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Navigating Today's Environment

The Directors' and Officers' Guide to Restructuring

SECOND EDITION

Michael Eisenband
Consulting Editor
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AMERICAN BANKRUPTCY INSTITUTE

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Consulting Editor

Michael Eisenband

Advisory Board

Carlin Adrianopoli

Amir Agam

Michael Buenzow

Robert Del Genio

Michael Katzenstein

Steven Simms

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17.I BANKRUPTCY: CONSIDERATIONS AND STRATEGIES FOR DIRECTORS AND OFFICERS OF MULTINATIONAL COMPANIES SEEKING TO RESTRUCTURE

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Cleary Gottlieb Steen & Hamilton LLP

Richard J. Cooper, *Senior Restructuring Partner*

Lisa Schweitzer, *Restructuring Partner*

John Veraja, *Associate*

Directors and officers of multinational companies considering restructuring should be aware of the viability of using Chapter 11 of the United States Bankruptcy Code to effectuate a successful financial or operational restructuring. Chapter 11 provides key advantages for a debtor compared to local insolvency policies in other countries. Directors should understand that their fiduciary duties when a company approaches insolvency or is insolvent may vary across jurisdictions, and that consideration must be given to the local regulatory environment in terms of planning a successful restructuring. There is a strong precedent of foreign directors and senior management approving Chapter 11 filings as the best available alternative.

Key attractions of a U.S. Chapter 11 process

Companies with and without substantial operations in the United States are increasingly opting to file for Chapter 11 as their main restructuring proceedings. While many multinational companies may be familiar with Chapter 15 of the U.S. Bankruptcy Code as an ancillary proceeding used to give effect in the United States to insolvency proceedings conducted outside of the United States, Chapter 11 is also available to domestic companies with substantial foreign operations as well as foreign companies with or without any U.S. operations. Indeed, Chapter 11 has been used by foreign companies across a wide variety of industries to implement restructuring agreements reached with major creditors (through pre-packaged bankruptcies) and to obtain breathing space to develop a reorganization plan. For example, major airlines in Chile, Mexico and Columbia sought Chapter 11 relief to reorganize after the COVID-19 pandemic hit, as did the world's largest offshore and well drilling company based in London. There have been multiple Chapter 11 filings in the fourth quarter of 2021 by foreign companies, including a pre-packed Chapter 11 case filed by one of the largest hotel operators in Mexico and a pre-arranged Chapter 11 filing by a Chile-based hydroelectric power project along with its U.S. affiliate. There have also been pre-packaged Chapter 11 filings by foreign companies where the debtor sought and received bankruptcy court approval of its proposed

Chapter 11 restructuring plan within hours of the company's filing, including in the Chapter 11 cases of a Helsinki, Finland-based business-to-business-for-employees travel management company and in the case of Seadrill New Finance Ltd. Foreign companies' use of Chapter 11 to reorganize is likely to continue given Chapter 11's distinct advantages for companies seeking to restructure.

Barriers to entry for filing Chapter 11 are low. Unlike in various other jurisdictions, companies do not need to demonstrate insolvency to file Chapter 11; they merely have to be experiencing some financial distress. They do not need substantial operations in the United States to avail themselves of Chapter 11's protections. In fact, if a company "resides or has a domicile, a place of business, or property in the United States," (11 U.S.C. § 109(a)) it can be a Chapter 11 debtor. Foreign companies typically file based on the existence of property located in the United States, where even a minimal amount of assets such as receivables owed by U.S. counterparties, local bank accounts or even a prospective debtor's funds held in a lawyer's retainer account, may be sufficient for establishing Chapter 11 eligibility. (*In re Glob. Ocean Carriers Ltd.*, 251 B.R. 31, 39 (Bankr. D. Del. 2000) holding that retainers paid on behalf of the debtors were sufficient property under the Bankruptcy Code).

Once in Chapter 11, a debtor will benefit from an expansive automatic stay. The automatic stay in bankruptcy immediately prevents any creditor actions against the debtor or its property outside of the bankruptcy proceeding, including any attempts to collect or enforce claims against the debtor (11 U.S.C. § 362). The automatic stay has purported worldwide applicability, and for creditors with significant U.S. ties such as international financial institutions, there is a strong incentive for such creditors to abide by the stay or otherwise risk facing contempt in a U.S. court (even though such creditor's underlying claims may be based entirely in a non-U.S. jurisdiction with little or no connection to the U.S).

Plan confirmation under Chapter 11 is flexible and the debtor can bind holdout creditors. Within one class, a debtor needs only to obtain the consent of a majority in number and two-thirds in amount of voting creditors for that class to accept the plan (11 U.S.C. § 1126(c)). By contrast, many other jurisdictions, including the United Kingdom and Hong Kong, require thresholds greater than 50% of voting creditors to bind the class. Moreover, Chapter 11 debtors are able to "cram down" a plan, i.e., to impose a plan on non-accepting classes of creditors as long as certain conditions are met (11 U.S.C. § 1129(b)). In order to cram down a Chapter 11 on a non-accepting class, the debtor must show that the plan is fair and equitable in accordance with the Bankruptcy Code (junior creditors are not paid until senior ones are paid in full — the so-called "absolute priority" rule) and does not unfairly discriminate against a class of creditors; such creditor classes do not receive worse treatment than other similar creditor classes. Other common law jurisdictions either offer no such cram down, or in the case of the United Kingdom, only recently adopted a similar procedure by amending insolvency law through the Corporate Insolvency and Governance Act 2020.

Under the U.S. Bankruptcy Code, Chapter 11 provides additional tools and powers advantageous to multinational companies:

(i) A trustee is not typically appointed, and existing management of the company remains in control after the filing of Chapter 11. The debtor is allowed to operate its business as a debtor-in-possession ("DIP") except in extraordinary circumstances, such as fraud or gross mismanagement where a trustee may be appointed on request (11 U.S.C. § 1104).

(ii) Companies have access to financial markets in the United States while in bankruptcy through so-called DIP financing. To attract existing lenders or third parties to provide additional funding, the new financing can be senior in payment priority and receive liens that are senior to existing secured claims subject to certain showings. The DIP financing market is well developed in the United States, and each of the major foreign airlines that filed Chapter 11 in 2020 obtained DIP financing notwithstanding the pending pandemic, including LATAM Airlines

($3.2 billion), Avianca Holdings ($2 billion) and Grupo Aeroméxico ($1 billion).

(iii) Under the Bankruptcy Code, Chapter 11 debtors have a broad right to assume (maintain and perform) or reject (effectively breach and not perform further) executory contracts at any time during the Chapter 11 proceeding (11 U.S.C. § 365). Executory contracts are pre-bankruptcy contracts where both parties have material performance obligations remaining as of the time of the case filing. A debtor's ability to reject disadvantageous contracts (where rejection typically results in an unsecured pre-petition claim for damages that can be compromised in the case) is critical to debtors needing to respond to changed market conditions, such as the foreign airlines that filed Chapter 11 in 2020 as a result of the COVID-19 pandemic who needed to reject or renegotiate numerous contracts related to their businesses. Additionally, the mere threat of rejection can be a useful tool for debtors seeking improved terms of their existing contracts.

(iv) A debtor, or in some cases, certain third parties, may pursue avoidance actions to unwind certain transfers made by the debtor prior to the bankruptcy filing (11 U.S.C. §§ 547, 548). Chapter 11 is useful for companies considering a reorganization that may have significant value in potential clawback claims because this avoidance power is unavailable under a Chapter 15 ancillary proceeding. Notably, U.S. avoidance actions are broader in scope compared to certain other jurisdictions, including with respect to the applicable look-back period, so debtors may be able to improve recovery of value on behalf of the estate through these claims.

(v) Finally, Chapter 11 can enable a debtor to sell some or all of its assets free and clear of existing liens and claims, with any security interest in the assets sold typically attaching to the proceeds of the sale subject to certain requirements (11 U.S.C. § 363). Bankruptcy sales can be relatively quick (sales may be completed in two to four months or even less depending on the specific circumstances). In August 2021, for instance, Alpha Latam Management LLC and its affiliates in Colombia and Mexico filed Chapter 11 to commence a sale process for their Colombian assets. In their declaration supporting the bankruptcy petition, the debtors specifically referred to the attractiveness of selling assets free and clear under Section 363 of Chapter 11: "[i]t quickly became evident, however, that potential buyers would be unwilling to pursue a purchase of the Colombian loan portfolio outside a sale under section 363 of the Bankruptcy Code."

Practical considerations for directors of multinational companies considering restructuring

When considering a restructuring through Chapter 11, directors of multinational companies should be aware that their fiduciary duties may differ across jurisdictions. For example, in the United States under Delaware law, the state where many U.S. companies are incorporated, directors are largely shielded from creditor lawsuits based on the business judgment rule; they may choose to file bankruptcy or continue to operate an insolvent entity outside of a proceeding so long as they act in good faith to the best interest of the corporation (*N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007); *Quadrant Structured Prod. Co., Ltd. v. Vertin*, 115 A.3d 535, 547 (Del. Ch. 2015)). This is not always the case in other countries, especially in certain European jurisdictions. While U.S. directors' fiduciary duties remain with the company throughout, and case law has moved away from heightened duties in the "zone of insolvency," in some jurisdictions such as the United Kingdom and Luxemburg, director duties may shift as the company approaches insolvency to the protection of creditors. In various countries, including Belgium, France and Germany, directors may be required to commence formal insolvency proceedings within certain prescribed time periods after a company becomes insolvent. Failure to do so could subject the director to personal civil liability for losses or even potential criminal liability in certain countries. In various prior cases, directors have been comfortable with the idea that the commencement of a Chapter 11 proceeding may satisfy their statutory duties with respect to these matters.

After a company enters Chapter 11, its directors may face a multitude of critical decisions, including whether to (i) sell parts of the company or potentially the entire company; (ii) enter into restructuring support agreements with certain creditors or stakeholders; (iii) approve a Chapter 11 plan and the terms of such plan; and/or (iv) issue new debt and/or equity as part of the capital structure of the reorganized entity. While the board is a fiduciary for all stakeholders and has an obligation to seek to maximize value for all stakeholders, in making its decisions the board can take into account factors other than valuation, including whether the relevant transaction involves material regulatory or other risks or is compliant with other requirements of the Bankruptcy Code (including, in the case of a plan of reorganization, whether it satisfies the requirements of Section 1129 of the Bankruptcy Code).

For foreign filers seeking to confirm a plan of reorganization, one particularly important requirement is that the plan comply with all applicable laws, including those that may apply in its jurisdiction of reorganization. Corporate laws in a debtor's home country regarding corporate governance and shareholder rights may materially affect the negotiation of a plan to exit Chapter 11. For example, parties may have to negotiate and develop workarounds where requirements in the Bankruptcy Code such as the absolute priority rule might seem at odds with certain corporate and securities law requirements in foreign legal regimes, including, in certain jurisdictions, vesting existing shareholders with the exclusive right to approve and/or participate in a capital-raise (*See* Richard J. Cooper, Kyle J. Ortiz, and Thomas S. Kessler, *Addressing Treatment of Equity of Foreign Law and the Code,* ABI JNL., Vol. XL, No. 4. (2021)). In some recent Chapter 11 cases, squaring the legal requirements of a company's home jurisdiction and the requirements of Chapter 11 has generated a great deal of litigation. For example, in the Chapter 11 cases of both LATAM Airlines and Aeroméxico, parties have raised objections to proposed distributions of value that are required by local law.

For companies with assets and creditors located in multiple jurisdictions, the debtor also may want to seek recognition of the U.S. Chapter 11 proceedings in their home country or other foreign jurisdictions. The recognition of the Chapter 11 proceeding in other jurisdictions may serve to enforce the statutory stay and further protect the debtor from needing to litigate with creditors who do not have ties to the United States in local courts. While recognition may be relatively straightforward in jurisdictions that have well-developed cross-border insolvency regimes such ones patterned on the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law"), a debtor may consider alternative options for enforcement of the bankruptcy protections to the extent statutory recognition procedures have not been implemented in a specific country. For example, Philippine Airlines Inc. recently obtained a Philippine local court's recognition of its U.S. Chapter 11 proceeding, a first for the country.

In addition to recognition, local law may require the company to take action or may prevent the company from utilizing the provisions of Chapter 11 that otherwise might be available in ways that may affect the conduct of the case. For example, local labor and union law could affect companies in a Chapter 11 proceeding where the company will want to maintain its relationships and agreements with unions and employees but may also want to obtain concessions from them as a key component of the restructuring process. While a U.S. debtor may reject a collective bargaining agreement subject to certain conditions (11 U.S.C. § 1113), a foreign filer may not necessarily be able to do so under relevant local law. In contrast, a foreign debtor may wish to provide financial protection to certain of its senior management immediately prior to or over the course of a Chapter 11 proceeding in order to ensure their retention. The Bankruptcy Code contains certain limitations on a debtor's ability to pay bonuses to employees which the board should be aware of before it enters into a Chapter 11 case. A debtor may make payments to key employees under a Key Employee Retention Plan upon approval of the bankruptcy court and after a showing that certain required factors have been satisfied (11 U.S.C. § 503(c)(1)). Chapter 11 debtors may pay a bonus under a Key Employee Incentive Plan with bankruptcy court approval, if such employees meet certain measurable milestones and the debtor sufficiently demonstrates to the bankruptcy court that such payments are justified by the facts and circumstances of the case (11 U.S.C. § 503(c)(3)). Companies should consider potential employment issues beforehand and develop a plan to effectively communicate with domestic and foreign employees and any unions regarding Chapter 11.

As debtors-in-possession in Chapter 11, foreign companies must also be aware of certain statutory reporting requirements contained in the U.S. Bankruptcy Code and reporting rules required by the Office of the United States Trustee, both upon filing the case and during the bankruptcy. One area that is particularly important relates to a debtor's cash management system, including the deposit and investment requirements under section 345 of the U.S. Bankruptcy Code. The U.S. Trustee, a bankruptcy administrator under the U.S. Department of Justice, also adopts reporting rules regarding bank accounts that debtors-in-possession must follow. Multinational companies considering a restructuring through Chapter 11 should conduct detailed analysis of location of their cash as well as expatriation options and limitations to ensure compliance with both local financial laws and the U.S. Bankruptcy Code.

In Chapter 11 cases, various committees of creditors and other stakeholders may take an active role in the case. Most commonly, an unsecured creditors' committee ("UCC") may, with court approval, investigate the debtor, its financial affairs and its business operations and object to certain relief sought or commence various litigation. The costs of the UCC's advisors are paid by the bankruptcy estate and a debtor will generally have to work with the UCC throughout the case, as the UCC will often be a key constituent with respect to approval of a Chapter 11 plan.

Finally, to maintain its global operations, a multinational debtor will likely have to be able to pay critical vendors that reside in non-U.S. jurisdictions. One way a debtor can obtain authority to do so in Chapter 11 is for the debtor to seek a foreign vendor order from the bankruptcy court that authorizes the debtor to make payments to foreign vendors on account of all or a portion of the debtor's pre-petition obligations to such foreign vendors. A foreign vendor order may minimize the risk that notwithstanding the statutory protections afforded by Chapter 11, a foreign vendor may seek to withhold goods or services or take enforcement action under local law which could include the involuntary commencement of insolvency proceedings and/or the assertion of personal liability against the debtor's directors or officers. Additionally, aside from its vendors, debtors hiring "professionals" for the bankruptcy case should be aware of the requirements contained in section 327(a) of the U.S. Bankruptcy Code indicating that such bankruptcy professional be "disinterested."

Directors of multinational companies and their legal advisors will need to consider local law in the jurisdictions in which the company operates when crafting a restructuring strategy. Any decision whether and where to commence a creditor protection proceeding requires a holistic assessment of the company's options and the relative benefits and limitations of different options. In various situations, Chapter 11 may prove to be superior compared to other local alternatives if the case is properly prepared and the potential risks are adequately identified and addressed in advance of a filing.

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