

MARINE
M O N E Y

ACADEMY

PRESENTED BY:
Holland & Knight

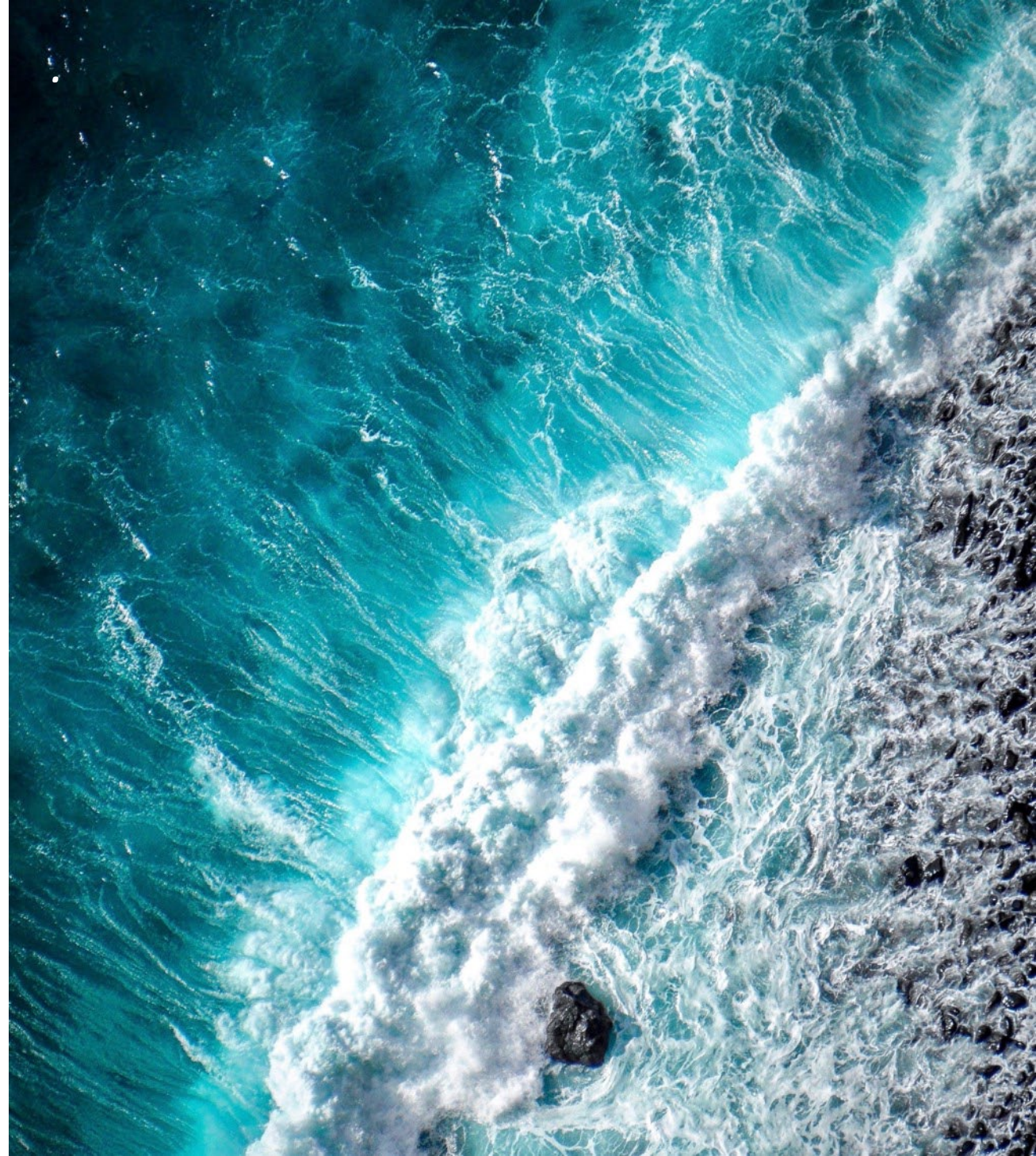
NEW YORK
2022

Bankruptcy in the US

Barbra R. Parlin
Holland & Knight LLP
31 W. 52nd Street
NY, NY 10019
212-513-3210
barbra.parlin@hklaw.com

Table of contents

- I. Overview of US Bankruptcy Proceedings
- II. Effect of Filing
- III. Section 365 and Executory Contracts/Unexpired
Leases; Recharacterization Risks
- IV. DIP Financing
- V. Emergence from Bankruptcy
- VI. Distributions and Claim Sales
- VII. Special Considerations for Foreign Debtors



Overview US Bankruptcy Proceedings

US insolvency proceedings are filed in specialized Bankruptcy Courts, overseen by Bankruptcy Judges and governed by the Bankruptcy Code, a federal statute that applies in all 50 states

Chapters 1, 3, 5 of the Bankruptcy Code contain definitions and provisions concerning the administration of claims and cases and generally apply in all cases

Although Bankruptcy Code is a federal statute, it incorporates applicable state or federal law governing underlying issues regarding property, contracts, security interests, etc.

Bankruptcy in the US

Cases under all chapters of the Bankruptcy Code are commenced by filing a petition:

- Each debtor must file a separate petition and separately qualify as a debtor under the applicable chapter.
- Venue of case need only be proper for first filed debtor; all others may file wherever an affiliate has filed.
- Filing of petition is a watershed – everything in case is either “pre” or “post” petition

Automatic Stay:

- In a plenary or full case, the “automatic stay” of Section 362 becomes effective immediately, serving to stay debt collection efforts and litigation involving the debtor
- Stay goes into effect regardless of whether a creditor has actual notice of a bankruptcy filing
- Does not stay “health, safety & welfare” regulations including environmental laws, criminal proceedings, certain other excepted acts
- Does not stay actions against third parties, such as affiliates or co-defendants, if not also a debtor, but court can extend the stay for cause to non-debtors under limited circumstances for limited purposes;
- Creditors can seek relief from the automatic stay, for cause and other reasons

Where should the case be filed?

28 U.S.C. 1408 provides venue rules for filing the petition

Venue of case proper

- wherever debtor is incorporated,
- where its principal place of business/assets in the US have been located for the 180 days preceding the filing;
- affiliates may file in district where venue is appropriate for first filed debtor

Venue often may be proper in more than one district; for chapter 15, venue usually based on where property in the US is located

Determination as to where to file will be guided by issues specific to the particular debtor

- Location of significant creditors/assets/witnesses
- Choice of law issues that could affect success of case
- Location of counsel/perceptions as to experience of court/speed with which case may be handled

Section 109 -- Who may be a debtor?

Must be a “person” that resides, has a domicile, a place of business or property in the U.S. at time of filing to be debtor under U.S. law

- US Bankruptcy Courts assert jurisdiction over insolvency proceedings of entities formed under foreign law, unlike insolvency regimes in other countries
- No COMI requirement in the US for plenary cases
- Value of U.S. based assets need not be significant (as little as a “peppercorn”); sometimes money in a law firm trust account

Section 109 also limits who may or may not be a debtor under each chapter:

- Cannot be a debtor under chapter 7 if a railroad, domestic insurance company, domestic bank, savings bank, credit union or other insured bank, or if a foreign insurance company engaged in business in the US or a foreign bank with a branch in the US; ok if a bank or insurance holding company
- Railroads, uninsured state banks and entities that file under chapter 7 (except stockbrokers and commodities brokers) can file under chapter 11
- Persons subject to a foreign proceeding may file under chapter 15, subject to the exclusions set forth in 1501(c)

Effect of filing – Automatic stay

Generally prevents creditors from pursuing actions against the debtor or exercising remedies to recover against a debtor's property, including setoffs, wherever located in the world

- As a practical matter, the effect of the stay may be limited if a creditor is not subject to personal jurisdiction in the US, and thus is not subject to the Court's contempt power, and ignores the bankruptcy filing
- Generally does not prevent draws on 3d party L/Cs

Provides the "breathing room" necessary for the debtor or trustee to assess and assemble all of the property of the estate without creditors seeking remedies to protect their own self-interests.

Accordingly: Allows for the preservation of the debtor's assets and the maximization of their value and for an equitable distribution of those assets to creditors.

N.B. There are statutory exceptions to the automatic stay:

The stay does not apply to governmental exercise of police powers nor to the collection of a criminal fine owed to the U.S. government

Non-debtor counterparties not stayed from exercising contractual rights to liquidate, terminate, accelerate, offset, net in connection with forward contracts/securities contracts

Section 546 contains safe harbour exempting certain transfers made in connection with such contracts from most avoidance actions (except intentional fraudulent transfer claims under § 548)

Effect of Filing – Estate

Filing petition creates an “estate”

Estate is comprised of all of the debtor’s legal and equitable interests in property as of the petition date;

Estate includes property/rights forfeited solely due to insolvency/financial condition/commencement of case

Estate defined very broadly; extent of debtor’s interest in property is determined by applicable state or non-bankruptcy federal law and includes pre-petition causes of action.

Filing does not expand existing property rights, but merely includes rights as of the petition date. If debtor is holding property in trust or in escrow it remains as such.

Estate does not include property transferred pre-petition unless and until such property is recovered in an avoidance action, but estate does include disposable income earned post-petition and during plan period

Effect of filing – Corporate Governance

- Chapter 7
 - Trustee appointed to take over day to day management of debtor
 - Existing management/board are removed
 - Operations closed or operated for short time, e.g., to complete wind-down or sale
- Chapter 11
 - Generally has no impact on the day to day management of the company.
 - Management and Board of Directors remain in place and continue to operate the company in the ordinary course, subject to their existing fiduciary obligations as imposed by non-bankruptcy law.
 - Management may also continue to operate the debtor during the post plan-confirmation process, unless removed by Board. Directors remain in place once reorganized, unless company liquidated or appropriately replaced by shareholders.
 - Debtor that operates during chapter 11 case without a trustee is referred to as a “debtor-in-possession.”
- Chapter 15
 - Foreign representative controls case

N.B. In certain situations, creditors or the United States Trustee may request appointment of a chapter 11 trustee “for cause.”

“Cause” includes fraud, dishonesty, incompetence or gross mismanagement of the debtor’s affairs; Appointment of trustee must be in the best interests of the creditors and equity holders.

A chapter 11 trustee replaces management and holds sole control over the operation of the company and chapter 11 process.

Appointment of a trustee terminates the debtor’s exclusive period to file a plan, making it possible for any party in interest to propose a plan.

Appointment of a chapter 11 trustee is the exception, not the norm.

Effect of Filing -- Claims

Petition Date is watershed date for “claims”
Bankruptcy Code defines “claim” **broadly** as: “a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured” and
“the right to an equitable remedy for breach of performance if such equitable remedy gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured.” 11 U.S.C. § 101(5)

Tort claims treated as “pre-petition” if there is a connection between debtor’s pre-filing conduct and claimant’s injury even if the injury does not manifest until after the petition date; tort claims arising out of actions after petition date are “post-petition”

Claims from contracts executed before petition date deemed “pre-petition” even if breach occurs post-filing

Pre-petition claims generally can be discharged in a chapter 11 case; no discharge if debtor is liquidating under chapter 7 or chapter 11; Post-petition claims not subject to discharge;

Regulatory actions for mandatory injunctive relief not a “claim” subject to discharge; Notice may affect whether a party is deemed to have a dischargeable “claim”

Section 365 -- Executory Contracts and Unexpired Leases

Section 365 provides rules for treatment of Debtor's executory contracts and unexpired leases

Equipment leases are treated as personal property leases and may be assumed/rejected at any time through plan confirmation

Debtor required to perform personal property lease obligations beginning from and after 60th day post-petition – in some cases debtor may not have to pay amounts for use during first 60 days until effective date of plan – usually negotiated in stipulation

Ipso Facto Clauses not enforceable; equipment may be used throughout case without need to cure pre-petition defaults prior to assumption

Non-debtor counter-party may not terminate relevant contract without seeking relief from the automatic stay, for cause – stipulation may provide for termination/return

Lessor has no automatic right to terminate or demand return or to compel assumption/rejection unless agreed to by the parties

Bankruptcy Court may grant relief after notice and a hearing based on the “equities of the case”

Assumption and Rejection

General Rule: a Debtor can only “assume” an executory contract or unexpired lease if it cures all defaults (both pre- and post-petition)

- Chapter 11 – personal property leases can be assumed at any time through confirmation
- Chapter 7 -- rejection automatic at 60th day unless Trustee moves to assume or assume/assign to third party

Debtor and Lessor/Counterparty are free to negotiate assumption terms that include less than a cure of all defaults, amendments to the agreement

- Examples of negotiated terms:
- Reduced monthly rent rate
- Allowance of pre-bankruptcy claim
- Lessor Contributions to modifications and overhauls
- Waiver or subordination of certain pre-petition claims
- Timing of Assumption: at signing or at exit from Chapter 11?

UCC provides basis to “recharacterize” certain types of leases as financing transactions

- Often used in context of finance leases/sale lease back transactions
- Result is that lessee-debtor holds title to equipment that is subject of lease
- Lessor holds claim “secured” by equipment (if properly documented) and unsecured claim in amount of excess of claim over equipment value
- Total claim amount depends on amounts due or that will come due under lease
- Entire claim may be treated as “unsecured” as to Debtor/Lessee if Lessor failed to perfect a security interest in the equipment under applicable law
- Result may be different if foreign law applies – e.g., English law
- Recharacterization may be used as negotiating or litigation tool

Bankruptcy Courts typically apply the **law governing the parties’ agreement** to determine law applicable to recharacterization

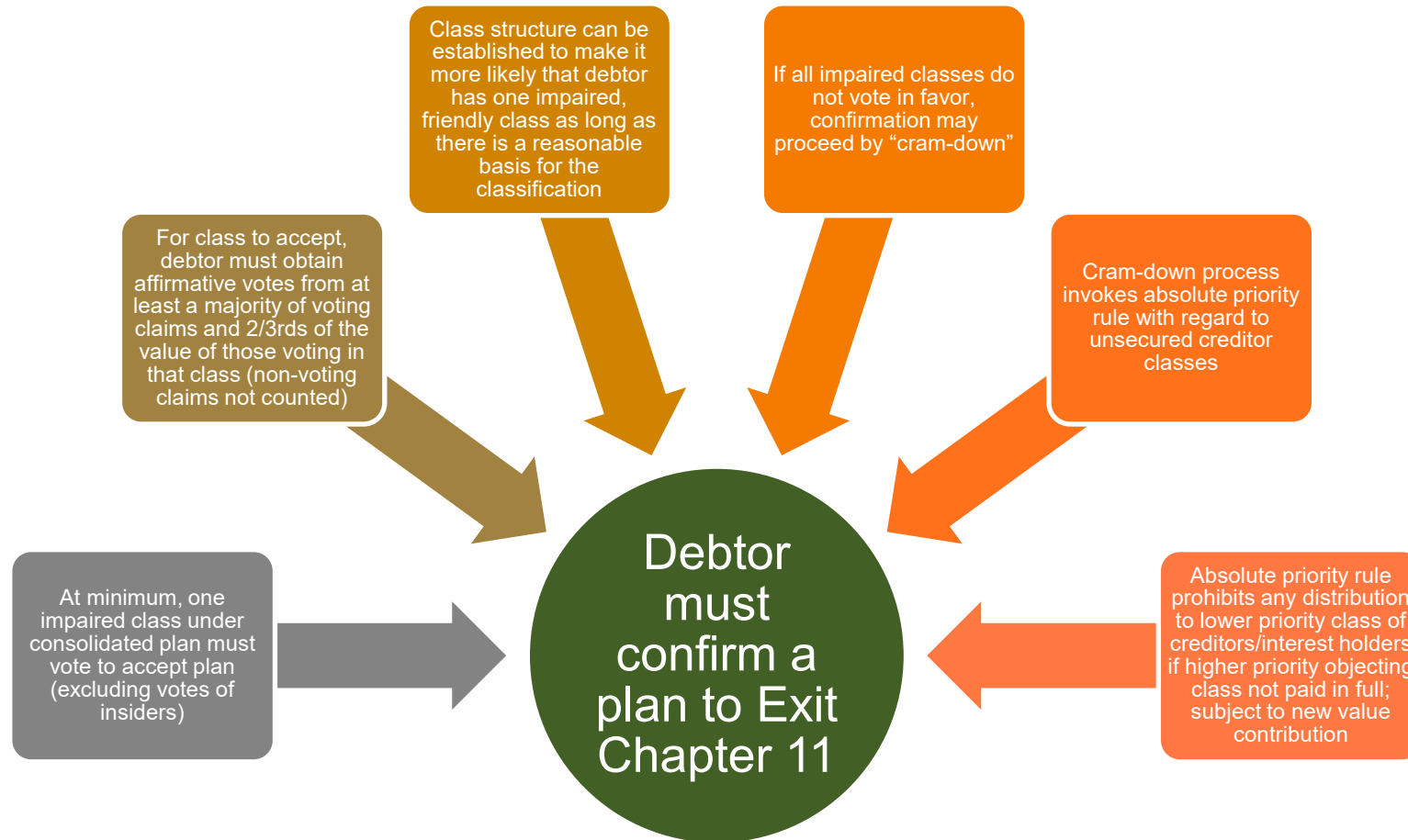
Lessor has ability to vote its secured and unsecured claims against Lessee

Lessor may also hold unsecured claim against other debtors based on guarantees

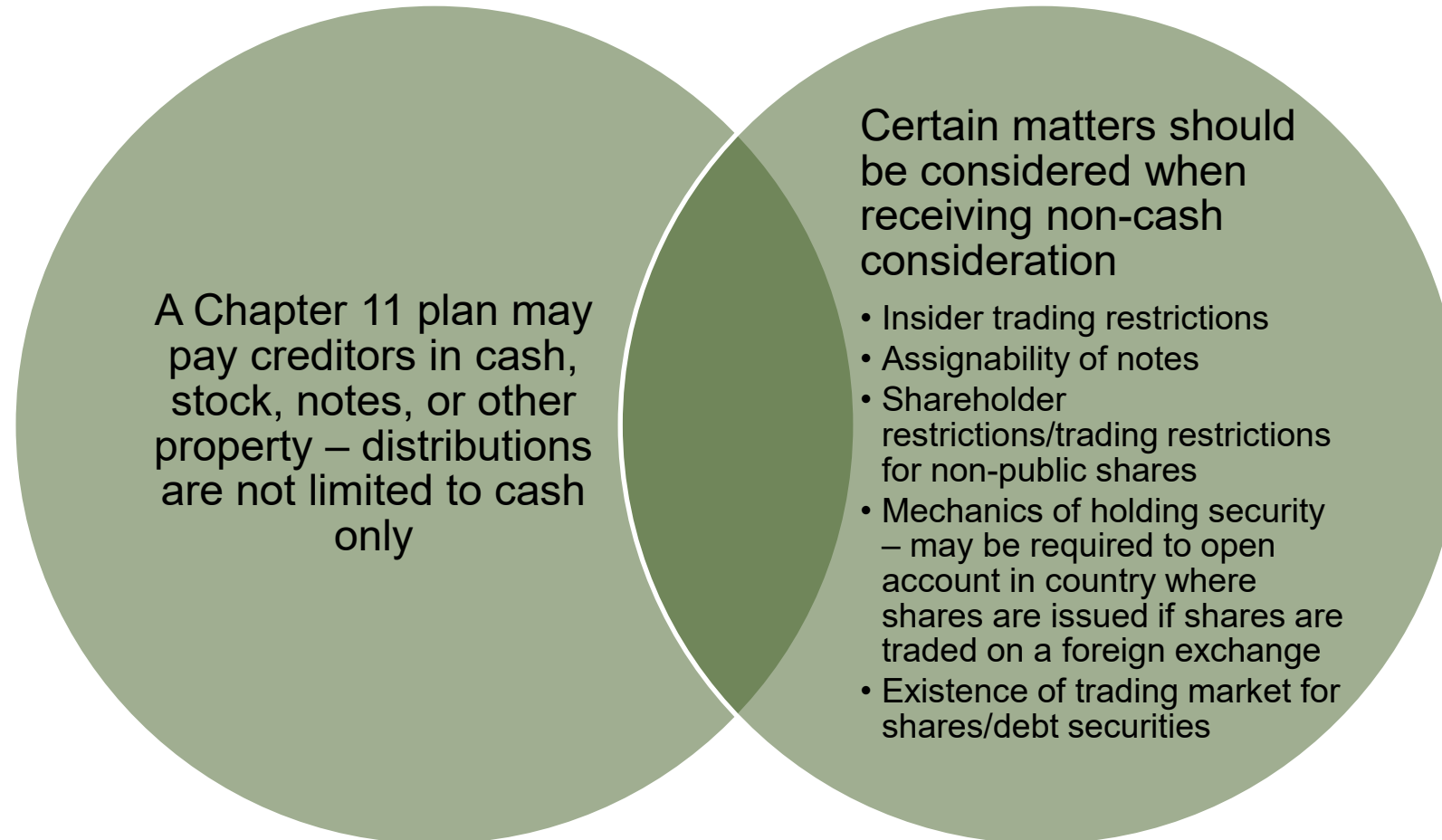
Section 364 -- Debtor in Possession Financing

- Section 364 provides rules by which a debtor may borrow money post-petition
 - Borrowing may be done on an unsecured, secured or super-priority basis
 - Pre-existing lenders often provide post-petition facility; roll up of pre-petition debt permitted
 - DIP Financing often is converted into Exit Facility at end of case
 - DIP Financing Order may include grants of adequate protection for pre-petition lenders
 - Debtor typically waives any challenge rights, but these are preserved for creditors committee, other parties in interest
- DIP financing often impacts potential recoveries
 - Debt to equity conversion features/requirements
 - Valuation – set by terms of DIP financing or market test
- Important to review terms of financing to ensure no impact on operating/finance leases – i.e. no liens on lease interests
- Equity conversion terms built into plan can and usually will dictate and limit recovery for unsecured creditors, other parties in interest
- Existing equity may use DIP financing as means to retain control post-emergence
- Does debtor have government funding/support? Costs?
- Fees, costs, reimbursement rights can have significant impact on recoveries for unsecured creditors
- Participation in DIP financing can impact other aspects of case

Overview of plan confirmation requirements



Plan Distributions



Claim Sales

Buyer's Perspective

Potential value of any distributions in the debtor's case above the price paid to the Seller

Acquire the right to vote on the debtor's plan of reorganization and participate more generally in the debtor's case

Might also be looking to acquire:

- equity in the reorganized debtor
- strategic investment in the debtor's capital structure
- undervalued claims sold by motivated Sellers e.g., those not willing or able to hold post-reorganization equity

Seller's Perspective

offers a minimum level of return in the bankruptcy case

avoids the risk of a delayed recovery
obtain a tax deduction, if the claim is sold for a loss

avoid volatility, as value of claims often fluctuates significantly over the course of a case

remove a receivable from their balance sheets

Additional Considerations

Foreign Debtors in US proceedings face other considerations:

Each foreign debtor must have property or location in US to permit filing;

Bankruptcy Courts assert world wide jurisdiction over the debtor's assets and that the stay applies wherever those assets are located, but creditors not subject to US jurisdiction/contempt power may ignore the stay, leaving debtor's assets abroad vulnerable to attachment or seizure;

Home country law may not recognize certain plan provisions, such as cancellation of existing equity, so may be required to comply with that law also or change strategy to effect comprehensive reorganization;

Officers and directors may be subject to liability in foreign jurisdictions for continuing in business while insolvent;

Extraterritorial application of US avoidance law to transfers occurring wholly outside the US may not be permitted, so avoidance powers may be less useful;

Potential that case may be derailed by procedural motions seeking venue transfer or dismissal;

Different/conflicting regulatory regimes may apply.

Additional Considerations (*cont'd*)

Foreign Debtors/Multinationals filing in US face additional considerations (cont'd):

Necessity for cooperation across insolvency systems;

- Main proceeding coupled with chapter 15 type cases in various jurisdictions;
- Cross-Border protocols between two main proceedings involving different parts of a multinational entity with locations in various jurisdictions;
- Race to control assets/Intercompany claims may make cooperation difficult;

Free and clear sales of assets located in foreign jurisdictions may not be recognized by foreign creditors/courts;

Different systems for recognizing/perfecting security interests and liens may challenge creditor expectations and outcomes;

May be questions as to whose law governs and whether a judgment entered by the US Court will be enforced in other jurisdictions (e.g. UK Gibbs Rule)

Contradictory law/regulations may result in contradictory outcomes for creditors litigating in different jurisdictions;

Foreign debtors typically must pay unsecured trade debt in full to avoid litigation at home – part of the process.