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Use of US Chapter 11 Filings by Non–US Corporations: Realistic Option or Non–Starter?

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From a US perspective, Chapter 11 is seen as the model for a court-supervised business restructuring and indeed, based on the Chapter 11 'look-alikes' being established in a number of other countries – for example the CCAA process in Canada, self-administration (*Eigenverwaltung*) in Germany, *Sauvegarde* in France – it seems to be setting the pattern for the development of more recovery-focused insolvency processes worldwide. However, from the perspective of the non-US corporation, a Chapter 11 filing is not top of the list of options; in fact, the thought of putting the future of your corporation in the hands of a judge in, for example, Delaware or the Southern District of New York, is probably viewed with some suspicion, if not as being absurd. This article examines some of the advantages and pitfalls of Chapter 11 for a non-US corporation. It is certainly not the universal solution, but by no means one to be rejected out of hand.

Approaches

The US Congress had made it clear in the relevant provisions of the Bankruptcy Code that a foreign corporation was eligible in the first instance to begin a case under Chapter 11 as long as it had property or an office in the US. Moreover, it is an option that is available whether the non-US corporation intends to file for insolvency in its country of domicile or not.

There are several options/variants to consider:

- A local filing in the country of domicile or Centre of Main Interest (COMI) coupled with an application by the local office holder for recognition in the US under Chapter 15 of the US Bankruptcy Code – the norm where there are assets and claims to protect or deal with in the US.
- A main filing in the local COMI together with a US secondary filing – where there are substantial assets and claims in the US, this may be more appropriate or convenient than a simple Chapter 15 recognition. However, the burden and high cost of a Chapter 11 filing may often favour settling for Chapter 15, unless there are compelling advantages associated with a full supporting US filing, which is fairly unlikely.
- Chapter 11 with recognition obtained in the other jurisdictions due to the adoption of the UNCITRAL Model Law or because the system allows for recognition of foreign office holders (eg in the Commonwealth countries).
- A main Chapter 11 filing:
  - free-standing (as for example, among several others, the Avianca and Truvo cases discussed below); or
  - in parallel main filings (as Federal-Mogul, in this instance combined Chapter 11 and UK administration); or finally
  - together with local supplementary filing(s).

Illustrative cases

The *Avianca* case in 2003/4 was the definitive test of whether a non-US-based multinational enterprise could restructure solely under Chapter 11 of the US Bankruptcy Code, without the benefit or burden of starting any insolvency procedure whatsoever in its country of domicile. The answer was a clear yes, but the case highlighted the following key issues:

- Due to the practical limitation on the ability of the US Court to impose an automatic stay in other jurisdictions, the need to agree in advance of filing (or be able to impose – see Truvo below) a voluntary stay to creditors' claims and proceedings in the home country (and in any other jurisdictions with significant creditors or claims).
- The need for a mechanism to deal with exceptions in the local jurisdiction (payment of selected local creditors) acceptable to creditors participating in the US proceedings or to obtain the necessary approval from the US Bankruptcy Court.
- The necessity to achieve agreement and compliance with the Plan of Reorganisation outside the US, by securing legally binding contractual acceptance of non-US creditors; this is critically important in the case of creditors with no significant US presence or business interests, who might

therefore not feel bound automatically to respect US Court jurisdiction.

– The desirability of filing in the US in a district court with the experience of dealing with foreign debtors and of the cross border complexities of multinational cases (in the Avianca case, the Southern District of New York in Manhattan was chosen for these reasons).

There are obvious limitations, especially the feasibility of obtaining an imposed or voluntary stay outside the US, and the risk of secondary filings, particularly in view of the distrust of the Chapter 11 process outside the US, and more especially in Europe.

The recent *Truvo* filing illustrated one way around the stay issue, but also highlighted an important issue concerning the scope of the US Bankruptcy Court's powers over non-filed foreign subsidiaries.

– Truvo is a Belgian publishing company that recently defaulted on its debt interest payment and urgently needed to restructure its financing. It has no operations in the US but a US holding company structure set up for funding purposes, which was filed under Chapter 11 in the form of a pre-negotiated bankruptcy on July 1, 2010.

– Although this had the support of 80% of the senior debt holders, it only had limited support (one senior lender with 15% second-lien) from the 'out-of-the-money' junior debt holders. No overseas operations have been filed in either Chapter 11 or local insolvency procedures.

– To prevent creditors enforcing on debt at the overseas operating company level, the US Court had granted a Temporary Restraining Order, later confirmed by the granting of a relief injunction, which should be effective against all creditors who have a US base or, for other reasons, would feel bound to respect the jurisdiction of the US Court.

– The plan envisaged the enforcement sale (under English law) of the overseas subsidiaries and the release of the liens of the unsecured bondholders, but this plan was opposed by the junior creditors. The issue of whether the US Bankruptcy Court had the power to sanction a reorganisation for non-bankrupt foreign subsidiaries with no assets or operations in the US and whose debt had been sold in Europe was not challenged.

– A revised plan with improved terms for the junior creditors has recently been agreed and confirmed.

The issue of 'forum shopping' recently caused some debate in the context of the Dutch-registered, German-based global aluminium company, *Almatis*.

– A dispute over alternative restructuring plans pitted the senior lenders led by Oaktree Capital Management against the equity sponsor, the Dubai-based sovereign wealth fund DIC, and the mezzanine lenders, and led to a Chapter 11 filing by the company backed by a pre-negotiated plan supported by over two-thirds of the senior lenders.

– This achieved the desired stay and prevented so called 'rogue' lenders filing in unfavourable European jurisdictions. However, the end result on exit five months later was effectively a reversion to the equity sponsor's original proposed restructuring plan, which provided full recovery to the senior lenders but frustrated Oaktree's 'loan-to-own' strategy.

– This case also exposed the high cost of disputed Chapter 11 proceedings, where the company is often responsible for the fees of all advisors.

Main features and advantages of Chapter 11

– A debtor-friendly process with an automatic stay on claims, litigation, security enforcement and contract termination, which leaves management running the company in the ordinary course of business subject to Court supervision and Court authorisation for actions outside the ordinary course.

– Well suited to a CRO-led restructuring.

– Provides for an initial 120 days exclusivity (can be extended with Court approval) for the debtor to file a plan of reorganisation.

– Permits use of cash collateral (pledged bank accounts) and priming lien (super-priority) debtor-in-possession (DIP) financing, to support trading through the filing.

– Makes provision for the potential abandonment of burdensome contracts and leases ('executory contracts') or compelling performance or sale of advantageous executory contracts, although difficult if the contracting parties are outside the US.

– Permits the useful 'stalking horse' bid mechanism within a Section 363 sale process (a sale is pre-negotiated with a selected stalking horse bidder, who may be a credit bidder, which sets a floor for bids in the auction process that then follows).

– Well suited to debt restructuring where it is important for commercial reasons to protect trade creditors, which can be accomplished through various provisions of the code (for minor or 'convenience' creditors, section 503(b) (9) claims from vendors on <20 days payment terms, and critical vendors), whilst lenders and equity sponsors negotiate, agree and obtain approval for the plan of reorganisation and associated exit funding.

– Potential for cram-down of dissenting creditor and equity classes (a highly effective threat).

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- High successful exit rate, either through restructuring or business sale.
- Can also be used to achieve an orderly wind-down with limited trading of the business (to avoid the erosion of value, particularly from reduced working capital realisations, often consequent on the immediate cessation of trading in Chapter 7 liquidation).

Significant drawbacks

- Complex and expensive process to manage, with onerous Court supervision, which makes it less well suited to extended trading bankruptcies.
- Can be seen as excessively debtor-friendly, especially by UK lenders accustomed to creditors enjoying control, although changes in 2005 (for example to administrative claims, property lease assumption time limits and management retention payments) have tilted the balance somewhat more towards creditors.
- Practical difficulties of carrying off a Chapter 11 filing without local secondary filings for a non-US corporation, especially with international operations in more than one country outside the US.
- A managed section 363 sale process needs careful choreography to avoid surprise outcomes.

In what circumstances should the Chapter 11 option be considered?

If the objective is merely to achieve a stay on US creditors, claims or litigation, then recognition under Chapter 15 is generally enough. A full Chapter 11 filing therefore needs to offer other advantages to justify the (high) costs. So that it is not seen to be an abuse of process, it helps if it is a good-faith filing and has the support of major overseas creditors.

We should consider first what the main objective of the insolvency filing is:

- Chapter 11 is a business recovery process; it may be used to implement an orderly wind-down of a business and achieve a better realisation than would be possible with a non-trading liquidation, but that is not its primary purpose.
- A sale of part(s) or the whole of the business may be efficiently and speedily achieved through the 363 sale procedure (which separates the sale of the business and assignment of contracts from the distribution of proceeds later); although an external sale or transfer to lenders of the total business may be best accomplished through a plan of reorganisation. Such reorganisations may be prepackaged (achieving solicitation and acceptance of the plan prior to commencement of the case) or at least pre-negotiated, with lock-up agreements securing the necessary creditor support, in advance of the filing.
- If the business is trading well but simply overleveraged, Chapter 11 offers the advantage of being able to pay down trade creditors selectively (for critical vendors, small or short-term trade creditors) whilst protecting the company (as set out above) from onerous contracts, litigation, debt or guaranty enforcement, as debt restructuring is carried through. Such re-financings are often impossible to negotiate consensually with the contractually necessary 100% support in companies with widely held or complex multi-tier debt structures, and therefore require the ability to override ('cram down') dissenting minority creditors. This is provided for by Chapter 11.
- Trading administrations in the UK and in certain other jurisdictions are often frustrated by the absence of financing to support trading costs. Use of cash collateral and priming lien (super-priority) DIP financing offers a solution, albeit with a cost and increasingly restrictive covenants.
- Chapter 11 has also been used as the classic response to one-off major claims or mass tort actions in the US, permitting a negotiated settlement under the umbrella protection of a judicial stay applying to these and other claims.

Conclusion – where is Chapter 11 advantageous?

The Chapter 11 tool for non-US corporations is best suited to situations when:

- the domestic or home jurisdiction is inflexible, burdensome or not suited to achieving the proposed objective;
- the entity or Group has a significant number of US creditors – bonds, banks or litigation claimants – and multi-tiered debt with complex inter-creditor agreements; and
- the financial creditors are US based or multi-jurisdictional and are therefore likely to pay heed to the US Courts.

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International Corporate Rescue

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