Berau May Expand US Restructuring Options for Foreign Issuers

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A recent decision in the U.S. Bankruptcy Court for the Southern District of New York clarifies that restructuring options under Chapter 11 or Chapter 15 are available to foreign issuers of U.S. debt, even if those issuers have no operations in the United States (*In re Berau Capital Resources PTE Ltd.*). The decision could have widespread implications for cross-border restructuring transactions involving U.S.-issued debt, since the ability to utilize Chapter 11 or Chapter 15 offers many advantages for foreign issuers.

Background

Over the past five years, foreign issuers without significant, or even any, U.S. operations have accessed the U.S. capital markets for high-yield, term loan B and other debt. Foreign issuers have been drawn to the U.S. debt markets because of historically low interest rates, which often were substantially better than prevailing rates in their home countries, and the greater levels of leverage available in the U.S. Particularly for commodity producers, which comprised a substantial proportion of the foreign borrowers in the U.S. debt market, being able to match U.S. dollar borrowing costs against the U.S. dollar revenue in which commodities are typically priced was appealing.

With recent economic pressures, especially in the energy and mining sectors, some of these foreign issuers now have little or no realistic prospect of repaying their debt obligations. Much of this debt has traded at substantial discounts to par value and thus has attracted private equity and hedge funds that invest in distressed businesses. Given the continued economic challenges within these sectors, funds invested in highly leveraged businesses are likely to increase pressure on those businesses to execute transactions to decrease debt in order to realize value by creating a viable business with a sustainable capital structure.

The *Berau* court held that contractual terms invoking New York law were sufficient to satisfy the Bankruptcy Code's eligibility requirement for U.S. bankruptcy jurisdiction, which may expand restructuring options for foreign issuers.

In *Berau*, which was decided on October 28, 2015, the company commenced a foreign insolvency proceeding in Indonesia and subsequently sought enforcement of that case in U.S. bankruptcy court under Chapter 15 of the U.S. Bankruptcy Code. The debtor, *Berau* Capital Resources PTE Ltd., was a Singaporean company that issued (and defaulted on) over $450 million of U.S. dollar-denominated notes. The company's debt documents contained typical provisions found in a U.S. debt issuance — an indenture governed by New York law, a New York forum selection clause and a provision appointing an authorized agent for service of process in New York. When determining whether Chapter 15 could be invoked, the bankruptcy court addressed whether contractual provisions in the company's debt documents satisfied the Bankruptcy Code Section 109(a) eligibility requirement of "property in the United States" that must be satisfied for U.S. bankruptcy jurisdiction.

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The *Berau* court held that contractual terms invoking New York law were sufficient to satisfy the eligibility requirement. It stated that contracts create property rights for parties, and state law governs such rights in bankruptcy cases. The court concluded that applicable New York law reflects a "legislative policy" that allows contract counterparties with transactions that meet specified threshold amounts to establish New York "property" by designating New York governing law and applying a New York forum selection clause.

The *Berau* decision bolstered a binding, yet often criticized, 2013 U.S. Court of Appeals for the Second Circuit decision: *In re Barnet* held that Section 109(a) applies to Chapter 15 cases and thus requires a Chapter 15 foreign debtor to reside or have a domicile, place of business or property in the United States to be eligible to file a Chapter 15 bankruptcy petition.

Advantages for Foreign Issuers

Because the eligibility standard applies equally to Chapter 11 and Chapter 15 proceedings, many foreign issuers will now have a clearer path to invoke U.S. bankruptcy court jurisdiction to implement balance sheet restructurings. Bankruptcy Code options present several advantages for foreign issuers, whether filing a separate Chapter 11 proceeding or using Chapter 15 in tandem with a foreign proceeding. They include:

Global Reach of the Automatic Stay. Section 362 of the Bankruptcy Code will provide certainty to foreign issuers (especially global companies with assets and operations in various jurisdictions) that plans of reorganization will be honored by global creditors with U.S. contacts.

No Insolvency Requirement. Unlike other insolvency regimes in host countries, companies do not have to be insolvent to take advantage of Chapter 11. Accordingly, directors and other fiduciaries of a foreign issuer may use Chapter 11 to proactively restructure a company's balance sheet before it faces a liquidity crisis.

Existing Management Remains in Place. Chapter 11 allows a company's directors and management to remain in control during a restructuring. Other types of foreign insolvency regimes mandate the appointment of an administrator or monitor to oversee the business.

Familiarity With Chapter 11. If debt that is being restructured is issued in the United States and is subject to U.S. governing law, global investors and creditors will be familiar with the Chapter 11 process. As a result, they should be more likely to support a deleveraging restructuring, given Chapter 11's certainty of outcome and binding effect on holdout creditors.

Plan of Reorganization as a Tool to Raise Additional Capital. The ability to raise additional capital through a U.S. capital markets transaction under a prepackaged Chapter 11 plan may provide additional liquidity not otherwise available to foreign issuers in their home countries.

In light of the *Berau* decision, we anticipate more foreign issuers will seek relief under the U.S. Bankruptcy Code to implement cross-border restructuring transactions.