WILLKIE FARR & GALLAGHER LLP

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November 2015

BUSINESS REORGANIZATION & RESTRUCTURING DIGEST

Business Reorganization & Restructuring Digest focuses on exploring recent legal developments, trends and emerging issues in notable North American, European and cross-border restructurings.

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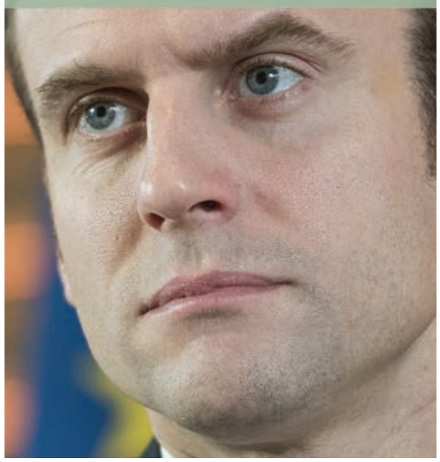
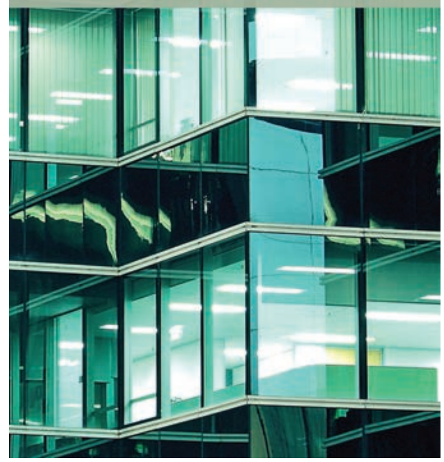
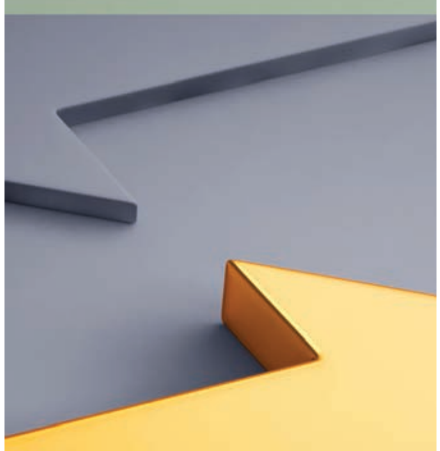
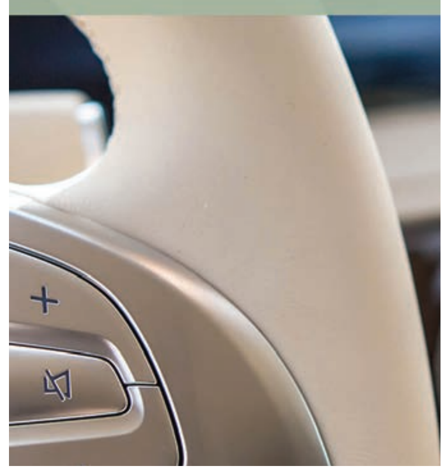








Latécoère manufactures aircraft fuselage components and engineers aerospace wiring. Globally, the company employs c. 4,800 employees and is a key supplier to aircraft manufacturers such as Boeing, Airbus, Dassault and Embraer.

EUROPE

Latécoère: A Successful Lender-Led French Restructuring

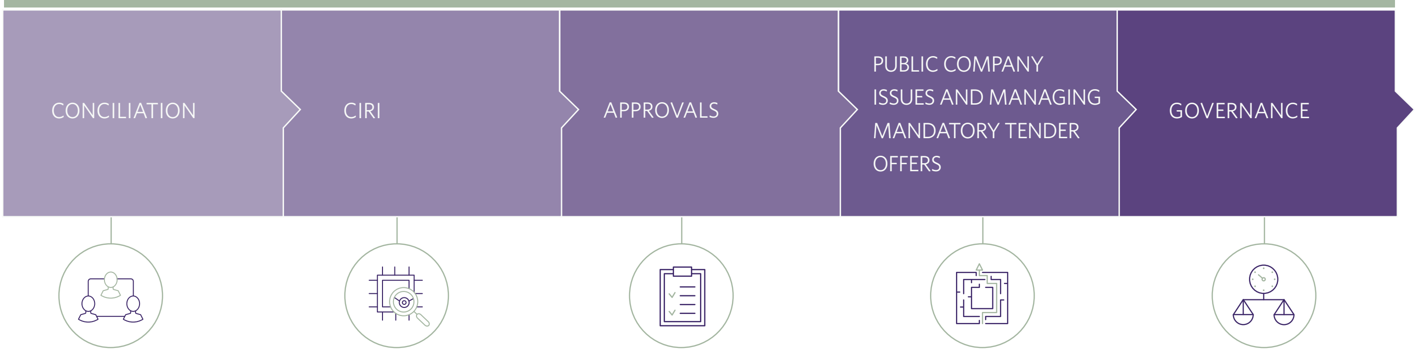
Willkie has acted on another successful French restructuring mandate in the form of the financial restructuring of Latécoère S.A., a Toulouse-based listed company operating globally in the aviation and aerospace sector.

Willkie acted for funds advised by Apollo Global Management and Monarch Alternative Capital, who led a lender working group comprising Apollo, Monarch, Davidson Kempner and Barclays. Upon completion of the restructuring, which comprised a partial debt-for-equity swap and new money injection, Apollo and Monarch (as "Anchor Investors") became substantial shareholders in the company and assumed sponsor-style roles with significant board representation.

Latécoère operates out of sites in France, Czech Republic, Brazil, USA, Mexico, Germany, Tunisia and Spain. The company manufactures aircraft fuselage components and engineers aerospace wiring. Globally, the company employs c. 4,800 employees and is a key supplier to aircraft manufacturers such as Boeing, Airbus, Dassault and Embraer. The company is listed in France and has numerous retail shareholders.

The transaction follows Willkie's earlier successful representation of (i) members of the ad hoc lender committee and anchor investors in the financial restructuring of the French fashion retailer Vivarte, which marked the largest-ever fully consensual French restructuring (involving a debt-for-equity swap/write-off of €2 billion and a €500 million infusion of new money), and (ii) Centerbridge and Angelo Gordon in their takeover of French pipe retailer Frans Bonhomme through a debt-for-equity swap.

The Latécoère transaction was notable for a number of complicating factors that Willkie dealt with in its role as lead restructuring counsel to the Anchor Investors:



CONCILIATION

The transaction was implemented using the French *conciliation* procedure whereby confidential court proceedings are opened to facilitate negotiation between a debtor and its major creditors under the supervision of a court appointed *conciliateur*. The *conciliation* process involves the negotiation, agreement and approval by the French commercial court of a binding restructuring *conciliation* protocol document pursuant to which the restructuring is implemented.

CIRI

The negotiation phase of the transaction was also notable for the involvement of the French Interministerial Committee for Industrial Restructuring (otherwise known as the "**CIRI**"). The CIRI is a division of the French Ministry of Finance with powers to oversee the restructuring of large companies (those with over 400 employees). This political dimension of the restructuring made for added complexity.

APPROVALS

Various state-level approvals were required to implement the transaction. Notably, these included the approval of the French Ministry of Economic Affairs with regard to the investment in the company by non-French foreign entities, principally due to the sector in which the company operates. In such circumstances, foreign investors can be required to give undertakings to the French state regarding the future conduct of a company's business and other matters.

PUBLIC COMPANY ISSUES AND MANAGING MANDATORY TENDER OFFERS

The fact that the company was listed caused a number of additional hurdles, notably including the need to obtain both: (i) shareholder approval to the transaction, and (ii) an exemption from the requirement for the Anchor Investors to launch a tender offer for the entire share capital on completion of the restructuring.

PUBLIC COMPANY ISSUES AND MANAGING MANDATORY TENDER OFFERS CONTINUED

Regarding the former, shareholders were required to formally approve the transaction to allow the equity restructuring elements of the transaction to proceed. The company's shares were widely held by many small disparate retail shareholders, a situation that had arguably contributed to the company requiring strategic guidance through the entry into the capital structure of the Anchor Investors. Notwithstanding certain quorum issues stemming from disregarded/dissenting shareholders, the requisite shareholder consent was ultimately obtained. However, the approval process serves as a reminder that, whilst the "Macron Law" (for details, please see France: New Creditor-Friendly Legislative Reforms, page 6) may tilt the balance of power slightly in favour of lenders, shareholder support remains essential in the restructuring of any French company (and, in particular, a French public company).

Regarding the latter, in France, if parties (either acting alone or "in concert" with others) obtain certain holdings in the total share capital or voting rights of a company they are required to launch a mandatory tender offer to purchase the entire company. In the circumstances, it was crucial for the Anchor Investors to obtain a formal exemption from the AMF (the French market authority) based on the financial difficulties of the company justifying the relaxation of such mandatory tender offer rules. The process for obtaining such an exemption was complex and involved the provision of an expert's fairness opinion regarding the price of the shares to be issued.

In addition, careful negotiation was required to manage risks posed by other stakeholders, including the company's employee shareholders, warrantholders and dissenting activist minority shareholders.

GOVERNANCE

The transaction involved a significant change of governance on closing. This required careful consideration of the different board structures permitted under French law and detailed advice to the incoming investor directors. In addition, compliance had to be ensured with new provisions of French law requiring a mandatory minimum number of female board members for French listed companies.

SUMMARY

The transaction serves as a useful reminder that French restructurings can be highly complex and nuanced, requiring a multi-disciplinary approach as well as a thorough understanding of the interests of various stakeholders, the political and commercial background, and the detailed legal requirements applicable to such deals, especially in a public company context.

However, the transaction also marks the successful completion of another debt-to-equity restructuring in the French market, all accomplished in an expedited time frame despite the complexity of the issues encountered. It also demonstrates that with experienced and expert counsel, it is possible to achieve a successful outcome for the company, employees, investors and other stakeholders in a jurisdiction that is often perceived as creditor-unfriendly.

AUTHORS

Graham R. Lane
Partner

Alexandra Bigot
Partner

Jason Taylor
Associate

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EUROPE

France: New Creditor-Friendly Legislative Reforms

Overview of the main amendments to French insolvency law introduced by the Macron Law

INTRODUCTION

The so-called "Macron Law" (a new law named after the French Minister of Economy, Emmanuel Macron, and designed to promote economic growth, commerce and equality in economic opportunities), was finally adopted on 6 August 2015. It came into force on 8 August 2015.

This new law includes amendments to French insolvency law regarding both the stakeholders involved in the implementation of such law and the mechanisms allowed under French insolvency proceedings themselves.

Some amendments are minor and/or do not change the content of the insolvency proceedings themselves. Such is notably the case regarding the modification of the status of a court-appointed *mandataire* (*mandataire de justice*) in terms of remuneration, access to the insolvency profession, exercise of powers, etc.

As regards creditors, the Macron Law provides that the government is authorised to make an order within six months to modify and clarify the legal regime applicable to pledges on tangible assets and pledges on inventories as part of Book VI of the French Commercial Code (which deals with insolvency law), in order to encourage the continued activity of the company as well as the payment of the company's liabilities. The Macron Law has also made it impossible to transfer by way of security a building constituting the principal residence of an entrepreneur for the benefit of creditors whose rights arise in connection with the economic activity of such entrepreneur.

However, the principal reforms of the Macron Law that are addressed below result in: (i) the introduction of specific rules permitting the disenfranchisement of shareholders within the framework of reorganization proceedings (*redressement judiciaire*) and (ii) the modification of insolvency courts' jurisdiction in order to provide for a more efficient treatment of large cases and cases involving companies within the same group.

Implementation of new mechanisms to disenfranchise shareholders in reorganization proceedings

In recent years, many French restructuring cases resulted in a take-over of a distressed company by creditors through a debt-for-equity swap mechanism. However, such restructuring solutions were possible to implement only because the shareholders agreed not to exercise veto rights that would prevent such shareholders from being diluted. Indeed, a restructuring plan involving the restructuring of the share capital required a positive vote by shareholders, the Court being authorised to confirm the plan only after such vote.

The Macron Law has introduced a new article into the French Commercial Code that provides for the ability to push through a debt-for-equity swap in circumstances where shareholders refuse to vote on share capital restructuring proposals contained in the restructuring plan, therefore granting French courts the power to dilute or compel divestiture of shareholder interests as part of reorganization proceedings[1].

There are numerous conditions that have to be met first before these mechanisms can be used:

- these mechanisms are only capable of being used in the framework of reorganization proceedings (*redressement judiciaire*). They cannot be used in safeguard proceedings. Accordingly, in safeguard proceedings, if shareholders do not accept the proposed restructuring, the procedure has to be converted into reorganization proceedings. This also means that it is impossible to provide for a debt-for-equity swap within the framework of accelerated safeguard and accelerated financial safeguard proceedings, without obtaining the consent of shareholders;
- only the judicial administrator or the public prosecutor may request the implementation of these mechanisms;
- the Court can only authorize the implementation of these mechanisms at least three months after the opening of proceedings; and
- the Court can only authorize the implementation of these mechanisms if:
  - the company has at least 150 employees (or the company is an *entreprise dominante* in respect of one or several other companies (pursuant to the French Labour Code), whose global headcount amounts to at least 150 employees);
  - the cessation of the business will trigger serious damage (*trouble grave*) for the national or regional economy and for the employment in that area;
  - the proposed share capital restructuring appears (after first having considered solutions resulting in the partial or total transfer of the company) to be the only solution to avoid such damage and to enable the continuation of the business; and
  - shareholders have refused to vote in favor of the share capital modification provided as part of the restructuring plan, or voted against it during the shareholders' meeting duly convened for such vote.

If the above conditions for implementation are met, the Court has the option to use one of the following two mechanisms:

- **First option:** the Court is entitled to appoint a *mandataire* in order to convene a shareholders' meeting and to vote in lieu of the shareholders who refused to vote or who voted against the plan; or
- **Second option:** the Court may order that the dissenting shareholders sell their shares to persons who have undertaken to comply with the proposed restructuring plan. If the parties do not agree on the value of the sale, an expert is appointed.

[1] This new article was challenged before the Constitutional Court, however, the Constitutional Court decided on 5 August 2015 that the new provision was **not** inconsistent with the French Constitution.

The mechanisms are therefore extremely complex and, in practice, we anticipate will largely be relied upon as a threat against dissenting shareholders rather than as a genuine implementation alternative. However, the new law should still encourage creditors to propose restructuring plans involving debt-for-equity swaps as it partially modifies, at least theoretically, the current balance of power between creditors and shareholders.

Modification of the jurisdiction of insolvency courts to deal with large cases and cases involving companies within the same group

Previously, a French commercial court had jurisdiction to handle cases involving only those debtors whose corporate headquarters or centre of main interests ("COMI") is located in that commercial court's geographical zone.

Such territorial jurisdiction raises two notable issues:

- not all commercial courts are equally equipped in terms of human and financial resources. For example, a small commercial court may not be able to handle large cases despite the geographical jurisdiction it has over the case; and
- companies belonging to the same group but with de-centralised management/headquarters may be subject to the jurisdiction of several different commercial courts.

Creation of specialized insolvency courts for large companies

The Macron Law will allow the creation of a limited number (to be determined pursuant to a future decree, but we anticipate approximately 13) specialized insolvency courts.[2]

These specialized insolvency courts will have jurisdiction to handle a debtor's safeguard, reorganization or liquidation proceedings (but also conciliation proceedings under specific circumstances) where one of the following criteria is met:

- the debtor has 250 or more employees and a turnover of at least €20 million; or
- the debtor has a turnover of at least €40 million; or
- the debtor is a holding company that, together with its operating subsidiaries, employs more than 250 employees and has a turnover in excess of €20 million; or
- the debtor is a holding company that, together with its operating subsidiaries, has a turnover in excess of €40 million.

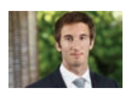
Regrouping insolvency proceedings opened in respect of several companies of the same group before the same court

New article L662-8 of the French Commercial Code provides that a commercial court has jurisdiction over any proceedings to be opened in respect of a company that (i) owns or controls or (ii) is owned or controlled by, a company in respect of which a proceeding is pending before it.

In short, a single commercial court will now have jurisdiction over all companies within an affiliated group. Such expanded jurisdiction should prevent conflicts in court rulings and facilitate the implementation of a restructuring solution for large cases involving groups of companies.[3]

AUTHORS

Vincent Pellier
Special European Counsel



Thomas Doyen
Associate

[2] These provisions will come into force as regards proceedings opened after 1 March 2016.

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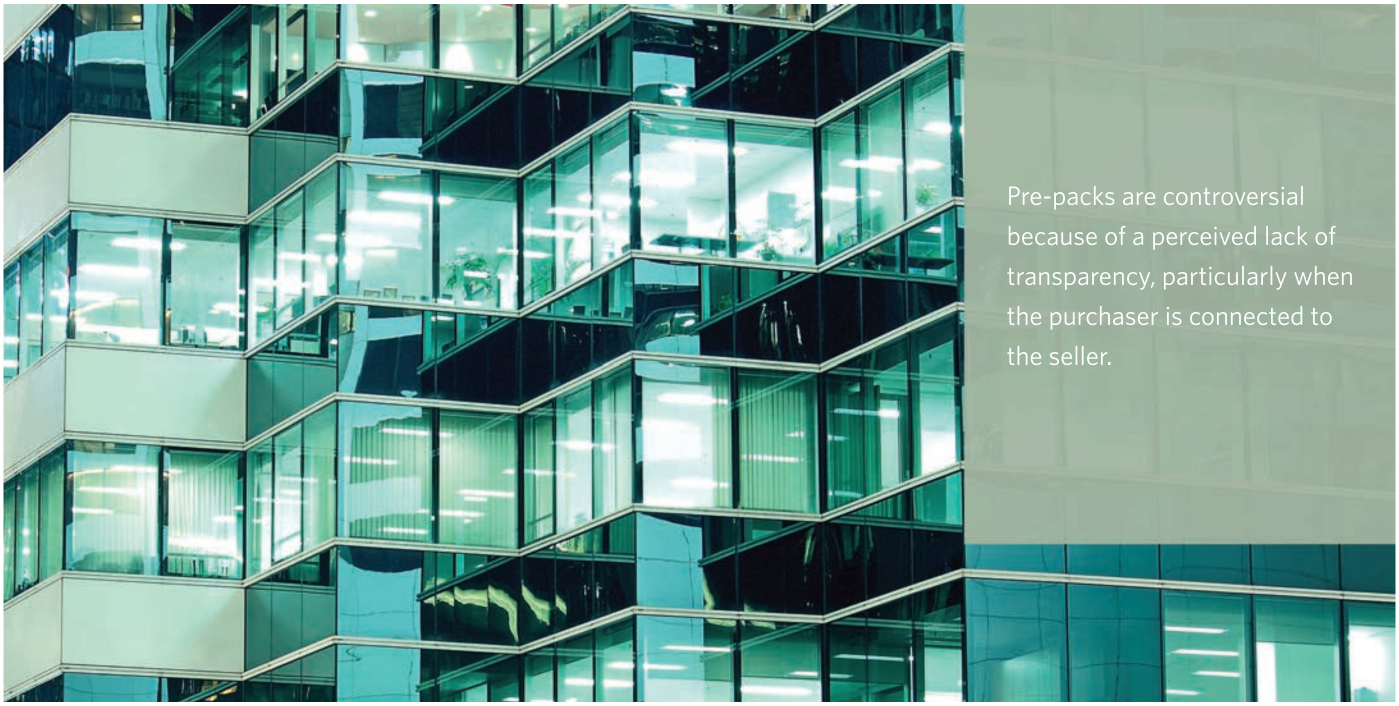

EUROPE

UK Pre-Pack Reform Update — Revisions to SIP 16

OVERVIEW

We reported in our December 2014 ***Digest*** regarding the "Graham Review" on UK pre-packs and proposals for reform. As a reminder, a "pre-packaged" sale in UK insolvency proceedings involves the sale of the business and/or assets of a debtor on "day 1" of the administration process with the marketing and valuation process front-loaded to minimise insolvency stigma and thus maximise value.

Pre-packs are controversial because of a perceived lack of transparency, particularly when the purchaser is connected to the seller.

Revisions to Statement of Insolvency Practice 16 ("SIP 16"), one of the key recommendations of the Graham Review, came into effect on 1 November 2015. SIP 16 forms part of the professional guidelines that UK insolvency practitioners should follow when carrying out their duties.

In brief, some of the key changes to SIP 16 are:

Pre-Pack Pool and viability statement

The revised SIP 16 refers to the well publiscised ability of connected party purchasers to: (i) approach the panel of experts known as the "Pre-Pack Pool" to obtain their blessing for the transaction, and (ii) prepare and provide to the Pre-Pack Pool a viability statement stating how the purchasing entity will survive for at least 12 months from the transaction date.

Valuations

Valuations should be carried out by independent valuers or advisors with sufficient professional indemnity cover. Any departure from this principle will need to be disclosed and justified by the insolvency practitioner.

Marketing

The new SIP 16 includes enhanced marketing guidelines with a view to providing reassurance to creditors that the consideration achieved for the sale is the best available for creditors. There is an emphasis on the insolvency practitioner explaining the particular marketing strategy to creditors and, again, justifying why it (or any departure from the guidelines) was appropriate.

Enhanced disclosure

SIP 16 has always required that insolvency practitioners disclose details of the sale to creditors reasonably promptly after completion. However, the information required to be disclosed has been enhanced with a view to ensuring that creditors are better informed.

COMMENT

Details of how the Pre-Pack Pool will operate in practice are starting to be made available and it is clear that secured creditors are not "connected parties" for the purposes of SIP 16. Importantly, this means that financial restructurings that are implemented via a pre-pack sale to a secured-creditor owned newco will continue to be outside the scope of oversight by the Pre-Pack Pool or the preparation of a viability statement.

However, for other restructurings that involve the accelerated disposal of assets to connected purchasers, it will be interesting to observe whether the Pre-Pack Pool will operate in an efficient manner and in particular what level of creditor and user confidence will be generated in the "experienced business people" who will opine on connected party pre-packs.

Notable potential issues regarding the Pre-Pack Pool include:

- the fact that no reasons will be given for issued opinions, there will be no appeal process and there are no guidelines as to what constitutes a reasonable pre-pack;
- there is a two business day turnaround time. This appears swift, but as many will know, pre-packs are often negotiated right up to completion against the backdrop of a business in free-fall and with directors concerned about their personal liability for continuing to trade pending a sale. As such, timing concerns will likely arise, particularly as to at what point it is appropriate for a purchaser to make the application; and
- the Pool is not a judicial body and its opinion is not binding. Will we start to see sales being made conditional upon the issuance of a favourable opinion? If so, we must query whether the risk of a "no sale" scenario as a result of the Pre-Pack Pool's existence will be more detrimental to creditors than a sale which has not been independently evaluated.

In addition, whilst enhanced information reporting to creditors should not be surprising given the current apparent public mistrust of certain aspects of the UK insolvency process, there may be reluctance by some sellers, purchasers and insolvency practitioners regarding the disclosure of sensitive details regarding pre-planned restructurings. There could accordingly be some discussions around whether the benefit gained from a pre-pack justifies the enhanced disclosure requirements. Another interesting point will be to see what certain organised unsecured creditor groups (*e.g.*, Her Majesty's Revenue and Customs for tax liabilities and the Pensions Regulator / the Pension Protection Fund for defined benefit pension scheme liabilities) do with such information and whether the new SIP 16 will, as probably intended, prompt more active scrutiny of, and potentially litigation against, insolvency practitioners arising out of pre-pack sales.

AUTHORS

Graham R. Lane
Partner

Jason Taylor
Associate

> *"A director cannot be expected to put a crystal ball on his or her desk at a time of huge shock and turmoil, and predict the likely consequences of an action, unless a consequence is either the only foreseeable one or is the only consequence that can be reasonably envisaged."*
>
> — District Judge Goodman

EUROPE

Criminal Liability of UK Directors for Failures Relating to Collective Redundancy Consultation

The snappily named Trade Union and Labour Relations (Consolidation) Act 1992 ("TULRCA") is beginning to cause directors and insolvency practitioners of distressed UK companies serious concern, more than 20 years after it came into force.

TULRCA governs situations in which an employer proposes to make large-scale redundancies, of 20 or more employees, within a 90-day period. The employer must consult on its redundancy proposal with representatives of the affected employees and also notify the Secretary of State for Business, Innovation and Skills ("BIS"). The collective redundancy consultation requirements of TULRCA are relatively complex (the headline rule is that the consultation must take place at least 30 days before the first dismissal, or at least 45 days in advance where 100 or more redundancies are proposed), and failure to comply can have significant consequences. Notably, if the consultation obligations are breached, a "protective award" of up to 90 days' gross actual pay may be ordered for each employee. In addition, failure to comply with the requirements is a criminal offence on the part of the employer, which now attracts an unlimited fine (it was capped at £5,000 prior to 12 March 2015). A director of the employer will also be criminally liable, if it is found that the offence was committed with his or her consent, connivance or due to his or her neglect.

The first directors of any UK company to be charged with a criminal offence under TULRCA were the former managing director, finance director and a sponsor-appointed non-executive director of City Link. The parcel delivery firm collapsed in December 2014 with more than 2,700 job losses. Administrators were appointed on Christmas Eve, and an initial round of 2,356 job losses were announced on New Year's Eve, with 230 further redundancies announced the following week. The former City Link directors were charged in June 2015, for failing to notify BIS of plans to make staff redundant.

The Redundancy Payments Service ("RPS"), which is part of the UK Government's Insolvency Service, is reported to have paid out around £5 million to former employees of City Link in statutory redundancy pay. Furthermore, it is understood that more than 250 former employees are seeking protective awards under TULRCA, for City Link's failure to properly consult on their redundancies. Again, it is the RPS (and ultimately the UK tax payer) that will cover the cost of any compensation.

In October 2015, the former chief executive and an insolvency practitioner involved in the administration of USC (a fashion division of Sports Direct) were also charged with the criminal offence of failing to notify BIS of plans to make staff redundant as required pursuant to TULRCA. Around 200 of USC's Scottish warehouse staff were given just 15 minutes' notice of their dismissal due to redundancy, following USC's collapse and the appointment of administrators in January this year.

Although it has been reluctant to comment, the new focus of BIS on bringing criminal prosecutions against directors and insolvency practitioners most likely results from a desire on the part of the RPS to seek reimbursement, as it is being required to pick up the tab for not only statutory redundancy payments of insolvent UK companies, but also the claims of former employees in circumstances where the statutory requirements of TULRCA have not been met.

This is understandable from a taxpayers' perspective. However, it exposes a considerable gap between business rescue culture and how employment interests are protected. In a well-planned solvent business reorganisation involving a reduction in headcount, complying with the statutory consultation and notification requirements of TULRCA will not be too difficult.

However, in distressed situations, there is no leeway or latitude in the TULRCA requirements. This is unrealistic in situations which are often unplanned and unexpected, and may lead directors to be caught uncomfortably between facing the risk of wrongful trading if they carry on the business in order to complete the statutory redundancy consultation and notification requirements, and facing criminal liability for failure to comply with TULRCA if they file for administration prior to completing the lengthy TULRCA process. Alternatively, it may lead to the need for UK company administrators to be funded in respect of the full notice and consultation period, which will not be realistic in many situations. And in situations where an administration pre-pack is being planned, undertaking a

First directors of any UK company to be charged with a criminal offence under TULRCA

City Link's
- former managing director
- finance director
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£5
MILLION

The RPS is reported to have paid out around £5 million to former employees of City Link in statutory redundancy pay

2,700+
JOB LOSSES

City Link collapsed in December 2014 with more than 2,700 job losses

It is the RPS (and ultimately the UK tax payer) that will cover the cost of any compensation for employees of an insolvent company such as City Link

consultation in advance could cause a leak of information to the market, generating insolvency stigma and undermining the intention of preserving as much value as possible for creditors.

On 13 November 2015, the City Link directors were acquitted of the criminal offences they had been charged with under TULRCA. District Judge Goodman held that it was not sufficiently clear that there was a 'proposal' to make redundancies at City Link, prior to the company entering administration. In addition, he found that the directors genuinely believed that a sale of the business (thereby avoiding mass redundancies) was not only possible but quite probable. BIS's lawyers had argued that the managing director would have seen that City Link's collapse was inevitable if he had looked into a crystal ball. Helpfully, the Judge commented: "*A director cannot be expected to put a crystal ball on his or her desk at a time of huge shock and turmoil, and predict the likely consequences of an action, unless a consequence is either the only foreseeable one or is the only consequence that can be reasonably envisaged*."

However, District Judge Goodman was at pains to emphasis the fact-specific nature of his findings in the City Link case: "*no employer should take that finding to be a precedent that an employer can avoid its responsibility [to inform over mass redundancies] simply by going into administration*."

The market now awaits the court's decision in the USC case with bated breath.

BIS itself issued a call for evidence on collective redundancy consultation for employers facing insolvency, earlier this year. A report is due before the end of 2015. It is to be hoped that, in future, a balance can be struck between employment interests and the realities of distressed and insolvent businesses.

AUTHOR

Iben Madsen
Associate

The Third Circuit recently became the first of the circuit courts to approve the use of structured dismissals in *Official Committee of Unsecured Creditors v. CIT Group/Business Credit Inc.*

NORTH AMERICA

Structured Dismissals: Justified in "Rare" Circumstances or the Future New Normal?

Traditionally, the chapter 11 process worked towards the paramount goal of plan confirmation, with two alternatives: a conversion to chapter 7, and a dismissal, returning parties to the *status quo ante*. The limited and often suboptimal universe of alternative case resolution options has historically served as a powerful deterrent that kept parties focused on the goal of plan confirmation. However, a new third alternative to plan confirmation has become an increasingly attractive one in which the court enters an order enforcing certain actions taken during the case (*e.g.*, asset sales and intercreditor settlements). Such orders do not (as is typically required under section 349 of the Bankruptcy Code) return all parties to the *status quo ante* and, in virtually all instances, sanction a value distribution scheme in conflict with the relative rights of economic parties-in-interest. These types of dismissals, called "structured dismissals," grant additional flexibility to all parties but have received criticism for contributing to the avoidance of the plan process or to the use of chapter 7 at the inception of the bankruptcy proceeding.

The Third Circuit recently became the first of the circuit courts to approve the use of structured dismissals in *Official Committee of Unsecured Creditors v. CIT Group/Business Credit Inc. (In re Jevic Holding Corp.)*.[1] While the Third Circuit stressed that such a disposition was justified only in "rare" circumstances, it nonetheless found that the circumstances at issue justified a departure from the typical bankruptcy process and, interestingly, approved a structured dismissal that departed from the standard priority scheme of section 507. Subsequently, in *In re ICL Holding Co.*,[2] the Third Circuit similarly approved a 363 sale of substantially all of a debtors' assets that distributed the proceeds in a manner at odds with section 507 — in advance of what all parties assumed would similarly be a structured dismissal — by finding that the proceeds were no longer assets of the estate and could be distributed by the purchaser as it pleased.

1 787 F.3d 173 (3d Cir. 2015).

2 No. 14-2709, 2015 BL 295784 (3d Cir. Sept. 14, 2015).

In just the first few months following the decisions in *Jevic* and *ICL Holding*, Willkie has guided the debtors in *In re WP Steel Venture LLC* (the "RG Steel Debtors") through the process of taking advantage of this increased flexibility and has received approval of a fully consensual settlement that, after implementation, will ultimately result in a structured dismissal of the debtors' cases.[3]

In re Jevic Holding Corp.

This case concerned a settlement between the debtors and their secured lenders. Under the terms of the proposed settlement: (a) the parties would execute mutual releases; (b) fraudulent conveyance and preference actions against the secured lenders would be dismissed; (c) those same lenders would contribute $2 million to an account to pay legal fees and certain administrative expenses; (d) the only remaining assets would be transferred to a trust set up to first pay administrative and tax creditors, followed by unsecured creditors on a pro rata basis; and (e) then the entire bankruptcy case would be dismissed. This settlement would in effect be a classic example of a "structured dismissal." However, the settlement left out a priority wage claim by the debtors' former truck drivers (the "Drivers") at the insistence of the debtors' secured creditor who was being sued by the Drivers on a related but distinct claim.

The Drivers and the U.S. Trustee objected to the proposed settlement, and the case eventually made its way to the Third Circuit. The Third Circuit acknowledged a lack of specific statutory authorization for structured dismissals in the Bankruptcy Code, but also noted that the Bankruptcy Code allows a bankruptcy judge to modify the typical return to the prepetition status quo provisions of a dismissal for "cause." The majority stressed that the Drivers themselves had admitted that no plan could be confirmed, and that a conversion to chapter 7 would benefit no one. The court thus held that "*absent a showing that a structured dismissal has been contrived to evade the procedural protections and safeguards of the plan confirmation or conversion processes, a bankruptcy court has discretion to order such a disposition.*"[4]

The majority then addressed the Drivers' argument that even if a structured dismissal is allowed under the Bankruptcy Code, such a dismissal must respect the standard priority scheme of section 507. The Third Circuit held that bankruptcy courts could approve settlements that deviate from the standard priority scheme only when they have "*specific and credible grounds to justify the deviation.*"[5] The majority then found that the bankruptcy court had sufficiently justified the deviation (providing for the payment of certain administrative and unsecured creditors while not providing for any distribution to the Drivers on account of their priority wage claim) from the standard priority scheme in approving the settlement — the bankruptcy court was in a situation where there was no alternative that would have provided some recovery to any creditors other than the debtors' secured creditors. Thus, while "a close call," the majority found that the bankruptcy court was correct to approve the settlement and structured dismissal.

In re ICL Holding Co.

This case concerns a challenge to a sale order and settlement for all of the debtors' assets to their secured creditor. The sale order and settlement included a $3.5 million cash payment by the purchaser to the official committee of unsecured creditors, which had agreed to withdraw all objections to the perfection of the secured creditor's liens and the proposed sale. Some proceeds of the sale were also set aside to pay the professionals of the debtors and the committee. The U.S. Trustee, however, objected to the sale, noting that the sale and settlement structure would bypass the I.R.S.'s administrative tax claim. As in *Jevic*, all parties agreed that a resolution of the case through a plan was unlikely.

Ultimately, the Third Circuit reached a decision approving the sale and settlement. Both the $3.5 million dollar payment to the unsecured creditors, and the escrow set-aside for the payment of professionals and wind down costs were not,

[3] No. 12-11661 (Bankr. D. Del. Oct. 15, 2015) [Docket No. 4464]. These efforts were led by Willkie attorneys Matthew A. Feldman and Shaunna D. Jones.

[4] 787 F.3d at 182.

[5] *Id.* at 184 (citing *In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir. 2007)).

ultimately, property of the bankruptcy estate and thus did not implicate *any* distribution requirements of the Bankruptcy Code. The Department of Justice (on behalf of the U.S. Trustee and the I.R.S.) contended that the $3.5 million dollar payment to unsecured creditors represented an increased bid for government assets, and thus should constitute estate property. The Third Circuit was not convinced, and held that because the cash never entered the estate, and the payment was not made at the debtors' direction, the payment could not be considered property of the estate. Similarly, while the escrowed funds set aside for the payment of professional and wind-down fees were in fact explicitly listed as consideration for the sale, and arguably were thus estate assets, the economic reality of the sale transaction, and the structure of the escrow (unused funds would be returned to the secured creditors), led the Third Circuit to conclude that the escrowed funds were not estate property.

The Third Circuit did not fully address what it considered to be the second key question: if the sale and settlement had involved estate property, would the sale and settlement have to comply with the ordinary priority scheme, specifically the absolute priority and unfair discrimination rules? However, in even phrasing this question, the Third Circuit may have signaled its view, by noting that most of the distribution requirements of the Bankruptcy Code (except for section 507) textually applied only in a chapter 11 plan context.[6]

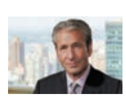
WP Steel Venture LLC

Taking immediate advantage[7] of the added clarity provided by *Jevic* and *ICL Holding,* the RG Steel Debtors obtained approval of a settlement that will ultimately result in a structured dismissal, following the claims reconciliation process. The RG Steel Debtors were facing a situation similar to *Jevic,* namely that the remaining estate assets were worth dramatically less than the outstanding secured claims. Realistically, no plan was confirmable, and a chapter 7 conversion would result in additional costs and a recovery for secured creditors only. Following over a year of mediation, the RG Steel Debtors and other major stakeholders (including the secured creditors, the unsecured creditors' committee, unions and representatives of pension beneficiaries) reached a global settlement providing for a claims settlement process resulting in limited payments to administrative, priority and unsecured creditors. While a few minor objections to the proposed global settlement were initially raised, all were resolved consensually prior to the hearing approving the settlement, and no parties have appealed the settlement order. After the conclusion of the claims allowance process, the chapter 11 cases will be dismissed.

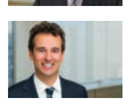
OBSERVATIONS

Both *Jevic* and *ICL Holding* show a new willingness (at least in the Third Circuit) for innovative workarounds to the traditional plan process, and a willingness, when confronted with dire circumstances, to allow a bending of an otherwise vigorously enforced traditional bankruptcy distribution scheme. Just how far the Third Circuit will be willing to go in tolerating these practices, and whether other circuits will follow its lead, remains to be seen. Nonetheless, pending broader judicial experience with structured dismissals, professionals negotiating value realization settlements should not feel precluded from departing from the ordinary priority scheme of the Bankruptcy Code, particularly when the passed-over creditors are unlikely to have received anything in a chapter 7 liquidation. *WP Steel Venture* already stands as an example of how structured dismissals can be used to effectuate a consensual global settlement for the benefit of all parties and bring cases to a final resolution where there are insufficient assets to follow the rigid priority schemes dictated in plans.

AUTHORS



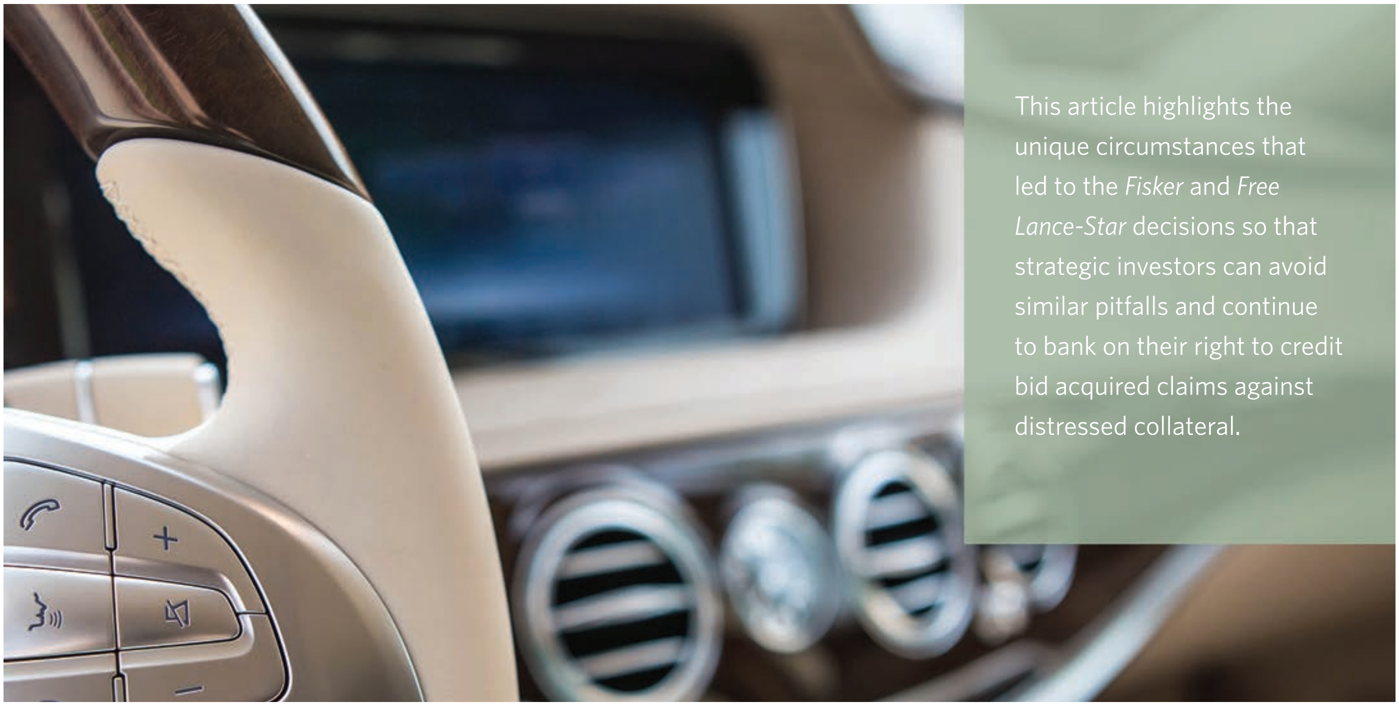
Marc Abrams
Partner



Gabriel Brunswick
Associate

6 *ICL Holding,* 2015 BL 295784 at *5.

7 Another structured dismissal was approved one day after the settlement order was approved in *WP Steel Venture*. *In re Endeavour Operation Co.*, No 14-12308 (Bankr. D. Del. Oct. 16, 2015) [Docket No. 987]. The *Endeavour* structured dismissal was ultimately approved on a fully consensual basis, and has not been appealed.



This article highlights the unique circumstances that led to the *Fisker* and *Free Lance-Star* decisions so that strategic investors can avoid similar pitfalls and continue to bank on their right to credit bid acquired claims against distressed collateral.

NORTH AMERICA

Fisker and *Free Lance-Star*'s Fading Legacy: An Investor's Right to Credit Bid Remains Secure

In the first half of 2014, two bankruptcy judges in separate jurisdictions limited the credit bidding rights of secured creditors that acquired their claims as part of apparent loan-to-own strategies. At the time, there was some concern that those cases signaled a shifting tide against strategic investments in distressed assets facilitated by policy conscious judicial intervention. Fortunately for the distressed investing community, the facts of the two 2014 cases are distinguishable from most cases, and no seismic shift in credit bidding policy has occurred to date. This article highlights the unique circumstances that led to the *Fisker* and *Free Lance-Star* decisions so that strategic investors can avoid similar pitfalls and continue to bank on their right to credit bid acquired claims against distressed collateral.

In re Fisker Automotive Holdings, Inc., Case No. 13-13087 (KG) (Bankr. D. Del. 2014)

On February 19, 2014, the United States Bankruptcy Court for the District of Delaware approved the sale of Fisker Automotive to Wanxiang America Corporation ("Wanxiang") for approximately $149.2 million. However, Wanxiang's bid may never have been considered were it not for Judge Kevin Gross's earlier decision to cap the credit bid of Hybrid Tech Holdings, LLC ("Hybrid"), being the holder of an asserted $168.5 million secured claim, at $25 million — the amount paid to purchase the claim approximately one month prior to filing.

Fisker Automotive Holdings, Inc. and Fisker Automotive, Inc. (together, "Fisker") were founded in 2007 to design, assemble and manufacture premium plug-in hybrid electric vehicles in the United States. The Department of Energy funded Fisker's initiatives through a senior secured loan that was acquired by Hybrid in October 2013. Hybrid paid $25 million for the outstanding senior loan of $168.5 million. Prior to filing voluntary bankruptcy petitions on November 22, 2013, Fisker and Hybrid negotiated an acquisition of Fisker's assets through a $75 million credit bid of Hybrid's holdings in the senior loan. On the first day of the cases, Fisker filed a motion to approve an expedited private sale asserting that the cost and delay arising from a competitive auction process or pursuing a potential transaction with anyone other than Hybrid would not likely increase value for the estates. Hybrid initially required that the sale be approved by January 6, 2014, or just 45 days from the bankruptcy filing.

The official committee of unsecured creditors (the "Committee") appointed in the case opposed the sale motion and filed a separate motion proposing a competitive auction in which Wanxiang would participate and bid against Hybrid's offer. The Committee disputed Hybrid's right to credit bid on the alternative bases that: (i) a material portion of the assets to be sold either were not subject to a properly perfected lien in favor of Hybrid, or were subject to a lien in favor of Hybrid that was in bona fide dispute; (ii) cause existed to limit Hybrid's right to credit bid because doing so would facilitate a competitive auction; or (iii) cause existed because the assets to be sold included both encumbered and unencumbered assets.

At the hearing to consider the sale motion and the Committee's motion for a competitive auction, Fisker and the Committee agreed, among other things, to limit the areas of dispute by stipulating that if Hybrid's right to credit bid remained uncapped there was no realistic possibility of a competitive auction. The parties also agreed that a sale of substantially all of Fisker's assets was necessary to realize the highest and best value for the estate and that only a subset of the assets to be sold constituted properly perfected Hybrid collateral, while some material assets were unencumbered.

Section 363(k) of the Bankruptcy Code provides that if property subject to a lien that secures an allowed claim is proposed to be sold, the holder of such claim may credit bid the claim "*unless the court for cause orders otherwise*." Judge Gross observed that failure to limit Hybrid's bid would preclude any auction, since no party was willing to bid more than the value of Hybrid's asserted secured claims, but that Wanxiang would otherwise be a motivated competing bidder in the right circumstances (notably, Wanxiang had recently purchased, through a separate bankruptcy auction, the lithium ion battery used in Fisker electric cars, which demonstrated Wanxiang's vested interest in purchasing Fisker's assets). Therefore, Judge Gross decided to limit Hybrid's credit bid to $25 million "for cause," on the basis that if he did not do so, bidding would not only be chilled, but frozen.

Judge Gross also determined that Fisker did not justify the expedited, private sale process required by Hybrid to the court's satisfaction. Fisker filed for bankruptcy on November 22, 2013 and proposed to conduct the sale hearing no later than January 3, 2014, which left the parties only 24 business days to challenge the sale motion and even less time for the Committee, which was not appointed until December 5, 2013. The expedited nature of the private sale was inconsistent with the court's notion of fairness, and Judge Gross would not permit Hybrid to "*short-circuit the bankruptcy process*."

After Hybrid's emergency appeals were denied, Wanxiang won the auction for Fisker's assets with a bid of approximately $149.2 million — a significant increase in value over Hybrid's initial $75 million credit bid.

In re The Free Lance-Star Publishing Co. of Fredericksburg, Va., Case No. 14-30315 (KRH) (Bankr. E.D. Va. 2014)

In *Free Lance-Star*, Judge Kevin Huennekens of the United States Bankruptcy Court for the Eastern District of Virginia limited an investor's right to credit bid its asserted approximately $45 million secured principal claim to $13.9 million for reasons similar to those Judge Gross relied upon in *Fisker*.

The Free Lance-Star is a publishing, newspaper, radio and communications company located in Fredericksburg, Virginia. In 2006, The Free Lance-Star borrowed approximately $50.8 million from Branch Banking and Trust ("BB&T") secured by certain of the company's real and personal property, but excluding its radio towers. In late June 2013, BB&T sold this non-performing loan to an affiliate of DSP Acquisition, LLC ("DSP"). Purchasing the loan was the first step in DSP's strategy to acquire all of The Free Lance-Star's assets, including its radio towers.

In early July 2013, DSP informed The Free Lance-Star that it wanted the company to file for bankruptcy so that DSP could credit bid for the assets. Upon realizing it did not hold a valid perfected lien on the radio towers, DSP asked The Free Lance-Star to execute deeds of trust in late July 2013, but such deeds of trust were never actually executed. In mid-August, and without informing The Free Lance-Star, DSP subsequently filed UCC fixture financing statements in the counties where the radio towers were located. Ninety days after the filing of the UCC statements, DSP renewed its pressure on the company to file for bankruptcy to facilitate the section 363 sale.

During the negotiations leading up to filing, DSP aggressively tried to limit the company's ability to sell to a third party. DSP urged The Free Lance-Star not to market its assets, insisted on a bankruptcy timeline of no more than six weeks between filing and closing, objected to the company hiring financial consultant Protiviti, and, after Protiviti was nevertheless hired, insisted that Protiviti's marketing materials contain a statement on the front page, in bold font, that DSP had a right to a $39 million credit bid. When Protiviti decided that the company did not need debtor-in-possession financing to bridge to a sale, DSP questioned the validity of Protiviti's projections, and insisted that the company borrow a new post-petition facility provided by DSP. Through a DIP facility, DSP hoped to acquire valid liens on the radio towers. When the company refused to take on DSP's DIP facility, all negotiations between The Free Lance-Star and DSP ceased.

On January 23, 2014, The Free Lance-Star commenced its bankruptcy cases by filing voluntary petitions, a motion to use cash collateral, and two sale motions, one to sell its newspaper and printing business assets, and another to sell its radio towers. DSP opposed the cash collateral motion, and asked for new liens on the radio towers as adequate protection, but did not disclose to the court that it had unilaterally recorded financing statements against the towers in August 2013. The court denied DSP's request for supplemental liens, finding that DSP's interest in the company's cash collateral was adequately protected by replacement liens (on other assets) and adequate protection payments offered by The Free Lance-Star.

On March 10, 2014, the court entered orders approving the bidding procedures for the two related sales, including the right of DSP to credit bid its claim against the assets on which it had valid liens or security interests. Also on March 10, DSP initiated an adversary proceeding seeking a declaratory judgment that it held valid and perfected liens on substantially all of The Free Lance-Star's assets, including the radio towers.

After conducting a three-day evidentiary hearing in late March, the court concluded that: (i) DSP did not have a valid lien on the radio towers and therefore could not credit bid on them; and (ii) DSP's inequitable conduct required the court to limit DSP's right to credit bid "*in order to foster a robust auction*." Relying on Judge Gross's opinion in *Fisker*, Judge Huennekens held that DSP's conduct provided sufficient cause to limit DSP's credit bid. Not only did DSP conceal its UCC filings at the cash collateral hearing where it asked the court for replacement liens on the same assets, but DSP also tried to chill bidding by pressuring The Free Lance-Star to forego, or at least shorten, the marketing period and to include a conspicuous advertisement of DSP's credit bid rights in the sale materials. The court found that DSP created genuine confusion in the marketplace regarding the extent of DSP's secured interest and DSP's role in the auction process, which influenced many interested parties to wait for the outcome of the court's credit bid ruling before committing to conduct comprehensive due diligence. Ultimately, relying on The Free Lance-Star's financial advisor's market-analysis to determine "*an appropriate cap for a credit bid that would foster a competitive auction process*," the court limited DSP's credit bid to $13.9 million.

Precedential Value of the Fisker *and* Free Lance-Star *Decisions*

Observers have noted that the *Fisker* and *Free Lance-Star* decisions diverged from the holding of the U.S. Supreme Court in *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, in which the Supreme Court affirmed the policy supporting a creditor's right to credit bid by denying the debtors' attempt to confirm a plan that did not provide a secured creditor the right to credit bid its claim and observing that "*the ability to credit-bid helps to protect a creditor against the risk that its collateral will be sold at a depressed price*."

In contrast, the *Fisker* and *Free Lance-Star* decisions seemed to revive the Third Circuit's older decision in *In re Philadelphia Newspapers, LLC*, wherein the court permitted the debtor to proceed with a plan that facilitated the sale of collateral secured by a lien without providing the secured creditor its right to credit bid. In support of its holding in *Philadelphia Newspapers*, the Third Circuit recognized the ability of a court to limit the right to credit bid "for cause" codified in section 363(k). The Third Circuit relied on precedent where the "for cause" standard was invoked to promote a competitive auction or when the classification and priority of a secured lender's claim was in dispute — situations arguably analogous to the facts in the Fisker and *Free Lance-Star* cases. *The Philadelphia Newspapers* decision concluded its discussion of section 363(k) by noting that "*a court may deny a lender the right to credit bid in the interest of any policy advanced by the Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment*."

RadLAX ensured that secured creditors' ability to credit bid under section 363(k) could not be circumvented through the use of a plan process. However, the *Fisker* and *Free Lance-Star* decisions were reminders that *RadLAX* did not address the ability of the court to restrict the right to credit bid "for cause." The 2014 decisions thus rekindled the concern that bankruptcy courts might resume the limiting of credit bidding to promote competitive auctions. However, thus far, those fears have not come to pass and the precedential value of the *Fisker* and *Free Lance-Star* decisions has been limited by the unique facts of those cases — *i.e.*, situations where the secured creditor actively tried to chill bidding via an expedited sale or by meddling in the sales process, and other interested parties disputed the legitimacy (and extent) of the creditors' security interests.

The absence of subsequent case law invoking *Fisker* and *Free Lance-Star*, and a recent recommendation from the American Bankruptcy Institute ("ABI"), caution against interpreting the court's power to limit credit bidding "for cause" too broadly based on the two 2014 opinions. Only two reported cases thus far have cited directly to *Fisker* and *Free Lance-Star*. In one, *In re Charles St. African Methodist Episcopal Church*, the debtor expressly disavowed reliance on *Fisker* and its rationale, and argued solely that the secured lender's credit bid should be limited by the value of the debtor's counterclaims against the lender. The court held that the existence of counterclaims against the lender does not constitute "cause" under section 363(k) to limit a credit bid. In the other, the court in *In re RML Development, Inc.* cited *Fisker* and *Free Lance-Star* for the proposition that the right to credit bid is not absolute, but only granted narrow relief by prohibiting a credit bid of the disputed portion of a secured claim. In 2014, the ABI published its final report and recommendations from its Commission to Study the Reform of Chapter 11. The ABI report recognized that *Fisker* and *Free Lance-Star* "*arguably expanded application of the cause standard for limiting credit bids*," but recognized that "*credit bidding is an integral part of the secured creditors' rights package*" and recommended that "*the chilling effect of a credit bid not be deemed sufficient cause to limit a credit bid*."

Though *Fisker* and *Free Lance-Star* have not led to a noticeable shift in bankruptcy courts' willingness to limit the rights of secured creditors, strategic investors should be aware of the circumstances of those two decisions and mindful not to repeat the mistakes made by the secured creditors in those cases. The two 2014 decisions serve as reminders that the right to credit bid is not inalienable: it belongs to the secured lender who holds valid liens and does not interfere with an open sales process.

AUTHORS

Paul Shalhoub
Partner

Daniel Forman
Associate

Jason D. St. John
Law Clerk

Willkie's Business Reorganization & Restructuring Department

Marc Abrams
Co-Chair
1 212 728 8200
mabrams@willkie.com

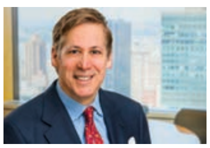
Matthew A. Feldman
Co-Chair
1 212 728 8651
mfeldman@willkie.com

Ana M. Alfonso
Partner
1 212 728 8244
aalfonso@willkie.com

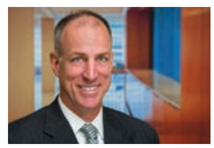
Alexandra Bigot
Partner
33 1 53 43 4550
abigot@willkie.com

Shaunna D. Jones
Partner
1 212 728 8521
sjones@willkie.com

Graham R. Lane
Partner
44 20 3580 4706
glane@willkie.com

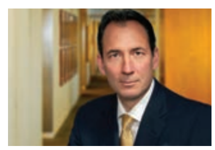


Alan J. Lipkin
Partner
1 212 728 8240
alipkin@willkie.com



John C. Longmire
Partner
1 212 728 8574
jlongmire@willkie.com

Joseph G. Minias
Partner
1 212 728 8202
jminias@willkie.com

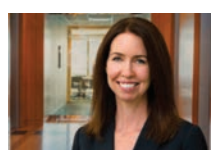


Paul V. Shalhoub
Partner
1 212 728 8764
pshalhoub@willkie.com

Rachel C. Strickland
Partner
1 212 728 8544
rstrickland@willkie.com

Verena Etzel
National Partner
49 69 79302 147
vetzel@willkie.com

Vincent Pellier
Special European Counsel
33 1 53 43 4539
vpellier@willkie.com



Robin Spigel
Special Counsel
1 212 728 8822
rspigel@willkie.com

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