Achieving Success in Transatlantic Restructuring

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Introduction

The figures speak for themselves: from 1994 to 2002 the UK has consistently received the highest percentage of US worldwide direct investment for any one country. During 2002, US direct investment in the UK was USD 18.9 billion, representing 15.8% of the US direct investment worldwide, almost double that in 1994.

The investment is reciprocal: during 2002, UK investment in the US was USD 14.9 billion (49.5% of UK worldwide direct investment). The US ranked as the first or second highest recipient of UK overseas investment between 1994 and 2002 in eight out of nine years. Perhaps even more pertinent is the concentration of the UK's investment in the US. While direct investment in the US had increased by 2002 to approximately 150% of that in 1994, total worldwide investment had decreased by almost a third.

With such volume of investment, it is inevitable that failures will occur. However, there is currently no established set of international rules to govern the interaction of US and UK insolvency and restructuring methods.

UNCITRAL

In 1997, the United Nations Commission on International Trade ('UNCITRAL') began to take steps towards global convergence with regard to insolvency legislation through the creation of a Model Law (the 'Model Law'). The model is intended for use during cross-border insolvency proceedings where there is court intervention and/or supervision – ideal for UK/US scenarios. It attempts to move away from a territorial approach to insolvency procedures to a more universal approach by preventing local realization of assets.

The Model Law provides a template for uniformity of approach without intruding on the sovereignty of individual states with an inappropriate 'one size fits all' remedy. It is, however, only a model, and its flexibility is also its weakness. To date, neither the US nor the UK have incorporated it into insolvency or restructuring legislation, although there are changes on the horizon. The US is proposing to introduce legislation in accordance with the Model Law as Chapter 15 to the Bankruptcy Code ('the Code'). Although the UK has not adopted it, there is provision in IA 2000 to give effect to the Model Law with or without modification.

The Model Law, while not providing an immediate remedy to the mismatches that exist between domestic procedures in international insolvencies and restructuring cases, has created a meeting ground for insolvency practitioners around the world to assist in the move towards a congruent global insolvency system.

This is a slow evolution, perhaps evidencing resentment towards lengthening the reach of foreign jurisdiction. However, as international investment has grown and international companies have failed, the need for synthesis in legislation between different jurisdictions is becoming clearer. Implementation of global legislation and global jurisdiction would promote equity and expediency, creating incentives for investors and lenders. However, this is inevitably at the cost of replacing a domestic regime that in all likelihood protects and favours domestic companies and creditors.

The cultural divergence between the attitude towards failing businesses in the UK and that held in the US is reflected in the presentation of restructuring procedures. As these differences have arisen, legislation has developed to support two different judicial systems which have become familiar to their domestic business population. During international reorganizations, professionals are left to depend upon the national laws of one or other or both of the jurisdictions that are both unfamiliar to non-domestic creditors and may actually conflict with the domestic legislation.

Chapter 11 and Administration

Until such time as there is internationally recognized legislation, investors are instead left hoping to recoup as much as they can using the procedures available, namely Chapter 11 of the Code in the US and Administration in the UK. Both Chapter 11 and Administration are processes that are intended to recover and/or

maintain the maximum value in a troubled company whilst allowing the company itself to survive.

The fundamental reason for Chapter 11 is to allow breathing space to enable a restructuring plan to be put into effect. The primary objective is the survival of the debtor and this can be effected by a plan or reorganization sanctioned by creditors. Administration is significantly more prescriptive. Following the introduction of the Enterprise Act reforms in September 2003, the administrator of a company (either appointed by the court or out of court by the company or the holder of a qualifying floating charge) must perform his functions with the objective of either rescuing the company as a going concern, or achieving a better result for the company's creditors as a whole than would be likely if the company were wound up, or realizing property in order to make a distribution to one or more secured or preferential creditors. Historically, the majority of Administrations have resulted in the sale of a company's assets.

A company need not be insolvent to file for Chapter 11 protection and this, therefore, encourages the use of this procedure before the company hits rock bottom. Although Court approval is not required for the filing, the Bankruptcy Courts are heavily involved in the procedure after the filing. Every party needs to have legal representation and all decisions must be approved by the Bankruptcy Court. In contrast, a company must be insolvent before Administration proceedings can begin. Consequently, applications for Administration are often a last resort for companies. This significantly hinders its use as a restructuring method, providing protection to the company too late.

Companies that have either their residence, domicile place of business or assets in the US can file for Chapter 11 protection. In the case of Cenargo, discussed in greater detail below, bank accounts that were opened shortly before the company filed for Chapter 11 were sufficient to allow satisfaction of jurisdiction requirements of the Bankruptcy Code. In contrast, prior to the introduction of EC Insolvency Regulation in May 2002, a company had to be registered in the UK for an Administration order to be granted.

The differences between legislation encourages 'forum shopping'; a subjective selection of legislation to benefit a local creditor base.

Both Chapter 11 and Administration are deemed to have global reach with an automatic stay over worldwide assets of the company once the application has been filed. However, recognition of the stay is highly questionable, hence overseas assets may not be adequately protected without filing for protection from local creditors. This brings the insolvency professional back to dealing with an international business on an unsatisfactory and fragmented basis revolving around inadequate domestic legislation.

EC Insolvency Regulation

The purpose of the EC Insolvency Regulation, introduced in May 2002, was to improve the efficiency and effectiveness of cross-border insolvency proceedings within the European Union. It does not attempt to harmonize the insolvency laws of each Member State but rather provides a framework which allows for separate proceedings to be instituted in several Member States concurrently in a way which ensures they do not compete with one another.

The EC Insolvency Regulation only applies if the debtor's Centre of Main Interests (as defined in the Regulation) is within the European Union. It allows main proceedings (for example, administration) to be opened only within the Member State where the debtor has its centre of main interests. Once main proceedings have been opened recognition is automatic and mandatory across the European Union.

Case studies

Despite the differences, some global restructurings have attempted to marry the Chapter 11 and Administration procedures together, primarily to obtain sufficient protection in both jurisdictions. We will now look at some of these restructurings and how jurisdictional issues were overcome, or not, as the case may be.

Federal-Mogul Corporation

Federal-Mogul Corporation ('FMC') was a global leader in the manufacturing and distribution of motor vehicle components. By January 2001, it had a global turnover of over USD 6 billion, employing over 55,000 people.

Through its acquisition of T&N Plc ('T&N') in the UK in 1998, FMC inherited large contingent liabilities arising from asbestos personal injury claims related to the building and automotive products T&N had historically produced, but since discontinued. By 31 December 2000, FMC had approximately 245,300 asbestos related claims pending and during 2000 it had received a further 104,800 new claims. FMC had provided for an aggregate liability of USD 1.8 billion. Despite this provision, the volume of claims continued to increase.

In order to protect itself from an uncontrolled asbestos claims process, on 1 October 2001, FMC simultaneously filed for Chapter 11 protection and Administration for 133 of its US and UK registered subsidiaries. The Administrations were part of a global rescue plan and operate in parallel with the Chapter 11 process. At the time, this represented the 11th largest Chapter 11 and the largest Administration in the UK for over 5 years.

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The decision to use proceedings in the US and the UK ensured that a stay over assets was enforced in both jurisdictions. However, with other differences between the US and UK insolvency regimes, one step further was taken. A formal Cross-Border Insolvency Protocol (the 'Protocol') was developed for the first time in an international restructuring procedure. This defined the expected roles of each of the parties involved in the process and their limitations too. It managed expectations, helped the US management over the cultural division between the US and UK processes and created an environment where a working relationship was possible between US management and the Administrators.

From the US point of view, the management were able to continue to trade the company in Chapter 11. In the UK, the use of Protocol and the Administrator's ability to terminate it at any time meant that the Administrator retained ultimate control and responsibility.

Complementary Chapter 11 and Administration proceedings confirmed the intention of the insolvency professionals to deal with the restructuring of the company and the protection of the stakeholders' value in the company on a global scale. The core business of FMC was viable and its current problems were only due to historic claims. The Protocol in this case was the mesh between the two jurisdictions as it allowed management to continue running the business without continual day to day input from the Administrators. The restructuring continues to take place with FMC still having the protection it requires until the asbestos claims issues are resolved.

BRAC Rent-A-Car International Inc (formerly Budget Rent-A-Car International Inc.)

BRAC Rent-A-Car International Inc (formerly Budget Rent-A-Car International Inc.) ('BRACII') formed part of the Budget group of companies that specialized in multi-national car rental. BRACII managed the worldwide operations outside North America and Canada, including the Europe, Middle East and Africa region ('EMEA').

In March 2002, Budget Group Inc., as it was then known, was de-listed from the American Stock Exchange when it failed to meet certain US Stock Market listing requirements. On 29 July 2002, as part of a recapitalization initiative, Budget Group Inc. and certain of its domestic subsidiaries, including BRACII, filed for Chapter 11 protection.

Although BRACII was registered as a US Company, it never traded in the US. It traded from premises in Hemel Hempstead in the UK. Its particulars were listed at the Companies Registry as both a branch and an overseas company.

The Chapter 11 filing was meant to provide an automatic stay over the Company's assets worldwide; however, an Italian creditor had the benefit of an Italian arbitration award that was registered as a judgment in the UK. In addition, the creditor had an interim charging order over BRACII's leasehold property.

With mounting pressure from the Italian creditor and the loss of financial support from its parent, BRACII looked to obtain further protection from its European creditors via an Administration Order, to enable a sale of its business. In January 2003, BRACII became the first non-UK incorporated business to be granted an Administration Order. It was successful in doing this because it argued that BRACII's Centre of Main Interest under the EC Insolvency Regulation was in the UK. Article 3(1) of the EC Insolvency Regulation provides that 'The courts of the Member State within the territory of which the centre of a debtor's main interest is situated shall have jurisdiction to open insolvency proceedings.' On this basis, an Administration Order was granted and the appropriate protection sought.

It was considered that a formal protocol in this instance was not required, as BRACII, unlike FMC, had ceased trading. The other major difference was that BRACII was already subject to Chapter 11 proceedings when the Administrators were appointed. However, this led to a conflict between the jurisdictions with regard to the 'relevant date' for creditors. Pursuant to the Chapter 11 proceedings, any liability incurred after the filing was deemed as an Administrative Expense and should be paid. However, under UK law, the same liability would be unsecured.

A sale of BRACII's business and assets had been completed as part of an overall sale of the EMEA business to Avis Europe Plc. BRACII was one of several seller parties, that included its US parent. In apportioning the sale proceeds between the seller parties, it was agreed that certain funds would be retained in the US for distribution to those creditors that had Administrative Claims in the US. All liabilities that were incurred pre-Chapter 11 and would in any event represent an unsecured claim in the UK, would be dealt with through a Company Voluntary Arrangement in the UK.

Again, this illustrates how world-wide protection was achieved and how jurisdictional issues were resolved through both Chapter 11 and Administration. This was a success because of the use of new legislation that enabled Administrators to establish the main proceedings for action across the EU sites in one location. In BRACII's case, this was in the UK. This removed the need to reconcile varying domestic laws, cutting down on litigation costs and the time needed to plan for and resolve potential issues, hence preserving the value of the company and increasing the likelihood that the business would be sold as a going concern.

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Cenargo International Plc

With both FMC and BRACII, the Chapter 11 filing and the Administration Orders were instigated by the debtor. The case of Cenargo demonstrates how individual creditors sought to improve their own positions by selecting the most favourable jurisdiction for them.

Cenargo was a company based in the UK, operating freight and ferry services in European waters. The majority of the company's assets, creditors and all of its employees were in the UK. The only connection that Cenargo had with the US was that it had two bank accounts that had been opened shortly before it filed for Chapter 11 protection and US bond holders who were owed approximately USD 175 million.

Cenargo filed for Chapter 11 protection in January 2003. However, the automatic stay provided by the Chapter 11 process did not prevent a local creditor from taking action. In particular, a lease creditor considered that the Chapter 11 filings were inappropriate and that the US Bankruptcy Law had been used purely to prevent them from terminating their leases over various vessels. The creditor believed that the correct jurisdiction should be in the UK and successfully applied to the UK Court for the appointment of joint provisional liquidators who were given specific powers to seek Administration Orders for the companies within the Group and apply to the US Court to dismiss the Chapter 11 proceedings.

This appointment triggered a series of events that led to the US and UK Courts injuncting the joint provisional liquidators and the management of the company. Eventually, the, issue was resolved by the US and UK Judges holding a telephone conversation to resolve the various contempt proceedings that had been issued by each of them.

Ultimately the US bondholders, following assurances from the lease creditor that it would not terminate its leases and repossess the vessels, requested the suspension of the Chapter 11 proceedings and the US Court deferred to UK legislation.

The Cenargo case demonstrates some of the potential pitfalls of multi-jurisdictional restructurings.

Global Crossing

Global Crossing was a successful global restructuring that avoided any UK Administration.

Global Crossing built a state-of-the-art global telecom network at a cost of approximately USD 24 billion. The group structure consisted of over 200 companies in 27 jurisdictions with the ultimate holding companies registered in Bermuda. Following the collapse of the global telecom market, the Group filed for Chapter 11 to obtain protection from its creditors and simultaneously sought the protection of the Bermudan Court through provisional liquidation proceedings. The Joint Provisional Liquidators were authorized to oversee the Chapter 11 process, thereby protecting the position of the debtor and its creditors. Unlike FMC, a formal protocol was not used. A considerable number of the Group's large creditors were global organizations with US interests. As such, the worldwide stay prevented these creditors from taking any action.

However, it was necessary for Global Crossing to instruct advisors to negotiate with the larger non-US creditors to prevent them from issuing proceedings in Europe. A majority of the creditors were agreeable to this, although it was necessary to go to some lengths to demonstrate that formal insolvency proceedings in any of the European jurisdictions would have resulted in minimal, if any, realization of their liability.

Global Crossing emerged from Chapter 11 in the US and provisional liquidation in Bermuda in December 2003. Creditors received USD 200 million cash payments and a 38.5% shareholding in the group going forward.

There was no need to increase the formality of the proceedings by filing for insolvency proceedings across the world, because of the concentration of creditors in the US. Indeed to do so would quite possibly have increased creditor resentment due to escalating costs and the resulting power struggles between the various parties that ensued in Cenargo.

Conclusion

The concept of using combined cross-border proceedings in restructuring is not new; the Maxwell case used both Chapter 11 and Administration.

As some of the case studies detailed above indicate, it has been possible to successfully restructure a worldwide company using both Chapter 11 and Administration to obtain the necessary protection. However, these are really 'fixes' for what will become a more common occurrence as businesses become more globally orientated. The ideal would be some convergence of insolvency legislation worldwide. However, due to the different emphasis placed on debtor and creditor rights in different jurisdictions, that appears to be a way off, and it will continue to be for the advisors to find innovative ways to successfully implement a cross-border restructuring.

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