Non-US Cos. Can Effectively Restructure Using Ch. 11

Law360, New York (January 28, 2014, 3:50 PM ET) -- Chapter 11 of the U.S. Bankruptcy Code is the most well-developed law of any insolvency regime in the world for helping troubled companies restructure their affairs. Some nations, like Canada and the United Kingdom, also have insolvency regimes that are very helpful for restructuring businesses, but few others do, and none of these systems is as commercially oriented as Chapter 11.

Advantages

Arguably, the most appealing feature of Chapter 11 is the ability to confirm a reorganization plan with less than unanimous stakeholder support, even if applicable credit agreements or indentures require unanimity to change fundamental economic terms like tenor and pricing.

For example, a business in Chapter 11 can sell substantially all its assets without shareholder approval. The assets also can be sold free and clear of secured and unsecured claims, without the need to obtain creditor approval, subject only to secured-creditor rights to bid their debt for their collateral.

Alternatively, a business in Chapter 11 can reorganize its capital structure pursuant to a reorganization plan that converts debt to equity, provides for new capital or new financing, and/or provides for the disposition of one or more business lines.

Confirmation of a Chapter 11 plan requires creditor consents, but the voting thresholds are low. Creditors vote by class, with holders of similar claims placed in the same class (e.g., bank debt in one class, senior bond debt in another, subordinated bond debt in yet another, etc.).

Only one class of creditors whose rights are impaired by the plan must vote to “accept” the plan and its terms for the reorganization plan to be confirmed, so long as the plan follows the “fair and equitable rule,” i.e., senior creditors are provided for in full before more junior creditors are.

Significantly, for an impaired class to be deemed to have accepted a plan, only one-half of the creditors in that class, holding two-thirds of the debt in that class, must vote in favor of the plan — counting only those who actually vote. A company in Chapter 11 therefore need not obtain a minimum level of participation (e.g., 50 percent of all holders) to confirm and consummate a Chapter 11 reorganization plan. As long as one impaired creditor class accepts, all other dissenters and abstainers will be bound by the plan.

These highly advantageous features of Chapter 11 make it an attractive tool not only for companies domiciled in the U.S., but also non-U.S. and other multinational companies. Many such companies have successfully utilized Chapter 11, including businesses with few assets, operations or employees in the United States.

Examples include several global shipping companies and, recently, Central European Distribution Corp., one of Russia's largest vodka distributors with operations in Hungary, Poland, Russia and Ukraine, which obtained court approval for its prepackaged Chapter 11 reorganization plan in May 2013.[1]

Important Considerations

Non-U.S. or multinational corporations contemplating Chapter 11 must assess several legal and practical considerations.

Location. While an enterprise need not have its headquarters, significant assets or employees in the U.S., each entity seeking Chapter 11 protection must have property in the United States — although a bank account with only $100 suffices. That said, the more U.S. contacts, the better: The practical reach of United States jurisdiction may be limited if none of the major stakeholders has a presence in the U.S. and may not be inclined to heed the directives of a U.S. court.

However, in many transactions, it is rare that a stakeholder has no U.S. presence. Even with an Eastern European enterprise like CEDC, the overwhelming majority of the bank and bond debt holders had some type of operations in the U.S., which subjected them to the jurisdiction of U.S. courts.

For this same reason, Chapter 11 likely is a more useful tool for implementing a balance-sheet restructuring of a non-U.S. or multinational company rather than a sale of non-U.S. assets. Indeed, it is not clear that U.S. bankruptcy courts would or could enter orders that would be respected in other jurisdictions governing the sale or other disposition of assets located only in foreign nations because, as a practical and legal matter (including U.S. court deference to foreign courts), the power and jurisdiction of a U.S. bankruptcy court over purely foreign assets may not be vindicated in foreign jurisdictions.

Shorter Stays. Prepackaged Chapter 11s also are very useful for non-U.S. and multinational companies. In a "prepack," the plan is negotiated and voted upon before the enterprise actually files bankruptcy, thereby minimizing its stay in bankruptcy.

This is especially important for non-U.S. entities, because their non-U.S. vendors, suppliers and employees typically associate bankruptcy with liquidation, failure and, in some cases, jail. Accordingly, the less time that the enterprise can be subject to formal court proceedings, the better.

With a prepackaged Chapter 11, the business has its restructuring solution and bankruptcy exit plan fully documented and "in hand" from day one of the U.S. bankruptcy case, which is critical to maintaining the franchise during its short stay in Chapter 11.

Non-U.S. Governing Documents. A helpful feature of some non-U.S. bank loans and indentures is that debt and related liens and guarantees may be compromised and released if only 90 percent of the holders agree (the threshold is unanimity under most U.S. loans and indentures).

An out-of-court exchange or tender offer therefore may have a higher chance of success with an enterprise governed by such documents, because the 90 percent threshold is easier to reach. In the case of CEDC, only its U.S. parent companies filed Chapter 11, which was utilized to significantly restructure its bond debt.

CEDC's Polish and Russian subsidiary-operating companies had guaranteed that debt and pledged their assets to secure their guarantee obligations. However, CEDC obtained more than 90 percent participation in its exchange offer/backup reorganization plan, allowing it to obtain the consensual release of these Polish and Russian subsidiaries.

Jurisdictional and Cultural Nuances. Chapter 11 cannot always solve all problems. Advisers to a multinational enterprise may need to work in advance with restructuring professionals in local non-U.S. jurisdictions to address unique problems and, most importantly, to educate stakeholders and decision makers there.

For example, the notion that public shares can be canceled in a U.S. bankruptcy is antithetical to the cultures and sensibilities of many nations. This was the case in Poland, where CEDC's shares had been publicly listed. Another notable example is South Africa, which has very creditor-friendly maritime laws that present challenges for shipping companies attempting to reorganize in the United States.

Perhaps most critically, board members, officers and employees of non-U.S. operating companies often have very different benefits and burdens compared to U.S. board members, officers and employees. In some nations, board members and officers are legally obligated to suspend business operations when their business becomes insolvent — there is no notion of debtor-in-possession financing, and officers and board members can be held personally (and sometimes criminally) responsible if the business continues to trade while insolvent.

One of the paramount rules in any cross-border restructuring, therefore, is to ensure that non-U.S. operating subsidiaries are adequately funded while parent entities restructure their troubled balance sheets.

Conversely, non-U.S. nationals who are board members, officers or others who will be involved in a Chapter 11 restructuring may need to be carefully educated about U.S. notions of fiduciary duty law. Regardless of the jurisdiction of organization of a particular entity, if it seeks the protection of a U.S. bankruptcy court, its officers and directors must follow U.S. bankruptcy law duties and disclosure requirements to the letter.

The level of disclosure required by U.S. law is often much higher than that required under the laws of non-U.S. jurisdictions. For example, solicitation materials accompanying prepackaged Chapter 11 plans can be very detailed, and the disclosure and disinterested obligations imposed upon professionals may seem very alien to non-U.S. advisers who have never encountered them before.

Chapter 11 affords a number of helpful tools for restructuring non-U.S. companies and is available to a larger number of non-U.S. enterprises than ever before. The barriers to taking advantage of Chapter 11 may be more cultural than legal. However, with sufficient planning and sensitivity to the legitimate concerns of those unfamiliar with Chapter 11, non-U.S. enterprises can use it as effectively as U.S. businesses.

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[1] Skadden was counsel to CEDC in its successful Chapter 11 restructuring.