with certain limited exceptions regarding securities that are property of the customers of the broker-dealer. If the broker-dealer is a registered futures commission merchant under the Commodity Exchange Act of 1936,[34] the SIPA Trustee will have additional obligations under the Part 190 regulations[35] promulgated by the Commodity Futures Trading Commission, with respect to any commodity customer accounts that have not been transferred to another futures commission merchant prior to the filing date.

Although bank holding companies can file for Chapter 11 relief, their subsidiary depository institutions are not eligible for relief under the Bankruptcy Code, and are typically resolved by the Federal Deposit Insurance Corporation (FDIC) under the Federal Deposit Insurance Act.[36] The FDIC has the authority to market a failed depository institution for sale to another depository institution, or the FDIC can insert itself as a receiver, close the bank and liquidate its assets to pay off creditors. The powers of the FDIC as receiver are very similar to those of a trustee in bankruptcy.[37]

Additionally, the Dodd–Frank Wall Street Reform and Consumer Protection Act[38] established the Orderly Liquidation Authority (OLA), which provides that the FDIC may be appointed as receiver for a top-tier holding company of a failing financial institution that poses a systemic risk to the United States. OLA sets forth the procedures that the federal government can take to cause the wind-down of financial institutions that were once considered 'too big to fail'. Pursuant to OLA, the FDIC can exercise many of the same powers it has as a bank receiver to liquidate systemically risky financial institutions. Moreover, under the Dodd-Frank Act, institutions that may be subject to OLA must provide the FDIC with resolution plans (commonly known as 'living wills'), to serve as road maps in the event the financial institution requires resolution.

33 Pub. L. No. 91-598 (1970), codified at 15 U.S.C. §§ 78aaa et seq.

34 Pub. L. No. 74-675 (1936), codified at 7 U.S.C § 1 et seq.

35 17 C.F.R. Part 190.

36 Pub. L. No. 81-797 (1950).

37 Federal Deposit Insurance Company, 'Overview: The Resolution Handbook at a Glance', available at www.fdic.gov/bank/historical/reshandbook/overview.pdf.

38 Pub. L. 111-203 (2010).

State law governs all regulation of insurance companies, including the resolution of insolvent insurance companies.[39]

The Bankruptcy Code has mechanisms for dealing with the insolvency proceedings of corporate groups and there is no special regime to address these types of filings. If multiple affiliated companies in the same corporate group seek relief under the US Bankruptcy Code, they will file separate bankruptcy petitions but will often seek joint administration of the various bankruptcy proceedings, meaning that the bankruptcy cases of each member of the group will be overseen by the same judge, which provides for greater efficiency in the administration of the cases. Importantly, joint administration does not mean that the assets and liabilities of the group will be combined. Rather, corporate separateness will be observed despite the joint administration of the cases, unless there is cause to breach corporate separateness and 'substantively consolidate' the assets and liabilities of the debtor.

vii Cross-border issues

As part of the 2005 Bankruptcy Abuse and Consumer Protection Act, the United States enacted Chapter 15 of the Bankruptcy Code, which is based on the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law).[40] Chapter 15 governs how a US court should treat a foreign insolvency proceeding when no plenary proceedings have been commenced in the United States and provides a mechanism for the cooperation between the US court and the foreign court overseeing a debtor's plenary insolvency proceeding. Generally, Chapter 15 allows for the commencement of an ancillary proceeding upon recognition of the debtor's foreign proceeding. Once the foreign proceeding is recognised by the US bankruptcy court, the automatic stay applies to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States[41] and the debtor's foreign representative enjoys certain powers and privileges under the Bankruptcy Code, such as the right to intervene in any court proceeding in the United States in which the foreign debtor is a party, the right to sue and be sued in the United States on the foreign debtor's behalf, the authority to operate the debtor's business and the authority to initiate avoidance actions in a case pending under another chapter of the Bankruptcy Code.

The bar for accessing plenary proceedings in the US bankruptcy courts is relatively low. A company can be eligible to commence a Chapter 11 proceeding in a US bankruptcy court so long as it is incorporated or has any property or operations in the United States. Because of the perceived debtor-friendliness of US bankruptcy courts and the courts' vast experience in restructuring large multinational companies, many multinational companies are filing for Chapter 11, even if their principal place of business, or centre of main interest, is located outside the United States. This trend has been particularly prevalent in the shipping industry. For example, in one recent case,

39 11 U.S.C. § 1011.

40 'United Nations Commission on International Trade Law (UNCITRAL): UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment', 30 May 1997, available at www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf.

41 11 U.S.C. § 1520.

the Taiwan-based TMT Group opened an office in Houston only a few days before filing for Chapter 11 protection in the United States Bankruptcy Court for the Southern District of Texas.[42]

II INSOLVENCY METRICS

Since the global financial crisis, which saw gross domestic product adjusted for inflation (real GDP) drop 2.8 per cent from 2008 to 2009, the US economy has experienced a period of slow growth. From 2009 to 2013 real GDP in the United States increased 2.3 per cent on an average annual basis, although the 1.9 per cent real GDP from 2012 to 2013 trailed this average.[43] Furthermore, reported unemployment continues to abate: the unemployment rate for July 2014 was 6.2 per cent, down from 7.3 per cent in June of the previous year and from its October 2009 high of 10 per cent.[44]

Additionally, credit is readily available to US businesses. In 2013, US corporations issued over $1.34 trillion in bonds, a 7.6 per cent increase over the $1.24 trillion issued in 2012 and 47 per cent above the $909 billion issued in 2011.[45] Through the first six months of 2014 over $769.4 billion worth of bonds has been issued.[46] Average interest rates have remained near historic lows; the 10-year Treasury rate is currently around 2.4 per cent and has ranged between 2.34 per cent and 3.01 per cent in the current calendar year.[47] It is currently anticipated that interest rates will rise in 2015 and 2016, as the Board of Governors of the Federal Reserve System (the Federal Reserve Board) considers scaling back its quantitative easing policy.[48]

42 *In re TMT Procurement Corp.*, No. 13-33763 (MI) (Bankr. S.D. Tex. 20 June 2013). There are limits to a foreign-based company's ability to seek Chapter 11 protection. See *In re Yukos Oil Co.*, 321 B.R. 396,410-411 (Bankr. S.D. Tex. 2005) (bankruptcy court declines to exercise jurisdiction over Chapter 11 case of a Russian oil company seeking to use the automatic stay to prevent a foreclosure sale by the Russian government).

43 United States Department of Commerce, Bureau of Economic Analysis, Selected NIPA Tables, Table 1.1.1, available at www.bea.gov/national/index.htm#gdp.

44 United States Department of Labor, Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, available at http://data.bls.gov/timeseries/LNS14000000.

45 Federal Reserve Board, New Securities Issues, US Corporations, available at www.federalreserve.gov/econresdata/releases/corpsecure/current.htm.

46 Id.

47 United States Department of Treasury, Daily Yield Curve Rates, available at www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yieldYear&year=2014.

48 Jon Hilsenrath, 'Fed Keeps Rates Unchanged, Sees Eventual Rise in 2015, 2016', *The Wall Street Journal* (18 June 2014 11.33 p.m.), available at http://online.wsj.com/articles/fed-ups-projections-for-short-term-interest-rates-1403114981.

US equity and equity-related proceeds totalled $278.5 billion in 2013, a 14 per cent increase compared with the $244.5 billion raised in 2012. The number of deals increased approximately 33 per cent, from 795 in 2012 to 1,056 in 2013.[49]

US corporate default rates have remained fairly low in 2014. Moody's measured the US speculative-grade default rate for the quarter ending 30 June 2014 at 1.9 per cent, down from 3.0 per cent for the same period in 2013.[50] Similarly, Moody's indicated that the leveraged loan default rate for the second quarter of 2014 was 1.7 per cent, down from 2.3 per cent in 2013.[51] The low default rates are attributed by some to the 'amend and extend' phenomenon, which has pushed out the proverbial 'maturity wall' until at least 2017.[52]

As a result of the improvement in the US economy, the availability of cheap debt and the relaxation of credit covenants, fewer businesses are seeking bankruptcy relief. Specifically, 7,136 businesses filed Chapter 11 bankruptcies in the 12 months ending on 30 June 2014,[53] which is a 13 per cent reduction from the 8,216 Chapter 11 business filings in the 12 months ending on 30 June 2013.[54] This trend continued into July, with Chapter 11 business bankruptcies totalling 357, down 34 per cent from the 539 initiated in July 2013.[55] The frequency of bankruptcy filings has steadily subsided since the peak of 12,445 Chapter 11 business filings in the 12 months ending on 30 June 2010.[56] In

49 Thomson Reuters, 'Global Equity Capital Markets Review' (last accessed 12 June 2013), available at http://dmi.thomsonreuters.com/Content/Files/4Q2013_Thomson_Reuters_Equity_Capital_Markets_Review.pdf.

50 Moody's Investor Services, 'Announcement: Moody's: Global speculative-grade default rate ends at 2.2% in second quarter', available at https://www.moodys.com/research/Moodys-Global-speculative-grade-default-rate-ends-at-22-in--PR_303853?WT.mc_id=NLTITLE_YYYYMMDD_PR_303853.

51 Id.

52 Moody's Investor Services, 'Announcement: Moody's: Speculative-Grade Maturity Wall Pushed to 2017; More Debt Held by Low-Rated Companies', available at https://www.moodys.com/research/Moodys-Speculative-Grade-Maturity-Wall-Pushed-to-2017-More-Debt--PR_265573.

53 United States Courts, 'US Bankruptcy Courts – Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the 12-Month Period Ending June 30, 2014', available at www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2014/0614_f2.pdf.

54 United States Courts, 'US Bankruptcy Courts – Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the 12-Month Period Ending June 30, 2013', available at www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2013/0613_f2.pdf.

55 Epiq Systems, Monthly Update – July 2014.

56 United States Courts, 'US Bankruptcy Courts – Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the 12-Month Period Ending June 30, 2010', available at www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2010/0610_f2.pdf.

2013, 71 public companies filed for bankruptcy, with combined assets of $42.6 billion, down from 87 companies with combined assets of $70.8 billion in 2012.[57]

Although in both 2012 and 2013 the incidence of bankruptcy filings was generally distributed across industries, many of the significant bankruptcy cases involved energy, shipping, and publishing and media companies.[58]

Eighty companies commenced Chapter 15 proceedings in the 12 months ending on 31 March 2014.[59] This is 19 more than were initiated during the 12 months ending on 31 March 2013[60] but below the 116 Chapter 15 cases initiated during the 12 months ending on 31 March 2012.[61]

III PLENARY INSOLVENCY PROCEEDINGS

i City of Detroit, Michigan[62]

In the 1950s, Detroit, Michigan, with a population exceeding 1.75 million, was the fourth largest city in the United States and the cradle of the booming American automobile industry. Since that time, however, and in large part because of the loss of manufacturing jobs from changes in the automobile industry, Detroit's population has steadily declined. Now, Detroit is the eighteenth largest city in the United States, with a population of approximately 685,000. As the population decreased, so did economic activity in Detroit and, correspondingly, tax revenue. At the same time, Detroit incurred significant liabilities as the result of, among other things, debt issuances and pension obligations. This led to growing budget deficits, declining credit ratings, increased unemployment and inadequate municipal services.

On 1 March 2013, as a result of the City's severe financial distress, the Governor of Michigan appointed Kevyn D Orr as the 'Emergency Manager' of Detroit. Following negotiations with various creditor constituencies, on 18 July 2013, the Emergency Manager ordered the commencement of a bankruptcy case under Chapter 9 of the Bankruptcy Code. As of the filing date, Detroit had liabilities of approximately $17.976 billion – making the Detroit bankruptcy case the largest case ever filed under Chapter 9. The city's liabilities primarily consist of bond issuances, swap liabilities and unfunded

57 New Generation Research, Inc., *The 2014 Bankruptcy Yearbook and Almanac* (Kerry A. Mastroianni ed., 2014).

58 See id. at 37–41.

59 United States Courts, *supra* note 52.

60 United States Courts, *supra* note 53.

61 United States Courts, 'US Bankruptcy Courts – Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the 12-Month Period Ending March 31, 2012', available at www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2012/0312_f2.pdf.

62 Substantially all information in the following section is taken from the Fourth Amended Disclosure Statement with Respect to Fourth Amended Plan for the Adjustment of Debts of the City of Detroit, Case No. 13-53846, ECF No. 4391 (Bankr. E. D. Mich. 5 May 2014) (the Disclosure Statement).

pension obligations (and debt issuances related to the pension obligations). Following the commencement of the Chapter 9 case, the United States Bankruptcy Court for the Eastern District of Michigan appointed both an Official Committee of Unsecured Creditors (which has since been disbanded) and an official committee to act as the representative for Detroit's retired employees who were entitled to receive pension, health and other post-employment benefits.

The Detroit case is quite complex with significant litigation. One of the key issues facing Detroit since the commencement of its bankruptcy case has been the threshold issue of whether the city is eligible to be a debtor under Chapter 9 of the Bankruptcy Code – over 110 objections have been filed challenging the City's eligibility, including one filed by the Governor of Michigan arguing that, although the city is eligible to be a Chapter 9 debtor, it is barred by the Michigan Constitution from impairing pension obligations. On 5 December 2013, the bankruptcy court issued an order holding that Detroit was eligible to be a Chapter 9 debtor and authorised to impair its pension obligations. An appeal of this order is currently pending in the Sixth Circuit Court of Appeals. At the time of writing, the city of Detroit has settled with a significant number of its creditors, including many of the retirees, objecting to eligibility. As a condition to the settlements, the city required the settling parties to drop their eligibility objections. As a result, the eligibility objection appeals are currently in abeyance pending successful plan confirmation.

On 20 August 2014, Detroit filed its Sixth Amended Plan for the Adjustment of Debts of the City of Detroit. The plan divides Detroit's creditors into 17 different classes, with each class receiving different treatment under the plan. The Disclosure Statement was previously approved by the bankruptcy court and Detroit commenced solicitation on its Chapter 9 plan in early May 2014. Most of Detroit's creditor classes accepted the plan, including the two classes made up of the city's pension claimants. Bond insurers Syncora Capital Assurance Inc and Syncora Guarantee Inc and Financial Guaranty Insurance Company, along with an *ad hoc* group of bondholders, were the only significant opposition to the city's plan heading into the confirmation hearing, other than individual objectors and some of the city's surrounding counties. A trial before the bankruptcy court to consider approval of Detroit's plan commenced on 2 September 2014.

ii Energy Future Holdings[63]

On 29 April 2014, Energy Future Holdings Corp (EFH), the largest generator, distributor and retail provider of electricity in the state of Texas, together with 70 of its direct and indirect subsidiaries, filed one of the largest cases ever under Chapter 11 of the Bankruptcy Code, with funded indebtedness of over $36 billion. EFH maintains three distinct business lines:

63 Substantially all information in the following section is taken from the Declaration of Paul Keglevic, Executive Vice President, Chief Financial Officer, and Co-Chief Restructuring Officer of Energy Future Holdings Corp., Et Al., in Support of First Day Motions, Case No. 14-10979, ECF No. 98 (Bankr. D. Del. 29 April 2014).

a 'Luminant', which consists of EFH's electricity generation, mining, wholesale electricity sales and commodities risk management and trading activities;
b 'TXU Energy', which consists of competitive retail electricity sales and related operations; and
c 'Oncor', a ring-fenced entity that conducts rate-regulated electricity transmission and distribution operations and is 80 per cent indirectly owned by EFH.

The EFH organisational structure is divided into two 'sides'. One side, which includes Energy Future Competitive Holdings Company LLC (EFCH), Texas Competitive Electric Holdings Company LLC (TCEH LLC) and TCEH LLC's direct and indirect subsidiary debtors (collectively, the TCEH Debtors) conducts the Luminant and TXU Energy business lines. The other, which includes Energy Future Intermediate Holding Company LLC (EFIH) and EFIH Finance Inc (together, the EFIH Debtors), conducts the Oncor business line.

The TCEH Debtors' primary debts include:
a \$22.635 billion in obligations under a senior secured credit facility, which includes \$2.054 billion under a revolving credit facility, \$1.062 billion under deposit letter of credit term loan facilities, and \$19.519 billion of term loan facilities, plus certain interest rate swap and commodity hedge obligations, secured by substantially all assets of the TCEH Debtors;
b \$1.75 billion in first lien notes, secured by the same collateral as and ranking *pari passu* with the obligations under the senior secured credit facility;
c \$1.571 billion in second lien notes;
d \$5.237 billion in unsecured notes; and
e \$875 million in pollution control revenue bonds.

The EFIH Debtors' primary debts include:
a \$3.985 billion in first lien notes, secured by EFIH's equity interest in Oncor;
b \$2.156 billion in second lien notes; and
c \$1.568 billion in unsecured notes.

In addition, EFH's primary debts include:
a \$1.864 billion in unsecured notes; and
b \$60 million in additional unsecured notes guaranteed by EFCH and EFIH.

EFH's Chapter 11 cases follow the largest private-equity buyout in history. In February 2007, EFH's predecessor, TXU Corp, entered into a merger agreement through which TXU was taken private through a leveraged buyout. In connection with the 2007 buyout, approximately \$31.5 billion in new debt was issued, including multiple first-lien secured, second-lien secured and unsecured notes.

The main cause of EFH's Chapter 11 filing was the substantial decline in natural gas prices in the United States that resulted from increased production due largely to hydraulic fracturing, or 'fracking'. This decline in price decreased the profitability of EFH's operations to the point where EFH was no longer able to service its significant debt burden.

Prior to the commencement of its Chapter 11 cases, EFH engaged in negotiations with certain of its larger creditor constituencies. The issue at the forefront of these negotiations was the form of a restructured EFH because if EFH restructured on a deconsolidated basis, without a step-up tax basis, it could trigger a tax liability in excess of $6 billion. These negotiations culminated in a restructuring support agreement (which has since been terminated) entered into by certain of the EFH's largest stakeholders, which provided for a tax-efficient, deconsolidated restructuring of EFH, through a 'tax-free spin'.

Following the filing, EFH has faced aggressive litigation on multiple fronts. Certain of its secured creditor constituencies commenced proceedings to determine whether 'make-whole' premiums are due on their notes, and, if so, to what extent. Whether such make-whole premiums are due may depend on both the language in the indentures and whether EFH is solvent.[64] Other note holders, who are slated to receive no recovery under the terms of the plan term sheet attached to the restructuring support agreement, objected to, among other things, the venue of the Chapter 11 cases in the District of Delaware and the approval of the restructuring support agreement.

At the time of writing, the parties to the make-whole litigation are in the process of negotiating a path forward that would allow the court to hear threshold matters of contract interpretation before, if necessary, holding hearings regarding whether EFH is solvent. Meanwhile, the restructuring support agreement has been terminated and the debtors continue to explore alternate proposals.[65]

iii James River Coal[66]

On 7 April 2014, James River Coal Company and 33 of its direct and indirect subsidiaries (collectively, James River) commenced Chapter 11 bankruptcy proceedings in the Eastern District of Virginia. James River's principal business is the mining, preparation and sale of metallurgical coal, thermal coal and steam coal, and its operations are managed through operating subsidiaries located throughout eastern Kentucky, southern West Virginia and southern Indiana. A dramatic decrease in domestic demand for coal, increased competition and sharply rising costs to comply with environmental laws and

64 *CSC Trust Co. of Del. v. Energy Future Intermediate Holdings Co. LLC*, Case No. 14-10979, ECF No. 1751 (Bankr. D. Del. 5 August 2014).

65 See Debtors' Notice of (A) Termination of Restructuring Support Agreement, (B) Withdrawal of Second Lien Opt-In, and (C) Withdrawal of EFIH Settlement Motion, EFIH Second Lien DIP Motion, and Restructuring Support Agreement Assumption Motion, Case No. 14-10979, ECF No. 1697 (Bankr. D. Del. 25 July 2014).

66 Davis Polk & Wardwell LLP is serving as counsel for James River in its Chapter 11 proceedings. Substantially all information in the following section is taken from the Declaration of Peter T. Socha in Support of the Debtors' Chapter 11 Petitions and First Day Pleadings, Case No. 14-31848, ECF No. 5 (Bankr. E.D. Va. 7 April 2014) or the Debtors' Motion for Entry of an Order Extending Debtors' Exclusive Periods Within Which to File a Plan and Disclosure Statement, Case No. 14-31848, ECF No. 440 (Bankr. E.D. Va. 26 June 2014).

other governmental regulations together contributed to James River's financial distress. James River entered bankruptcy with a book value of $1.066 billion in assets against $818.7 million in liabilities.

James River's primary debts include:

a $64.7 million in letters of credit issued under a senior secured credit facility, secured by substantially all of the debtors' assets;

b $464.5 million in unsecured convertible notes of various classes;

c $66.4 million in liabilities under the Federal Coal Mine Health and Safety Act of 1969; and

d $68.2 million in workers' compensation liabilities.

James River initiated its Chapter 11 cases to either consummate a sale of some or all of its businesses to a third party or to raise debt or equity capital for a standalone restructuring. In support of this strategy, the debtors filed a motion contemporaneously with the initiation of the bankruptcy cases to approve strategic transaction bidding procedures to be employed with respect to a sale of all or substantially all of their assets or the sponsorship of a plan of reorganisation. These procedures were approved by order of the bankruptcy court on 9 May 2014. James River held an auction from 18 to 20 August 2014, in accordance with the bidding procedures. Upon the conclusion of the auction, James River selected a bid submitted by JR Acquisition, LLC, a wholly owned subsidiary of Blackhawk Mining LLC (together with its affiliates, Blackhawk), as the successful bid.[67] Blackhawk will purchase certain of James River's assets for an aggregate purchase price of $52 million plus the assumption of certain liabilities.[68] Blackhawk's bid was approved by the bankruptcy court on 26 August 2014.

iv Executive Benefits

The Supreme Court of the United States recently issued a decision in the Chapter 7 case of Bellingham Insurance Agency, Inc (BIA), holding that a bankruptcy court may submit proposed findings of fact and conclusions of law to a district court in 'core' proceedings where the bankruptcy court lacks constitutional authority to enter final judgment. This decision, *Executive Benefits Ins Agency v. Arkison*,[69] answers some, but by no means all, of the questions raised by courts following the Supreme Court's opinion in *Stern v. Marshall*.[70] Some background is helpful to better elucidate the potential impact of the decision.

BIA filed a voluntary Chapter 7 bankruptcy petition in the Western District of Washington on 1 June 2006. Peter Arkison, BIA's Chapter 7 trustee, thereafter filed a fraudulent transfer action against the Executive Benefits Insurance Agency, Inc (EBIA). EBIA was not a creditor of the BIA estate and filed no claims in BIA's Chapter 7 case.

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67 Notice of Selection of Successful Bid, Case No. 14-31848, ECF No. 561 (Bankr. E.D. Va. 21 August 2014).

68 Id.

69 *Exec. Benefits Ins. Agency v. Arkison*, No. 12-1200, slip op. (U.S. 9 June 2014).

70 *Stern v. Marshall*, 564 U.S. 2, 131 S. Ct. 2594 (2011).

The bankruptcy court granted summary judgment for Arkison on the fraudulent transfer claims, and the district court affirmed. EBIA then appealed the decision to the United States Court of Appeals for the Ninth Circuit. After EBIA filed its opening appellate brief, the Supreme Court issued its opinion in *Stern*, which held that bankruptcy judges do not have constitutional authority to enter a final judgment on a debtor's compulsory state law counterclaim even though final adjudication of that claim by the bankruptcy court was authorised by statute.

In light of *Stern*, EBIA moved to dismiss its appeal in the Ninth Circuit for lack of jurisdiction to finally decide the trustee's fraudulent transfer claims. EBIA argued, among other things, that there was a 'gap' in the bankruptcy statute with respect to claims that are defined as 'core' under the Bankruptcy Code but may not, as a constitutional matter, be adjudicated as such ('*Stern* claims'), since bankruptcy courts lacked both the constitutional authority to issue final judgments and the statutory authority to issue proposed findings of fact and conclusions law with respect to such claims.[71] Neither party to the dispute contested the conclusion that the fraudulent transfer claim at issue was a *Stern* claim.

The Ninth Circuit rejected the motion, holding that EBIA had impliedly consented to the bankruptcy court's adjudication of the fraudulent transfer claim and that the bankruptcy court's judgment could instead be treated as proposed findings of fact and conclusions of law, subject to *de novo* review by the district court.

On appeal from the Ninth Circuit, the Supreme Court affirmed that the statutory grant of jurisdiction under 28 USC Section 157 allows bankruptcy courts to issue proposed findings of fact and conclusions of law with respect to *Stern* claims. In other words, *Stern* did not create a 'gap' in the bankruptcy statute. However, the Supreme Court did not reach the question of whether parties could consent to the jurisdiction of the bankruptcy court to hear claims that otherwise would fall outside the bankruptcy court's constitutional jurisdiction.

The *Executive Benefits* decision brings some clarity to the bankruptcy process, as parties may continue to bring proceedings that implicate *Stern* claims in the bankruptcy courts without running the risk that the court will be powerless to recommend findings to the district court. The question of whether the consent of the parties to the bankruptcy court entering final judgment on a *Stern* claim can cure any Article III defect, however, remains open. On 1 July 2014, the Supreme Court granted *certiorari* in *Wellness Int'l Network v. Sharif* on this question.[72]

71 See Reply Brief of Petitioner 9-12, Case No. 12-1200 (U.S., June 2013).

72 *Wellness Int'l Network v. Sharif*, 134 S. Ct. 2901 (2014). The Supreme Court will also consider whether the presence of a subsidiary state property law issue in a 11 U.S.C. § 541 action brought against a debtor to determine whether property in the debtor's possession is property of the bankruptcy estate means that such action does not 'stem from the bankruptcy itself' and therefore, that a bankruptcy court does not have the constitutional authority to enter a final order deciding that action. Id.

v Residential Capital

As discussed in last year's edition of *The International Insolvency Review*, on 14 May 2012, Residential Capital, LLC (ResCap), at the time, the fifth-largest servicer of residential mortgage loan in the United States, filed for Chapter 11 protection in the United States Bankruptcy Court for the Southern District of New York. At the time of its filing, ResCap had approximately $15.3 billion in debt. These Chapter 11 cases were hotly contested among ResCap and its various creditor groups and on 15 November 2013, the bankruptcy court entered an order[73] in connection with the confirmation of the ResCap Chapter 11 plan, which could have significant implications for the treatment of secured creditors in Chapter 11 cases.

To understand the potential impact of this decision, some background is necessary both about the ResCap cases and the Bankruptcy Code. In January 2012, prior to the filing of the Chapter 11 cases, ResCap commenced a marketing process for its assets. This process resulted in two separate 'stalking horse' purchase agreements. During the Chapter 11 cases, ResCap closed these two sale transactions, both to entities that submitted bids that were higher and better than the stalking-horse bids. Thereafter, a trial was held by the bankruptcy court to determine a number of issues among the debtors and the creditors' committee, on the one hand, and certain junior secured note holders of ResCap, on the other hand. Among these issues was the extent to which the note holders' lien attached to proceeds of one of the asset sales.

Section 552 of the Bankruptcy Code provides, generally, that prepetition liens do not attach to property of the debtor that is acquired after the petition date, unless such after-acquired property is 'proceeds, products, offspring or profits' of the prepetition collateral and the relevant security agreement provides that the lien attaches to such after-acquired property.[74] One of the issues in the ResCap case was the extent to which the note holders' lien attached to 'goodwill' that was sold by the debtors.

The bankruptcy court held that the note holders did not 'provide an adequate basis for valuing goodwill on the petition date' and therefore failed to meet their burden 'in demonstrating the extent of their lien on goodwill as of the petition date'.[75] The court then looked at whether the note holders lien' extended to goodwill that was generated after the petition date. Although the note holders' security agreement provided that their lien attached to, among other things, proceeds, products, offspring and profits of their collateral, the court held that it did not extend to the goodwill generated after the petition date.[76] The basis of the court's decision was that the carve-out for proceeds, products, offspring and profits is 'intended to cover after-acquired property that is directly attributable to prepetition collateral, without addition of estate resources', and because ResCap worked during their Chapter 11 cases to increase their goodwill, debtor resources were used. Because the note holders failed to provide evidence as to the portion

73 *In re Residential Capital, LLC*, 501 B.R. 549 (Bankr. S.D.N.Y. 2013).

74 11 U.S.C. § 552(b)(1).

75 501 B.R. at 611.

76 Id. at 612.

of the goodwill that was attributable to their collateral, the court held that their lien did not extend to the value of the sale attributable to goodwill.[77]

While the effect and breadth of this holding remain to be seen, it is an indication that 'blanket liens' may not be sufficient to ensure total coverage in a Chapter 11 case. Further, it is likely that unsecured creditors attempt to expand this ruling to continue to attack secured creditors' liens.

vi Revel Atlantic City[78]

On 19 June 2014, Revel AC, Inc and five of its direct and indirect subsidiaries (collectively, Revel) commenced Chapter 11 bankruptcy proceeding in the District of New Jersey. Revel owns and operates Revel Atlantic City, a casino and resort facility in Atlantic City, New Jersey. This is Revel's second trip through Chapter 11 in as many years.

With Morgan Stanley as the initial financier, construction of Revel Atlantic City began in 2007. The project soon ran into financial trouble and, after several years of delays and mounting costs, Morgan Stanley abandoned the unfinished project. The financier wrote down 98 per cent of the approximately $1.25 billion that had been invested in the property and sold its interest in the project to an investor group for $30 million. Revel subsequently raised $1.15 billion in additional financing from a group of lenders led by JPMorgan and received a $261.4 million economic redevelopment and growth grant from the state of New Jersey, which allowed Revel Atlantic City to be completed.

Revel Atlantic City opened for business on 2 April 2012 and immediately began accruing large losses. Revel thus began restructuring discussion with its stakeholders in early February 2013, which led to the solicitation of votes approving a prepackaged plan of reorganisation (the 2013 plan). The 2013 plan was confirmed and became effective on 21 May 2013.

Revel's operations, however, continued to struggle, and the company was once again faced with limited liquidity by late 2013. In November 2013, Revel agreed to certain amendments to its secured credit facilities that provided approximately $75 million in additional liquidity. Notably, the lenders required Revel to hire an investment banker and begin pursuing a sale, merger, equity investment or other similar transaction as a condition to this incremental financing. Revel conducted a prepetition marketing process but could not reach a deal with any potential buyer. Revel then attempted to conduct a sale of substantially all of its assets during its Chapter 11 cases but was unable to find a buyer.[79] The casino, the newest and largest in Atlantic City, will cease operations in September.[80]

77 Id.

78 Substantially all information in the following section is taken from the Declaration of Shaun Martin in Support of First Day Motions and Applications, Case No. 14-22654, ECF No. 5 (Bankr. D. N.J. 19 June 2014).

79 Charles V Bagli, 'Revel, Atlantic City's Newest and Largest Casino, Is Closing', *The New York Times* (12 August 2014), available at www.nytimes.com/2014/08/13/nyregion/revel-atlantic-citys-newest-and-largest-casino-is-closing.html.

80 Id.

As of the petition date, Revel's primary debts included:

a $137 million in obligations under a first-lien credit facility; and

b $310 million in obligations under a second-lien credit facility.

Obligations under both facilities are secured by substantially all of Revel's assets.

IV ANCILLARY INSOLVENCY PROCEEDINGS

i Barnet[81]

Octaviar Administration Pty Ltd (Octaviar), an Australia-based property finance group, was placed into 'external administration' in Australia on 3 October 2008 and was subsequently ordered to liquidate. The liquidators of the Octaviar estate (the foreign representatives) thereafter investigated certain causes of action against Drawbridge Special Opportunities Fund LP (Drawbridge) and, on 3 April 2012, commenced a lawsuit in Australia against certain of Drawbridge's affiliates asserting avoidance claims and related equitable claims and seeking A$210 million.

On 13 August 2012, the foreign representatives petitioned the bankruptcy court for the Southern District of New York for an order recognising the Australian liquidation proceeding as a foreign main proceeding under Chapter 15. Octaviar did not transact business in the United States or have any operations in the United States. However, the foreign representatives asserted that Octaviar may have had assets in the United States in the form of claims or causes of action against entities located in the United States. The Chapter 15 case was initiated to facilitate investigation into these potential claims.[82] The bankruptcy court entered an order recognising the Australian foreign main proceeding on 6 September 2012.[83]

On direct appeal to the United States Court of Appeals for the Second Circuit, Drawbridge argued that Octaviar had not demonstrated that it was eligible to be a debtor under Chapter 15. Section 103(a) of the Bankruptcy Code provides, with one exception that is not relevant here, that Chapter 1 'of this title appl[ies] in a case under Chapter 15'.[84] Chapter 1 of the Bankruptcy Code includes Section 109(a), which provides that 'only a person that resides or has a domicile, a place of business, or property in the United States ... may be a debtor under this title'. Because Octaviar had not established that it had any domicile, place of business, or property in the United States, Drawbridge contested, Octaviar could not be a debtor under Chapter 15 and its case must be dismissed. The Court of Appeals agreed, and Octaviar's Chapter 15 case was dismissed.[85]

81 For a more detailed discussion of *Barnet* and its ramifications, see Chapter 1.

82 Verified Petition Under Chapter 15 for Recognition of a Foreign Main Proceeding at paragraph 37, Case No. 12-13443, ECF No. 2 (Bankr. S.D.N.Y. 13 August 2012)

83 Order Granting Recognition of a Foreign Main Proceeding, Case No. 12-13443, ECF No. 18 (Bankr. S.D.N.Y. 6 September 2012).

84 11 U.S.C. § 103(a).

85 *In re Barnet*, 737 F.3d 238 (2d Cir. 2013).

The Second Circuit's decision potentially limits access to Chapter 15 for foreign debtors who lack assets, a domicile or a place of business in the United States. However, it may still be possible for such a debtor to initiate a case after moving property into the jurisdiction, as Octaviar subsequently succeeding in doing.[86]

ii ABC Developmental Learning Centres

ABC Developmental Learning Centres (ABC), an international childcare business based in Australia was placed into an Australian voluntary administration in November 2008 and then into liquidation in June 2010. Concurrently with the commencement of the voluntary administration, ABC's secured creditors, who held a lien on substantially all of ABC's assets, appointed receivers for the company. Because excess proceeds from the collateral were not expected to be available for distribution to unsecured creditors, the receivers could have seized control of substantially all of ABC's assets (including its US assets). As a result, the administrators (and later, liquidators), delegated management of the company to the receivers.

Later, to stay a US action by a judgment creditor, RCS Capital Development (RCS), the liquidators filed a Chapter 15 case for ABC. RCS objected to recognition of the Australian proceeding on various grounds, mainly that because of the pending receivership, there was not a 'collective judicial or administrative proceeding' as required for recognition under the Bankruptcy Code and ABC did not hold an interest in the US assets that were subject to the action because they were controlled by the receiver for the benefit of the secured creditors.

The case was appealed to the Court of Appeals for the Third Circuit, which rejected RCS's arguments. The Third Circuit held that Chapter 15 accommodates the recognition of foreign insolvency proceedings that may be very different from US proceedings, particularly with respect to the rights of secured creditors. Though RCS argued that the approach of bifurcating encumbered and unencumbered assets taken by Australian insolvency law was less likely to rehabilitate the debtor than the US approach, the Third Circuit held that the failure to recognise the Australian proceeding would yield an even worse result and one even less likely to be rehabilitative, as it would result in the proverbial 'race to the courthouse'. In so holding, the Third Circuit reaffirmed the foundation of comity on which the Model Law – and correspondingly, Chapter 15 – is based.

iii MtGox

On 7 February 2014, MtGox, a Japanese corporation and, at the time, one of the largest online bitcoin exchanges, halted all withdrawals. Three weeks later, following the mysterious disappearance of nearly all of its and its customers' approximately 850,000 bitcoins (worth approximately $473 million at the time), on 28 February 2014, MtGox filed for bankruptcy protection in Tokyo. Shortly thereafter, on 9 March 2014, MtGox filed for Chapter 15 relief, primarily to enjoin two pending litigations in the United States. The Japanese insolvency proceeding was recognised at a foreign main

86 *In re Octaviar Administration Pty Ltd*, Case No. 14-10438 (SCC), ECF No. 18 (Bankr. S.D.N.Y. 19 June 2014).

proceeding on 19 June 2014. Following the MtGox events, various US regulators have adopted different positions regarding the bitcoin business. For example, the Federal Reserve has stated that it does not have the authority to regulate bitcoins, the Commodities Futures Trading Commission has publicly said that it is looking at whether the agency has jurisdiction over bitcoins and other virtual currencies, and the New York Department of Financial Services issued a press release stating that it will accept applications for the establishment of regulated virtual currency exchanges in New York State.

iv Oui Management

Oui Management, a fashion model agency in Paris, which commenced a '*sauvegarde*' procedure in the Paris Commercial Court in September 2012 did not file for Chapter 15 relief, yet the principles of comity played an important role in the case. Despite one of Oui Management's creditors, Oui Financing, suing Oui Management and its president and principal shareholder, Steven Dellar, who was a non-debtor guarantor of the debt, in US federal court in New York, Oui Management did not file for Chapter 15 relief. Rather, Dellar filed a motion to dismiss, in which he argued that it would be more orderly and expedient to have the disputes between Oui Management and Oui Financing resolved in one proceeding – the French insolvency proceeding. On 9 October 2014, the US court issued an order granting the motion to dismiss on the principles of comity. The court stated that precedent counselled in favour of 'deference to a foreign court of proper jurisdiction … so long as the foreign proceedings are procedurally fair and do not violate public policy'. The US court refused to accept Oui Financing's argument that the French proceeding was unfair and, as it held that the claim against Dellar was closely intertwined with the claim against Oui Management, therefore, allowing the action would constitute an 'end run around a parallel foreign bankruptcy proceeding', which, as an act of a sovereign nation, was entitled to 'a proper level of respect'.

V OTHER RECENT DEVELOPMENTS

i Republic of Argentina v. NML Capital[87]

On 16 June 2014, the US Supreme Court declined to hear an appeal by the Republic of Argentina of a lower court order ruling that Argentina needed to make payments on account notes issued prior to its debt restructuring.[88] The denial of certiorari was a significant blow to Argentina in its ongoing legal battle with certain hedge funds that did not take part in the country's debt restructuring (discussed below). Although the underlying cases are not US based insolvency cases, the Supreme Court's denial of certiorari was much talked about in the US distressed debt market.

As is well known, in 2001, Argentina defaulted on its external debt. Between 2005 and 2010, Argentina worked to restructure its debt by offering creditors new securities in exchange for the defaulted ones. While approximately 92 per cent of the bondholders

87 Davis Polk & Wardwell LLP is serving as counsel for Citibank, NA in connection with this matter.

88 *Republic of Arg. v. NML Capital, Ltd.*, 2014 U.S. LEXIS 4259 (16 June 2014).

accepted this settlement, a number of creditors, including NML Capital, an affiliate of Elliot Management, and other distressed debt funds, did not and brought actions in the United States to collect on the defaulted securities (Argentina had waived sovereign immunity in its bond indentures).[89]

In February 2012, the District Court for the Southern District of New York ordered that if Argentina made a payment on account of the exchanged notes, it must make a ratable payment on account of the original, unexchanged notes. Because the original notes were in default and had been accelerated, this meant that if Argentina were to pay 100 per cent of owing obligations due, at any time, under the exchanged notes, it would have to make a payment of 100 per cent of the full amount owing under the original notes, which totals approximately $1.33 billion.[90] On 23 August 2013, the Court of Appeals for the Second Circuit affirmed this ruling, and Argentina appealed to the Supreme Court.[91] By refusing to hear the case, the Supreme Court has left the District Court ruling intact.

Following the denial of *certiorari*, Argentina ceased making interest payments on any of its external debt to avoid paying the full amount owing under the original notes. On 30 July 2014, the 30-day grace period on a $539 million interest payment expired, causing Argentina to default on $29 billion in debt.[92] Following the alleged default (which Argentina denies), Argentina's Merval stock index fell 8.4 per cent, and the peso fell to 12.65 per dollar on the black market, from 12.30.[93] At the time of writing, the Argentine government is attempting to offer a bond swap that would allow it to pay bondholders in Argentina instead of in the United States.[94] District Judge Thomas Griesa has said that this scheme would violate the District Court's order, and the price of the bonds fell in response to the offer.[95] Argentina has asserted that terms of the restructured notes prevent it from paying the holdout investors and that it is

89 Petition for Writ of Certiorari at 1, *Republic of Arg. v. NML Capital Ltd.*, No. 13-990 (18 February 2014).

90 Id.

91 *NML Capital, Ltd. v. Republic of Arg.*, 727 F.3d 230 (2d Cir. 2013).

92 Nicole Hong, Argentine Debt Feud Finds Much Fault, Few Fixes, The Wall Street Journal (Aug. 1, 2014 7:41 a.m.), available at http://online.wsj.com/articles/argentina-mulls-legal-options-in-debt-dispute-1406814851.

93 Id.

94 Ken Parks and Taos Turner, 'Argentina Moves to Pay Exchange Bondholders in Argentina', *The Wall Street Journal* (20 August 2014 11.59 a.m.), available at http://blogs.wsj.com/frontiers/2014/08/20/argentina-moves-to-pay-exchange-bondholders-in-argentina.

95 Nicole Hong and Matt Day, 'US Judge Says Argentina's Debt Swap Proposal Is Illegal', *The Wall Street Journal* (21 August 2014 5.10 p.m.), available at http://online.wsj.com/articles/judge-to-hold-hearing-in-argentina-debt-dispute-thursday-afternoon-1408630889.

considering different legal strategies to allow it to pay or settle with the bondholders. The next interest payment on the restructured notes is due on 30 September 2014.[96]

ii Puerto Rico Electric Power Authority[97]

The Commonwealth of Puerto Rico and its public corporations, which are responsible for providing public services, are currently facing an economic crisis as a result of an economic recession that has persisted since 2006, high rate of unemployment (15.2 per cent in January 2014),[98] population decline (approximately 1 per cent a year since 2011),[99] and high levels of debt and pension obligations. The Commonwealth has projected that it will close the current fiscal year with a $650 million budget deficit, and its public corporations face a combined deficit of $800 million and debt of $20 billion.[100] As a result of these economic challenges, Puerto Rico and the public corporations have seen their credit downgraded to non-investment grade status.

The Government Development Bank of Puerto Rico (GDB) has the statutory role of financial adviser and fiscal agent to the government of the Commonwealth, its instrumentalities, municipalities, and public corporations, and has historically financed the public corporations. As of 30 June 2014, the GDB had $6.9 billion in loans to Puerto Rico and its public corporations, comprising 48 per cent of the GDB's total assets.[101] In response, over the past six months, the Commonwealth has taken steps to prohibit further loans from the GDB to the public corporations, which in turn has exacerbated the liquidity crisis at the public corporations.

The Puerto Rico Electric Power Authority (PREPA or the Authority) is a public corporation and is the only entity authorised to provide electricity services in Puerto Rico. The economic conditions affecting the Commonwealth more broadly and the recent cut-off of funding from the GDB have contributed to PREPA's current financial distress. Moreover, PREPA's facilities are outdated, resulting in PREPA being overly dependent on expensive petroleum.

PREPA's primary debts include:

a $8.3 billion in bonds, secured by a pledge of revenues; and

b two revolving facilities used to finance fuel purchases, with total outstanding borrowings of $699 million.

96 Nicole Hong and Matt Wirz, 'Bondholders in Talks with Argentina on Legal Strategies' *The Wall Street Journal* (4 September 2014 5.47 p.m.), available at http://online.wsj.com/articles/bondholders-in-talks-with-argentina-on-legal-strategies-1409867227.

97 Davis Polk & Wardwell LLP is serving as counsel for Citibank, NA in connection with this matter.

98 2014 US Dept of Labor Report, available at www.bls.gov/eag/eag.pr.htm.

99 Annual Estimates of the Resident Population for Selected Age Groups by Sex for the United States, States, Counties, and Puerto Rico Commonwealth and Municipios: 1 April 2010 to 1 July 2013.

100 Preamble to Puerto Rico Public Corporation Debt Enforcement and Recovery Act, Act No. 71-2014 (the Recovery Act).

101 Id.

On 3 July 2014, PREPA defaulted on its payment obligations under its revolving facilities. Its lenders agreed to a short-term forbearance until 14 August 2014, which provided PREPA and its creditors additional time to negotiate a solution to the crisis.

On 14 August 2014, PREPA announced that it had negotiated further forbearance agreements with its bondholders and revolving lenders until 31 March 2015. PREPA will continue to make required debt service payments to its bondholders and interest payments to its revolving lenders during this period. An amendment to the bond documents will provide PREPA with additional liquidity in the form of access to approximately $280 million held in its construction fund for payment of current expenses and capital improvements. As part of the forbearance, PREPA has committed to completing a five-year business plan by 14 December 2014 and to appointing a chief restructuring officer by 8 September 2014, and must deliver a full debt restructuring plan by 2 March 2015.[102]

PREPA's in-court restructuring options are limited by the fact that it is ineligible to file for Chapter 9, as the Bankruptcy Code specifically prevents Puerto Rican municipalities from initiating cases under the Chapter.[103] It is also unclear whether PREPA is eligible for Chapter 11. To fill this statutory gap, on 25 June, Governor Alejandro García Padilla announced the Recovery Act. The Recovery Act was approved by the Commonwealth's Senate and House of Representatives without public hearing or debate that same day and was signed into law by Governor Padilla on 28 June 2014. The Recovery Act is designed to allow public corporations to adjust their debts in the interests of all creditors.

No public corporation has yet availed itself of the Recovery Act. If a company were to do so, it is likely that creditors would challenge its validity on a number of Constitutional grounds. Indeed, at the time of writing there are pending lawsuits that challenge the Recovery Act, although it remains to be seen whether these actions are ripe.

iii New tools for resolving systemically important financial institutions[104]

The unplanned failure of Lehman Brothers in 2008 was preceded by a run on liquidity that led to Lehman's bankruptcy, which in turn led to wholesale closeouts of open financial contracts, the selling of collateral into distressed markets and ultimately the sale

102 Government Development Bank for Puerto Rico, 'PREPA Reaches Agreements with Creditors', available at www.gdb-pur.com/documents/PREPA_Aug14Forbearance_PressRelease_081414_FINAL.pdf.

103 11 U.S.C. § 101(52). Legislation has recently been proposed to amend Chapter 9 to include Puerto Rico. H.R. 5305, the Puerto Rico Chapter 9 Uniformity Act of 2014, recently introduced by Resident Commissioner Pedro Pierluisi, proposes to amend Chapter 9 to include Puerto Rico. See 'Pierluisi Introduces Bill to Include Puerto Rico in Chapter 9 of the US Bankruptcy Code', available at http://pierluisi.house.gov/media-center/press-releases/pierluisi-introduces-bill-to-include-puerto-rico-in-chapter-9-of-the-us.

104 Substantially all information in the following section is taken from the Statement of Donald S Bernstein Before Subcommittee on Regulatory Reform, Commercial and Antitrust Law, US House of Representatives, Washington, DC 15 July 2014.

of Lehman's businesses and remaining assets at fire-sale prices. Since 2008, there has been a focus on ensuring that future failures of systemically important financial institutions (SIFIs) proceed in a manner that minimises systemic risk and does not put taxpayers at risk, while preserving due process and the rule of law.

A proposal currently under consideration in Congress in draft bill form is the addition of a new subchapter to the Bankruptcy Code that would allow SIFIs to take a 'single point of entry' approach to resolution. Single point of entry involves commencing resolution proceedings only with respect to the financial firm's top-level parent holding company, with all losses of the distressed financial firm being borne by shareholders and creditors of that entity and not by taxpayers. Operating entities, like the firm's banking or broker-dealer subsidiaries, would not be placed in insolvency or resolution proceedings, would be recapitalised using assets of the holding company and would continue as subsidiaries of a newly-created, debt-free bridge holding company. The old holding company's creditors and shareholders would be left behind either in bankruptcy proceedings or in a receivership under the Federal Deposit Insurance Corporation's OLA, and a viable recapitalised firm would be created, the value of which would be preserved without requiring bankruptcy or a prolonged resolution process for the firm's operating entities.

To facilitate a single point of entry remedy, the draft bills generally provide SIFIs in bankruptcy with tools that are analogous to those available under Title II of the Dodd-Frank Act, including (1) the power to create and transfer the failed holding company's assets to a bridge financial company; (2) a temporary stay on financial contract terminations and a temporary override of cross-defaults; and (3) the ability to assume financial contracts and related guarantees. As one advocate for the proposal testified in front of Congress, '[e]xpanding the options available by continuing to develop resolution approaches under both the existing Bankruptcy Code and OLA will maximise the flexibility to resolve distressed financial firms in a manner that minimises systemic risk and does not put taxpayers at risk while preserving due process and the rule of law'.[105]

V TRENDS

Bankruptcy filings in the United States have continued to decline since their 2009–2010 peak during the global financial crisis.[106] Companies have been buoyed by access to cheap capital because of historically low interest rates as a result of the Federal Reserve's quantitative easing measures. The Federal Reserve Board's decision to continue its quantitative easing provides relief for companies with highly leveraged balance sheets that likely would have struggled to meet their debt obligations had interests rates begun to rise.[107] Continued low interest rates should continue to allow distressed companies to refinance their debt and postpone the need to commence bankruptcy proceedings.

105 Id.

106 *The 2014 Bankruptcy Yearbook and Almanac* (see footnote 57, *supra*), at 16.

107 See Jon Hilsenrath, 'Fed Keeps Rates Unchanged, Sees Eventual Rise in 2015, 2016'; see footnote 47, *supra*.

The energy industry however, has experienced a number of bankruptcies over the past few years despite the general availability of cheap credit, and this trend is unlikely to abate in the near term. In particular, the coal industry will continue to be hit hard by the prevalence of cheaper and cleaner sources of energy, such as natural gas. The coal industry has already been hampered by decreasing revenues, increasing regulation and large unfunded pension and retirement liabilities. Added to this, the federal government is preparing to launch new emissions standards that will take a further toll on the beleaguered industry.[108] The gaming industry is also likely to continue to experience bankruptcy filing, as traditional gambling hubs, such as Atlantic City,[109] struggle to remain profitable as additional gaming locations increase in popularity. Caesars Entertainment Corporation (together with its subsidiaries, Caesars), for instance, is currently attempting to avoid joining the ranks of bankrupt gaming enterprises by restructuring more than $20 billion in debt out of court, even as junior bondholders allege that Caesars' private equity sponsors have stripped the company of valuable assets and that Caesars has defaulted on its debt obligations.[110] Whether these efforts will prove successful remains to be seen.

i Pre-arranged plans, pre-packaged plans and 363 sales in Chapter 11

As stated earlier, reorganisation of a debtor under Chapter 11 is often the best way of achieving the goal of providing the maximum return to creditors through the bankruptcy process. That said, a complete restructuring under Chapter 11 can be a time-consuming and costly process for a struggling debtor, and an extended stay in bankruptcy can be fatal for a debtor that does not have sufficient liquidity to pay professionals' fees and maintain operations through a multi-year Chapter 11 process.

For these reasons, the past several years have seen an increase in the number of Chapter 11 bankruptcies that are pre-arranged or pre-packaged. 'Pre-arranged' is a loose term to describe a Chapter 11 case where certain creditors or other interested parties have worked with the debtor prior to the filing of the case to negotiate an agreed upon course for company's reorganisation. Often these parties will enter into formal agreements with the debtor pursuant to which they agree to take or not take certain actions in furtherance of planned reorganisation. A 'pre-packaged' Chapter 11 is one in which votes for the company's Chapter 11 plan are solicited prior to the Chapter 11 filing and the company enters Chapter 11 with a clear and predetermined course for its reorganisation. In the year 2013, 18 publicly traded companies filed pre-arranged or pre-packaged Chapter 11 cases, up from 14 in 2012 and nearly three times the number that filed in 2011.[111]

108 See United States Environmental Protection Agency, 'Clean Power Plan Proposed Rule', available at www2.epa.gov/carbon-pollution-standards/clean-power-plan-proposed-rule.

109 Gambling revenues in Atlantic City have decreased 45 per cent since 2006. See UNLV Center for Gaming Research, Atlantic City Gaming Revenue, available at http://gaming.unlv.edu/reports/ac_hist.pdf.

110 See *Wilmington Savings Fund Society, FSB v. Caesars Entertainment Corp.*, Case No. 10004 (Del. Ch. 4 August 2014).

111 *The 2014 Bankruptcy Yearbook and Almanac* (see footnote 57, *supra*), at 171.

Of that group, all but one emerged from bankruptcy in less than six months (Penson Worldwide, Inc, the one exception, took roughly seven months to sell certain assets and liquidate pursuant to its pre-arranged plan).[112]

There has also been an increase in the number of Chapter 11 proceedings used to effect sales of substantially all of a debtor's assets free and clear of any liens, claims or encumbrances. Such 'Section 363 sales' (named after the applicable provision of the Bankruptcy Code) can be used to effectuate sales of valuable assets or profitable business units for the benefit of the debtor's creditors. While such sales are an integral part of the Chapter 11 process, increasingly, they have been used early in cases to sell significant portions (or all) of a debtor's assets and, as a result, have been met with criticism because it can be argued that they enable a debtor to chart a course for its Chapter 11 case free of the creditor protections associated with voting on and confirming a Chapter 11 plan of reorganisation. At the same time, however, these sales can allow a debtor to efficiently realise value for depreciating assets.

ii Rights of secured creditors

Recent decisions, including *Fisker Automotive Holdings*[113] and *Free Lance-Star Publishing*,[114] may signal a trend of bankruptcy courts reacting to what they view as 'loan-to-own' investors seeking to exert excessive control over debtors and the bankruptcy process.

In *Fisker*, Hybrid Tech Holdings, LLC (Hybrid) purchased a $168.5 million secured claim against the debtor for $25 million with a view towards credit bidding the full $168.5 million in connection with an auction for substantially all of the debtor's assets.[115] The bankruptcy court found that no other parties would bid on the debtor's assets if Hybrid was allowed to credit bid its full claim, but at least one other party was likely to participate in the auction if Hybrid's claim was capped at $25 million.[116] Moreover, the bankruptcy court found that 'foster[ing] a competitive bidding environment' could constitute 'cause' to limit a secured creditor's right to credit bid under Section 363(k) of the Bankruptcy Code.[117] The bankruptcy court therefore capped Hybrid's right to credit bid at $25 million.[118] Likewise, the *Free Lance-Star* court, citing *Fisker*, limited the amount a secured creditor that had purchased its claim from an existing lender could bid on the grounds (among others) that the limitation would 'restore enthusiasm for the sale and foster a robust bidding process'.[119] Moving forward, negotiations between debtors

112 Id.

113 No. 14-CV-99 (GMS), 2014 WL 210593 (Bankr. D. Del. 17 January 2014).

114 Case No. 14-30315-KRH, 2014 Bankr. LEXIS 1611 (Bankr. E.D. Va. 14 April 2014).

115 Fisker, No. 14-CV-99 (GMS), 2014 WL 210593 at *2.

116 Id. at *5.

117 Id. at *4 n.2.

118 The fact that the bid amount was capped at the price that Hybrid paid for the secured claim appears to have been happenstance: the court relied upon a stipulation between the debtor and the creditors' committee that $25 million was the limit that would permit a robust auction process. Id. at *6.

119 Free Lance-Star, 2014 Bankr. LEXIS 1611, at *19.

and secured creditors may become the subject of more intense scrutiny by creditors' committees and the courts.

Secured creditors also suffered a setback in a recent bench ruling in the *Momentive Performance Materials* bankruptcy case.[120] On 26 August 2014, the bankruptcy court held that Momentive Performance Materials could satisfy the cramdown standard of 1129(b) of the Bankruptcy Code as to its oversecured creditors with replacement notes paying the creditors a below-market interest rate. Rejecting arguments made by objecting creditors that a market rate of interest was required, the court approved the use of the below-market rate that was computed by reference to the prime rate, with an additional margin to compensate the creditors for the risk of non-payment. The court reasoned that the Bankruptcy Code does not require an interest rate that covers creditors' costs or provides them with a profit. If not overturned on appeal and if adopted by other courts, this ruling may shift the leverage in future cases in favour of debtors and unsecured creditors, potentially enabling them to satisfy secured creditors with long-term replacement notes at below-market rates, thus obviating the need for some debtors to secure takeout financing and potentially providing additional value for unsecured creditors at the expense of secured creditors.

Over the years, the pendulum has swung back and forth between periods when courts are inclined to fully protect the rights of secured creditors and periods when courts appear inclined to question some of those rights, strengthening the hand of Chapter 11 debtors and their unsecured creditors. The *Fisker*, *Free Lance-Star* and *Momentive* decisions, along with the *Residential Capital* decision discussed in Section III above, may be understood in the context of greater emphasis on balancing the rights of secured and unsecured creditors under the Bankruptcy Code at a time when secured lending has become the norm. Indeed, the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11, which has been active since 2011, was largely formed in response to the expansion of the use of secured credit and the growth of distressed-debt markets.[121]

iii Venue

Bankruptcy venue was a popular issue in 2011, with the Bankruptcy Venue Reform Act of 2011 being introduced in Congress. The bill sought to make it more difficult for a debtor to assert that its chosen venue is proper based solely on its jurisdiction of incorporation or the jurisdiction of incorporation for an affiliate debtor that files first. The bill sought to curtail the number of bankruptcies filed in the popular jurisdictions of New York and Delaware, particularly for companies that do not have significant operations in those jurisdictions. The Bankruptcy Venue Reform of 2011 caused a stir in the bankruptcy community, but did not make it out of the House Judiciary Committee's Subcommittee on Courts, Commercial and Administrative Law.

Venue may reappear as a focal point in the near future. As discussed in last year's edition of *The International Insolvency Review*, the courts may see the decision to transfer

120 *In re MPM Silicones, LLC, et al.*, Case No. 14-22503 (Bankr. S.D.N.Y. 26 August 2014).

121 See ABI Commission to Study the Reform of Chapter 11, Purpose of the Commission, available at http://commission.abi.org/purpose-commission.

venue in the *Patriot Coal* case from the Southern District of New York to the Eastern District of Missouri[122] as a model for deciding whether to transfer venue away from the magnet jurisdictions. One such objection was recently raised in the *Energy Future Holdings* cases, discussed generally in Section III above. There, the indenture trustee for the TCEH debtors' second-line debt, joined by certain other creditor constituencies, (unsuccessfully) moved to transfer venue from the District of Delaware to the Northern District of Texas.[123]

iv Mediation

Another effect of the increased strain on the US judiciary could be the rise of mediation in bankruptcy cases, as an antidote to costly and time-consuming traditional litigation. Mediation has sometimes proven to be an effective method of creating consensus around a plan of reorganisation from multiple parties, which cannot be achieved as easily in the binary and adversarial litigation system.

Mediators are also playing a central role in bankruptcies filed under other chapters of the Bankruptcy Code. Several US bankruptcy courts have created mediation programmes to provide for mortgage modification in Chapter 13 individual debtor cases. Further, mediators have been tapped to enable the discussions between creditors and the local government official in the major Chapter 9 municipal bankruptcies of Detroit, MI and Stockton, CA. Mediation will be likely to play a larger role in Chapter 11 bankruptcies in the years ahead.

122 *In re Patriot Coal Corp.*, 482 B.R. 718 (Bankr. S.D.N.Y. 2012).

123 Motion of Wilmington Savings Fund Society, FSB Pursuant to 28 U.S.C. §§ 1408 & 1412 and Rule 1014 of the Federal Rules of Bankruptcy Procedure to Transfer Cases to the United States District Court for the Northern District of Texas, Case No. 14-10979, ECF No. 5 (Bankr. D. Del. 29 April 2014).

Appendix 1

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Outside the firm, Mr Bernstein is a member of the editorial board of *Collier on Bankruptcy*, the treatise on US bankruptcy law.

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Since 2012 she has also been a member of the board of the Guarantee Fund for Judicial Administrators and Receivers, and from 2008 to 2011 she was a member of the board of the National Council of Judicial Administrators and Receivers.

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