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Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates has approximately 1,700 attorneys on four continents, and serves clients in every major financial centre globally. Skadden brings in-depth knowledge of the markets in which it operates and numerous local law capabilities to multi-jurisdictional, cross-border and domestic legal matters. In both the US and internationally, Skadden provides representation, strategic advice, innovative and practical legal solutions, and litigation assistance to financially troubled public and private companies and their major lenders, creditors, investors and transaction counterparties. In the US, Skadden focuses on Chapter 11 and 15 proceedings, out-of-court restructurings and related litigation in a variety of situations, including "prepackaged" and "prearranged" bankruptcies.

Authors

Jay Goffman is global co-head of Skadden's corporate restructuring practice, and was a pioneer in the use of prepackaged restructurings. He has led numerous multibillion-dollar, high-profile and record-setting out-of-court, prepackaged, prearranged and traditional Chapter 11 restructurings worldwide. Jay is highly ranked, and has won many awards that include the "Blue Cloud Award", AJC National Human Relations Award and the NYIC Leadership in Credit Award. Deals include American Airlines, America West, CEDC, Centro, Charter, MGM Studios, Memorex Telex, Roust, Russian Standard Bank and SunEdison.

Christine A Okike is a partner in Skadden's corporate restructuring practice. She represents debtors, creditors, equity holders, investors, sellers, purchasers and other parties-in-interest in all stages of complex restructuring transactions, including prepackaged, prearranged and traditional Chapter 11 cases, out-of-court workouts, distressed acquisitions and cross-border proceedings. She has a broad range of experience across a number of industries, including automotive, sports, entertainment, retail, energy, real estate, financial institutions, transportation, travel, healthcare, printing, tax, media and telecommunications.

Paul Leake is global co-head of Skadden's corporate restructuring practice, and has led numerous large and complex US and cross-border corporate restructurings. He represents debtors, commercial banks and bank groups, distressed investment funds, noteholder committees, official creditors' committees, unsecured creditors and distressed investors in all forms of corporate restructurings. His areas of focus include advising US and transnational businesses on Chapter 11 reorganisations and liquidations, out-of-court restructurings, secured financings, distressed acquisitions and investments in troubled companies in industries such as retail, shipping, mining, airlines, energy, healthcare, publishing, satellite communications and real estate.

1. Market Trends and Developments

1.1 State of the Restructuring Market

The number of business bankruptcy filings in the United States rose steadily in 2019. According to a report by FTI Consulting, in the first half of 2019, there were 74 Chapter 11 cases filed where liabilities exceeded USD50 million, representing a 19% increase over the same period last year. The number of mega cases (those where liabilities exceeded USD1 billion) dropped from 15 in the first half of 2018 to 11 in the first half of 2019. Middle-market filings dominated the first half of the year – 61% of Chapter 11 cases filed had liabilities of between USD50 million and USD250 million, compared to 51% over the same period the year before. As of October 2019, it appears almost certain that the total number of Chapter 11 filings in 2019 will exceed the total number filed in 2018.

The increase in Chapter 11 filings corresponds with a slowdown in the US economy. After years of record growth, the US economy is finally cooling, and some economists believe a recession is looming. The US Bureau of Economic Analysis estimates that US economic growth slowed to 1.9% in Q3 2019, reflecting a drop in exports and inventory investment that is directly linked to the US's continuing trade war with China.

The US trade war with China began in 2018 and has escalated rapidly. Despite both sides signaling at various times that they are willing to end trade hostilities, both countries continue to raise tariffs on each other's imports. Notwithstanding the dispute, through August 2019, Chinese imports to the US were down only 4% year over year, meaning that for the most part US consumers are absorbing higher prices on goods made in China, rather than abstaining from purchasing them. By contrast, US exports to China are down 24% over the same period. As a result, the US trade deficit with China grew by nearly 12% in 2018 to USD420 billion, and the gap has widened by an additional 8% through August 2019. The US Chamber of Commerce has described the trade war as a "major threat" to the US economy, and earnings calls of large companies during the summer of 2019 revealed that manufacturing, industrial and retail companies were the most concerned about the tariffs.

Lower than expected job growth in September 2019, accompanied by a drop in wage growth, contributed to fears of a stalling US economy, though these fears have been partially calmed by more recent revised employment numbers. Unemployment levels remain at record lows and remain a reason for optimism: September's 3.5% unemployment rate is the lowest since December 1969. However, wage growth peaked in February 2019 at 3.4%, and has trended downward over the course of the year. That number is particularly concerning as workers continue to have less purchasing power than they did in 2008, prior to the last US recession.

The government has made efforts to combat the weak economic growth caused in part by the trade war by lowering interest rates. The federal funds rate was recently lowered to 1.75%, after starting the year at 2.5%. Low interest rates mean that many distressed companies will be able to obtain financing on favourable terms, potentially permitting them to avoid comprehensive restructurings or making reorganisation more feasible. Nonetheless, there are signs that the next cycle of financial restructurings may be approaching.

The US's record-high corporate debt levels have been news for several years now, yet the amount of corporate debt only continues to rise. As of Q2 2019, large companies in the US owe approximately USD9.95 trillion, which is 47% of the country's GDP (the highest ratio of corporate debt to GDP in US history). Approximately USD5 trillion of that debt will become due in the next five years. Even though many companies have taken advantage of low rates to refinance their debt, this amount of leverage remains troubling. If the appetite for corporate debt fades, companies may face financial distress or reduce their spending and hiring. Either outcome would negatively affect the economy.

Another possible sign of future financial distress is the trend in recent years towards weakened borrower covenants in debt securities and instruments. Covenant quality improved slightly in Q1 2019 but remained weak overall, with a rating of 3.9 out of 5 (where 1 means that covenants are extremely strong, and 5 means that they are extremely weak). While companies may negotiate "covenant-lite" borrowing terms from yield-hungry lenders, the prevalence of "cov-lite" loans and non-investment grade bonds may reflect the underpricing of risk and become a wave of borrower defaults without advance covenant breaches when economic conditions change.

1.2 Changes to the Restructuring and Insolvency Market

As noted at the outset, Chapter 11 filings have risen this year. Companies from the energy (primarily oil and gas), retail and healthcare industries have accounted for nearly half the Chapter 11 cases filed annually since 2016. While each of these sectors has benefited in recent years from a strong US economy, they remain a focus of restructuring activity and are particularly vulnerable as economic growth slows. Unsurprisingly, most of the year's high-profile filings to date are in these industries.

Oil and Gas

Oil and gas bankruptcies rose significantly in 2019. By mid-August 2019, with over four months remaining in the year, there had been almost as many oil and gas bankruptcies filed as in the whole of 2018, and the aggregate debt from the year's filings so far – nearly USD20 billion – has already exceeded the USD17 billion in debt from 2018's filings. The biggest oil and gas filings of the year include oilfield service provider Weatherford International and notable oil and gas producers Sanchez Energy, Halcón Resources, Vanguard Natural Resources and Legacy Reserves.

Retail

Retail filings account for 14% of all Chapter 11 cases filed in the first half of 2019. Several ongoing retail industry changes have driven the recent retail bankruptcies, including increased online sales (including the Amazon effect), the success of discount chains, changing retail consumer demographics and preferences, and a decrease in retail mall traffic. Some of the year's major filers include Gymboree, Shopko, Charlotte Russe, Payless ShoeSource, Diesel, Roberto Cavalli and Barneys New York. Some bankruptcy filers will use the bankruptcy process to try to restructure, while others will cease operations entirely.

Healthcare

Healthcare bankruptcy filings are down slightly through the first two quarters of 2019 as compared to the same period in 2018. Nonetheless, healthcare filings represented 20% of total filings in the first half of 2019 (the highest of any industry), although most of these filings were smaller than the average Chapter 11 cases. A number of factors account for increased financial stress in the healthcare market, including a change from volume-based to value-based reimbursement schemes; payer-led demand for less costly outpatient (rather than inpatient) procedures; the increased need for equipment and technology investments; and heightened competition among competitors, particularly in rural hospitals and senior-assisted living facilities. M&A activity has been high in the healthcare sector as companies attempt to merge to save on costs while increasing revenue channels.

2. Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations

2.1 Overview of Laws and Statutory Regimes

In the United States, business reorganisations and liquidations are undertaken under both federal and state law regimes. At the federal level, restructuring and liquidation proceedings are governed largely by Title 11 of the United States Code (the "Bankruptcy Code"). Chapters 1, 3 and 5 of the Bankruptcy Code contain general rules, definitions and eligibility requirements for bankruptcy cases. Those three chapters apply to federal bankruptcy cases under Chapter 7 (liquidation) and Chapter 11 (reorganisation) of the Bankruptcy Code. As federal law, the Bankruptcy Code is supreme and pre-empts conflicting state laws that may also provide for business liquidations, receiverships and similar regimes.

State law alternatives to federal bankruptcy law are usually available only to entities organised within a particular state that do not have substantial assets located in multiple states.

2.2 Types of Voluntary and Involuntary Restructurings, Reorganisations, Insolvencies and Receivership

Federal Regimes

Under the Bankruptcy Code, with some exceptions, there are two primary types of bankruptcy cases that apply to business entities: Chapter 7 liquidation cases and Chapter 11 reorganisation cases. Chapter 9 bankruptcy is used by municipalities that are eligible to file for bankruptcy under the Bankruptcy Code. There are also distinct Bankruptcy Code provisions that apply to railroad, family farmers, fishermen and other businesses.

Chapter 7 liquidation cases are relatively straightforward. Commencing a case under Chapter 7 creates an "estate", comprised of all of the debtor's property and rights. The Bankruptcy Code requires the appointment of a Chapter 7 bankruptcy trustee, who is tasked with administering and promptly liquidating all property of the estate for the benefit of creditors in the order of their respective statutory payment priorities set by the Bankruptcy Code and state law.

Chapter 11 business bankruptcy cases are most often used by companies seeking to reorganise their financial affairs and operations pursuant to a Chapter 11 reorganisation plan. Chapter 11 may also be used to liquidate a business pursuant to a Chapter 11 plan of liquidation.

State Law Regimes

Several regimes exist under state common law and state statutory law to facilitate the liquidation or restructuring of failing businesses. The state law-based regimes described below are in addition to contractual arrangements, including out-of-court restructurings and "work-outs" with creditors, whereby a company agrees with certain of its creditors on new terms of repayment or other treatment of the company's existing indebtedness.

Assignments for the Benefit of Creditors

General assignments for the benefit of creditors (ABCs) are available under, and governed by, common law or statute in all 50 states. Through an ABC, an entity assigns, by way of a deed or otherwise, all of its property to an assignee or receiver. The assignee or receiver, similar to a Chapter 7 trustee, administers the assigned assets for the benefit of the business entity's creditors. ABCs usually implement creditor distributions following state-law priorities that are similar to the distribution priorities among creditors in cases under Chapter 7 of the Bankruptcy Code. However, an ABC generally does not impose a bankruptcy-like automatic stay of the exercise of creditor rights and remedies, and therefore does not prevent creditors from commencing an involuntary bankruptcy case or taking other actions or pursuing other remedies against the company. An ABC does not provide for the assumption or rejection of executory contracts.

Receiverships
State law receivers and receiverships may be authorised and ordered by a state court. Receivership laws vary among the 50 states. Typically, a receivership is commenced by petition of a creditor that requests a court to order that the debtor company be placed into receivership. In receivership, the company and its properties are administered by a court-appointed receiver for the benefit of creditors. Court-appointed receivers generally have stronger and more flexible powers than assignees in ABCs because the court ordering the receivership will tailor its receivership order and the authority of the receiver to the circumstances of the particular case.

Statutory Dissolutions
Under applicable state statutes, business entities (corporations, limited liability companies and limited partnerships) may have options to dissolve, wind down their affairs in an orderly manner, liquidate or dispose of their assets, make distributions, and terminate their legal existence. State law statutes typically specify dissolution and wind-down notice requirements and procedures requiring that provision must be made for the payment of creditors before any distributions can be made to equity holders. Because dissolutions and wind-downs may be undertaken with or without court supervision, and because the dissolved company or its directors may choose individuals or a firm that will manage the wind-down, dissolutions may be disfavoured by creditors, especially creditors in a complex corporate and organisational structure.

2.3 Obligation to Commence Formal Insolvency Proceedings
In the United States, there is no law that a company must be placed into bankruptcy or insolvency proceedings if it becomes insolvent. Accordingly, there are no formal civil or criminal penalties for failure to file bankruptcy cases. Companies are typically placed in bankruptcy at the discretion and direction of their directors and officers, who must weigh the practical, legal and financial consequences of filing bankruptcy cases. As a practical matter, the failure to commence bankruptcy at the appropriate time can lead to issues with contract counterparties, the loss of a company's access to liquidity and capital markets, the loss of going-concern value, and events of defaults under the company's credit facilities that may cause rapid business deterioration and losses.

In some circumstances, directors and officers with fiduciary duties may face personal liability for their failure to conduct the business and preserve its value in a manner consistent with their legal and fiduciary duties under state and federal laws.

2.4 Procedural Options
If a company determines that it is appropriate to commence a bankruptcy case or state law insolvency proceedings, said company is generally permitted to proceed as it deems appropriate, subject to eligibility requirements.

2.5 Commencing Involuntary Proceedings
In the United States, creditors may commence involuntary bankruptcy cases against a financially distressed company. Under Bankruptcy Code section 303, creditors may petition a bankruptcy court to initiate bankruptcy proceedings under Chapter 7 or Chapter 11 of the Bankruptcy Code against a debtor company. If a debtor has 12 or more creditors who hold non-contingent and undisputed claims, then an involuntary bankruptcy petition against the debtor may be filed by no fewer than three creditors holding in the aggregate non-contingent and undisputed unsecured claims totaling at least USD16,750. If the debtor has fewer than 12 such creditors, an involuntary bankruptcy petition may be filed by one or more creditors holding at least USD16,750 of such claims.

Following the filing of an involuntary Chapter 7 or 11 bankruptcy petition, the debtor subject to the involuntary petition may contest it. If the debtor opposes the petition, the bankruptcy court, after a trial, will grant the bankruptcy petition only if the petitioning creditors show either that (i) the entity is generally unable to pay its debts as they become due (excluding debts subject to a bona fide dispute), or (ii) a custodian, receiver or trustee was appointed to take charge of substantially all of the debtor's property within the 120 days before the involuntary petition was filed. An involuntary Chapter 7 or 11 case commences when an involuntary bankruptcy petition is granted by the bankruptcy court.

Outside of a bankruptcy, under applicable state laws that vary from state to state, one or more creditors may request a state court to appoint a receiver for an insolvent entity. See **7.1 Types of Voluntary/Involuntary Proceedings.**

2.6 Requirement for Insolvency
A business entity need not be insolvent to qualify for, and commence, a case under either Chapter 7 or Chapter 11 of the Bankruptcy Code. However, some level of financial distress is generally required in order to take advantage of the federal bankruptcy laws, and a bankruptcy case may be dismissed if it is filed in bad faith.

Typically, only insolvent business entities qualify for the appointment of a state law receiver. Insolvency is not usually required for an ABC or state law dissolution. Legal "insolvency" may be defined in different ways under various state and federal laws and judicial decisions.

2.7 Specific Statutory Restructuring and Insolvency Regimes

Banks are not eligible to be debtors under the Bankruptcy Code. Instead, federal US banking laws permit the Federal Deposit Insurance Commission (FDIC) to close a financially troubled bank and act with a high degree of autonomy as its receiver. In special circumstances with large-scale economic implications, the Dodd Frank Act authorises the FDIC to resolve the financial issues of a company that derives 85% of its earnings from financial activities.

Like banks, domestic US insurance companies are not eligible to commence bankruptcy cases under the Bankruptcy Code. However, insurance companies may be placed into trusteeship or receivership and wound-down under applicable state laws. All states have enacted some form of model legislation designed to provide courts, trustees and receivers with guidance on how to administer an insolvent insurance company.

In the US, broker-dealers are authorised to file for bankruptcy under Chapter 7 of the Bankruptcy Code; however, their insolvencies tend to be governed by specialised federal securities laws, including the Securities Investor Protection Act (SIPA). Similar to the FDIC in the administration of an insolvent bank, the Securities Investor Protection Corporation (SIPC) enjoys a great deal of autonomy when administering an insolvent securities broker.

Chapter 12 of the Bankruptcy Code provides the statutory framework for the reorganisation of a family farm or family fishery. A subchapter of Chapter 11 deals with the reorganisation of a railroad, and permits a railroad liquidation in limited circumstances. Chapter 9 provides a bankruptcy process for qualifying municipalities.

3. Out-of-court Restructurings and Consensual Workouts

3.1 Restructuring Market Participants

In the United States, a company in need of financial restructuring may pursue and complete a restructuring without commencing a Chapter 11 bankruptcy case if it has sufficient liquidity and time to negotiate and reach an agreement with its financial creditors and other primary stakeholders. Even if a company is unable to restructure entirely out of court, it can save considerable time and money by reaching agreement on restructuring terms with key stakeholders prior to commencing a Chapter 11 case to effectuate the restructuring.

In the United States, sophisticated creditors, debtors and restructuring professionals understand that a negotiated out-of-court financial restructuring is often preferable to potentially litigious and less certain in-court restructuring outcomes. Under the right circumstances, consensual out-of-court restructurings may provide the best results for a financially distressed company and its stakeholders. A consensual out-of-court restructuring or "workout" may deleverage a financially distressed company and resolve risks and uncertainties for its employees, customers, suppliers and creditors if it provides the company with sufficient liquidity and a healthy balance sheet.

Out-of-court restructurings can avoid the high costs, possible reputational stigma, uncertainties and potential business disruptions that may arise during a Chapter 11 case. Even if a restructuring cannot be consummated entirely out of court, negotiations may culminate in a prepackaged bankruptcy case (known as a "prepack") or a pre-negotiated bankruptcy case, each of which generally takes much less time to complete than a traditional bankruptcy case. Creditors who do not consent to the terms of the out-of-court restructuring will be bound by the bankruptcy court process, so long as the terms of the restructuring have adequate creditor support, and the plan otherwise complies with the statutory requirements, to confirm a plan of reorganisation.

Typically, out-of-court restructurings are the product of fluid and multi-faceted negotiations between a company and its primary stakeholders and their advisers. There are no strict frameworks or rules for out-of-court restructurings. The lack of a formal framework gives parties flexibility and freedom to negotiate multi-party agreements and creative solutions.

An out-of-court restructuring is typically a strategic option for companies that seek solely to restructure funded debt on their balance sheets (a "balance sheet restructuring" as opposed to an "operational restructuring"). Obtaining unanimous approval on restructuring terms from diverse and unorganised creditor constituencies is usually extremely difficult or impossible. For that reason, the rights of diverse general unsecured creditors, including contract counterparties, employees, trade creditors and the like, are most often left unimpaired in an out-of-court restructuring. In addition, securities laws can complicate a restructuring process for companies with publicly traded debt. It follows that balance sheet restructurings based on negotiated agreements with organised, sophisticated financial creditors predominate in out-of-court restructurings.

If a company has sufficient liquidity for extended negotiations and is otherwise a good candidate for an out-of-court restructuring, the threat or prospect of a possible Chapter 11 filing can be a powerful negotiation tool. If a financially distressed company has developed the support of requisite majorities of creditors needed to confirm a Chapter 11 plan over the opposition of dissenting creditors, the company may convince dissenting creditors that its proposed out-of-court restructuring is better for them than the treatment they will receive in Chapter 11. Creditors that refuse to agree to the terms of an out-of-court restructuring run the risk that a company will file a prepackaged or pre-negotiated bankruptcy case and obtain approval of a plan, over their dissent, that treats them less favourably than they would be treated in the out-of-court restructuring. In short, a company can use the threat of Chapter 11 as a weapon to line up unco-operative dissenting creditors.

3.2 Consensual Restructuring and Workout Processes

There is no standard timeline or singular process for out-of-court restructurings; a company's unique circumstances, exigencies and creditor objectives drive the timing, developments and outcomes in an out-of-court restructuring. Strategies, processes, types of agreements and timelines depend heavily on the facts of each case.

Out-of-court restructuring negotiations often take many months to complete. The complexity of negotiations and the number of parties involved may extend the timeline. Timelines may shorten if an announcement is made about the restructuring process that causes suppliers to tighten trade credit. Often, a distressed company and its advisers will simultaneously pursue out-of-court negotiations and prepare for and negotiate a prepackaged or pre-negotiated bankruptcy case that will be commenced if out-of-court negotiations fail or a Chapter 11 case is needed to bind dissenters.

While the timeline of a particular out-of-court restructuring may be fluid and unpredictable, the contours of the process and the types of agreements negotiated are often predictable. At the onset of restructuring talks, debt holders and lenders will assess the company's situation to determine whether a restructuring is feasible. Lenders, bondholders or other creditor groups may form ad hoc committees and employ their own legal and financial advisers to evaluate the company and its financial condition. Lenders and bondholders will conduct business and legal due diligence, including reviewing the company's business plans and projections, financial covenants, debt structure, liquidity and assets to determine what, if any, restructuring options are feasible.

Creditors and their advisers will require a company to provide confidential information relating to its cash flows and financial projections in order to accurately assess the company's prospects. During the initial phases of a workout, a company will seek agreements that protect its confidential information. Prior to disclosing sensitive business information to lenders or creditors, a company will negotiate a confidentiality agreement or non-disclosure agreement (NDA) with such parties. If the company has issued any securities, it will want to negotiate a material non-public information (MNPI) clause in the NDA agreement, which will prevent creditors who receive MNPI during negotiations from trading in the company's securities while negotiations are ongoing. Creditors may insist that a company agree to make disclosures of MNPI by future dates certain so that such creditors may then resume trading in the company's securities.

When negotiating out-of-court restructurings, companies often seek standstill agreements or waivers of credit agreement defaults from lenders. A standstill or forbearance is an agreement with lenders or other creditors that they will not exercise specified remedies otherwise available to them, for a specified time period. Lenders may also agree to waive their rights to declare defaults and to exercise default remedies for expected company violations of specific financial covenants. In exchange for their agreements to waive and forebear, creditors will often receive fees and the company's agreement that it will pay the costs of the lenders' advisers and counsel.

It is common for ad hoc creditor groups or steering committees to form during out-of-court restructuring negotiations. These groups help a company structure an effective process for negotiating and reaching agreement on restructuring terms. Companies therefore often agree to pay legal and financial adviser fees incurred by organised ad hoc and steering committee groups.

Prior to or during restructuring negotiations, competing creditor groups may negotiate and reach intercreditor agreements. Intercreditor agreements (and closely related subordination agreements) between two or more of a company's creditors may fix and prioritise their competing rights to receive payments of cash or other property from a company, including proceeds of a sale of shared collateral, as well as determine timelines and details with respect to such creditor groups' respective abilities to exercise remedies.

An intercreditor agreement may also restrict a junior-lien creditor's rights in bankruptcy, such as by limiting the junior creditor's ability to object to bankruptcy sales, preventing the junior creditor from objecting to debtor-in-possession financing, and controlling junior creditor voting rights in Chapter 11 (though bankruptcy courts may not enforce voting restrictions). With some exceptions, intercreditor agreements are generally enforceable in bankruptcy.

3.3 New Money

Out-of-court restructuring agreements may provide for an infusion of new liquidity for a company. Outside of bankruptcy, existing creditors and new lenders are free to grant new loans to a company on terms that are valid under applicable non-bankruptcy law and the company's existing debt documents. If a company has unencumbered collateral, it may pledge that collateral to new or existing lenders in exchange for new loans. If substantially all of a company's assets are already encumbered by liens, existing lenders may offer new credit to a company under new loan agreements or amended terms of existing agreements. New money lenders may agree to the "take out" of existing debt owed to existing creditors using new loan proceeds. Negotiations between and among financial creditors typically influence and determine the terms of any new money credit extended to a company.

3.4 Duties on Creditors

A creditor's legal obligations to a company are typically defined contractually by the terms of the agreement between the parties. Generally, creditors owe no fiduciary duties to the company or to each other, and are free to act in their own self-interest, even if doing so disadvantages the company or other creditors.

However, in rare bankruptcy cases, a creditor's misconduct may cause its claim to be "equitably subordinated", which means that, as a matter of equity, a court orders lower priority claims to recover ahead of a claim held by the creditor who has acted inequitably. A creditor does not risk having its claim equitably subordinated by simply pursuing its own self-interest to the detriment of others. Equitable subordination is appropriate only if a creditor's conduct has resulted in an inequitable injury to other parties.

In certain circumstances, a creditor may lose its right to vote on a plan of reorganisation based on its conduct. Under section 1126(e) of the Bankruptcy Code, a bankruptcy court may designate or disallow a creditor's vote on a plan of reorganisation if the vote was not cast in good faith. Courts have deemed vote designation appropriate in cases where a creditor casts its vote in an attempt to obtain an advantage that other similarly situated creditors are not entitled to; has an ulterior motive (eg, the pursuit of a competitive advantage); acts inconsistently with protecting its self-interest as a creditor; or attempts to put the debtor out of business.

3.5 Out-of-court Financial Restructuring or Workout

Out-of-court financial restructurings are fundamentally consensual and contractual in nature and, therefore, are implemented without judicial intervention or approval, pursuant to the contractual terms of multi-party agreements between the company, its significant creditors and other key stakeholders.

Outside of bankruptcy, companies are generally unable to bind minority dissenting creditors or dissenting equity holders to restructuring terms. A small minority of dissenting creditors may exert outsized leverage to block an out-of-court restructuring. If a dissenting minority refuses to agree to the terms of the restructuring, the company may choose to file a prepackaged or pre-negotiated bankruptcy to effect the terms of the restructuring and bind dissenting creditors. See **6.1 Statutory Process for a Financial Restructuring/Reorganisation**.

4. Secured Creditor Rights and Remedies

4.1 Liens/Security

A secured creditor is a creditor that has a right to payment against a debtor secured by a lien on or security interest in debtor property (collateral). Such liens and security interests may be granted contractually, judicially or by operation of law.

Generally, non-bankruptcy law governs the priority, extent and enforceability of such liens and security interests, and how and when a secured creditor may enforce its right to payment against its collateral if the debtor does not meet its payment obligation. The priority among secured creditors with liens on the same collateral usually depends on the point in time when each creditor perfects its liens. Unless otherwise agreed to contractually, creditors who perfect their liens first typically have first priority rights over later-perfected secured creditors with respect to any proceeds of collateral that is subject to competing secured creditor liens.

Under the Bankruptcy Code, a claim is secured to the extent of the value of the secured creditor's interest in the estate's interest in collateral property (11 USC. § 506(a)). Generally, outside of an insolvency process, secured creditors are able to enforce payment of an obligation by foreclosing on their collateral. In bankruptcy, limits are placed on a secured creditor's ability to enforce its liens and security interests and recover on its collateral. In the event of bankruptcy, a secured creditor who has not perfected its liens or security interests before bankruptcy will be treated as an unsecured creditor.

A creditor's security may take a variety of forms. For real property, mortgages are the standard type of security taken by secured creditors. Mortgage laws and remedies are governed by the law of the state where the real property is located. Under certain state laws, there are other types of security in real estate, such as land sale contracts and deeds of trust. For personal property (or "chattels"), Article 9 of the Uniform Commercial Code (the UCC) governs the perfection and enforcement of security interests. The UCC is not itself enacted law (it is merely a set of standardised laws produced by an outside committee of experts), but all 50 states have enacted the UCC in some form. The goal of the UCC is to create a standard set of laws across the United States that deal with the securitisation of chattels. The UCC governs a wide variety of chattels, including shares, debt instruments, accounts and other intangible types of property. In addition to the mechanisms described above, creditors may become secured by real property or chattels pursuant to court judgments, mechanics liens, tax liens or other types of liens that arise by operation of non-bankruptcy law.

Federal statutes covering trade marks, copyrights and patents include provisions for recording certain interests in intellectual property. Each recording system differs, and the rights protected in trade marks, copyrights and patents by proper recordation also differ.

4.2 Rights and Remedies

Generally, outside of bankruptcy, each state's laws govern the rights and remedies of secured creditors. Secured creditors with mortgage liens on real property collateral may, upon a default by the mortgagor, obtain a judgment in court, foreclose on the real property, and force a judicial sale of the property. In some jurisdictions, secured creditors may credit bid their secured claims at judicial sales of real property collateral. Alternatively, some jurisdictions allow for strict foreclosure in which a secured creditor takes ownership of the property in complete satisfaction of its debt without a judicial sale. Likewise, applicable state laws that are generally based on the UCC dictate the rights and remedies of a creditor with chattels as collateral.

As described above, many states have their own insolvency regimes outside of federal bankruptcy law, including receiverships and ABCs. See **2.2 Types of Voluntary and Involuntary Restructurings, Reorganisations, Insolvencies and Receivership** and **7.1 Types of Voluntary/Involuntary Proceedings**. Secured creditors may assert their secured claim rights in state law receivership proceedings and ABCs in accordance with the applicable state law.

When a voluntary bankruptcy petition is filed, or an order for relief has been granted on an involuntary bankruptcy petition, the Bankruptcy Code's section 362 "automatic stay" takes effect and automatically stays the commencement or continuation of all creditor actions, including secured creditor actions, to collect on a debt owed by the debtor. Unless there is a bankruptcy court order granting a secured creditor relief from the automatic stay, the secured creditor cannot exercise creditor remedies otherwise available to it under non-bankruptcy law. In short, bankruptcy constrains secured creditors from asserting their claims and enforcing their liens and security interests without further order of the bankruptcy court.

In a Chapter 11 reorganisation case, large secured creditors may have significant opportunity to influence the progress and outcome of a Chapter 11 case and the terms of a plan of reorganisation. Senior secured lenders with paramount liens and adequate protection rights may often dictate or block debtor-in-possession financing terms, or provide such financing themselves, and require the debtor to meet case progress milestones as a condition to new financing and the use of secured creditor cash collateral. In addition, senior secured lenders have considerable influence over the terms of the debtor's Chapter 11 plan, which can only be confirmed over their objection if certain statutory requirements are met. See **4.5 Special Procedural Protections and Rights**.

In Chapter 7 liquidation cases, validly perfected secured creditors have paramount "adequate protection" rights under the Bankruptcy Code protecting their pre-petition liens and security interests, and first priority rights to payment out of the proceeds of their collateral. This gives secured creditors strong leverage against Chapter 7 trustees who, as a practical matter, usually cannot use the collateral of secured creditors without their consent. However, a debtor or trustee may surcharge collateral for the necessary costs of preserving or disposing of such collateral (11 USC. § 506(c)).

4.3 Typical Timelines

Unless there is a judicial order modifying or granting relief from the section 362 automatic stay, the stay remains in effect until a bankruptcy case is closed or dismissed, thereby preventing a secured creditor's unilateral enforcement of its claims and liens against debtor collateral property. Secured creditors may be entitled to relief from the automatic stay if, for instance, their liens and security interests are not adequately protected during a bankruptcy case. See **4.5 Special Procedural Protections and Rights**.

4.4 Foreign Secured Creditors

Similarly situated creditors in a case under the Bankruptcy Code are treated alike. Foreign creditors, whether secured or unsecured, encounter no greater or lesser rights, protections or impediments than similarly situated domestic US creditors. The treatment of a foreign creditor's claim depends on the type of its claim, not the foreign status of the creditor. However, as a practical matter, if the bankruptcy court does not have personal jurisdiction over a foreign creditor to, for example, enforce the automatic stay, the debtor may seek bankruptcy court approval to treat that foreign creditor differently than the bankruptcy laws would otherwise dictate.

4.5 Special Procedural Protections and Rights

Applicable state laws give secured creditors high priority rights to payment in state law receivership proceedings and ABCs. In Chapter 7 and 11 cases under the Bankruptcy Code, secured creditors have the following rights, among others.

Adequate Protection Rights

Secured creditors are entitled to and may seek "adequate protection" of their liens and security interests in debtor property to protect against any diminution in the value of their interests in collateral that might occur during a Chapter 11 case with the passage of time or as a result of use of the collateral property or the imposition of post-petition financing liens on the property. Adequate protection can take many forms, including periodic cash payments to the secured creditor (usually in the amount of post-petition interest that would otherwise be payable contractually) or granting the secured creditor replacement liens on other debtor property. The general purpose of adequate protection is to protect the value of a secured creditor's lien interest in debtor property, and to compensate the secured creditor for any reduction in value of its collateral after the commencement of a bankruptcy case.

Relief from Automatic Stay

Section 362(d) of the Bankruptcy Code gives secured creditors the right to seek a bankruptcy court order granting the secured creditor relief from the section 362 automatic stay to exercise remedies against the secured creditor's collateral. A bankruptcy court may lift or modify the automatic stay in the following circumstances:

- "for cause", including "the lack of adequate protection" of the secured creditor's lien interest in debtor property;
- if the debtor "does not have an equity" in the property that is subject to the secured creditor's lien, and such property "is not necessary to an effective reorganization"; or
- if the filing of the bankruptcy petition "was part of a scheme to delay, hinder or defraud creditors", involving a transfer of the secured creditor's real property collateral.

Cram-Down Treatment Rights

A secured creditor that is not to be paid in full under the terms of a Chapter 11 plan, and that does not vote to accept the plan, has enforceable rights to require that the plan proponent demonstrates that the proposed plan either (a) makes full payment on the allowed amount of the secured claim with deferred payments (with a market interest rate) equal to the present value of the secured claim, (b) sells the secured creditor's collateral free and clear of the secured creditor's liens, with a new lien attaching to the proceeds, at a sale that provides the secured creditor with an opportunity to credit bid, or (c) provides the secured creditor with the "indubitable equivalent" of the allowed amount of its secured claim (11 USC. § 1129(b)(2)(A)). The "indubitable equivalent" standard requires that the secured creditor receives the equivalent of the secured amount of its claim or the value of its collateral by, for example, cash payments being made to the secured creditor equal to the allowed amount of its claim, abandoning the collateral back to the secured creditor, or granting the secured creditor a substitute lien on collateral of the same or greater value.

5. Unsecured Creditor Rights, Remedies and Priorities

5.1 Differing Rights and Priorities

Outside of bankruptcy, the applicable state laws control the priority of payment rights of creditors, and such laws may vary across jurisdictions. Typically, secured creditors have priority over unsecured creditors with respect to the proceeds of their collateral.

If the debtor enters bankruptcy, unsecured creditors may assert their unsecured claims as permitted by the Bankruptcy Code and any applicable bankruptcy court order, and may recover on their claims to the extent distributions are made to unsecured creditors.

In a Chapter 7 bankruptcy case, unsecured creditor rights to payments on their claims are dictated by the strict statutory priority scheme set by section 726 of the Bankruptcy Code. Various classes of creditor claims have descending priority over holders of stock or other equity ownership interests.

In a Chapter 11 case, creditor payment rights are set by the terms of a plan of reorganisation or liquidation confirmed by the bankruptcy court that are, in turn, governed by the Bankruptcy Code's priority scheme. The Bankruptcy Code's hierarchical creditor priority scheme, in descending order of priority, is as follows:

- secured claims;
- administrative expense claims;
- priority unsecured claims;
- general unsecured claims; and
- subordinated claims.

Secured creditors have first priority payment rights in bankruptcy to the extent of the value of their collateral. A creditor's claim may be partially secured and partially unsecured. If a secured creditor's claim is greater than the value of its collateral, then the creditor will have two separate claims: a secured claim equal to the value of the collateral, and an unsecured claim for the "deficiency" in collateral value (11 USC. § 506(a)). A secured creditor has no priority rights to payment of proceeds of assets of the debtor's estate that are not subject to the secured creditor's lien.

An administrative expense claim has a payment priority junior to secured claims and senior to other unsecured claims. See **5.9 Priority Claims in Restructuring and Insolvency Proceedings**.

A general unsecured claim is a debt or other obligation owed by the debtor that is not secured by a lien or security interest. The general rule is that all pre-petition general unsecured claims are generally entitled to equivalent bankruptcy treatment and the same payment priority, but there are statutory exceptions to the rule.

Section 507 of the Bankruptcy Code provides enhanced statutory priority for certain types of pre-petition unsecured claims that are entitled to payment in full before lower ranked general unsecured claims receive a distribution.

Section 510 of the Bankruptcy Code provides that particular claims may be subordinated to general unsecured claims. For instance, a contractual subordination agreement entered into between creditors before the bankruptcy case will generally continue to be enforceable during the bankruptcy case as between the parties to the agreement. Section 510 also provides that claims for damages arising from the purchase or sale of securities are subordinated to all claims that are senior to or equal to the claim or interest represented by the security. Also, claims of creditors that engage in "inequitable" conduct may be subordinated to other claims by order of the bankruptcy court.

5.2 Unsecured Trade Creditors

Unsecured pre-petition trade claims are generally entitled to no higher priority or better treatment than other general unsecured claims. However, in bankruptcy cases, Bankruptcy Code section 503(b)(9) grants administrative expense priority to claims of pre-petition unsecured trade creditors arising out of their delivery of goods to the debtor within 20 days of a bankruptcy filing, up to the value of the goods delivered during that time period.

Trade creditors may also receive full or substantially full payment on their pre-petition unsecured claims in bankruptcy if such trade creditors are determined by court order to be "critical vendors" of the debtor. Generally, critical vendors are those who provide unique goods or essential services to the debtor, and are irreplaceable vendors. Before a debtor can pay the pre-petition claims of critical vendors, the debtor must obtain a bankruptcy court order authorising such payments.

Another way unsecured trade creditors may receive full or substantially full payment of their claims under a Chapter 11 plan is if their claims qualify as "convenience class" claims under the plan. Typically, convenience class claims are a separately classified class of smaller unsecured claims that receive payment in full under a Chapter 11 plan for ease of administration of the plan. Whether a particular Chapter 11 plan includes a convenience class and the size range of claims in that class varies on a case-by-case basis.

Trade creditors who deliver goods and services during a bankruptcy case hold administrative expense priority claims that are usually paid by the debtor in the ordinary course of business during a Chapter 11 case. Such claims are entitled to payment in full under a confirmed Chapter 11 plan.

5.3 Rights and Remedies for Unsecured Creditors

Upon the commencement of a bankruptcy case, the automatic stay of section 362 of the Bankruptcy Code takes effect, preventing creditors from asserting their non-bankruptcy rights and remedies. See **6.2 Position of the Company**.

Unsecured creditors and other parties-in-interest in a bankruptcy case may, in limited circumstances, move the bankruptcy court to dismiss a voluntary bankruptcy petition "for cause". Such cause may include unreasonable delays by the debtor. Also, in some jurisdictions, creditors may seek dismissal of a bankruptcy case if it was filed in "bad faith" (relevant factors include a debtor's lack of truthfulness with the court and improper management of the estate). Likewise, in some circumstances, unsecured creditors may seek to convert a Chapter 11 case to a Chapter 7 liquidation case, pursuant to section 1112(b) of the Bankruptcy Code.

After a bankruptcy case has been properly commenced, unsecured creditors have rights to assert their claims by filing proofs of claim in the manner and before the deadlines set by the bankruptcy court and applicable provisions of the Bankruptcy Code and related rules. Individually, unsecured creditors are parties in interest in a bankruptcy case with standing to participate and be heard in the proceedings. Unsecured creditors may, among other things, file motions seeking judicial relief, object to motions filed by other parties, and object to the confirmation of a proposed Chapter 11 plan. Unless a Chapter 11 plan provides for payment in full of unsecured claims or provides for no distribution to such creditors, unsecured creditors have the right to vote to accept or reject the plan.

As discussed below, the interests of general unsecured creditors are represented by an official committee of unsecured creditors, which is typically appointed in most large Chapter 11 cases. See **6.3 Roles of Creditors**.

5.4 Pre-judgment Attachments

Prior to a bankruptcy filing, an unpaid unsecured creditor may proceed in state court to seek a pre-judgment attachment of debtor property. Pre-judgment attachments are governed by state laws that vary by jurisdiction. Pre-judgment attachments allow an unsecured creditor to simultaneously preserve its rights against debtor property at the same time the creditor proceeds with a civil action to obtain a monetary judgment against the debtor, so that the creditor can collect against the debtor's property if successful in the litigation.

5.5 Timeline for Enforcing an Unsecured Claim

The time it takes to enforce unsecured claims varies depending on the particular circumstances, the applicable state laws and whether the debtor has filed for bankruptcy. Before the commencement of a bankruptcy proceeding and the imposition of the automatic stay, state law will govern creditor collection efforts. The length of time it takes a creditor to collect on a debt outside bankruptcy will generally depend on the time required to obtain and foreclose on a judgment.

In Chapter 7 or 11 bankruptcy cases, unsecured creditors must generally wait for the conclusion of the bankruptcy case before they receive any recovery.

5.6 Bespoke Rights and Remedies for Landlords

A landlord's rights and remedies against its lessee depend on whether the lessee has commenced bankruptcy. Outside of bankruptcy, when a lessee defaults and fails to pay amounts owed under a lease, the landlord may assert its claims for unpaid rent or other charges, and commence an eviction proceeding against the lessee, in accordance with applicable state law.

Upon commencement of a lessee bankruptcy, the section 362 automatic stay will halt landlord eviction and collection actions against the lessee-debtor. However, the Bankruptcy Code generally requires a debtor to assume or reject its obligations under an unexpired lease within 120 days of the bankruptcy petition date. This deadline may be extended for an additional 90 days by court order upon a showing of cause. The bankruptcy court may grant a further extension only upon the prior written consent of the lessor.

In bankruptcy, a landlord's claim for unpaid pre-petition rent is a general unsecured claim. If the lease is assumed, the lessor's pre-petition claim and all other claims of the lessor under the lease are entitled to administrative expense priority treatment and must be paid in full. If the debtor rejects its obligations under the lease, the lessor's pre-petition claim remains a general unsecured claim, and the lessor may also file a claim for damages resulting from the rejection. Such a rejection damages claim is capped at the rent reserved by such lease for a year or 15% of the remaining lease term, not to exceed three years, whichever is greater (11 USC. § 502(b)(6)). Generally, any claim for rent payable during the pendency of the bankruptcy case when the debtor occupies the property is entitled to administrative expense priority.

5.7 Foreign Creditors

As described above, foreign unsecured creditors are treated no differently than domestic creditors under the Bankruptcy Code. See **4.4 Foreign Secured Creditors**.

5.8 Statutory Waterfall of Claims

A liquidation can occur either under Chapter 7 or Chapter 11 of the Bankruptcy Code, or in receivership, ABC or dissolution proceedings governed by state law. State laws that vary from state to state govern payment priority waterfalls in such state law proceedings.

Liquidation distributions in Chapter 7 cases are governed by the statutory claims priority scheme set by section 726 of the Bankruptcy Code. In the event of a Chapter 7 liquidation, claims are paid in descending order of priority, with the highest priority creditors receiving payment first.

Under a Chapter 11 plan of liquidation, the waterfall of distributions to creditors will be fixed by the terms of the confirmed plan and, to the extent accepted by voting creditor classes, need not comply strictly with the section 726 priority scheme.

5.9 Priority Claims in Restructuring and Insolvency Proceedings

Under the Bankruptcy Code, administrative expense claims are entitled to first priority in payment after secured creditor claims are paid out of the proceeds of their secured creditor collateral. A confirmed Chapter 11 plan must provide for payment in full of administrative expense claims, unless the holders of such claims agree to different treatment. Such administrative expense claims are claims for "the actual, necessary costs of preserving the estate". Administrative priority expenses include post-petition operating expenses such as post-petition wages, taxes and amounts payable to trade creditors who have supplied goods and services during the bankruptcy case, bankruptcy court approved professional fees and, generally, amounts owing to lenders and other creditors who have extended new money financings or trade credit to a debtor during a bankruptcy case.

Other priority unsecured claims receive payment after administrative expense claims, but before general unsecured claims. Common priority claims under the Bankruptcy Code are certain employee wage claims up to certain dollar amounts incurred during the 180 days prior to the bankruptcy filing, certain employee benefit programme contribution claims up to a capped dollar amount, and certain tax claims.

Applicable state laws govern the priority of administrative costs, expenses and fees incurred by receivers and assignees in state law receiverships and ABCs.

6. Statutory Restructurings, Rehabilitations and Reorganisations

6.1 Statutory Process for a Financial Restructuring/Reorganisation

A rehabilitative financial restructuring in the United States is achieved by confirmation of a Chapter 11 plan of reorganisation in a Chapter 11 case under the Bankruptcy Code. A Chapter 11 case gives a financially distressed company the opportunity to continue operating as a going concern while restructuring its balance sheet, its operations, or both. A Chapter 11 case proceeds under the judicial supervision of a US bankruptcy court.

A primary function of a Chapter 11 case and confirmed Chapter 11 plan is to bind all creditors, equity interest holders and other parties in interest to the terms of the plan and its treatment of various classes of creditors and equity interest holders. A Chapter 11 reorganisation case may be the best or only strategy for restructuring a company when dissenting creditors are unwilling to agree to terms out-of-court. A company may choose to file a prepackaged, pre-negotiated or traditional Chapter 11 case.

Prepackaged Cases

When minority dissenting creditors make it difficult or impossible to accomplish a fully consensual restructuring out-of-court, a company may commence a prepackaged or a pre-negotiated Chapter 11 bankruptcy case in order to bind dissenting creditors to otherwise agreed terms of a restructuring. Before commencing a prepackaged or pre-negotiated bankruptcy case, the debtor and its supporting creditors will typically execute a restructuring support agreement (RSA), which is generally enforceable in bankruptcy and binds the debtor and supporting creditors to the agreed terms of a bankruptcy restructuring. Creditors who are signatory to an RSA will agree to support the terms of the Chapter 11 reorganisation plan contemplated by the RSA.

In a prepackaged bankruptcy case, the debtor company negotiates and documents a plan of reorganisation and solicits votes on the plan prior to filing for Chapter 11. Unlike out-of-court restructurings that require unanimous or near-unanimous creditor support, a debtor does not need creditors to unanimously accept its Chapter 11 plan – only a majority in number of voting creditors that hold at least 2/3 of the dollar amount of debt voted in a class are needed to confirm a bankruptcy plan. Once the requisite accepting votes are obtained, the company files its Chapter 11 case and submits its prepackaged plan for confirmation. A court date is obtained for a hearing on confirmation of the prepackaged plan, often within weeks or little more than a month after commencement of the Chapter 11 case.

Pre-Negotiated Cases

A pre-negotiated bankruptcy is similar to a prepack, except that, by definition, creditors will not have voted on the Chapter 11 plan of reorganisation prior to commencement of the debtor's Chapter 11 case. An RSA may be signed before or after a company files for bankruptcy, but votes on the plan of reorganisation are not solicited until after the company has sought bankruptcy protection and the bankruptcy court has had an opportunity to approve the solicitation and disclosure documents.

Pre-negotiated bankruptcies may be required when rights of diverse, unorganised classes of creditors will be impaired by the terms of a Chapter 11 plan. In that circumstance, a broad, public solicitation of votes on a Chapter 11 plan prior to bankruptcy is usually impracticable or impossible, and likely to damage going-concern business operations and values. Although pre-negotiated bankruptcies may be speedy and last only a few months, the frequent lack of complete restructuring agreements and an agreed Chapter 11 plan at the time of filing creates additional risks and uncertainties.

Traditional Cases

If pre-bankruptcy restructuring negotiations fail and significant creditors begin to exercise remedies against the company, or if the financially distressed company lacks the liquidity needed to operate its business and continue negotiations outside of bankruptcy, it may commence a "traditional" Chapter 11 reorganisation case, in which the debtor company operates its business and reorganises its financial affairs under bankruptcy court supervision. In the Chapter 11 case, the company may obtain post-petition debtor-in-possession financing needed for continued business operations and to pay the high costs of a Chapter 11 case; restructure its business operations; negotiate with creditors and formulate reorganisation plan terms; propose and solicit creditor acceptances of a reorganisation plan; and, thereafter, obtain bankruptcy court confirmation of its reorganisation plan. A traditional Chapter 11 reorganisation process may take months or even years.

A financially distressed company may commence a Chapter 11 case by filing a voluntary Chapter 11 petition in a bankruptcy court if the company has a domicile, place of business or property in the United States. There is no requirement for the company to be insolvent, but some financial distress is required for a good faith filing. Permissible objectives include preserving a business as a going concern and maximising recoveries for creditors.

A voluntary Chapter 11 petition may be dismissed as a bad faith filing if, for instance, the Chapter 11 filing is determined to be an abuse of judicial process, merely a litigation tactic against another party or an effort to delay legitimate efforts by secured creditors to exercise their rights, or if the filing entity has no real prospect of reorganising.

An involuntary bankruptcy petition may be filed against a company by its creditors if the requirements of section 303 of the Bankruptcy Code are satisfied. See **2.5 Commencing Involuntary Proceedings**.

A Chapter 11 plan is, effectively, a multi-party contract that resolves claims against and liabilities of the debtor entity in a manner consistent with the requirements of the Bankruptcy Code. The terms of a confirmed Chapter 11 plan are binding on all creditors, equity interest holders and other parties in interest. Chapter 11 plan terms are typically the product of extensive multi-party negotiations between the company, senior lenders and other secured creditors, an official committee representing unsecured creditors, and other significant parties in interest, including those who might purchase assets, provide funding or otherwise participate in restructuring transactions contemplated by the plan.

Under section 1123 of the Bankruptcy Code, a plan must include, among other provisions, terms that: (i) designate and define classes of claims and equity interests, specify the treatment of each class, and provide for the same treatment for each claim or interest in a particular class, unless the holder of a claim or interest agrees to less favourable treatment; and (ii) provide adequate means for implementation of the plan. Plan terms may impair or leave unimpaired any class of claims or interests; provide for the assumption, rejection or assignment of executory contracts and unexpired leases; provide for the sale of property and the distribution of sale proceeds; and modify the rights of holders of secured and unsecured claims.

The Chapter 11 plan process is very flexible. While the form of most Chapter 11 reorganisation plans is similar, the terms of a particular plan are unique – how a company is reorganised to improve its financial condition, what treatments various creditors receive, what the capital structure of the reorganised company will be, and numerous other issues are case-specific and highly negotiated. The terms of a confirmed Chapter 11 plan, to the extent they are accepted by voting creditor classes, may provide for distributions of value and payments to classes of creditors and equity holders that vary from their respective rights and priorities under the statutory priority scheme under section 726 of the Bankruptcy Code. See **7.1 Types of Voluntary/Involuntary Proceedings**.

Numerous types of Chapter 11 plan-based transactions may be used to restructure financially distressed companies. For instance, Chapter 11 reorganisation plans may provide for:

- a conversion of certain creditor claims into equity of the reorganised company;
- a new money investment by old equity holders giving them continued ownership and control of the reorganised company;
- a treatment that leaves unimpaired (or unchanged) the claims of certain creditors;
- a third-party equity investment under the plan giving the third party ownership of the reorganised company; and
- sales of the company or its assets.

A Chapter 11 plan may be confirmed consensually with votes of acceptance by all classes entitled to vote. If not all classes vote to accept the plan, the confirmation of a plan at least requires that it be accepted by the requisite majorities of creditors voting in at least one impaired creditor class without counting the votes of insiders. A class of creditors accepts a plan if holders of at least two thirds in amount and more than one half in number of those voting vote to accept the plan. Thus, only claimholders who actually vote are counted for the purposes of determining acceptance.

If at least one impaired creditor class votes to accept the plan and the plan otherwise satisfies all other requirements of the Bankruptcy Code, the plan will be binding on all creditors and equity interest holders, regardless of whether or not they voted to accept the plan. In other words, a plan's terms can be "crammed down" on dissenting creditor and equity classes if the Bankruptcy Code's section 1129(b) cram-down requirements are met. See **4.5 Special Procedural Protections and Rights**.

A company may file a Chapter 11 plan at any time during its Chapter 11 case. Typically, a plan confirmation process will take at least 60 days or longer after a proposed Chapter 11 plan has been negotiated, documented and filed. A Chapter 11 debtor has the exclusive right to propose a Chapter 11 plan for the first 120 days of its Chapter 11 case, and this exclusive period may be extended for up to a maximum of 18 months after the commencement of the Chapter 11 case. Before the debtor may solicit votes on the plan, it must obtain bankruptcy court approval of a disclosure statement that provides "adequate information" to those entitled to vote on the plan about the Chapter 11 case, the plan and their treatment under the plan (11 USC. § 1125).

A Chapter 11 debtor files a statement of financial affairs and schedules of assets and liabilities early in its case. The schedules include a listing of known creditors and their respective claims. The schedules of claims are the initial basis for Chapter 11 claims recognition, and indicate whether particular claims are unliquidated, contingent and/or disputed. After a debtor files its schedules, as well as its statements of financial affairs, the court orders a deadline and procedure for creditors to file proofs of claim (Fed. R. Bankr. P. 3003(c)). Usually, the court-approved claims filing deadline (also known as a claims "bar date") is approximately 45–60 days after the publication and mailing of notice of the deadline to known creditors. Unless a particular claim has been scheduled by a debtor as undisputed, non-contingent and liquidated in amount, a creditor must timely file a proof of claim to preserve its claim. A timely proof of claim also must be filed by a creditor who disputes the scheduled amount of its claim or whose claim has not been scheduled. Untimely proofs of claim may be barred by the bankruptcy court's claims bar date order.

After the proof of claim deadline, the debtor assesses filed claims and the claims register to classify claims for Chapter 11 plan purposes. Claims of a similar type are classified together in classes of "substantially similar" claims for Chapter 11 plan treatment and voting purposes (11 USC. § 1122). When a class is unimpaired under the plan – meaning the rights of holders of claims or equity interests in the class will not be changed or impaired by the plan – such class is deemed to accept the plan, and class members do not vote. Likewise, if a plan provides that a particular class retains no rights and receives no value, the class is deemed to have rejected the plan without any solicitation of votes of that class. Contingent, unliquidated and disputed claims may be estimated by the bankruptcy court for purposes of voting on and confirming a plan.

Filed claims are deemed allowed by the Bankruptcy Code, unless and until they are objected to by a party in interest (11 USC. § 502(a)). If an objection to a claim is filed, the bankruptcy court will enter an order allowing or disallowing the claim in whole or in part after notice and an evidentiary hearing at which the claimant and objector may litigate the merits of the claim (11 USC. § 502(b)). The claims allowance/disallowance process in Chapter 11 cases (otherwise known as "claims reconciliation process") usually occurs after the confirmation and consummation of a Chapter 11 plan. Disputed larger claims may be contested and allowed, disallowed or estimated by the bankruptcy court prior to or during the plan confirmation process.

After votes have been solicited and obtained from classes entitled to vote on a plan, and after the deadline for filing objections to the confirmation of a Chapter 11 plan has passed, the bankruptcy court holds an evidentiary hearing on the confirmation of the plan. At the confirmation hearing, the plan proponent must show that required acceptances of the plan have been received and that the plan satisfies all of the requirements of the Bankruptcy Code, including that the plan contains all plan provisions required by section 1123(a), and meets the numerous section 1129 confirmation requirements, including cram-down requirements under section 1129(b), if relevant. See **6.12 Restructuring or Reorganisation Agreement**.

The bankruptcy court will consider and sustain or overrule confirmation objections. If the court decides to confirm a plan, it will enter an order with findings of fact and conclusions of law that all Bankruptcy Code confirmation requirements have been satisfied. Plan objectors sometimes appeal confirmation orders, but appeals may become moot if the appellant does not obtain a stay of the confirmation order before a plan is substantially consummated.

Following the confirmation and consummation of a Chapter 11 plan, the reorganised company must perform its obligations and effectuate the transactions contemplated by the plan, including implementing the plan's treatment of various classes of creditors and equity interests (11 USC. § 1142(a)). A confirmation order typically discharges the pre-petition claims and liabilities of a debtor, and includes plan-based injunctions against post-confirmation actions by creditors and other parties in interest that are inconsistent with the confirmed plan.

Upon the effective date of the plan (which occurs when the plan is substantially consummated), the Chapter 11 debtor emerges from bankruptcy as a "reorganised debtor". Payments to be made on the effective date and thereafter are made in accordance with the plan's terms. Chapter 11 cases may continue for purposes of making periodic distributions to creditors, reconciling and resolving disputed and unliquidated claims, adjudicating litigated matters, and otherwise resolving disputes concerning the implementation of the plan.

6.2 Position of the Company

Upon the filing of a voluntary Chapter 11 petition by a debtor, the company is automatically authorised (without need for court approval) to proceed in bankruptcy as a "debtor-in-possession", and may continue to operate its business (11 USC. § 1108). The Chapter 11 company's internal governance and management continue under the applicable non-bankruptcy law. The debtor company's incumbent directors and officers continue to manage the company's business and properties, and perform the debtor's duties under the Bankruptcy Code.

No bankruptcy court approvals are required for ordinary course business transactions, including ordinary course property uses and sales, and the incurrence of ordinary course unsecured debt (such as trade credit). However, the use, lease or sale of property outside the ordinary course of business requires bankruptcy court approval (11 USC. § 363). See **6.7 Restrictions on a Company's Use of or Sale of Its Assets** and **6.8 Asset Disposition and Related Procedures**. If the Chapter 11 company needs to obtain credit and incur debt outside the ordinary course of business, it may do so only with bankruptcy court approval (11 USC. § 364). See **6.10 Priority New Money**.

In circumstances typically involving fraud, dishonesty or gross mismanagement of the affairs of the debtor by its current management before or during the Chapter 11 case, the bankruptcy court may appoint a Chapter 11 trustee to displace the debtor and incumbent management, and to take control of the debtor's property and business (11 USC. § 1104(a)). If a Chapter 11 trustee has not been appointed, the court may appoint an "examiner" to investigate the debtor, its management and affairs as appropriate, and may grant an examiner expanded powers to perform Chapter 11 duties that the court orders a debtor not to perform (11 USC. §§ 1104(c), 1106(b)).

The Bankruptcy Code specifies the rights, functions and duties of a Chapter 11 debtor company, including duties to:

- file a list of creditors;
- file schedules of assets and liabilities, current income and expenditures;
- file a statement of financial affairs;
- account for all of the company's property;
- examine proofs of claim and object to their allowance as appropriate;
- furnish information requested by parties in interest, unless the court orders otherwise;
- file a Chapter 11 plan as soon as practicable; and
- file reports that the bankruptcy court orders (11 USC. §§ 521, 1107, 1108).

During a Chapter 11 case, the debtor company is protected by the automatic stay of section 362 of the Bankruptcy Code, which applies very broadly in any Chapter 11 or 7 bankruptcy case to protect a debtor and its properties against unilateral creditor actions and other interferences with estate property. Subject to certain statutory exceptions, the section 362 stay applies globally, automatically and generally to all persons and entities. The stay gives a Chapter 11 debtor company an opportunity to stabilise its business and affairs, negotiate with creditors and other stakeholders, and formulate and propose a Chapter 11 plan of reorganisation.

Willful violations of the automatic stay may result in bankruptcy court sanctions, damages awards and punitive damages. However, relief from the automatic stay may be granted in certain circumstances (11 USC. § 362(d)). See **4.5 Special Procedural Protections and Rights** and **6.3 Roles of Creditors**.

6.3 Roles of Creditors

Individual creditors and ad hoc or other creditor groups have standing to appear and be heard in a bankruptcy case, and a bankruptcy court may permit them to intervene generally or in any specific Chapter 11 matter or proceeding. Creditors may file motions seeking bankruptcy court relief (including relief from the automatic stay), file objections to motions filed by the debtor or others, and object to confirmation of a Chapter 11 plan. However, many individual creditors do not organise, especially general unsecured creditors, and individually do not play an active role in a Chapter 11 case.

Similarly situated creditors under particular credit agreements or debt instruments including indentures may be represented by a common agent or indenture trustee, who may act in a Chapter 11 case in accordance with the terms of applicable agreements. Such agents and indenture trustees may take instructions from controlling creditors and "steering committees" or "ad hoc committees" of such creditors, and may employ sophisticated counsel and financial advisers to represent particular creditor group interests.

The rights of unsecured creditors in a Chapter 11 case are usually represented by an official committee of unsecured creditors. The Bankruptcy Code requires the United States Trustee (the "US Trustee") to appoint an official committee of creditors holding unsecured claims "as soon as practicable" after the commencement of a Chapter 11 case. The US Trustee may appoint additional committees of creditors or equity security holders as he or she deems appropriate (11 USC. § 1102(a)).

Ordinarily, the members of an official committee of unsecured creditors appointed by the US Trustee are unsecured creditors willing to serve who hold the seven largest unsecured claims against the debtor (11 USC. § 1102(b)). In practice, the US Trustee exercises discretion when selecting and appointing official committee members, will interview those who express interest in serving, and will also take into account the views of the Chapter 11 debtor about whether particular creditors should be appointed.

An official committee in a Chapter 11 case monitors developments in the case and acts as it deems appropriate to advance the interests of the parties it represents. An official committee owes fiduciary duties to the parties it represents, and may be expected to provide information requested by class members and to recommend to them whether to accept or reject a proposed plan. An official committee may employ attorneys, financial advisers and other professionals to assist the committee in its role, and the fees, costs and expenses incurred by an official committee and its professionals are paid by the debtor's estate to the extent approved by the bankruptcy court.

The official committee typically plays an active role in the Chapter 11 process and is involved in plan formulation, negotiation and confirmation. Among other things. the official committee may consult with the debtor concerning the administration of the case, and investigate the conduct, assets, liabilities and financial condition of the debtor, the operation of the debtor's business, and any other matter relevant to the case or a plan. The official committee has standing to be heard on all matters, and may take positions adverse to the debtor and/or object to the confirmation of the Chapter 11 plan. A bankruptcy court may give standing to an official committee to commence estate causes of action against third parties in certain circumstances.

6.4 Claims of Dissenting Creditors

Creditors whose claims are impaired under a proposed Chapter 11 plan may vote to reject the plan. However, unanimous creditor acceptances of a Chapter 11 plan are not required – as long as the requisite voting majorities under the Bankruptcy Code are satisfied, the Chapter 11 process is intended to permit the confirmation of a Chapter 11 plan over the opposition of dissenting creditors who do not vote on the plan or who vote to reject the plan, unless dissenting creditors show that the plan is non-confirmable as a matter of law. If dissenting creditors show that a proposed plan does not satisfy the mandatory Bankruptcy Code confirmation requirements, it will not be confirmed – or may need to be modified in order to be confirmable. Each plan confirmation requirement of section 1129(a) of the Bankruptcy Code must be satisfied. See **6.12 Restructuring or Reorganisation Agreement**.

When a class of creditors has voted as a class to accept a plan, its terms will be binding on all creditors within the class, including individual creditors who voted against the plan, unless such dissenting creditors can show that the plan does not provide them with at least as much value on account of their claims as they would receive in a hypothetical liquidation of the debtor under Chapter 7. If creditors make such a showing, the plan is not confirmable (11 USC. § 1129(a)(7)(A)(ii)).

A Chapter 11 plan may be confirmed over the dissent of entire non-accepting creditor classes as well. If one or more impaired creditor classes vote as a class to accept the plan, the plan's treatment of non-accepting creditor classes can be "crammed down" on such classes if the plan provides that each creditor in a non-accepting class receives at least as much value as it would receive in a hypothetical Chapter 7 liquidation of the company and the plan (i) does not discriminate unfairly against non-accepting classes and (ii) is "fair and equitable" with respect to each such class (11 USC. § 1129(b), providing cram-down requirements). Plan terms satisfy the "fair and equitable" standard and may be crammed down on non-accepting unsecured creditor classes if no class junior to a non-accepting unsecured creditor class will receive any payment until the non-accepting class is paid in full, and no class senior to the non-accepting unsecured creditor class will receive more than the allowed amount of their claims (11 USC. § 1129(b)(2)(B)). Likewise, a plan may be confirmed and crammed-down over the dissent of a non-accepting secured creditor class if it satisfies the requirements of section 1129(b)(2)(A), as discussed above. See **4.5 Special Procedural Protections and Rights**.

The Bankruptcy Code also provides for the cram-down of non-accepting classes of equity interests (11 USC. § 1129(b)(2)(C)).

6.5 Trading of Claims Against a Company

Generally, claims of creditors may be freely traded and transferred during a Chapter 11 case. However, various contractual and legal restrictions may limit trading in a Chapter 11 company's debt and debt securities.

6.6 Use of a Restructuring Procedure to Reorganise a Corporate Group

It is common for bankruptcy cases of affiliated business entities to be administered together as "jointly administered" cases before a single bankruptcy court and judge. Affiliated Chapter 11 debtor companies are routinely represented by the same bankruptcy counsel and other advisers, and a single "joint Chapter 11 plan" may be proposed by and confirmed to reorganise all the affiliated debtor entities.

6.7 Restrictions on a Company's Use of or Sale of Its Assets

All of a Chapter 11 debtor's legal and equitable interests in property as of the commencement of the Chapter 11 case become property of the debtor's estate, wherever they are located and by whomever they are held (11 USC. § 541). Any use, sale or lease of estate property outside the ordinary course of business requires bankruptcy court approval (11 USC. § 363(b)). If a use, sale or lease of property requires bankruptcy court approval, a court will generally grant approval if the use, sale or lease is shown to be a sound exercise of the debtor's business judgement.

6.8 Asset Disposition and Related Procedures

A Chapter 11 debtor may sell estate property in the ordinary course of business without bankruptcy court approval, but otherwise bankruptcy court approval of a sale is required (11 USC. 363(b)). A court will generally defer to a debtor's business judgement and approve a sale of property if the sale process and procedures are reasonable, fair and used to maximise value for the estate. See **7.2 Distressed Disposals**.

6.9 Secured Creditor Liens and Security Arrangements

In a Chapter 11 case, a secured creditor may agree to release its liens on property of the estate that is sold in a Chapter 11 case, in return for "adequate protection" of its lien interest by having the lien attach to the proceeds of the sale or other property. Section 363(f) of the Bankruptcy Code permits property to be sold free and clear of all liens, claims or interests. See **4.5 Special Procedural Protections and Rights** and **7.2 Distressed Disposals**.

6.10 Priority New Money

In Chapter 11, an operating company usually needs ordinary course trade credit from its vendors and suppliers. The Bankruptcy Code permits a debtor company to obtain unsecured credit and incur unsecured debt in the ordinary course of business without bankruptcy court approval, and those who extend such credit are entitled to administrative expense priority rights of repayment (11 USC. § 364(a)).

A debtor may also need significant additional borrowings of new money financings during the Chapter 11 case. The Bankruptcy Code authorises the debtor to obtain unsecured or secured post-petition financing outside of the ordinary course of business ("DIP Financing"), with bankruptcy court approval after notice and a hearing. DIP Financing may be secured by a lien on unencumbered property, a junior lien on already-encumbered property, or a "priming" lien that is senior or equal to existing liens on the property. The bankruptcy court and debtor must provide "adequate protection" to pre-existing secured lenders whose collateral and liens are subjected or subordinated to (primed by) new DIP Financing liens (11 USC. § 364(b)-(d)).

The Bankruptcy Code permits a Chapter 11 debtor to use "cash collateral" (ie, cash, cash equivalents and cash proceeds of debtor accounts receivable and other collateral property that is subject to pre-existing liens and security interests) with the consent of all holders of liens on or security interests in the cash collateral, or if there is no consent, by order of the bankruptcy court if the order provides "adequate protection" of such liens and security interests (11 USC. § 363 (c), (e)).

Creditors and other parties in interest may object to proposed DIP Financing, but the Bankruptcy Code's provisions for DIP Financing permit a bankruptcy court to approve DIP Financing and non-consensual use of cash collateral over such objections if certain conditions are satisfied. Senior pre-petition secured lenders often provide DIP Financing needed by a Chapter 11 company, and usually receive senior, priming DIP Financing liens and negotiated terms of "adequate protection". The repayment rights of secured super-priority DIP Financing lenders typically have the highest payment priority rights in a Chapter 11 case.

6.11 Determining the Value of Claims and Creditors

The Chapter 11 process may be used to establish and determine the allowed amount and value of creditor claims, whether secured or unsecured. Substantive non-bankruptcy law usually determines whether asserted claims are valid and allowable, and in what amounts, but unless a claim is oversecured, claims for post-petition interest are usually disallowed by the Bankruptcy Code (11 USC. § 506(b)). In Chapter 11 cases, the value and allowed amount of most claims are determined in an allowance/disallowance process (or "claims reconciliation process"), often occurring after a Chapter 11 plan is confirmed and consummated. See **6.1 Statutory Process for a Financial Restructuring/Reorganisation**.

6.12 Restructuring or Reorganisation Agreement

Section 1129(a) of the Bankruptcy Code enumerates mandatory requirements that apply to confirmation of a Chapter 11 plan for a business entity. The section 1129(a) confirmation requirements incorporate other provisions of the Bankruptcy Code (for instance, section 1123(a)'s requirement for inclusion of certain mandatory provisions in a Chapter 11 plan). The burden is generally on a Chapter 11 plan proponent to show that the following section 1129(a) requirements are satisfied:

- the plan must comply with all applicable provisions of the Bankruptcy Code, including provisions that govern the classification of claims and the required contents of a plan;
- the plan proponent must comply with applicable provisions of the Bankruptcy Code, including, for instance, provisions governing disclosure statements and solicitations;
- the plan must be proposed in good faith and not by any means forbidden by law;
- any payments made by the plan proponent, the debtor or any person issuing securities or acquiring property under the plan must be approved by the court as reasonable;
- the identity and affiliations of any individuals who will serve as officers or directors or in other key positions following confirmation of the plan must be disclosed;
- if the debtor charges rates that are subject to government regulatory approvals, any rate change that applies post-confirmation must be approved or subject to regulatory approval;
- the plan must provide that any holder of a claim or interest in an impaired accepting class that did not vote to accept the plan will receive or retain property of a value not less than it would receive if the debtor were liquidated in a Chapter 7 case;
- if a creditor holding a secured claim has properly elected under section 1111(b)(2) to retain its lien and have its entire claim treated as a secured claim, the plan must provide that such creditor receives or retains property having a value as of the effective date of the plan not less than the value of the creditor's collateral;
- each class under the plan has accepted the plan or is unimpaired (but if this requirement is not satisfied, the plan may be confirmed by "cram-down" of any impaired non-accepting class if the applicable requirements of section 1129(b) cram-down are satisfied);
- the plan must provide for payment in full in cash of the allowed amount of administrative expense claims and certain other priority claims, unless the holders of such claims agree to different treatment;
- one impaired class of claims must have voted as a class to accept the plan without counting the votes of insiders;
- the plan must be feasible – ie, confirmation of the plan is not likely to be followed by a liquidation of the reorganised company or by a need for further financial reorganisation beyond that proposed by the plan;
- all fees payable to the US Trustee must be paid; and
- the plan must provide for the continuation and payment of all retiree benefits to the extent required by section 1114(e)(1)(b) or 1114(g) for the duration of time the debtor has obligated itself to provide such benefits.

6.13 Non-debtor Parties

The terms of a confirmed Chapter 11 plan may release non-debtor parties from actual or potential claims held by the debtor against such parties. Bankruptcy courts typically require showings that the released parties provided some consideration for the releases they receive. Such consideration may be monetary or other contributions to the debtor during the Chapter 11 case or pursuant to the plan. Chapter 11 plans routinely provide for general releases of possible estate claims and causes of action against officers and directors of a Chapter 11 debtor company in consideration of their services to the company during the Chapter 11 case, although such releases have been subject to increasing scrutiny.

Chapter 11 plans may also propose and effectuate "non-consensual third-party releases" on creditors of a debtor in consideration of the value they will receive under a plan, whereby creditors are deemed to release, upon consummation of the plan, any direct or derivative claims and causes of action that individual creditors might have or assert against non-debtor "released parties" (including current and former officers, directors and employees of the debtor, official committee members, lenders to the Chapter 11 company, plan funders and other parties who have made it possible for the plan to be confirmed). Such non-consensual third-party releases are often contentious.

6.14 Rights of Set-off

In Chapter 11 cases, creditors may have rights to off-set and reduce a pre-petition obligation they owe to the debtor by the amount of a pre-petition obligation owed by the debtor to the creditor. Such "set-off" rights and "recoupment" rights may be enforced to the extent permitted by non-bankruptcy law and the Bankruptcy Code. Generally, the section 362 automatic stay prevents a creditor from exercising any set-off rights unless the creditor obtains a bankruptcy court order modifying the automatic stay. In practice, set-off rights are usually determined and exercised in connection with the bankruptcy claims reconciliation process.

6.15 Failure to Observe the Terms of Agreements

Chapter 11 plans and confirmation orders usually include injunctions that prohibit creditors and other parties in interest from taking actions that are inconsistent with express plan terms. If a debtor or other party fails to perform any act necessary to consummate or implement the terms of a confirmed plan, the bankruptcy court may direct the performance of such acts (11 USC. § 1142(b)). Failure to comply with a court order may result in contempt of court sanctions, damages and penalties.

A party may also request the bankruptcy court to convert the Chapter 11 case to a case under Chapter 7 in circumstances where a debtor is unable to effectuate substantial consummation of a confirmed plan, or by its acts or omissions is in "material default" with respect to a confirmed plan, or where a confirmed plan is terminated due to the occurrence or non-occurrence of a condition specified in the plan.

6.16 Existing Equity Owners

Existing equity owners of a Chapter 11 company may retain equity or receive distributions of value on account of their equity interests pursuant to the terms of a Chapter 11 plan in certain circumstances. For instance, the enterprise value of the debtor may be sufficient to pay creditors in full, thereby allowing equity holders to retain their ownership interests, or a 363 sale may result in proceeds in excess of amounts required to pay all creditors in full, in which case equity holders will receive distributions of any residual value.

Generally, equity holders do not retain ownership of the reorganised company if the company is insolvent. Typically in that circumstance, the Chapter 11 plan provides that old equity interests are cancelled without any distribution on account of such interests, but the facts and circumstances of particular cases may permit better plan treatment.

In some cases, existing equity interests may retain their ownership interests in exchange for making contributions of substantial "new value" to the debtor's estate. Any new equity to be received by an existing equity holder on account of such new value must be subject to a market test – ie, be subject to higher and better third-party offers.

7. Statutory Insolvency and Liquidation Proceedings

7.1 Types of Voluntary/Involuntary Proceedings

Insolvent companies may be liquidated voluntarily or involuntarily under federal law, pursuant to Chapter 7 or Chapter 11 of the Bankruptcy Code. See **2. Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations**.

Alternatively, an insolvent company may also be liquidated pursuant to varying laws of the 50 states that provide for:

- the appointment of receivers;
- general assignments for the benefit of creditors; and
- the dissolution of business entities.

See **2.2 Types of Voluntary and Involuntary Restructurings, Reorganisations, Insolvencies and Receivership**.

In the United States, the point at which a liquidation proceeding may be commenced by a company is generally in the company's discretion. The exceptions to this rule include the commencement by creditors of an involuntary Chapter 11 or Chapter 7 case, or when a state court orders the appointment of a receiver or the dissolution of the insolvent entity.

Chapter 11 Liquidations

A key advantage of a Chapter 11 liquidation is that the Chapter 11 company's existing managers and directors usually remain in control to oversee continued operations and the liquidation of the business as a going concern. Management continuity and knowledge may preserve and maximise going-concern values when business assets are sold.

The timelines and duration of Chapter 11 liquidations vary from case to case. Chapter 11 provides maximum flexibility for a liquidation, but it is the most expensive and often time-consuming type of liquidation proceeding. Distributions to creditors generally cannot be made until a Chapter 11 plan of liquidation is proposed and confirmed by a bankruptcy court, which may take many months or longer.

Confirmation of a liquidating Chapter 11 plan requires satisfaction of the same legal standards for confirmation of a

Chapter 11 plan of reorganisation. See **6.1 Statutory Process for a Financial Restructuring/Reorganisation**. The "feasibility" requirement requires a showing of sufficient funding to consummate the liquidating plan. Unless there is sufficient net sale proceeds or other funding required to pay secured and administrative expense claims in full and to fund the plan, the legal standards for confirming a liquidating Chapter 11 plan cannot be satisfied.

A Chapter 11 case may be converted to a Chapter 7 liquidation case if a Chapter 11 plan cannot be confirmed. The Chapter 11 debtor may request such conversion voluntarily as a matter of right, or another party in interest may request conversion for "cause", pursuant to section 1112(b) of the Bankruptcy Code. "Cause" is defined under section 1112(b)(4) of the Bankruptcy Code to include, among other things:

- substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;
- gross mismanagement of the estate;
- failure to file a disclosure statement, or to file or confirm a plan, within the time fixed either by the Bankruptcy Code or by order of the court; and
- inability to effectuate substantial consummation of a confirmed plan.

Instead of converting its Chapter 11 case to Chapter 7 when a liquidating plan cannot be confirmed or consummated, a Chapter 11 debtor may seek a "structured dismissal" of its bankruptcy case: a court-ordered dismissal of the bankruptcy case combined with certain additional relief, such as court-approved distributions to certain creditors and releases for various parties. However, bankruptcy courts cannot approve structured dismissals that do not strictly adhere to the Bankruptcy Code's payment priority scheme absent consent of affected parties (Czyzewski v Jevic Holding Corp., 137 S. Ct. 973 (2017)).

Chapter 7 Liquidations

A Chapter 7 case may be a viable alternative to Chapter 11 when the going-concern value of a debtor's business and properties has been lost. Chapter 7 may be preferable if the liquidity needed to administer the high costs of Chapter 11 or to continue or restart business operations is unavailable, or if incumbent management is untrustworthy, unreliable or unco-operative. Administrative expenses are generally lower in Chapter 7 than in Chapter 11.

Upon the commencement of a Chapter 7 case, the incumbent debtor management and directors are immediately replaced by an interim Chapter 7 trustee appointed by the US Trustee (11 USC. § 701(a)). The interim trustee exercises complete control over the debtor's estate and properties in accordance with the Bankruptcy Code. The interim trustee will continue as trustee unless creditors holding undisputed, non-contingent unsecured claims elect a different permanent Chapter 7 trustee of their own choosing (11 USC. § 702).

The Bankruptcy Code confers broad powers and duties on a Chapter 7 trustee. A Chapter 7 trustee must "investigate the financial affairs of the debtor" and liquidate and distribute the debtor's property "as expeditiously as possible" (11 USC. § 704). The Chapter 7 trustee collects and sells the debtor's assets in one or more 363 sales, and uses net proceeds (if any) to pay creditors in accordance with statutory priorities set by section 726 of the Bankruptcy Code. The statutory distribution priorities among various classes of creditors and equity interest holders is mandatory in Chapter 7 liquidation cases. A Chapter 7 trustee may make distributions to creditors without court approval of any formal distribution plan. At the conclusion of a Chapter 7 case, the Chapter 7 trustee is required to file a final report and a final account of its administration of the estate.

Creditors may exercise set-off rights in Chapter 7, subject to the automatic stay. Set-off rights are generally resolved before a creditor receives any distributions from the Chapter 7 trustee.

State Law Receiverships

An insolvent business may be liquidated in state law receivership proceedings under the supervision of a state court. For companies with significant or complicated assets across multiple jurisdictions, a Chapter 7 or 11 case under federal law may be more practical. Commencement of a state law receivership proceeding does not preclude the subsequent commencement of a bankruptcy case that may supersede and stay the receivership.

Under the laws of most states, state courts have authority to appoint receivers, either by statute or under their general equitable authority. The authority of state law receivers is typically limited to liquidating a company's assets and distributing the proceeds, but receivers may sometimes be empowered to operate a business.

State law receivership proceedings may be commenced when a creditor or shareholder requests a state court to appoint a receiver. State receivership laws and procedures vary greatly from state to state. After the receiver is appointed, it has jurisdiction over all property of the insolvent entity, except for real property located outside of the state.

The mechanics of receivership proceedings, including procedures for filing claims and determining the priority of such claims, are governed by applicable state laws and state court rules. Assets are distributed by the receiver to claimants on a pro rata basis by order of priority. This process is generally similar to a federal bankruptcy case, though the payment of the fees of the receiver takes first priority.

After a receivership is commenced, receivers file schedules of assets and liabilities, creditors may file claims (which the receiver may object to), notice is provided to creditors prior to a sale or other disposition of assets, and the receiver may pursue litigation on behalf of the insolvent entity. At the conclusion of the receivership proceeding, the receiver is required to file a final report and a final account of the distribution of the company's assets.

The duration of a receivership proceeding varies depending on the factual circumstances and applicable procedures. A court may use its equitable authority and judicial discretion to order a stay of litigation against an insolvent company in receivership. The procedures for rejecting executory contracts are not prescribed by statute, and may be determined by the court exercising jurisdiction over the receivership proceeding. Typically, there are no special rules or procedures governing creditor set-off rights in receivership proceedings.

Assignments for the Benefit of Creditors (ABCs)

In an ABC, a debtor company (as "assignor") executes an agreement with an experienced individual or entity fiduciary (the "assignee"), providing for the general assignment of all of the debtor's assets to the assignee as a trustee for the benefit of the debtor's creditors. An ABC functions much like a Chapter 7 liquidation under the Bankruptcy Code, but is subject to the laws of the state in which the assignment is made. Each state has statutes that govern ABCs in its jurisdiction, but common law rules usually inform practice. ABCs may either be court supervised or proceed without judicial supervision, depending on the law of the applicable state.

The assignment of all of a debtor's assets creates an estate. The transfer of assets is subject to any and all creditor claims and pre-existing valid liens and security interests encumbering such assets. The assignee as a fiduciary for creditors acquires all right, title and interest in the assigned assets for the purposes of liquidating the assets and making distributions to creditors in order of their respective state law priorities.

An ABC does not result in an automatic stay of creditor actions.

Dissolutions

State law dissolutions permit a business entity to wind-up its affairs, liquidate or dispose of its assets, pay its liabilities and claims, and conclude its existence. Dissolution and wind-up procedures vary from state to state and for differing forms of business entities. There is no stay of legal proceedings or creditor enforcement actions upon the commencement of a dissolution under state law.

Corporate dissolutions are typically commenced voluntarily by shareholder vote. In some circumstances, a corporation may also be dissolved involuntarily by court order. A corporation need not be insolvent to be dissolved. In a voluntary corporate dissolution, the board of directors adopts a dissolution resolution including a plan of liquidation that outlines the steps to be taken to dissolve the corporation and wind up its affairs. The dissolution resolution is subject to shareholder approval.

The winding-down process typically includes:

- prosecuting and defending or settling to conclusion all civil, criminal or administrative suits;
- disposing of the corporation's property;
- paying or making adequate provision for payment of the corporation's actual, disputed, contingent and foreseeable liabilities; and
- distributing remaining corporate assets (if any) to stockholders.

In a state law dissolution, the corporation may provide notice of the dissolution to all of its known creditors, and may also publish a notice of dissolution in a local newspaper. The notice will usually set a deadline by which creditors must alert the corporation of their claims in order to receive payment before any distributions are made to shareholders.

Although some states, such as Delaware, do not permit a shareholder to file a lawsuit to involuntarily dissolve a corporation, a state's attorney general is generally able to file a lawsuit to request the revocation or forfeiture of the corporation's charter if there has been an abuse of corporate power. If a corporation is dissolved as a result of such a court order, the liquidation plan will be prepared by a court-ordered trustee or receiver and may be subject to court approval.

The duration of a state law dissolution and wind-down process varies depending on the factual circumstances and applicable state law and procedures. Once the winding-up process is completed and all distributions are made, the corporation's dissolution is complete.

In a corporate dissolution, the corporation must generally abide by the terms of its existing contracts, including any termination rights. A company in a state law dissolution proceeding does not have a unilateral or statutory right to reject contacts. Creditors may exercise set-off rights in accordance with applicable state laws and any relevant contractual agreements between the creditor and the company. No special set-off rules apply during the dissolution process.

7.2 Distressed Disposals

The manner in which business assets are sold, or otherwise disposed of, in a liquidation – and who has authority to make such dispositions – depends on the type of liquidation proceeding.

Dispositions in Receiverships

In a receivership under state law, the court-appointed receiver generally has exclusive authority to negotiate and execute any sale of the company's assets, which must then be reported to the court. State law receiverships may allow for certain "free and clear" sale transactions.

Dispositions in an ABC

In an ABC, the designated assignee takes title to all of the assignor company's assets for the benefit of its creditors. The assignee exercises its discretion about how best to liquidate assets and maximise their value. Asset sales by an ABC assignee must comply with applicable laws, and will be subject to the liens of secured creditors. Usually, applicable state law does not permit an assignee to sell "free and clear" of liens, so secured creditor consent to such free and clear sales must be obtained. If the ABC is court-supervised, a sale – especially of assets subject to liens – may require court approval.

Dispositions in Dissolutions

In state law dissolutions, the persons authorised by the company's directors to administer the dissolution and wind-up of the company's affairs will negotiate and consummate asset sales and dispositions in accordance with the company's plan of dissolution. No judicial approval is required, unless the dissolution has been ordered by a court or is subject to judicial supervision. No "free and clear" asset sales are available in a corporate dissolution, and no special credit bidding rules apply.

Bankruptcy Abandonment of Property

Under section 554 of the Bankruptcy Code, with the approval of the bankruptcy court, a Chapter 11 debtor, or a Chapter 11 or Chapter 7 trustee, may abandon property that is burdensome or of inconsequential value.

363 Sales in Bankruptcy Cases

In Chapter 11 and Chapter 7 cases, the debtor or trustee, as applicable, is authorised to sell assets outside the ordinary course of business with bankruptcy court approval, pursuant to section 363 of the Bankruptcy Code. Section 363 sales often include the assumption and assignment to a purchaser of particular executory contracts and unexpired leases if the purchaser wants to assume the debtor's rights and obligations under such agreements.

A bankruptcy court will approve the use or sale of debtor property outside the ordinary course of business as long as it is a sound exercise of the debtor's business judgement and is in the best interests of the debtor's estate. In deciding whether to approve a sale or use of debtor property, a court may consider numerous factors, such as:

- the proportionate value of the assets to be sold compared to the value of the debtor's estate as a whole;
- the amount of time elapsed since the commencement of the bankruptcy case;
- the likelihood that a Chapter 11 plan of reorganisation will be proposed and confirmed in the near future;
- the effect of the proposed disposition on future plans of reorganisation;
- the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property;
- which of the alternatives of use, sale or lease the proposal envisions; and
- whether the assets to be sold are increasing or decreasing in value.

Section 363 of the Bankruptcy Code permits both public and private sale transactions. Bankruptcy courts generally favour a public auction process, to ensure that a sale transaction is fair and market-tested. A bankruptcy court-approved 363 sale process is flexible and tailored to maximise value in light of the particular facts and circumstances of the case.

Debtors and bankruptcy trustees often seek advance bankruptcy court approval of bidding procedures that will apply to a particular 363 sale. Bidding procedures may include the following:

- "qualified" bidder requirements, including execution of a confidentiality agreement, statement of bona fide interest and written evidence of available cash or financing for the transaction;
- procedures for conducting due diligence, including a time period during which due diligence must be completed, a confidential data room process and procedures for requesting additional information;
- requirements for "qualified" bids, including the deadline for submitting bids, required cash deposits and the form of purchase agreement;
- auction rules, including the auction time and place, overbid and minimum bidding requirements, allowance of "credit bids" and the involvement/attendance of interested parties; and
- parameters for determining the successful bid, including selection, timing and criteria, and any required consultations with the official creditors committee and other key parties in interest.

In many 363 sales, a potential purchaser is selected as the "stalking horse" bidder. The initial "stalking horse bid" sets a floor value for the sale and assures that the debtor has a sale transaction to consummate before further efforts are undertaken to seek a higher bid. It is common for a secured creditor to be the stalking horse bidder when its collateral is being sold. Section 363(k) of the Bankruptcy Code specifically permits a secured creditor that is a prospective asset buyer to credit as purchase price (or "credit bid") the amount of any claims it may have that are secured by the property being sold. Credit bidding rights give a secured creditor some control over a sale of collateral property to ensure the collateral is being sold for the highest price. The right to credit bid, however, is not absolute, and the Bankruptcy Code permits the bankruptcy court "for cause" to deny a purchaser the right to credit bid. A credit bid might be disallowed if it would chill bidding for the debtor's assets, or when the validity of the bidder's asserted secured claim is in dispute at the time of the proposed sale. If the secured creditor is the successful bidder, the creditor's claim is reduced by the amount of its credit bid.

A stalking horse bidder usually receives bidder protections in exchange for its agreement to make an initial firm bid, and to compensate it for its due diligence costs and accepting the risk of being outbid. Common bidder protections include a break-up fee, which typically ranges from 1-3% of the value of the stalking horse bid, plus an expense reimbursement, both of which are payable in accordance with the negotiated terms of the bidder protections, usually if a transaction is consummated with an alternative buyer. A limited "no shop" period may protect a stalking horse bidder during the time between the execution of its purchase agreement and when the bankruptcy court approves the bidder protections. Bidder protections are not immediately enforceable upon the execution of a stalking horse purchase agreement; rather, they must be approved by the bankruptcy court.

An expeditious 363 sale may be accomplished by negotiating and executing a purchase agreement with a stalking horse bidder prior to commencement of a Chapter 11 case, and then seeking bankruptcy court approval of the transaction promptly after the Chapter 11 case is commenced. An officer of the debtor will execute the sale agreement before bankruptcy, but the company's obligations will remain subject to bankruptcy court approval of the agreement.

Parties in interest in a bankruptcy case may object to a proposed 363 sale, so there is a risk that a proposed sale may not be approved by the bankruptcy court. Under section 363(m) of the Bankruptcy Code, a sale of debtor property to a good faith purchaser generally cannot be unwound after the sale closes, even if the bankruptcy court's approval of the sale is overturned on appeal.

Section 363 sales are often viewed favourably by potential purchasers for the following reasons:

- 363 sales are generally quicker and less expensive than the process needed to confirm a Chapter 11 plan;
- purchasers have the ability to select specific assets they wish to purchase and the liabilities they are willing to assume;
- assets can generally be sold "free and clear" of all liens, claims, interests and encumbrances if the requirements of section 363(f) of the Bankruptcy Code are satisfied;
- bankruptcy court approval of a 363 sale and "good faith" findings by the bankruptcy court under section 363(m) will insulate the sale from future attack; and
- the waiting period for US antitrust approval may be shortened to 15 days.

In a 363 sale, a purchaser may acquire assets "free and clear" of all liens, claims, interests and other encumbrances on the assets. A "free and clear" sale is permitted as long as one of five conditions in section 363(f) of the Bankruptcy Code is satisfied:

- the applicable non-bankruptcy law would permit a sale of such property free of the interest;
- consent of the non-debtor party holding the interest;
- the interest is a lien and the sale price is greater than the aggregate value of all liens on the property being sold;
- the interest is in bona fide dispute; or
- the entity asserting an interest in the assets could be compelled in a legal or equitable proceeding to accept a money satisfaction of such interest.

Whether one or more of the section 363(f) conditions is satisfied with respect to particular interests or liabilities may often be disputed. Whether section 363(f) permits a 363 sale free and clear of all successor liability claims is not clear.

Undisclosed and unauthorised agreements among potential bidders and collusive bidding arrangements may be illegal or even criminal. Under section 363(n) of the Bankruptcy Code, such agreements are grounds to avoid a 363 sale or to recover additional consideration from the purchaser.

7.3 Failure to Observe Terms of Agreed/Statutory Plan

The consequences for a company or creditor failing to comply with the terms of a confirmed Chapter 11 plan are described in **6.15 Failure to Observe the Terms of Agreements**.

7.4 Priority New Money During the Statutory Process

In both Chapter 11 and Chapter 7 cases, new money may be loaned to a debtor, Chapter 11 trustee or Chapter 7 trustee, pursuant to section 364 of the Bankruptcy Code. See **6.10 Priority New Money**.

Usually, there are no special rules or restrictions that apply to possible new money financings in state law receiverships, ABCs and dissolutions that would prohibit receivers, assignees or others in charge of a state law liquidation from borrowing or accepting the funds that might be needed to complete a liquidation process.

7.5 Insolvency Proceedings to Liquidate a Corporate Group

In Chapter 11 and Chapter 7 cases under the Bankruptcy Code, joint administration of multiple bankruptcy cases commenced by affiliated business group entities is permitted. See **6.6 Use of a Restructuring Procedure to Reorganise a Corporate Group**.

7.6 Organisation of Creditors or Committees

In a Chapter 11 case, an official committee of unsecured creditors is appointed by the US Trustee. See **6.3 Roles of Creditors**.

In a Chapter 7 case, the role of an official creditors' committee is more limited than an official Chapter 11 creditors' committee because a Chapter 7 creditors' committee is not authorised to take any substantive action without first consulting with the Chapter 7 trustee, and is not entitled to have any professional fees and expenses paid by the debtor's estate. In a Chapter 7 case, the members of an official committee of unsecured creditors are elected by a vote of creditors that are entitled to vote to select the Chapter 7 trustee under section 702(a) of the Bankruptcy Code. The official committee of unsecured creditors in a Chapter 7 case may have between three and 11 members, all of whom must hold an allowable unsecured claim against the debtor (11 USC. § 705).

There are no official committees of creditors in a state law receivership, ABC or corporate dissolution proceedings.

7.7 Use or Sale of Company Assets During Insolvency Proceedings

In Chapter 11 and Chapter 7 cases, a Chapter 11 debtor, or a Chapter 11 or Chapter 7 trustee, may use estate property in the ordinary course of business without court approval. Any use or sale of estate property outside the ordinary course of business requires bankruptcy court approval (11 USC. § 363(b)). See **6.8 Asset Disposition and Related Procedures** and **7.2 Distressed Disposals**.

In state law receivership, ABC and dissolution proceedings, whether judicial approval of a use or sale of assets is required – or whether any other condition (including secured creditor consent to use or sell secured creditor collateral) applies – will depend on the particular state laws that apply and whether a proceeding is subject to judicial supervision.

8. International/Cross-border Issues and Processes

8.1 Recognition or Relief in Connection with Overseas Proceedings

Foreign, non-US companies that meet the eligibility requirements set forth in the Bankruptcy Code may commence plenary Chapter 11 or Chapter 7 bankruptcy cases in US bankruptcy courts. Many foreign business entities commence Chapter 11 proceedings in the US by showing that they conduct business or hold property located in the US. If a company commences a plenary insolvency proceeding outside the US, the Bankruptcy Code also provides procedures for the foreign proceeding to be recognised in US bankruptcy courts and, in that case, affords the non-US debtor certain rights and protections.

Eligible non-US insolvency proceedings are recognised in the US through Chapter 15 of the Bankruptcy Code, which provides for the commencement of an ancillary US bankruptcy case to assist a foreign court in a foreign insolvency proceeding. Chapter 15 is based on the United Nations Commission on International Trade Law's Model Law on Cross-Border Insolvency. More than 40 nations or territories have adopted legislation based on this Model Law, which, at its core, is premised on international comity. Much like a Chapter 11 case, a Chapter 15 bankruptcy case serves both protective and facilitative functions. A Chapter 15 bankruptcy case commenced in a US bankruptcy court by or for a foreign non-US debtor that has commenced foreign insolvency proceedings outside the US serves to protect the non-US debtor by allowing it to stay both actions against its assets in the US and litigation pending against it in US courts. A Chapter 15 case also facilitates a foreign debtor's restructuring efforts by allowing it to administer, sell or transfer property within the jurisdiction of the US, and to take other actions in furtherance of its restructuring.

By filing a petition under Chapter 15 of the Bankruptcy Code, a "foreign representative" petitions a US bankruptcy court for recognition of a "foreign proceeding". A "foreign representative" is a representative who is authorised in a foreign proceeding to administer the reorganisation or liquidation of the foreign debtor's assets or affairs, or to act in a Chapter 15 case as a representative of such foreign proceeding (11 USC. § 101 (24)). A "foreign proceeding" is a "collective" judicial or administrative proceeding in a foreign country under the supervision of a non-US court and the laws of that jurisdiction relating to reorganisation, insolvency or liquidation of the debtor. In order to be eligible to seek recognition under Chapter 15, a non-US entity must meet the US Bankruptcy Code's eligibility requirements: it must either be domiciled, conduct business or hold property in the US.

Upon the filing of a Chapter 15 petition, the bankruptcy court will hold a hearing to consider entering an order of recognition of the foreign proceeding, either as a foreign "main" proceeding or as a foreign "non-main" proceeding. The distinction between "main" and "non-main" is crucial. If the foreign proceeding is recognised as a main proceeding, because the foreign proceeding is in the country where the debtor's centre of main interests is located, the US automatic stay goes into effect and much of the core relief available to a Chapter 15 debtor is granted automatically. On the other hand, if a Chapter 15 proceeding is recognised as a foreign non-main proceeding (ie, the centre of main interests of the foreign debtor is located in a third country), all relief requested in the Chapter 15 case is left to the discretion of the US bankruptcy court.

For a foreign proceeding to be recognised as a main proceeding, the debtor's "establishment" (ie, a place of operation from which the debtor conducts non-transitory economic activity) in the country of the foreign proceeding must be the debtor's centre of main interest. It is a rebuttable presumption that the debtor's centre of main interest is the country of the debtor's registered office. The presumption may be rebutted using evidence of the location of the debtor's headquarters, its management, its primary assets, or the creditors most likely to be affected by the case. In making the centre of main interest determination, a US bankruptcy court may also consider which foreign jurisdiction's laws will apply to most disputes between the debtor and its creditors.

8.2 Co-ordination in Cross-border Cases

One of the policies underlying Chapter 15 is to encourage co-operation between US courts and their non-US counterparts. To effectuate this policy, and to facilitate co-ordination and communication between courts, US courts have employed a number of procedures with varying degrees of formality in Chapter 15, Chapter 11 and other cases. A bankruptcy court may appoint a person or entity to act at the direction of the court, or may enter into a cross-border protocol or cross-border agreement with a non-US court. Protocols and agreements clarify and allocate the responsibilities of the relevant US and foreign courts over certain issues, and establish methods by which the courts will communicate. Less formal arrangements include communication of information and developments by methods considered appropriate by the bankruptcy court, including statements made on the record at the relevant proceedings by the parties in interest.

8.3 Rules, Standards and Guidelines

Debtors in Chapter 15 cases will often seek to allocate and clarify the scope of authority of the various courts in Chapter 15 and plenary cases, sometimes through a cross-border protocol. Generally, US courts will respect the decisions and procedures of foreign jurisdictions and tribunals so long as they are not "manifestly contrary to the public policy of the United States" (11 USC. § 1506). This public policy exception to the recognition of foreign decisions has been interpreted narrowly and will generally only apply in exceptional circumstances.

While Chapter 15 serves important facilitative and protective functions, it was not designed to reconcile differences between the insolvency regimes of various nations. It is important for creditors to understand their rights and remedies under various insolvency regimes because a debtor's decision to file a plenary proceeding in a certain jurisdiction may operate to alter such rights and remedies, even if the debtor also files an ancillary proceeding, such as a Chapter 15 case.

8.4 Foreign Creditors

As described above, foreign creditors are treated no differently than domestic creditors under the Bankruptcy Code. See **4.4 Foreign Secured Creditors**.

9. Trustees/Receivers/Statutory Officers

9.1 Types of Statutory Officers

Federal laws and various state statutes provide for and require the appointment of individuals or entities to function in executive, supervisory, fiduciary or representative roles in connection with bankruptcy, insolvency and similar proceedings governed by federal or state laws.

Under federal bankruptcy law, these individuals and entities include, among others, bankruptcy court judges, the US Trustee, official committees of unsecured creditors or equity holders, Chapter 7 and 11 trustees, and examiners.

Various federal and state law-based insolvency proceedings, including receiverships, ABCs and state law dissolutions, involve statutory officers who are appointed judicially or otherwise. For instance, a receiver is appointed in state court receiverships; in ABCs, an assignee is appointed; for banks in receivership, the FDIC is appointed as receiver for the failed bank; and various state laws govern who may be duly authorised to administer the wind down of dissolved business entities and insolvent insurance companies.

9.2 Statutory Roles, Rights and Responsibilities of Officers

Bankruptcy Court Judges

Federal bankruptcy court judges preside over business reorganisation and liquidation cases under the Bankruptcy Code. Bankruptcy courts are units of the federal court system, and exercise subject matter jurisdiction over bankruptcy cases. Bankruptcy judges play the paramount official role in bankruptcy cases. Among other things, they approve all debtor-company transactions that are outside the ordinary course of business, issue orders authorising the employment of professionals, decide numerous contested matters that arise in a case, and ultimately decide whether proposed Chapter 11 plans of liquidation or reorganisation may be confirmed in compliance with the Bankruptcy Code.

United States Trustee

The US Trustee is an official in the US Department of Justice who acts as a governmental "watchdog" in Chapter 7 and 11 cases. Among other things, the US Trustee interviews the debtor, appoints members of official committees, reviews professional employment and fee applications, and reviews, comments on and sometimes objects to motions filed in the bankruptcy case if it believes the relief sought is inconsistent with the Bankruptcy Code, other federal law or public policy.

Creditors' Committee

An official committee of unsecured creditors in a Chapter 11 case monitors developments in the Chapter 11 case and acts as it deems appropriate to advance the interests of unsecured creditors. See **6.3 Roles of Creditors**. An official creditors' committee in a Chapter 7 case functions differently. See **7.6 Organisation of Creditors or Committees**.

Trustee

In Chapter 7 liquidation cases, a trustee displaces the debtor's existing management, and liquidates the assets of the estate and distributes the proceeds to creditors. A Chapter 7 trustee has the right to employ attorneys and other professionals, with bankruptcy court approval.

Similarly, in the rare instance where a Chapter 11 trustee is appointed, the trustee takes on the roles and responsibilities of the debtor, displaces incumbent management, controls the debtor's properties and estate, is responsible for managing and operating the debtor's business, and files all reports and other pleadings, including a plan of reorganisation or liquidation. A Chapter 11 trustee has the right to employ attorneys and other professionals, with bankruptcy court approval.

Examiner

An examiner may be appointed in a Chapter 11 case to investigate specific matters related to the debtor as ordered by the bankruptcy court. For instance, an examiner may investigate questionable pre-bankruptcy transactions, possible litigation claims against third parties, and allegations of fraud, dishonestly, incompetence, misconduct or mismanagement by current or former management. An examiner reports its findings to the bankruptcy court, and may employ professionals to assist in its duties.

Assignee

In a state law ABC, the assignee is the person appointed to act as a fiduciary for creditors. The assignee liquidates the debtor's assets and distributes the proceeds to creditors in accordance with their respective priorities under applicable state law.

Receiver

In a state law receivership, a receiver is appointed by a state court, most often to liquidate an insolvent business when a creditor or shareholder successfully requests a receivership. The receiver's authority is governed by the applicable state law and orders of the court.

FDIC, as Receiver

In an FDIC receivership, the FDIC acts as a receiver for a failed bank. The FDIC's authority and role are governed by federal banking law, specifically the Federal Deposit Insurance Act. As receiver, the FDIC assumes the task of selling/collecting assets of a failed bank and settling its debts, including claims for deposits in excess of the insured limit.

9.3 Selection of Officers

United States Trustee

The US Trustee is a federal official appointed by the President as an official in the US Department of Justice.

Creditors' Committee

Bankruptcy Code section 1102 gives the US Trustee authority to appoint members of an unsecured creditors' committee in Chapter 11 cases. Members of an official creditors' committee in a Chapter 7 case are selected differently. See **6.3 Roles of Creditors** and **7.6 Organisation of Creditors or Committees**.

Trustee

In liquidation cases, an initial interim Chapter 7 trustee is appointed by the US Trustee at the outset of the case. The interim trustee is selected from a panel of pre-qualified trustees in the district where the case is filed, and often remains the Chapter 7 trustee for the entirety of the case. However, the Bankruptcy Code allows creditors to elect a different trustee at the section 341 meeting of creditors required by the Bankruptcy Code.

If a trustee is ordered in a Chapter 11 case, the US Trustee typically selects and appoints the Chapter 11 trustee in consultation with key parties in interest, subject to final court approval.

Examiner

In Chapter 11 cases, the appointment of an examiner may be ordered by the bankruptcy court upon the request of a party in interest or the US Trustee, in which case the US Trustee selects and appoints the examiner in consultation with key parties in interest, subject to final court approval.

10. Advisers and Their Roles

10.1 Typical Advisers Employed

In the United States, any sizeable out-of-court business restructuring or in-court bankruptcy case will involve numerous restructuring professionals who advise and assist the financially distressed company, its major stakeholders and other parties in interest on strategic, legal, financial, operational and administrative restructuring issues, tasks and decision-making. Professionals include attorneys, accountants, financial advisers, investment bankers, and others. A company may also employ a specialised business consultant, a chief restructuring officer or others with industry-specific expertise or general experience in operational restructurings to help run the company while it is undergoing an out-of-court or formal bankruptcy process. In large Chapter 11 cases, claims agents are employed to assist with bankruptcy case administration. Public relations firms may be employed as well.

10.2 Compensation of Advisers
In bankruptcy, who employs a professional determines how the professional is paid. An adviser who is retained by a debtor or an official committee in a Chapter 11 case may seek payment from the debtor's estate by filing a fee application. The Bankruptcy Code details a non-exhaustive list of factors that a bankruptcy court may consider in awarding fees to professionals employed by the debtor or an official committee. While any party in interest may object to a professional fee application, the US Trustee typically plays a significant role in screening fee applications and ensuring compliance with the Bankruptcy Code and other applicable professional compensation rules. In larger Chapter 11 cases, a fee examiner may be appointed by the court to monitor and report to the court on professional fees. Professional fees and expenses approved by a bankruptcy court are granted administrative expense priority, meaning they must be paid ahead of general unsecured creditor claims.

While the employment of professionals by individual parties in interest in a Chapter 11 case does not require bankruptcy court approval, those parties must also usually pay the fees and expenses of their retained professionals.

10.3 Authorisation and Judicial Approval
The Bankruptcy Code requires that a debtor, an official creditors' committee, bankruptcy trustees and certain other parties must obtain bankruptcy court approval to retain particular professionals, and such professionals must satisfy statutory requirements. When a debtor company retains an attorney to represent and advise the company as its bankruptcy counsel, the Bankruptcy Code requires the attorney to meet certain requirements and disclose any potential conflicts.

Section 327 of the Bankruptcy Code governs employment of restructuring professionals, and includes the requirement that an employed professional is a "disinterested person" (as defined in section 101(14) of the Bankruptcy Code) and does not hold an interest adverse to the estate. In order to be disinterested under the Bankruptcy Code, an attorney or other professional adviser must not be an equity holder, director, officer or employee of the debtor. While the Bankruptcy Code does not expressly define "adverse interest", the "no adverse interest" requirement has been applied by many courts to mean, at a minimum, that a professional cannot simultaneously represent a creditor and the debtor in a Chapter 11 case.

A professional retention application must include a declaration from the proposed professional disclosing its connections with the debtor and all other parties in interest. The required disclosures allow the bankruptcy court to assess whether a prospective professional has any conflicts that might be disqualifying.

A debtor may retain special counsel to handle matters in its bankruptcy case that might pose a potential conflict for the debtor's primary restructuring counsel. The employment of such special conflicts counsel is common in large, complex Chapter 11 cases where hundreds or thousands of creditors and other parties in interest make it difficult for any single law firm to be entirely free of potential conflicts.

A Chapter 11 debtor company almost always employs "ordinary course" professionals – ie, non-restructuring professionals who do not advise on core restructuring matters. Ordinary course professionals have typically been pre-bankruptcy advisers to the debtor, and provide advice and representation on ordinary course, non-bankruptcy matters. Debtors retain and compensate their ordinary course professionals in accordance with streamlined procedures routinely approved by bankruptcy courts.

10.4 Duties and Responsibilities
Attorneys assist, advise and represent a company in out-of-court restructurings and in in-court bankruptcy cases. In both of those circumstances, the company's attorneys provide advice on strategic alternatives and represent the company in the negotiation and documentation of restructuring transactions and agreements.

If a Chapter 11 bankruptcy case is commenced, counsel prepares and files bankruptcy petitions and motions seeking the court orders required to operate the debtor's business, advises the Chapter 11 company and its board on their bankruptcy duties and obligations, advises on strategic case issues including the formulation of a Chapter 11 plan, negotiates with lenders, creditors and other parties in interest, represents the company in litigation and settlement discussions, and generally works with other debtor professionals to co-ordinate numerous matters that affect the outcome of the Chapter 11 case.

A Chapter 11 company's other professionals (including investment bankers and financial and business advisers) work with management and bankruptcy counsel as a team to advance the company's Chapter 11 goals as determined by the company's board and senior management.

As noted above, restructuring professionals may also be hired by other stakeholders in the debtor's Chapter 11 case.

11. Mediations/Arbitrations

11.1 Utilisation of Mediation/Arbitration

Arbitrations and mediations, sometimes referred to as "alternative dispute resolution", are sometimes agreed to in commercial and other transaction agreements, and in disputed matters generally as an alternative to litigation. In the restructuring and insolvency context, arbitration may be employed when the parties have previously agreed to arbitrate their disputes under an agreement incorporating an enforceable arbitration clause. Mediations, on the other hand, are routinely ordered by bankruptcy courts to resolve disputes arising in Chapter 11.

11.2 Mandatory Arbitration or Mediation

A bankruptcy court may order mandatory arbitration in a bankruptcy case only when a pre-petition contract contains a mandatory arbitration provision. Bankruptcy courts have the power to order mandatory mediation of disputes.

11.3 Pre-insolvency Agreements to Arbitrate

Generally, pre-bankruptcy agreements to arbitrate are enforceable in bankruptcy. When deciding whether to enforce an arbitration clause in a pre-petition contract between a debtor and a non-debtor, the bankruptcy court will first seek to determine whether the dispute to be arbitrated is a "core" matter in the bankruptcy case or a "non-core" matter. A contract dispute is "core" if it is unique to or uniquely affected by the bankruptcy proceedings, or if it directly affects a core bankruptcy function. If the dispute is "core", a bankruptcy court need not honour a pre-insolvency arbitration clause. If the dispute is "non-core", an arbitration clause in a pre-petition agreement will generally be enforced by a bankruptcy court and will be referred to arbitration.

11.4 Statutes Governing Arbitration/Mediation

Alternative dispute resolution is recognised and enforced by federal statutes and procedural rules governing the operation of the United States judiciary. The Federal Arbitration Act, 9 USC. § 1 et seq., applies in both bankruptcy and non-bankruptcy contexts, and provides that federal courts will honour arbitration agreements between parties to a dispute, and limits judicial review of arbitral decisions. The Alternative Dispute Resolution Act, 28 USC. § 651, requires courts to adopt local rules authorising the use of mediation and arbitration in civil actions. Many federal courts, including bankruptcy courts, have adopted rules that facilitate mediations and arbitrations.

11.5 Appointment of Arbitrators

In bankruptcy mediations, the mediator is usually selected by mutual agreement of the parties to the mediation and then appointed by the bankruptcy court.

When mandatory arbitration is required by pre-petition contracts, the process for choosing and appointing the arbitrator is usually set forth in, and governed by, the pre-petition contract. Commonly, an arbitration provision may provide for three arbitrators, one selected by each of the parties to the dispute, with the third arbitrator selected by the two arbitrators selected by the parties.

12. Duties and Personal Liability of Directors and Officers of Financially Troubled Companies

12.1 Duties of Directors

In the United States, state and federal laws, statutes and judicial decisions impose duties on officers, directors and managers of business entities. Such duties generally apply regardless of whether or not a company is financially troubled. Failure to satisfy such duties may result in personal liability.

At the federal level, non-bankruptcy statutes (such as Sarbanes-Oxley and the Dodd-Frank Act) impose duties that may be implicated when a company, especially a publicly traded company, experiences financial distress or bankruptcy. Federal court decisions applying the federal statutes inform the potential duties and liabilities that may apply in particular circumstances. Such non-bankruptcy federal statutory duties and liabilities are outside the scope of this commentary.

Federal court decisions indicate that trustee-like duties apply to officers, directors and managers when a corporation is in bankruptcy. For instance, in Pepper v. Litton, 308 US 295, 307 (1939), the United States Supreme Court stated that, in bankruptcy, the "standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation – creditors as well as shareholders." In CFTC v. Weintraub, 471 US 343 (1985), the Supreme Court said that "bankruptcy causes fundamental changes in the nature of corporate relationships. One of the painful facts of bankruptcy is that the interests of shareholders become subordinated to the interests of creditors... [T]he debtor's directors bear essentially the same fiduciary obligation to creditors and shareholders as would the trustee for a debtor out of possession. Indeed, the willingness of courts to leave debtors in possession 'is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee'" (Id. at 355).

State laws generally provide for potential duties and liabilities, including fiduciary duties, of officers, directors and managers of corporations and other business entities, that apply regardless of whether or not a company is financially troubled or in bankruptcy. As to which state's fiduciary laws apply to officers and directors in a particular case, the "internal affairs doctrine" generally governs, and is a conflicts of laws principle that recognises that only one state should have the authority to regulate a corporation's internal affairs – matters particular to the relationships among or between the corporation and its current officers, directors and shareholders – because, otherwise, a corporation could be faced with conflicting demands.

The variety of numerous state law legal standards and judicial decisions addressing fiduciary duties cannot be canvassed in this commentary, but the law of the state of Delaware is informative and will be described here because a majority of publicly traded corporations in the United States are formed under Delaware law. Courts elsewhere sometimes look to Delaware law and judicial decisions when applying and interpreting their own corporate fiduciary laws.

Generally, officers, directors and managers of a financially distressed or insolvent entity who seek to fulfil their fiduciary duties should act with due care, in an informed manner, and with the benefit of professional advice after considering all reasonable alternatives, to maximise the value of the company for the benefit of all residual claimants – rather than focusing on who might have legal standing to assert a claim for breach of fiduciary duties.

Fiduciary Duties of Directors and Officers of Delaware Corporations

The Delaware General Corporation Law (DGCL) states that, unless otherwise provided by law or in the company's Certificate of Incorporation, "[t]he business and affairs of every corporation organised under this chapter shall be managed by or under the direction of a board of directors." In carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders. Directors owe both a duty of loyalty and a duty of care.

Officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty.

Duty of loyalty

The duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally. A classic example of conduct implicating the duty of loyalty is when a fiduciary either appears on both sides of a transaction or receives a personal benefit not shared by all shareholders. A director must remain independent in his or her decision making. Independence means that a director's decision is based on the merits of the subject before the board rather than extraneous considerations or influences.

The duty of loyalty includes, among other things, the duty to act in good faith. Violations of the duty to act in good faith include so-called "subjective bad faith" – ie, fiduciary conduct motivated by an actual intent to do harm – and intentional dereliction of duty, which is a conscious disregard for one's responsibilities. Such conduct is "non-exculpable" and "non-indemnifiable".

Duty of care

The duty of care requires directors to use the amount of care that an ordinarily careful and prudent person would use in similar circumstances. It requires directors to consider all material information reasonably available in making business decisions, and to reasonably inform themselves of alternatives. The greater the significance of the decision, the greater the requirement to source and consider alternatives. To be found liable for a breach of the duty of care, Delaware law requires that directors have acted with gross negligence. Delaware courts have stated that the definition of gross negligence used in Delaware corporate law jurisprudence is "extremely stringent" and "means reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason." Due care in the decision-making context is "process" due care only.

Under Delaware law, a corporation may include a provision in its Certificate of Incorporation that exculpates its directors from monetary liability arising from a breach of the duty of care. This exculpation does not apply to officers of a corporation.

Standards of Review for Fiduciary Duty Claims Under Delaware Law

Depending on the allegations and the nature of the challenged decision, claims for breach of fiduciary duty are analysed under one of several different standards of review, including the business judgement rule, "intermediate" scrutiny under the Delaware Supreme Court decisions in Unocal and Revlon, and entire fairness.

Business judgement rule

The business judgement rule is a corollary common law precept to the fundamental statutory principle that the business affairs of a corporation are managed by or under the direction of the board of directors. The business judgement rule has been described as a presumption, a substantive rule of law and a procedural guide for litigants. As a presumption, the business judgement rule holds that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. As a substantive rule of law, the business judgement rule provides that there is no liability for an injury or loss to the corporation arising from corporate action when the directors, in authorising such action, proceeded in good faith and with appropriate care. As a procedural guide, the business judgement rule places the initial burden on the plaintiff to rebut the presumption of the business judgement rule. The plaintiff must prove by a preponderance of the evidence that the directors' decision involved a breach of fiduciary duty. If a plaintiff is successful, the burden then shifts to the defendants to prove the entire fairness of the transaction. It does not create liability per se. The Delaware Supreme Court has stated that the business judgement rule presumptions apply to both directors and officers.

If the business judgement rule presumptions are not rebutted, directors' business decisions will not be disturbed if they can be attributed to any rational business purpose. A plaintiff who fails to rebut the business judgement rule presumptions is not entitled to any remedy unless the transaction constitutes waste. A claim of waste will arise only in the rare case where directors irrationally squander or give away corporate assets.

Intermediate scrutiny

Delaware law recognises an "intermediate standard of review", under which Delaware courts are instructed to undertake enhanced scrutiny to review the reasonableness of a board's decision to undertake certain corporate actions, if disputed. The reasonableness standard permits a reviewing court to address inequitable action even when directors may have subjectively believed that they were acting properly. Delaware courts have stated that reasonableness review does not "permit a reviewing court to freely substitute its own judgement for the directors", nor provide "a license for law-trained courts to second-guess reasonable, but debatable, tactical choices that directors have made in good faith."

For instance, under Revlon, enhanced judicial scrutiny of the reasonableness of director decisions under an intermediate standard of review may be applied when a corporation's decision to undertake certain transactions is challenged:

[T]he directors of a corporation "have the obligation of acting reasonably to seek the transaction offering the best value reasonably available to the stockholders" … in at least the following three scenarios: (1) "when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganisation involving a clear break-up of the company"; (2) "where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company"; or (3) when approval of a transaction results in a "sale or change of control."

If director actions are challenged in these circumstances, Delaware courts are required "to examine whether a board's overall course of action was reasonable under the circumstances as a good faith attempt to secure the highest value reasonably attainable. There is no single blueprint that a board must follow to fulfill its duties, and a court applying enhanced scrutiny must decide whether the directors made a reasonable decision, not a perfect decision."

Entire fairness

Under the "entire fairness" standard of judicial review, defendant directors must establish to the court's satisfaction that the challenged transaction was the product of both fair dealing and fair price. Fair dealing embraces questions of when the transaction was timed, how it was initiated, structured, negotiated and disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. Fair price relates to the economic and financial considerations of the proposed transaction, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.

Unless there are strict procedural requirements, in transactions where a controlling stockholder stands on both sides, there is a presumption that the transaction is reviewed under the entire fairness standard of review.

Exculpation and Indemnification for Directors and Officers Under Delaware Law

The DGCL includes two ways by which a corporation can shield directors from personal monetary liability for breaches of fiduciary duty: an exculpation provision under Section 102(b)(7) of the DGCL; and indemnification under Section 145 of the DGCL.

Section 102(b)(7)

Under 8 Del. C. § 102(b)(7), a Delaware corporation can include in its Certificate of Incorporation, except as otherwise described, "[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director." Notably, Section 102(b)(7) precludes exculpating directors for, among other things, "any breach of the director's duty of loyalty to the corporation or its stockholders"; "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law"; and "any transaction from which the director derived an improper personal benefit." Delaware courts have stated that Section 102(b)(7) "bars the recovery of monetary damages from directors for a successful shareholder claim that is based exclusively upon establishing a violation of the duty of care." Section 102(b)(7) does not apply to officers.

Section 145

Under 8 Del. C. § 145, a Delaware corporation is granted broad and flexible powers to indemnify a person "who was or is a party or is threatened to be made a party" to a proceeding "by reason of the fact that the person is or was a director [or] officer … of the corporation." This indemnification extends to both the costs of defending and certain types of liability incurred in such a lawsuit. The statute sets "two boundaries for indemnification".

The statute requires a corporation to indemnify a person who was made a party to a proceeding by reason of his service to the corporation and has achieved success on the merits or otherwise in that proceeding. At the other end of the spectrum, the statute prohibits a corporation from indemnifying a corporate official who was not successful in the underlying proceeding and has acted, essentially, in bad faith.

For any circumstance between the extremes of "success" and "bad faith", the DGCL leaves the corporation with the discretion to determine whether to indemnify its officer or director. Between the boundaries of "success" and "bad faith", a corporation may choose to undertake permissive indemnification of an officer or director.

In addition to indemnification, Section 145 also authorises corporations to advance to an officer or director the costs and expenses incurred in defending against a lawsuit subject to Section 145 so long as the corporation receives "an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation."

Fiduciary Duties of Managers of a Delaware Limited Liability Company

Managers and members of a Delaware limited liability company (an LLC) have traditional fiduciary duties, but those duties may be modified or limited by the LLC agreement.

Until recently, the Delaware Limited Liability Company Act (the "Act") did not expressly impose fiduciary duties on managers or members of an LLC. Rather, Section 18-1101(c) of the Act provided that "to the extent that, at law or in equity, a member or manager has duties (including fiduciary duties)", such duties may be expanded, restricted or eliminated by provisions in the LLC agreement, provided that the LLC agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

In 2013, however, the Delaware General Assembly amended the Act to make it clear that traditional fiduciary duties applied to members and managers of LLCs under the rules of law and equity relating to fiduciary duties. Accordingly, if an LLC agreement is silent regarding these matters, traditional fiduciary duties will be implied as a matter of Delaware law.

The two "cornerstone" fiduciary duties that would apply are the duty of care and the duty of loyalty. The duty of care requires managers to act with the degree of care that an ordinarily prudent person in a like position would use under similar circumstances, and to act on an informed basis. In discharging the duty of care, a manager is entitled to rely in good faith on information, opinions, reports and statements presented by another manager, or by a member, officer or employee of the LLC, or by any other person as to matters reasonably believed to be within such person's professional or expert competence.

The duty of loyalty requires managers to act in a manner the manager honestly believes to be in the best interests of the LLC and its members. The duty of loyalty requires managers to be both "disinterested" and "independent", and to refrain from conduct such as fraud, bad faith and self-dealing. In discharging this duty, managers also owe a duty of good faith and a duty of full and fair disclosure to the members. Under common law fiduciary duty principles, members, like stockholders of a Delaware corporation, do not generally owe fiduciary duties to the LLC or other members, other than in limited circumstances, such as where the member is a controlling member or is actively participating in decision making as a managing member.

Because of the ability to restrict, expand or eliminate fiduciary duties granted by the Act, parties to an LLC agreement are well advised to specify the extent, if any, of the fiduciary duties of managers, members and other persons, and to include any presumptions of good faith, standards of review and/or the ability to rely on experts or reports to ease the burden of review. Regardless of whether or not fiduciary duties apply, as a matter of Delaware law, the implied contractual covenant of good faith and fair dealing inures to every contract, including every LLC agreement, and such covenant (and liability for a bad faith violation of such covenant) may not be eliminated. The implied covenant is rarely invoked by Delaware courts, and Delaware courts will not apply the implied covenant to override express contractual provisions or to imply fiduciary duties when the LLC agreement expressly eliminates such duties.

12.2 Direct Fiduciary Breach Claims

Outside bankruptcy, the general rule is that directors do not owe creditors duties beyond the relevant contractual terms. As a result, even when a corporation is insolvent or in the "zone of insolvency", creditors do not have standing to bring direct claims for breach of fiduciary duty. However, creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties because the corporation's insolvency makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value. The fiduciary duties that creditors gain derivative standing to enforce are not special duties to creditors, but rather the fiduciary duties that directors owe to the corporation to maximise its value for the benefit of all residual claimants.

The Delaware Court of Chancery has stated that directors of an insolvent corporation "do not have a duty to shut down the insolvent firm and marshal its assets for distribution to creditors, although they may make a business judgment that this is indeed the best route to maximise the firm's value." Notwithstanding a company's insolvency, directors continue to have the task of attempting to maximise the economic value of the firm. When directors make decisions that appear rationally designed to increase the value of the firm as a whole, Delaware courts do not speculate about whether those decisions might benefit some residual claimants more than others.

To obtain standing to sue derivatively, a creditor need only establish that the corporation was insolvent at the time the lawsuit was filed, as shown by the balance sheet test or the cash flow test. The creditor does not need to show that the corporation was continuously insolvent through judgment or "irretrievably insolvent".

With respect to the rights of creditors outside bankruptcy, Delaware law is clear that managers of an LLC do not owe fiduciary duties to creditors of the LLC, even when the LLC is insolvent. The Delaware Supreme Court has held that creditors of a Delaware LLC have no standing to assert derivative claims against managers (including any claims of breach of fiduciary duties) on behalf of an LLC, even if the LLC is insolvent. A statutory right to bring derivative claims only exists in favour of a member or assignee of an LLC interest. Lenders and other counterparties contracting with an LLC typically seek contractual rights and remedies in lieu of standing to assert a derivative claim.

12.3 Chief Restructuring Officers

The appointment of a professional chief restructuring officer or "CRO" is common in large and complex Chapter 11 cases in the United States. There is no express statutory basis in the Bankruptcy Code for appointing a CRO. Rather, the appointment of CROs has developed as a practical solution to provide independent and professional assistance to incumbent management of financially troubled companies.

Generally, CROs have professional restructuring and industry experience, giving them credibility with the debtor's various constituencies. Typical CRO functions include formulating a restructuring strategy, assisting in developing a plan of reorganisation or liquidation, and maintaining ordinary course operations during a Chapter 11 case. The appointment of a CRO may assuage creditor concerns about existing management and decrease the likelihood that parties in interest will seek the appointment of an examiner or Chapter 11 trustee.

12.4 Shadow Directorship

The concept of "shadow directorship" is not recognised in American jurisprudence. Most analogous to a shadow director is a controlling stockholder, who acts as the de facto leader or controller of the corporation. Delaware law may impose fiduciary duties upon controlling stockholders.

"Lender liability" is an umbrella term encompassing a variety of common law theories based on contract and tort law as well as claims under federal and state statutes. In some jurisdictions, lender liability causes of action may rise when a lender exercises excessive control over a borrower's affairs. The underlying theory of such an action is that, in effect, the lender is acting as an officer or director of the borrower and thereby owes the borrower, as well as the borrower's creditors and stockholders, fiduciary duties.

12.5 Owner/Shareholder Liability

Stockholders ordinarily face no personal liability for corporate debts or liability to creditors of a corporation, absent veil piercing or alter ego liability. However, in certain circumstances, Delaware law imposes fiduciary duties upon stockholders who own majority interests or who exercise control over corporate business affairs to act fairly with respect to other stockholders.

13. Transfers/Transactions That May Be Set Aside

13.1 Historical Transactions

Federal bankruptcy law provides statutory causes of action to avoid (ie, set aside or unwind) certain transfers made to or for the benefit of third parties, primarily fraudulent transfer avoidance actions under Bankruptcy Code section 548, and preferential transfer avoidance actions under Bankruptcy Code section 547.

Fraudulent Transfers/Fraudulent Conveyances

There are two types of transfers of debtor property that constitute a fraudulent transfer under Bankruptcy Code section 548. The first is a transfer made with actual intent to hinder, delay or defraud creditors. The second is a constructively fraudulent transfer, which is a transfer made in exchange for less than "reasonably equivalent value", at a time when the transferor was either insolvent, undercapitalised or generally unable to pay its debts as they came due.

The Bankruptcy Code provides some defences and limitations to fraudulent transfer liability. Transferees who "take for value" and in "good faith" may have a defence to fraudulent transfer actions. The word "value" in this context is defined as "property, or satisfaction or securing of a present or antecedent debt of the debtor." The Bankruptcy Code also provides certain statutory safe harbours against fraudulent transfer liability with respect to certain otherwise-avoidable transfers.

Preferential Transfers

Preferential transfers may be avoided under Bankruptcy Code section 547, which provides that a debtor or trustee may avoid: (i) a transfer; (ii) of an interest of the debtor in property; (iii) to or for the benefit of a creditor; (iv) for or on account of an antecedent debt owed by the debtor before such transfer was made; (v) made while the debtor was insolvent; (vi) made on or within 90 days before the date of the filing of the petition (or between 90 days and one year before the filing of a petition, if the creditor was an insider at the time of the transfer); and (vii) that enables the creditor to receive more than it would receive if the case were a case under Chapter 7 of the Bankruptcy Code.

Affirmative defences may be asserted against voidable preference liability. The most common affirmative defences, each of which is fact-intensive, include the following:

- the ordinary course of business defence;
- the subsequent new value defence; and
- the contemporaneous exchange of value defence.

The burden is on the transferee to prove all elements of a claimed defence by a preponderance of the evidence.

13.2 Look-Back Period

Generally, under the Bankruptcy Code, fraudulent transfers may be avoided if they were made or incurred on or within two years before the commencement of a bankruptcy case. However, section 544 of the Bankruptcy Code permits a trustee or Chapter 11 debtor-in-possession to rely on any applicable longer state law fraudulent transfer look-back (or "reach-back") periods. State law reach-back periods may be up to four or six years after the transfer was consummated.

Preference liability is imposed under section 547 of the Bankruptcy Code for any transfer of an interest of the debtor in property that was made on or within 90 days before the bankruptcy case, if the elements of section 547 are satisfied and the creditor-transferee has no defences. The 90-day preference "reach-back" period is extended to one year prior to the bankruptcy case if the transferee was an insider of the debtor at the time of the transfer.

13.3 Claims to Set Aside or Annul Transactions

A bankruptcy trustee (or a Chapter 11 debtor) has standing to assert fraudulent transfer and preference avoidance actions. A bankruptcy trustee's (or Chapter 11 debtor's) avoidance powers are exclusive during the bankruptcy case.

Creditors' committees and individual creditors may seek derivative standing to assert avoidance actions on behalf of the debtor's estate, especially in cases where the debtor may have a conflict. The bankruptcy court must order and authorise such derivative standing. The terms of a Chapter 11 plan of reorganisation or liquidation may provide that the reorganised debtor or some other estate representative, such as a litigation trustee, may retain and assert avoidance actions following consummation of the plan.

State law fraudulent transfer actions may be asserted by creditors outside federal bankruptcy cases, but cannot be commenced or continued by creditors after the commencement of bankruptcy and the imposition of the automatic stay.

14. Importance of Valuations in the Restructuring and Insolvency Process

14.1 Role of Valuations

Valuations are important to the resolution of numerous matters that may arise during a Chapter 11 case. Different matters and disputes implicate differing legal standards and valuation needs.

Some of the bankruptcy matters in which valuations may be determinative of outcomes are outlined below.

Adequate Protection

Secured creditors are entitled to seek "adequate protection" of their lien interests in debtor property to protect against any diminution in value that might occur during a Chapter 11 case. See **4.5 Special Procedural Protections and Rights**. Determining the value of a secured creditor's collateral, and whether the secured creditor has been adequately protected during the bankruptcy case, requires valuation of the relevant collateral.

Appointment of Official Equity Committee

An official committee of equity holders may be appointed under section 1102(a)(2) of the Bankruptcy Code if, among other things, the debtor is solvent. The solvency determination may require a valuation.

Determination of Secured Status of Claim

Section 506 of the Bankruptcy Code allows for the "bifurcation" of partially secured claims into secured and unsecured components. Valuations of collateral may be required to fix an undersecured creditor's secured and unsecured claim amounts. See **5.1 Differing Rights and Priorities**.

Fraudulent Transfer Litigation

Parties asserting constructive fraudulent transfer actions must prove that the debtor was insolvent at the time of the alleged fraudulent transfer, or rendered insolvent as a result of it. Proving insolvency usually requires a valuation of the debtor's assets and liabilities.

Preference Litigation

Preference actions under section 547 of the Bankruptcy Code permit the recipient of an alleged preference to rebut a presumption that the debtor was insolvent during the 90-day "preference period". The plaintiff, on the other hand, must show that the transferee received more than it would have received in a hypothetical Chapter 7 liquidation of the debtor. Valuations are needed if the foregoing issues are disputed.

Confirmation of a Chapter 11 Plan

Valuations play a central role in the Chapter 11 plan confirmation process. In order for the debtor to propose a plan, it must determine the reorganisation value of the company, which determines what stakeholders will receive when the debtor emerges from bankruptcy. In addition, the enterprise value of the reorganised company is needed to determine the value of new securities to be distributed to creditors in satisfaction of their claims. A hypothetical liquidation analysis is also needed to satisfy the "best interests of creditors" test set forth in section 1129(a)(7) of the Bankruptcy Code. This test requires that each holder of a claim or interest must either vote to accept the plan, or receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would receive or retain in a hypothetical Chapter 7 liquidation.

Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

4 Times Square
New York
NY 10036

Tel: +1 212 735 3000
Fax: +1 212 735 2000
Email: info@skadden.com
Web: www.skadden.com

14.2 Initiating a Valuation

There is no hard and fast rule regarding who will or may initiate a valuation process in a US bankruptcy case. As noted above, numerous matters in a Chapter 11 case may require some sort of valuation. Valuations may be initiated by different parties in interest, depending on the context in which valuation issues arise.

14.3 Jurisprudence

Valuation jurisprudence is well developed in the United States. Bankruptcy courts are very familiar with accepted valuation methodologies commonly used by investment bankers and similar professionals who provide valuation reports, opinions and testimony.

The particular circumstances of a Chapter 11 case, the purpose for the valuation, the context in which a valuation dispute arises, the nature of a company's business and assets, industry norms and the reliability and availability of business projections may all influence the types of valuations and methodologies that will be used by parties and relied upon by the bankruptcy court.

Typically, the parties to a valuation dispute each select and retain their own valuation experts. It is ultimately up to the bankruptcy judge to weigh, evaluate and determine the credibility of competing expert opinions and evidence of value when making valuation findings.