# Restructuring the obligations of a European corporation through a US-style process

James F Conlan, co-chairman, corporate reorganisation and bankruptcy group
Larry J Nyhan, co-chairman, corporate reorganisation and bankruptcy group
**Sidley Austin LLP**

The capital structures of many European companies have become increasingly complex with the growth of syndicated leveraged loans, second-lien debt, mezzanine debt and high-yield bonds. As the use of these leveraged financing products has grown in Europe, European companies are both increasing their overall usage and adding forms of debt with which European legal systems have little experience compared with the United States. There is likely to be a meaningful and unprecedented increase in restructuring activity in Europe as the economic environment becomes less favourable for highly leveraged entities and disputes relating to these forms of financing arise in European forums.

These future European restructurings will be more complicated than those previously encountered in Europe, given the increased complexity of the capital structures and the increased diversity of the investors within those capital structures. Many of the investors in these new leveraged capital structures are from the United States or have US roots. Given the vast increase of US participants in leveraged European companies and the increased complexity of their capital structures, the pursuit of a US-style restructuring process has not only become more feasible, but may often be the most desirable process (along with a local complementary process) to execute complex restructurings for European companies.

This chapter discusses the potential advantages of, and various considerations related to, restructuring the obligations of a European corporation through a US-style process, with a particular emphasis on reorganisation pursuant to Chapter 11 of the US Bankruptcy Code.

### Emerging trends in the European credit market

With the influx of new investors (including US investors) into the European credit market and the resulting increase in liquidity, many of the traditional premises of European leveraged credit have begun to erode, contributing to the general degradation of credit standards. The availability of relatively low-cost financing with minimal covenants and restrictions, as well as a perceived ability to refinance such debt almost at will, has led to historic levels of debt for many European corporations, which in many instances well exceed their reasonable debt capacity.

There are now unprecedented levels of depth and diversity in the financing markets for European businesses, regardless of size or industry. In addition, many European companies are choosing to finance their growth through an assortment of debt products, taking advantage of the decreasing price of such borrowings and the increasing flexibility of lenders. Such favourable markets for borrowers have led, in certain instances, to overly aggressive structures and higher financial risk, which translates to:

- higher leverage;
- decreasing credit quality;
- increasing numbers of requested (and granted) covenant waivers, as well

as looser covenants and back-ended debt structures; and
- recapitalisations involving a combination of leveraged products, including first and second-lien secured debt, mezzanine financing, public notes and other forms of high-yield debt.

Additionally, part of the European liquidity movement (including the influx of US investors) has been spurred on (until recently) by collateralised loan obligations (CLOs). Importantly, the majority of such CLOs are based in the United States, along with the hedge funds, prime rate funds and other holders that purchase the majority of leveraged loans from the issuers. US funds make for some of the largest, most-seasoned European CLO players and some of the many first-time entrants in the European markets. Over the past couple of years the total number of CLOs issued has drastically increased in Europe and US investors have become active in many other aspects of the European high-yield market, including distressed situations.

Faced with a complicated capital structure and a contingent of US-based investors and/or US law-governed debt instruments, a European company may conclude that a reorganisation under Chapter 11 (assuming it can be successfully maintained, as further discussed below) provides it with greater flexibility, control and options as compared to a European insolvency process in addressing and resolving its financial predicament. In addition, given the wealth of precedent that has developed during the 30 years since the Bankruptcy Code was adopted, and the recognised commercial sophistication of certain bankruptcy courts within the United States (most notably in New York and Delaware), reorganisation under Chapter 11 may be perceived as offering certainty and stability at a company's most difficult hour.

## Advantages of Chapter 11 for a European company

While substantive insolvency regimes in Europe vary from country to country, Chapter 11 contrasts with most of these regimes in several important ways that may make Chapter 11 more attractive to both European corporations and US investors.

### *Maintenance of corporate control*

In a Chapter 11 process management and the board of directors (with few exceptions) continue to maintain control over the company, its assets and the restructuring process. This is a critical distinction between Chapter 11 and many European insolvency regimes. European insolvency laws generally do not permit existing management or the board of directors to retain control of the restructuring process once the insolvency proceeding has been initiated. In most circumstances, a court-appointed officer (eg, a UK administrator) displaces the board of directors. Such an appointment may materially detract from the company's ability to reorganise effectively and, in some instances, may preclude any meaningful restructuring.

Indeed, in many European jurisdictions the concept of a US-style reorganisation is either new and untested or still impracticable. In many countries, insolvent business enterprises are simply liquidated or managed for a brief period by a receiver that is appointed by the principal creditor (usually a secured lending group). In the latter case, it is unsurprising that the interests of unsecured creditors are often viewed with considerably less import than those of the secured creditors. As a result, businesses and certain creditors' constituencies alike may welcome a Chapter 11 reorganisation as a means of effectively preserving both of their interests in a restructuring of a European company.

### *Increased or enhanced availability of liquidity*

In many instances, a company's ability to secure new financing may be crucial to effectuating a restructuring. The Bankruptcy Code authorises a company (as debtor in possession) to obtain financing in the context of a bankruptcy proceeding with the approval of the bankruptcy court. Among other things, the bankruptcy court will approve the financing terms and can make findings that validate the liens securing such financing, which provide lenders with certainty that would otherwise be lacking in extending financing to a financially distressed entity. Under certain circumstances, a bankruptcy court may authorise that the debtor-in-possession financing be secured by liens on collateral of the debtor that are senior to existing liens on the same collateral (otherwise referred to as priming). European insolvency laws generally do not permit a debtor company (or a trustee or administrator) to obtain financing on a priming basis in the manner contemplated under Section 364 of the Bankruptcy Code. Moreover, because the market of prospective lenders for debtor-in-possession financing is extensive and

well developed, a European company may be able to obtain more competitive pricing or better terms, or be exposed to a larger pool of potential funding sources (both traditional and non-traditional lenders) in the context of a Chapter 11 proceeding as compared to a European insolvency process, where the entire concept of such types of financing may be novel and face uncertain treatment.

Other distinctions include the company's ability to use cash collateral and maintain its existing cash management system during a Chapter 11 case. European regimes tend to be more restrictive concerning a debtor's use of cash collateral over the objection of a secured creditor. Moreover, most European regimes require that each corporate debtor be ring fenced so that intercompany cash management arrangements that are common among affiliated debtors under Chapter 11 cannot easily be replicated.

### *Ability to 'cram down' a restructuring plan on dissenting classes*

The Bankruptcy Code allows a debtor to confirm a plan of reorganisation over the objections of one or more dissenting classes of creditors, assuming that certain conditions are satisfied. The ability to cram down a confirmed plan provides a debtor with considerable leverage in negotiating with its stakeholders, potentially avoiding blocking positions that may delay the restructuring process, and seeking and achieving confirmation of a plan without unanimous creditor support. European insolvency regimes do not generally incorporate the Chapter 11 cram-down provisions, thereby providing creditors with enhanced leverage in regard to the company in European systems as compared to Chapter 11.

### *Treatment of executory contracts*

Chapter 11 may afford the debtor greater flexibility to assume, assume and assign or reject executory contracts and certain types of lease, regardless of contractual provisions that would otherwise prohibit assignment or operate to terminate such contract or lease upon the insolvency of the debtor. In Chapter 11 a debtor has the ability to shed undesirable contracts and leases as part of the reorganisation process, and any claims for damages as a result of doing so are treated in the same manner as other general unsecured claims. This is a restructuring tool that may not be available to companies under many European insolvency regimes, where even if a trustee or administrator can reject a contract or lease, the company nonetheless remains liable for the full amount of the damages relating to the breach of that contract or lease.

### *Implementation of pre-negotiated or pre-packaged plans*

Except for pre-negotiated company voluntary arrangements or Section 425 schemes of arrangement in the United Kingdom, European insolvency proceedings are generally not used to 'backstop' out of court settlements. Indeed, while certain European regimes could in theory accommodate pre-negotiated restructurings (eg, Italy and Germany), this approach has not been widely used in large cases. In contrast, pre-negotiated and pre-packaged plans are often used in Chapter 11 to facilitate a consensual restructuring between a company and its principal creditor/stakeholder constituencies.

An out-of-court restructuring plan is often negotiated and implemented between the company and its creditors against the backdrop of Chapter 11, without a Chapter 11 case ever being filed. For example, it may be possible for the company to execute an out-of-court restructuring through an exchange offer. Alternatively, the exchange offer may be backed by or included as part of a pre-packaged Chapter 11 plan, which would permit the company to solicit creditor acceptance of both the exchange offer and the plan before the Chapter 11 case is filed, and therefore expedite the restructuring through the Chapter 11 process. If there is insufficient time for an out-of-court exchange offer backed by a pre-packaged Chapter 11, then a pre-negotiated Chapter 11 can be negotiated with principal creditors that are contractually locked up to support the Chapter 11 plan. Unlike many European insolvency regimes, Chapter 11 may be used as a backstop to an out-of-court restructuring (a pre-pack backed exchange offer) or as a tool to implement an agreed restructuring (a pre-pack or pre-negotiated Chapter 11 plan).

### *Other benefits unique to Chapter 11*

In addition to the foregoing, European companies may find other aspects of Chapter 11 useful depending upon their particular circumstances, including:

- the imposition of the automatic stay upon filing

for bankruptcy, which generally prevents claim enforcement by creditors and has the capacity for worldwide effect if the requisite support is garnered in local, complementary proceedings;
- once a Chapter 11 reorganisation is initiated, a period of exclusivity of up to 18 months during which only the company can propose a plan of reorganisation;
- the possibility of reorganising with a new value plan, the ability to sponsor a rights offering and negotiate a backstop agreement for such offering and the capability to capture certain exemptions to US securities laws when issuing securities in exchange for debt; and
- the ability of the debtor's management and board of directors potentially to secure legal releases and/or indemnities as part of a plan of reorganisation.

Moreover, various protections are afforded to creditors, equity holders and parties in interest in Chapter 11 reorganisations that may not be available under many European insolvency regimes, including:
- the formulation of committees for the express purpose of representing the collective interests of similarly situated creditors and, if warranted, equity holders;
- the hiring of financial and legal advisers to perform analyses (debtors are required to allow significant due diligence by the advisers during the course of the bankruptcy proceeding) and propose reorganisation options for the benefit of the committees that are paid for by the debtor's estate;
- the ability to obtain a contingent recovery even if recovery would be unlikely in the event of a sale or liquidation, including the possibility of purchasing delevered securities in the reorganised company as part of a new value plan or through a rights offering;
- the potential to craft an alternative plan of reorganisation if the period in which the company has the exclusive right to do so expires or is terminated; and
- transparency and court supervision.

## Characteristics of a European candidate for Chapter 11

If Chapter 11 is a legally viable alternative for a European corporation, senior management and the board of directors may well prefer a Chapter 11 filing over an insolvency proceeding in the corporation's home country. The ability to retain control of the process will be viewed as crucial.

A European candidate for Chapter 11 will generally have the following characteristics:
- The restructuring need is driven by overleverage rather than systemic operating problems;
- A meaningful component of the company's funded debt is held by US investors and/or is governed by US law;
- The company has some property (eg, bank accounts) or affiliations (eg, a subsidiary) in the United States; and
- Its funded debt holders are prepared to permit local creditors (eg, labour, trade and local governmental units) to be treated generously.

If possible, the planned restructuring should not prescribe a treatment for a class of creditors that prejudices them in comparison to the treatment they would be entitled to receive under the insolvency regime in the debtor's home country.

While the Chapter 11 proceeding would be the plenary proceeding, it may be necessary or desirable to initiate a complementary insolvency proceeding in the company's home jurisdiction – or in any other jurisdiction(s) in which the company or its affiliates have substantial assets or businesses – to ensure that the protections afforded by the Chapter 11 process are not undermined by collateral actions in those jurisdictions. This has been accomplished in other Chapter 11 cases involving European corporations, including Federal-Mogul/Turner & Newall (UK administration), Budget Rent-A-Car International (UK administration) and Sea Containers Ltd (Bermuda provisional liquidation). Additionally, a careful assessment must be performed to gauge the likelihood that any non-US creditors will mount a forceful venue challenge in the event of a US filing. The likelihood and relative level of force of any such challenge may well turn on the size of any non-US creditors' claims, and the treatment that such claims would be afforded under a plan of reorganisation as compared to the treatment that they would receive in the company's home jurisdiction. In addition, it may be possible to obtain relief in the complementary proceeding that ensures enforcement and application of the automatic stay to creditors which are beyond the reach of the US bankruptcy. The prospect of an enforcement action being initiated in the home jurisdiction by creditors having no US presence must be considered. In order to make this

assessment, the relative size, organisation level and type (ie, whether they can be considered litigious or aggressive) of the creditors should be considered. Finally, the pre-selection of administrators or trustees (where permitted), together with pre-negotiated protocols, can preserve management and board control and reinforce the primacy of the Chapter 11 proceeding, thereby minimising the likelihood of a successful collateral attack.

The Bankruptcy Code does not prohibit a European corporation from being a Chapter 11 debtor. However, even if jurisdiction and venue are satisfied, the bankruptcy court can dismiss a case under either Section 305 or Section 1112(b) of the Bankruptcy Code. Section 305(a)(1) permits dismissal of a case if the interests of creditors and the debtor would be better served by dismissal, and Section 1112(b) similarly contemplates dismissal if it is in the best interests of creditors and the estate. Moreover, Section 305(a)(2) permits dismissal if a foreign proceeding has been recognised and the purposes of Chapter 15 of the Bankruptcy Code (which is discussed in detail below) would be best served by dismissal. In addition, if a pending foreign insolvency proceeding has been recognised as a foreign main proceeding, any subsequently filed US bankruptcy case will, pursuant to Section 1528 of the Bankruptcy Code, generally be limited in effect to assets in the United States. Ensuring that the Chapter 11 is the plenary proceeding and, where possible, implementing a complementary proceeding in the home jurisdiction (with appropriate protocols) may be viewed as crucial to the bankruptcy court in overcoming any challenge to the primacy of the Chapter 11 case. Potential Chapter 11 debtors are also advised to weigh the comparative advantages and disadvantages of filing their bankruptcy petition in a specific jurisdiction within the United States, such as the Southern District of New York or the District of Delaware, where the courts are generally more experienced in handling cross-border cases and the unique issues faced in such cases.

## Considerations for Chapter 15

Cross-border insolvencies present a myriad of legal complexities, choice of law conflicts and jurisdictional conundrums that are not typically encountered in insolvency proceedings within a single jurisdiction or forum. Faced with various restructuring alternatives, a European company may wish to consider commencing a Chapter 15 proceeding in furtherance of a foreign proceeding initiated in its home jurisdiction. A Chapter 15 proceeding is, in brief, a proceeding whereby a foreign debtor requests that a US bankruptcy court recognise and give effect to insolvency proceedings that it has commenced in another country, thereby protecting its assets and business in the United States from collateral attack while its foreign insolvency proceedings progress.

In an attempt to introduce a "modern, harmonized and fair framework to address more effectively instances of cross-border insolvency", the United Nations Commission on International Trade Law (UNCITRAL) adopted the Model Law on Cross-Border Insolvency, which serves as a procedural vehicle to assist enacting states in providing effective and efficient mechanisms for dealing with insolvency proceedings involving more than one country. Fourteen countries have enacted or adopted legislation based on the Model Law, including the United States and Great Britain (which enacted such legislation on April 4 2006 by means of the Cross-Border Insolvency Regulations 2006). The countries which have adopted the Model Law are shown in Table 1.

**Table 1**

| Year enacted | Country |
|---|---|
| 2000 | Japan |
| 2000 | Mexico |
| 2000 | South Africa |
| 2002 | Montenegro |
| 2003 | Poland |
| 2003 | Romania |
| 2004 | Serbia |
| 2005 | British Virgin Islands |
| 2005 | United States |
| 2006 | Colombia |
| 2006 | Eritrea |
| 2006 | Great Britain |
| 2006 | New Zealand |

Chapter 15 of the Bankruptcy Code came into effect as part of the Bankruptcy Abuse, Prevention and Consumer Protection Act of 2005 (which was signed into law on April 20 2005 and became effective, for the most part, on October 17 2005). Chapter 15 adopts, in large measure, the Model Law and replaces Section 304 of the Bankruptcy Code in dealing with multinational insolvencies.

Chapter 15 is intended to streamline and

simplify the process and procedures for seeking recognition of a foreign proceeding in the United States. In order to commence a case under Chapter 15, a foreign representative must file a petition for recognition of a foreign proceeding, with a statement identifying the pending foreign proceeding(s), evidence of its commencement and evidence of the appointment of a foreign representative. To be eligible for Chapter 15 an entity must be eligible to be a debtor pursuant to Section 109(b) of the Bankruptcy Code.

Once recognition is obtained, a foreign representative may commence an involuntary case under Section 303 of the Bankruptcy Code, or a voluntary Chapter 7 or Chapter 11 case if the foreign proceeding is the main proceeding. In addition, under Section 1509 of the Bankruptcy Code a foreign representative:

- is entitled to comity or cooperation by the court;
- has the capacity to sue and be sued in a US court; and
- may apply directly to a US court for appropriate relief.

The type of relief available upon recognition of a Chapter 15 recognition will depend on whether the foreign proceeding is a main or non-main proceeding. For example, upon recognition of a foreign main proceeding, the automatic stay applies to bar any actions from being taken against the debtor or its assets. However, the effect of the automatic stay in Chapter 15 differs from Chapter 11 in that the stay in Chapter 15 does not purport to have worldwide effect, but rather is limited to the territorial jurisdiction of the United States.

Other effects of recognition of a foreign main proceeding in the United States consist of:

- the availability of adequate protection for secured creditors;
- the imposition of rights and restrictions governing the sale or use of estate property, post-petition transfers and liens on after-acquired property (as it pertains to estate property located in the United States); and
- the ability of the foreign representative to operate the debtor's business (unless the court orders otherwise).

While a foreign non-main proceeding can be recognised by a court, there is no automatic stay on such recognition and assistance is limited.

Importantly, Chapter 15 is not a 'one-size-fits-all' solution for restructuring European companies. Indeed, numerous considerations may counsel strongly in favour of pursuing restructuring alternatives other than commencing an ancillary case under Chapter 15. For example, unlike Chapter 11, Chapter 15 does not:

- ensure that management and the board of directors will control the restructuring process;
- provide a means to liquidate and discharge certain types of liability, including mass tort liabilities; or
- permit a debtor to cram down a restructuring plan on a dissenting creditor class or to subordinate the claims of certain stakeholders equitably.

Moreover, the debtor's ability to recover preferential transfers (ie, overpayments to creditors made shortly before a bankruptcy case is commenced) may be limited in a Chapter 15, as the right to pursue preference and other avoidance actions is not generally provided in Chapter 15.

## Conclusion

Chapter 11 is a viable and, in many instances, preferable means to restructure for many European corporations. It offers a number of advantages not found generally in other European insolvency regimes – most importantly, that management and the board of directors retain control of the restructuring process. The ability of the company to manage and control its own restructuring process will be viewed as critical to ensuring that the value of the enterprise is preserved and maximised for the benefit of all stakeholders. Although many European insolvency regimes have been moving towards a US model in recent years, they lack certain crucial features (as highlighted above) that set Chapter 11 apart as a procedure for effectuating complex restructurings. Moreover, even where European insolvency systems have sought to replicate many of the features of the US system, it remains largely untested whether foreign courts will permit those features to afford US-style protection in practice. For these reasons, in many cases where a significant number of creditors are US-based and/or the debt instruments are governed by US law, it is likely that European companies may well prefer to file for Chapter 11 rather than to initiate an insolvency proceeding in their local country. Any evaluation of a European company's restructuring alternatives should include a proper assessment of Chapter 11 as a method to effectuate a restructuring.