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A U.S. Perspective on Cross-Border "Informal" workouts:
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PRELIMINARY OBSERVATIONS

- Most of the larger and more complex business reorganizations and debt restructurings in the U.S. are conducted through a formal bankruptcy court process under the U.S. Bankruptcy Code (11 U.S.C. Section 101 et. seq.) (hereinafter, "Bankruptcy Code"). While the parties may develop the "exit strategy" outside of a court-supervised process, negotiations often culminate with the submission of a "prepackaged" or "prenegotiated" plan that is "washed through" the bankruptcy process to bind dissenters to the plan.
- As financial transaction become increasingly multi-tiered and complex, it is virtually impossible to achieve a 100% "buy in" from all necessary constituents for a workout-absent the threat of a credible formal bankruptcy alternative. Since a small group of dissenters may thwart attempts to achieve an out-of-court compromise or debt restructuring, the U.S. bankruptcy process, with its pervasive "automatic stay" and ability to cram down dissenters, can be a credible and useful business tool to effectuate a sound restructuring/reorganization plan.
- Even in liquidating cases, powers afforded by the Bankruptcy Code (such as the ability to sell assets free and clear of liens, the power to avoid preferential and fraudulent conveyances and the ability to assume and assign or reject unexpired leases and certain types of contracts where obligations remain unperformed by both parties to the contract) provide additional vehicles for realizing value for creditors of an insolvent debtor.
- From a debtor's perspective, the Chapter 11 bankruptcy process allows a debtor to remain in control of a workout; if creditors push too hard, the Debtor may seek to retain control by filing a voluntary petition under Chapter 11 of the Bankruptcy Code.
- Under U.S. Federal law, bankruptcy courts have pervasive *in rem* jurisdiction over property of the estate wherever located and *in personam* jurisdiction over any person within the territorial boundaries of the U.S. These broad jurisdictional powers of the bankruptcy courts coupled with the "automatic stay" induce recalcitrant creditors (even foreign creditors) to the bargaining table. Thus, parties in "workouts" conducted outside of the bankruptcy process in the U.S.(or with a U.S. "nexus") always negotiate against the backdrop of the rights and remedies afforded by the Bankruptcy Code.

"NON-BANKRUPTCY" ALTERNATIVES

Many of the mid-tier and smaller business reorganizations/debt restructurings and liquidations in the U.S. are conducted outside of the bankruptcy process. While the alternatives range from contractual arrangements (forbearance agreements, creditor compositions, Assignments for the Benefit of Creditors, trust mortgages) to proceedings conducted under State or Federal court supervision (such as State and Federal court receiverships), in all of these alternatives, there is always the possibility that dissenting creditors (or a debtor) may seek to invoke the rights and remedies afforded by the Bankruptcy Code by filing an involuntary (or voluntary, in the case of a debtor) petition under Chapter 7 (liquidation) or Chapter 11 (reorganization) of the Bankruptcy Code. The following is a summary of the most common "non-bankruptcy" alternatives currently in use in the U.S.:

- **Assignment for Benefit of Creditors ("ABC").** A creature of State law, a typical ABC involves the transfer of all assets of a debtor's estate to a fiduciary (the "Assignee") who is charged with converting all the debtor's assets to cash and distributing the proceeds *pro rata* to like creditors similarly situated-usually in accordance with the priority scheme set forth in the U.S. Bankruptcy Code. Notice of the assignment is given to creditors and all parties-in-interest and parties may assert claims for payment against the estate. In order to participate in the assignment estate, creditors have to timely file claims by a bar date set by the Assignee and must signify their assent to the ABC by executing an assent form (essentially, the ABC becomes a binding contract between the assenting creditors and the Assignee). The Assignee is also charged with pursuing claims or causes of action belonging to the estate for the benefit of the estate and its creditors. While an ABC may be a useful tool-particularly in a liquidating case, creditors might file an involuntary petition in bankruptcy in order to have the liquidation conducted under the auspices of a bankruptcy proceeding where, for instance, they believe that there may be a greater return to creditors through recoveries under the avoidance powers and other causes of action afforded by the Bankruptcy Code.
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- **State or Federal Court Receivership.** State and Federal court receiverships can serve as a less-costly and burdensome alternative to the bankruptcy process. In some situations, where the "stigma" of a Chapter 11 filing might have a deleterious effect on a business, a debtor and its lenders might consensually agree to the appointment of a receiver in State or Federal Court. In these situations, the receiver might be charged with preserving the business and preparing the enterprise for sale as a going concern.. In sum, a receiver (a private party who is often chosen for his particular knowledge of the debtor's business) may operate the business to preserve it's going concern value (pending a sale, for instance)and conduct private or public auctions of the debtor's assets and pursue litigation on behalf of the estate. Here again, dissenting creditors might seek to file an involuntary bankruptcy petition (or, in the case of non-consensual receivership, the debtor might try to regain control over the estate through a voluntary Chapter 11 filing). However, in such an event, the bankruptcy court might very well choose to dismiss the filing if the court were to find that such dismissal were in the best interest of creditors.
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- **"Trust Mortgage" or "Secured Escrow".** In some out-of-court workouts, negotiations with creditors (particularly, with representatives of unsecured trade creditors) might result in the granting of security to creditors -usually in the form of a junior lien on the debtor's assets-to secure the payment stream under the proposed workout plan to that class of creditors. In these situations, the debtor might execute a "Trust Mortgage" or "Secured Escrow" naming a "Trust Indenture Trustee" or "Escrow Agent" (usually the attorney for the creditor group) who would serve as a fiduciary for that class of creditors and would be charged with the task of monitoring the workout plan, collecting payments made by the debtor to the class and distributing the payments to the allowed claims of assenting creditors of that class *pro rata.*
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- **Secured Party Sale.** A common remedy for secured creditors in the U.S. is the disposition of collateral (including sales of all or substantially all of the assets of a business where the creditor has an all-asset lien) by way of a foreclosure/public trustee foreclosure (real estate) or a secured party sale (personal property and general intangibles, for instance) conducted under Article 9 of the Uniform Commercial Code (adopted by all the States in the U.S.). While the threat of a foreclosure or a secured party sale may force a debtor into seeking relief through a voluntary Chapter 11 filing, in some instances, secured party sales are undertaken with the debtor's consent (particularly where the purchase price exceeds the secured party's debt and possibly providing a small return to unsecured creditors).
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- **Creditor Composition.** A "creditor composition" can be a versatile and useful reorganization or debt restructuring tool, particularly where a debtor has an open line of communication with its key creditors and is able to achieve near 100% "buy in" from its secured and unsecured creditors. Some of the

factors that lead to a successful composition include clear and open communication with the debtor's creditors, a well-developed and "transparent" plan or "exit strategy "and a bleak "liquidation alternative" to the composition. While creditor compositions are particularly useful in smaller cases where a debtor may not have a complicated debt structure, many compositions can evolve into "prepackaged" or "prenegotiated" plans of reorganization/liquidation where resort to the bankruptcy process may be necessary to "cram down" the plan on dissenting parties.

- **Forbearance Agreement.** A forbearance agreement is the most common non-bankruptcy workout tool in use in U.S. workouts involving secured lenders. From a lender's perspective, a well-drafted forbearance agreement will extract additional concessions from the debtor (such as liens on previously free assets and guarantees) and will usually require that the debtor conduct its operations during the forbearance period in accordance with a tight budget and under careful monitoring by the lenders and their professionals. During the forbearance period, the parties engage in negotiations resulting (in successful cases) in a debt restructuring, a refinance (usually by an outside lender) or, in many cases, in the development of an "exit strategy" which may involve "washing" the plan through the bankruptcy process.

FOREIGN AND DOMESTIC CREDITORS' RIGHT/REMEDIES IN AND OUTSIDE OF THE BANKRUPTCY PROCESS

U.S. courts are open to domestic and foreign litigants alike. However, foreign litigants must take heed that the initiation of a lawsuit in a U.S. courts is a "two -edged sword", as the foreign litigant may be subjecting itself to the jurisdiction of the U.S. court (and to suit by other parties in the U.S.). Foreign creditors may also avail themselves of the rights/remedies afforded by the Bankruptcy Code (such as participating as a petitioning creditor in an involuntary bankruptcy petition) and participate in distributions from U.S. bankruptcy estates

Under the Bankruptcy Code, "Foreign Representatives" (e.g.: receivers or trustees in foreign insolvency proceedings) may also avail themselves of the provisions of the Bankruptcy Code by (i) participating as a petitioning creditor in an involuntary proceeding under Section 303 of the Bankruptcy Code (ii) requesting that the bankruptcy court abstain from proceeding with a domestic plenary case to allow matters to be resolved in the foreign proceeding under Section 305 of the Bankruptcy Code and/or (iii) filing a petition commencing an "ancillary" U.S. bankruptcy proceeding under Section 304 of the Bankruptcy code as an aid to the orderly administration of the foreign proceedings. Section 306 of the Bankruptcy Code provides that the foreign representative may take the steps outlined in (i)-(iii) above without fear of being subjected to the jurisdiction of any court in the U.S. "for any other purpose". Finally, foreign parties may also file plenary bankruptcy proceedings in the U.S., provided that the jurisdictional requirements of Section 109 of the Bankruptcy Code are satisfied. Although Section 109(a) of the Bankruptcy Code requires that a person "must reside or have a domicile, place of business or property in the United States", these jurisdictional provisions have been liberally construed by the U.S. courts (even the existence of a bank account in the U.S. may be sufficient).

The process for asserting claims in bankruptcy cases and the Bankruptcy Code sections relating to involuntary bankruptcy cases, abstention motions and ancillary cases are outlined below:

- **Involuntary Bankruptcy Cases (Section 303 of the Bankruptcy Code).** Where there are fewer than 12 creditors, a single creditor with claims of at least $11,625 may file an involuntary petition seeking relief under Chapter 7 or 11 of the Bankruptcy Code. Where there are more than 12 creditors, there must be at least three creditors with claims in the aggregate of at least $11,625. Petitioning creditors' claims must not be "contingent as to liability or the subject of a bona fide dispute". Moreover, unlike other regimes where the "bar" to the entry of an order for relief is a "balance sheet" test of insolvency, under the

U.S. system, the petitioners must only establish that the debtor is "generally not paying such debts as such debts become due." A "foreign representative" may also file an involuntary petition. In sum, if a debtor is generally not paying its debts as they become due, it is fairly easy for creditors to obtain an order for relief under Chapter 7 or 11 of the Bankruptcy Code. In practice (especially in cases involving operating businesses) when threatened by an involuntary filing, debtors will often file a voluntary petition under Chapter 11 (or convert the involuntary case to a voluntary Chapter 11 reorganization case)-thereby regaining control over the process.

- **Abstention (Section 305 of the Bankruptcy Code).** On motion to the bankruptcy court, a creditor may seek the dismissal of or suspension of all proceedings in a bankruptcy case if the court determines that "the interests of creditors and the debtor would be better served by such dismissal or suspension" or, in the event there is a pending foreign proceeding, a "foreign representative" may seek such dismissal or suspension if the court finds that certain factors are present (see discussion below on Section 304 of the Bankruptcy Code). In sum, under certain circumstances, foreign creditors (and foreign representatives) may move for and obtain dismissal of a bankruptcy case or suspension of all proceedings in that case.

- **Cases Ancillary to Foreign Proceedings (Section 304 of the Bankruptcy Code).** A "foreign representative"(defined in the Section 101 (24) Bankruptcy Code as a "duly selected trustee, administrator, or other representative of an estate in a foreign proceeding") may, under this section, commence a case in a U.S. bankruptcy court ancillary to that foreign proceeding to obtain relief (such as an order enjoining domestic creditors from pursuing domestic litigation) in furtherance of the goals of that foreign proceeding (such as requiring that all claims be asserted and determined in that foreign proceeding). In recent years, there has been an explosion of ancillary filings in the U.S., as foreign representatives in foreign insolvency proceedings have taken advantage of this section of the Bankruptcy Code to assist them in their administration of their debtors' estates. In determining whether to grant the petition, this section of the Bankruptcy Code also provides that the court should be guided by factors that would "best assure an economical and expeditious administration" of the estate including: (i) the just treatment of claims and interest holders in the estate (ii) protection of U.S. claimholders against "prejudice and inconvenience" in the processing of claims in the foreign proceeding (iii) the prevention of preferential or fraudulent dispositions of property of the estate (iv) an orderly distribution of estate proceeds substantially "in the order prescribed" by the Bankruptcy Code (v) comity and (vi), "if appropriate", the opportunity for a "fresh start" for the individual debtor that is the subject of the foreign proceeding. In recent years, courts have liberally construed these standards to give great deference to foreign insolvency proceedings and laws

- **Claims Process.** The assertion of claims in a formal bankruptcy proceeding in the U.S. is fairly straightforward and there is no discrimination against foreign creditors. In a Chapter 11 case, where a creditor's claim is scheduled (on the debtor's schedules of liabilities) as being non-contingent, liquidated and undisputed, the creditor need not take any further steps to assert its claim, as long as the creditor is in agreement with the amount as scheduled and the classification of the claim by the debtor (e.g.: "secured", "unsecured" or "priority"). However, in the event a creditor's claim is disputed by the debtor (or in the event the creditor's records reflect a higher claim than as scheduled by the debtor on its schedules), the creditor must file its written "proof of claim" (essentially, a form setting forth the name and address of the creditor, the basis of the claim, the amount and any claimed priority with attached supporting documentation) by the "bar date" set by the Court and such claim is deemed to be *prima facie* valid unless properly objected to. In a Chapter 7 liquidation case, a creditor must file its proof of claim by the bar date (which is usually 90 days after the first meeting of creditors-approximately 120 days after the entry of an order for relief). In a Chapter 11 case, the timing of the bar date will be driven by the pace of the reorganization case. Thus, in a "prepackaged" or "prenegotiated" plan scenario, the bar date will be set

earlier on. On the other hand, if a debtor is embroiled at the outset of the case in skirmishes with its lenders or with other creditors, the debtor may postpone its request for a bar date until it is ready to proceed with its plan. In the event of a timely objection to a proof of claim, unless resolved by the parties out-of-court, the objection will be resolved by the court upon notice and opportunity for hearing. With respect to notice of bar dates, generally, notice in small cases is given by mail and in larger more complex cases, by publication or in some cases, by the posting of the bar date on web pages ("mega" cases like *Enron* and *WorldCom*, for example, maintain web pages where parties may obtain all sorts of relevant information concerning these cases.

CONCLUDING OBSERVATIONS

- Foreign creditors in debt restructurings/ business reorganizations / liquidations that are conducted either in our outside of the bankruptcy process essentially have the same rights as domestic creditors to participate in the filing of involuntary proceedings, to request that a bankruptcy court dismiss or suspend proceedings and to file suit against U.S. defendants and assert claims against U.S. debtors. Foreign creditors should take heed, however, that the filing of a claim in a bankruptcy proceeding or a lawsuit in U.S. courts may subject the creditors to the jurisdiction of U.S. courts.
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- Because of the efficacy of the "formal" U.S. bankruptcy process, there is less of an impetus towards the development and utilization of a harmonized "informal" workout structure in the U.S.
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- Foreign creditors must be mindful that since all "out-of-court" workouts in the U.S. are conducted against the backdrop of the rights/remedies afforded to parties under the Bankruptcy Code, in the event negotiations break down, the proponents of the reorganization/orderly liquidation plan may resort to a bankruptcy filing in the U.S. in order to bind dissenters to the plan.
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- The relative explosion of ancillary case filings by foreign representatives in the U.S. coupled with the U.S. courts' deference to foreign insolvency proceedings and procedures, along with the increased and creative use by U.S. bankruptcy courts and foreign insolvency courts of "protocols" in cross-border cases (setting forth the "ground rules" for court-to-court communications, disposition of assets, resolution of claims, etc.) have enhanced the ability of parties (and courts) to effectively manage increasingly-complex cross-border cases.
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- While it is anticipated that the U.S. will shortly adopt the UNCITRAL Model Law on Cross-Border Insolvencies (which, if adopted by the U.S. and a "critical mass" of countries, should be an important step towards the path of increased cooperation between countries in cross-border insolvency situations and hopefully, lead to a global "level playing field" for creditors asserting cross-border claims), much work needs to be done to harmonize the substance of international insolvency law to alleviate the conflicts of cultures and regimes that persist in today's environment.

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