Cross-Border Insolvency Considerations in Light of the COVID-19 Pandemic

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The COVID-19 pandemic is wreaking havoc on global markets and eroding the solvency of businesses across the world. Now more than ever, companies and their advisors should consider the potential benefits the U.S. Bankruptcy Code confers not only upon U.S. debtors but also foreign debtors with assets located in the United States. Part I provides a brief overview of the chapter 11 process and the powerful tools it offers a debtor seeking to restructure its business. Part II provides an overview of the cross-border insolvency framework laid out in chapter 15 of the Bankruptcy Code. Chapter 15 provides the legal framework by which U.S. Bankruptcy Courts recognize foreign insolvency proceedings and provides effective mechanisms for maximizing the value of the debtors’ assets while protecting the rights of all interested parties.

Part I - Overview of the Chapter 11 Process

In a chapter 11 case, a single forum is created in which all parties necessary for a consensual resolution are assembled with the goal of negotiating, designing and implementing a one-time, comprehensive solution to the debtor’s financial problems. All debt collection actions are stopped and the debtor is afforded the time and breathing room necessary to focus on restructuring its business.

A chapter 11 case does not produce pre-defined outcomes. Put differently, chapter 11 cases can serve as the backdrop for many different types of restructurings, including a sale of the business, a reorganization, a liquidation or a combination of several approaches. Chapter 11 of the Bankruptcy Code creates the framework for the negotiated or judicial resolution of disputes and determination of creditors’ relative recoveries (both as to value and allocation, i.e., total enterprise value, and form, i.e., cash, notes, stock). The Bankruptcy Court serves as a forum for the approval of negotiated compromises and/or the resolution of disputes when negotiations fail.
Can foreign debtors file for chapter 11?

Yes. Any company that has assets in the United States is eligible to be a chapter 11 debtor. There is no minimum amount of assets necessary to qualify for chapter 11 protection.

What advantages incentivize companies to use chapter 11?

1. The debtor continues to control its business and operate in the ordinary course

Generally, the debtor remains in possession of its assets and continues to manage its business after the filing of a bankruptcy petition. This postpetition entity is known as a “debtor in possession.” A debtor in possession performs two central roles in the chapter 11 process: (i) it allocates value and seeks to influence and control the ultimate determination of what reorganization value is given to various tiers of creditors and other stakeholders; and (ii) it manages the business during the cases.

The ultimate allocation of value among and between creditors and shareholders is determined by the terms of a plan of reorganization — often referred to simply as “the plan” — which dictates what recoveries they will receive on account of their claims or interests. The plan is a heavily negotiated document and, in most cases, has received the consent of creditor and equity constituencies. It will only be approved after impaired creditors and shareholders (i.e., those creditors and shareholders whose pre-chapter 11 rights are altered by the proposed plan) have voted to accept it.

2. Voting thresholds permitting reorganization with less than unanimous consent

While a plan will only be approved after impaired claimants and shareholders have voted to accept it, the vote need not be unanimous. An impaired class of claimants accepts a plan if, of those voting, the holders of two-thirds in amount, and more than one-half in number, of claims accept. An impaired class of equity interest holders accepts a plan if, of those voting, the holders of two-thirds in amount of interests accept.

In certain circumstances, a plan of reorganization may be confirmed in the absence of the requisite class acceptances, provided that at least one impaired class (without counting insiders’ votes) has accepted the plan. Thus, a creditor’s rights could be altered without its (or its class’s) consent. A “cram down” may be effected upon a rejecting class of unsecured creditors if the plan provides that: (i) (A) each holder of a claim in the rejecting class be paid in full or (B) no claim or equity interest junior to the claims of the rejecting class receive any distribution (the “absolute priority” rule); and (ii) the plan does not discriminate unfairly among claimants (i.e., the plan treats similar claims in the same way and no claimant is paid more than 100%).

A cram down of secured creditors (sometimes referred to as a “cram up” because they sit at the top of the capital structure), such as mortgagees, requires that either: (i) the creditor (A) retain its lien, whether the property is held by the
debtor or transferred to a third party and (B) receive deferred payments with a present value at least equal to the value of the creditor’s secured claim; (ii) if the property is sold free and clear of liens, the creditor’s lien attaches to the sale proceeds; or (iii) the creditor receive the “indubitable equivalent” of its claim. Although the secured creditor must receive distributions under the plan equal to the present value of its collateral, its other rights may be affected. Thus, a plan may restrict secured debt by imposing new terms, e.g., longer maturity, lower interest, lien retention, or more lenient amortization.

3. Imposition of automatic stay

The filing of a bankruptcy petition immediately triggers the automatic stay arising under section 362 of the Bankruptcy Code. The automatic stay is a broad statutory injunction and generally prohibits the commencement or continuation of any formal or informal legal or other action against the debtor or its property on account of prepetition transactions (i.e., transactions that arose prior to the commencement of the chapter 11 case). Subject to certain exceptions, the automatic stay prevents the enforcement of judgments against the debtor; acts to obtain possession of the debtor’s property; acts to create, perfect, or enforce liens; and actions to collect on a prepetition claim or to set off against a prepetition claim. The automatic stay provides a debtor with breathing room to evaluate its status, restructure its operations, and, ultimately, propose a plan of reorganization. There are penalties for knowingly violating the automatic stay.

4. Ability to borrow money on a super-senior basis to finance reorganization and emergence efforts

The Bankruptcy Code contains several provisions designed to encourage lenders to provide debtor in possession (“DIP”) financing in chapter 11 cases. For example, bankruptcy courts have the power to allow DIP lenders to “prime” existing secured claims (i.e., provide liens senior or equal to existing liens). To obtain a priming DIP loan, a debtor must show both that it is unable to obtain such credit otherwise and that the existing secured lenders will be “adequately protected” against diminution in the value of their security interests. “Adequate protection” can take on many forms, including periodic cash payments to the secured lender, payments of post-petition interest, or granting of additional liens to the creditor on previously unencumbered assets. Priming DIP loans ordinarily are provided by the existing secured lender: only in rare circumstances will a hostile DIP financing be approved.

5. Asset sale protections (for buyers and sellers)

A debtor in possession may sell property free and clear of any interest of an entity other than the debtor if: (i) non-bankruptcy law permits such sale; (ii) such entity consents; (iii) such interest is a lien and the property is sold at a price that is greater than the aggregate value of all its liens; (iv) such interest is in a bona fide dispute; or (v) such entity could be compelled to accept money in satisfaction of such interest. Importantly, an asset sale conducted during the course of a chapter 11 case will be immune from avoidance (i.e., claw back) based on later assertions that the purchase price was insufficient.
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Asset sales can include all or substantially all of a debtor’s assets, and can take place both prior to confirmation of a plan and pursuant to a plan. Pre-confirmation sales of all or substantially all of a debtor’s assets typically require a business need (such as the risk of substantial and/or imminent value loss) to justify pursuing them outside of a plan.

6. **Power to assume favorable contracts/leases and reject onerous ones**

A debtor’s ability to assume or reject executory contracts and unexpired leases is a key restructuring tool. Generally speaking, an executory contract is a contract under which, as of the petition date, there remains meaningful performance due on both sides. Debtors reject burdensome or costly contracts or leases and assume beneficial ones that they elect to retain or assign to a purchaser or other third party. Absent a finding by the Bankruptcy Court that a particular executory contract or lease is “severable,” (i.e., multiple contracts memorialized in a single document), debtors are prohibited from assuming a contract in part and rejecting a contract in part. Rather, a contract or lease must be assumed or rejected in full. This rule precludes a debtor from retaining only the beneficial provisions of a contract while shedding the burdensome provisions.

7. **Fresh start: permanent injunction and discharge of claims upon emergence**

A confirmed plan binds the debtor, all entities issuing securities or acquiring property under the plan, and all creditors, shareholders, and general partners in the debtor. Except as provided in the plan or the order confirming the plan, the confirmation of the plan vests all of the property of the estate in the debtor free and clear of any liens and interests and discharges (releases) the debtor from any debt that arose before the date of confirmation, subject to performance of its obligations under the plan.

**Part II – Cross-Border Insolvency Framework**

Chapter 15 of the Bankruptcy Code facilitates foreign insolvency proceedings and authorizes a U.S. Bankruptcy Court to recognize and enforce foreign orders or decrees. Chapter 15’s flexibility allows it to be used for a multitude of reorganization purposes, starting with injunctive relief to protect a foreign debtor’s assets located in U.S. territory. Both provisional and final relief under chapter 15 have been used to:

- provide a debtor with protection against termination of its U.S. executory contracts;
- establish procedures for U.S. creditors to file proofs of claim against a foreign debtor;

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1 In chapter 11 cases, a debtor in possession has until 120 days after the petition date to assume or reject an unexpired lease of nonresidential real property. The Bankruptcy Court may approve a one-time, 90-day extension of this deadline. Any further extensions are subject to lessor consent.

2 A debtor is not discharged if the plan is a liquidating plan, the debtor does not engage in business after the plan’s consummation, and the debtor would be denied a discharge in a chapter 7 case.
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- bind U.S. creditors to the terms of a restructuring plan implemented in a foreign proceeding;
- facilitate asset sales approved in a foreign proceeding through the implementation of auction processes that cover the range of modalities practiced under the Bankruptcy Code;
- facilitate postpetition financing by providing lenders the protections afforded by the Bankruptcy Code; and
- establish protocols for substantive interaction and communication between foreign and U.S. Courts.

What is the process for obtaining recognition of a foreign insolvency proceeding?

Under chapter 15, a company representative or foreign court-appointed official with administrative oversight (a “foreign representative”) may petition a U.S. Bankruptcy Court for “recognition” of a foreign insolvency proceeding. The petition must be accompanied by documents showing the existence of the foreign proceeding and the appointment and authority of the foreign representative.

The foreign representative must provide parties-in-interest with 21 days’ notice of the hearing to consider recognition of a foreign proceeding. In the interim, however, the foreign representative can request “provisional relief.” Generally, U.S. bankruptcy courts will grant such provisional relief as long as the foreign representative can show that it is likely that the foreign proceeding will be recognized and that urgent relief is needed to protect the U.S. assets of a foreign debtor. Such provisional relief may include:

- staying proceedings against the debtor’s assets;
- suspending the right to transfer, encumber, or otherwise dispose of any of the debtor’s assets;
- providing for the examination of witnesses and discovery;
- granting provisional approval of postpetition financing; and
- entrusting the administration or realization of the debtor’s assets to the foreign representative to preserve value where assets are perishable, susceptible to devaluation, or otherwise in jeopardy.

After notice and a hearing, the U.S. Bankruptcy Court is authorized to issue an order recognizing the foreign proceeding as either a “main proceeding” (if the company’s center of main interest is in the foreign country where the foreign insolvency proceeding is pending) or as a “foreign non-main proceeding” (if the company’s center of main interest is in a jurisdiction other than where the foreign insolvency proceeding is pending). Generally, this distinction is minor, and, in either situation, the foreign representative likely will be entrusted with the company’s assets in the United States for administration in the foreign insolvency proceeding.
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Immediately upon recognition of the foreign insolvency proceeding, the automatic stay and certain other provisions of the Bankruptcy Code take effect to protect the debtor's assets located in the United States. The foreign representative is also authorized to operate the debtor's business in the ordinary course.

Willkie has extensive experience representing both debtors and creditors in large, complex chapter 11 cases as well as complex cross-border insolvencies. For example, Willkie played a critical role in the restructuring of Pacific Exploration & Production Corporation (“Pacific”), which was effected, in part, through simultaneous insolvency proceedings before the Ontario Superior Court of Justice Commercial List pursuant to the Companies’ Creditors Arrangement Act (Canada) (“CCAA”), the U.S. Bankruptcy Court for the Southern District of New York pursuant to chapter 15 of the U.S. Bankruptcy Code, and the Colombian Superintendencia de Sociedades pursuant to Colombia’s Ley 1116 of 2006. Representing PricewaterhouseCoopers Inc., the Canadian court-appointed monitor for Pacific, Willkie successfully navigated Pacific's restructuring through the U.S. chapter 15 process by obtaining recognition of the Canadian CCAA proceeding as a foreign main proceeding and securing the U.S. Bankruptcy Court’s recognition of the Canadian Court’s order sanctioning the CCAA Plan. The U.S. Bankruptcy Court’s recognition order was an integral step toward the implementation of the CCAA Plan.

Business Reorganization & Restructuring Department Overview

Willkie Farr & Gallagher LLP’s Business Reorganization & Restructuring Department is comprised of highly regarded, business-minded attorneys with experience advising clients in complex, multijurisdictional restructuring matters. For over 40 years, Willkie has achieved successful results for our clients because of the creativity, practical legal judgment, collective experience, collaboration and complementary skill sets that our professionals bring to our broad-ranging practice. Willkie is one of the few preeminent law firms whose restructuring group routinely represents clients in all aspects of the modern, complex world of international restructuring—from distressed companies, to potential investors, to creditor groups, and all stakeholders in between. Our group’s interdisciplinary approach and experience allows Willkie to provide its clients with world class restructuring services.
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Willkie has multidisciplinary teams working with clients to address coronavirus-related matters, including, for example, contractual analysis, litigation, restructuring, financing, employee benefits, SEC, other corporate-related matters, and CFTC and bank regulation. Please click here to access our publications addressing issues raised by the coronavirus. For advice regarding the coronavirus, please do not hesitate to reach out to your primary Willkie contacts.

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