By Richard J. Cooper, Luke A. Barefoot and Jack Massey

Chapter 11 Restructurings of Latin American Energy Companies

Richard J. Cooper
Cleary Gottlieb Steen & Hamilton LLP
New York

Coordinating Editor
Luke A. Barefoot
Cleary Gottlieb Steen & Hamilton LLP
New York

Jack Massey
Cleary Gottlieb Steen & Hamilton LLP
New York

Richard Cooper and Luke Barefoot are partners, and Jack Massey is an associate, in Cleary Gottlieb Steen & Hamilton LLP's Bankruptcy and Restructuring Group in New York.

The effects of recent macroeconomic and environmental conditions (*e.g.*, higher interest rates, spiking commodity prices and El Nino effects, among others), as well as changing legislative and industry conditions (*e.g.*, the move to decarbonization and the shortage of transmission assets), have created challenging conditions across many global energy markets, but none more so than in Latin America, particularly in Chile. Stakeholders in businesses stressed by these conditions often ask whether chapter 11 can be used as a tool to effectuate a balance-sheet restructuring — leaving the operations of their business intact while right-sizing their financial obligations.

While chapter 11 can be a highly efficient means of accomplishing a restructuring for energy companies located outside of the U.S., it also presents a unique set of challenges relating to the treatment of certain contracts, which, for energy companies in particular, may take the form of one or more commodity supply agreements or forward contracts (such as power-purchase agreements) that can be among a debtor's most significant assets.

One challenge for foreign debtors relates to the Bankruptcy Code's safe harbors, which may protect contracts on the basis of characteristics of the counterparty, or its other business dealings, that are likely to be unknown (or unknowable) to the debtor — creating uncertainty in the process of developing a plan structure, or significant litigation risk, delay and/or discovery expense. Another challenge is presented by key contracts with counterparties that may claim not to be subject to the jurisdiction of U.S. courts, and may lack material assets in the U.S., such that U.S. court orders may be difficult to enforce against them.

Recent experience shows that one option to address these issues is to deploy the "ride-through doctrine," which permits contracts to "ride through" unaffected by a chapter 11 plan (*i.e.*, neither assumed nor rejected), allowing a balance-sheet restructuring to take place without litigation in the U.S. over any individual contract. However, the ride-through option requires careful consideration of subsequent litigation risks in foreign tribunals.

Commodity Supply Agreements, Forward Contracts and Other Potentially Safe-Harbored Contracts

Energy firms are likely to have significant contracts in the form of commodity supply agreements or forward contracts, such as power-purchase agreements, whether as suppliers, providers or intermediaries. Depending on the contract's terms, prevailing market conditions and the role played by the debtor, a contract may represent a significant asset (*e.g.*, a contract to sell power to a particular purchaser at higher than market rates) or a significant liability (*e.g.*, a contract to purchase power from a particular supplier at higher than market rates). With some important exceptions, § 365 of the Bankruptcy Code provides a valuable tool in either scenario, permitting a debtor to assume or reject these sorts of executory contracts. In the case of a contract that is a liability, § 365 permits the debtor to reject it (with the counterparty obtaining a contractual-damages claim that is pre-petition and subject to compromise), even where the contract could not ordinarily have been terminated unilaterally. In the case of a contract that is an asset, § 365 permits a debtor to assume it, even where the contract includes an *ipso facto* clause that would otherwise permit the counterparty to terminate or accelerate the contract upon the debtor's filing of a bankruptcy petition or the existence of other indicia of insolvency.

The § 556 Safe Harbor

The Bankruptcy Code includes a swath of provisions that vest rights and powers in the debtor (most notably the automatic stay and the qualified right to assume, reject and assign executory contracts and unexpired leases), and render unenforceable certain types of contractual provisions (such as anti-assignment clauses and *ipso facto* clauses that permit a party to terminate a contract based on a debtor's insolvency or the filing of a bankruptcy case). These provisions are designed to give the debtor breathing room to reorganize and prevent individual creditors from exercising contractual rights at the expense of the debtor's reorganization efforts. However, these goals of the Code can directly conflict with the proper functioning of the securities and commodities markets, in which participants must be able to close existing positions and enter into new ones, and where the inability of a single participant to do so can have destructive ripple effects on entire segments of financial markets. The Code's safe harbors are designed to prevent this ripple effect.

The safe harbor under § 556 of the Bankruptcy Code is of particular relevance to foreign ener-

gy companies considering a balance-sheet restructuring under chapter 11. This safe harbor applies only where the contract itself, and the contract counterparty, meet certain criteria. In order to qualify for the safe harbor, the contract in question must be either a commodities contract (which is defined broadly in § 761(4) of the Bankruptcy Code) or a forward contract (where the reason for termination relates to the financial condition of the debtor or the chapter 11 filing itself).

The § 556 safe harbor also applies only where the counterparty is a "commodity broker, financial participant, or forward contract merchant" (all of which have specific definitions under the Code). A debtor is likely to be able to assess whether a contract counterparty is a commodity broker (defined as a "futures commission merchant, foreign futures commission merchant, clearing organization, leverage transaction merchant, or commodity options dealer ... with respect to which there is a customer")[1] or a forward contract merchant (defined as a company, "the business of which consists in whole or in part of entering into forward contracts as or with merchants in a commodity").[2] In the context of a commodity contract with a debtor in the energy industry, commodity brokers and forward-contract merchants stand in contrast to *end users* of a commodity (*e.g.*, an industrial plant that consumes electricity that is delivered pursuant to a power-purchase agreement), even if the power-purchase agreement in question is otherwise fairly characterized as a forward contract.

A debtor is much *less* likely to know whether a given counterparty may qualify as a "financial participant," the final category of counterparty that is protected under the § 556 safe harbor. This definition calls for a much more detailed and fact-intensive inquiry, involving information that — critically — a debtor might not necessarily know about a given contract counterparty, and that might not be publicly available. The Code's definition of "financial participant" includes any firm that has one or more outstanding financial contracts[3] with the debtor or any other entity of a total aggregate gross value of at least $1 billion in notional or actual principal amount outstanding, or has gross mark-to-market positions of not less than $100 million in such contracts.[4]

This holistic consideration of the contract counterparty's total exposure, including through contracts with third parties, is consistent with the Code's goal of preventing a chapter 11 restructuring from creating destructive ripple effects through the financial markets. However, it creates significant uncertainty for debtors, who may not know (without the benefit of discovery) whether a valuable contract may be assumed, or whether the counterparty may rely on this safe harbor to exercise contractual termination rights immediately following a chapter 11 filing. This uncertainty creates the risk that a debtor will enter chapter 11 with the intention of effectuating a reorganization plan that depends on the assumption of a key contract, only to learn belatedly that the counterparty will take the position that the debtor cannot do so because the counterparty is able to terminate the contract.

Contracts with Foreign Firms Not Subject to U.S. Jurisdiction

The aforementioned uncertainties can be compounded in the case of foreign debtors, because the contractual counterparties to these and other contracts might have few or no contacts with the U.S., and therefore might not be — or might claim not to be — subject to the jurisdiction of U.S. courts. It is black-letter law that a presiding bankruptcy court possesses exclusive *in rem* jurisdiction over all property of the estate.[5] Bankruptcy courts have consistently held that this jurisdiction forms the basis for courts' decisions affecting most (if not all) elements of a debtor's estate, including executory contracts to which the debtor is a party.[6] However, at least one court has held that in order to make the determinations necessary to approve the assumption of an executory contract, it was first required to establish a basis for asserting *in personam* jurisdiction over the counterparty to the contract.[7] Even if the contract counterparty possesses such sufficient ties to the U.S. as to be subject to the jurisdiction of U.S. courts, establishing these ties can be expensive and time-consuming, which could compromise the efficiency of an in-court balance-sheet restructuring.

Even where a contract assumption has been approved by a court, it can be difficult to enforce an order of a U.S. bankruptcy court against a firm with few or no ties to the U.S., particularly if the party is located in a country that has not adopted the 1997 UNCITRAL Model Law on Cross-Border Insolvency (UNCITRAL MLCBI) or its successor-model law, the 2018 UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments (UNCITRAL MLIJ).[8]

Thus, the debtor could find itself in a situation wherein it cannot enforce or obtain U.S. court orders without first conducting burdensome jurisdictional discovery and briefing, or where a contract is validly assumed or rejected by the debtor, but the assumption or rejection order (or the confirmed plan that effectuates the assumption or rejection) is not enforceable in the debtor's, or the counterparty's, home jurisdiction. While firms that do business in the U.S. may choose to respect U.S. court orders for commercial reasons, a firm that operates exclusively in a single country that has not adopted the UNCITRAL MLIJ might have no commercial incentive to do so.

1 11 U.S.C. § 101(6).
2 11 U.S.C. § 101(26).
3 The relevant types of contracts, for purposes of the definition of "financial participant," are securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements and master netting agreements. 11 U.S.C. § 561(a)(1)-(6).
4 11 U.S.C. § 101(22A).

5 11 U.S.C. § 1334(e)(1).
6 *See In re Drexel Burnham Lambert Grp. Inc.*, 138 B.R. 687, 702 (Bankr. S.D.N.Y. 1992) ("Executory contracts are property of the estate.").
7 *See* Hearing Transcript, *In re Alto Maipo Delaware LLC, et al.*, No. 21-11507 (KBO) at 58:16-19 (Bankr. D. Del. April 26, 2022) ("I ... will not adjudicate the assumption motion without an adversary proceeding, proper service and an establishment of personal jurisdiction over [the contract counterparty]."). This decision appears to be in tension with the holding of *In re Sae Young Westmont-Chicago LLC*, 276 B.R. 888, 896 (Bankr. N.D. Ill. 2002), in which the court approved the assumption of a lease over a personal-jurisdiction objection from the lessee, noting that "the bankruptcy judge has such [exclusive] authority over a debtor's property, no matter where the property is located."
8 Brazil, Colombia, Chile and Mexico are the only major Latin American countries, among 58 states globally, to have enacted legislation substantially adopting the UNCITRAL MLCBI. To date, no states have enacted legislation adopting the more recent UNCITRAL MLIJ.

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The "Ride-Through" Doctrine

In either of the aforementioned scenarios — where the contract in question is, or could be, subject to the § 556 safe harbor or is with a foreign firm that is not, or claims not to be, subject to personal jurisdiction in the U.S. — the Bankruptcy Code permits one particularly useful workaround: While the Code *permits* a debtor to assume or reject any executory contract, it does not require that all contracts be assumed or rejected.[9] Under the so-called "ride-through doctrine," a debtor may permit an executory contract to "ride through" the bankruptcy unaffected, meaning that the contract is not addressed in the chapter 11 plan at all.[10] Where a contract rides through, the counterparty retains any rights or causes of action that it may have had prior to the petition date, and may bring claims — or seek to terminate the contract — after the automatic stay is lifted subsequent to confirmation of a plan.

The ride-through approach, self-evidently, does nothing to address any dispute that might exist between the debtor and the contract counterparty. In particular, if the contract includes an *ipso facto* clause that would permit the counterparty to terminate the contract as a result of the bankruptcy filing or the debtor's insolvency, such clause remains in effect after plan confirmation where the contract is given ride-through treatment. Any dispute between the parties over such a clause would be properly heard in local courts in the jurisdiction where the parties are at home, or in accordance with the contract's forum-selection clause. In addition, where the debtor is on notice of a claim that might be brought by the counterparty after the plan is consummated and the automatic stay is lifted, the bankruptcy court must consider the debtor's likelihood of success in such a dispute as part of its assessment of the feasibility of the plan as a whole. Where the contract in question is a significant asset (or liability) of the debtor, the significance of this consideration is particularly acute.

Conclusion

Despite these pitfalls, bankruptcy courts have consistently approved plans that permit contracts to ride through, and multiple circuit courts of appeals have adopted the ride-through doctrine or similar formulations.[11] The ride-through doctrine remains an attractive means for a foreign debtor to effectuate a balance-sheet restructuring without the need for litigation in the U.S. over any particular contract. abi

9 The sections of the Bankruptcy Code that bear on the treatment of executory contracts are § 365, which provides that a debtor "*may* assume or reject" executory contracts (11 U.S.C. § 365(a)) (emphasis added), and § 1123, which provides that a plan "*may* provide for the assumption, rejection, or assignment" of executory contracts (11 U.S.C. § 1123(b)(2)) (emphasis added). Section 1129, which governs plan confirmation, does not include any reference to the assumption or rejection of contracts. While *dicta* in certain cases might suggest otherwise, no Code section requires assumption or rejection of executory contracts.

10 *See* Mark R. Campbell & Robert C. Hastie, "Executory Contracts: Retention Without Assumption in Chapter 11: 'Ride-Through' Revisited," *ABI Journal* (March 2000); *see also* Mette H. Kurth & Joel Ohlgren, "Ride-Through Revisited (Again): The Strategic Use of the Ride-Through Doctrine in the Post-*Catapult* Era," *ABI Journal* (June 2005). Both articles are posted at abi.org/abi-journal. Commentators have also referred to the doctrine as the "carry-through" doctrine. *See* Campbell & Hastie, *supra*.

11 *See In re Public Serv. Co. of New Hampshire*, 884 F.2d 11 (1st Cir. 1989); *In re Matter of Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991); *In re Boston Rd. Ltd. P'ship*, 21 F.3d 477 (2d Cir. 1994).

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