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THE GUIDE TO CORPORATE CRISIS MANAGEMENT

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Publisher's Note

Latin Lawyer and LACCA are delighted to publish *The Guide to Corporate Crisis Management*. Edited by Sergio J Galvis, Robert J Giuffra Jr and Werner F Ahlers, partners at Sullivan & Cromwell LLP, the fifth edition of this guide brings together the knowledge and experience of leading practitioners from a variety of disciplines and provides guidance that will benefit all practitioners.

We are delighted to have worked with so many leading individuals to produce *The Guide to Corporate Crisis Management*. If you find it useful, you may also like the other books in the Latin Lawyer series, including *The Guide to Mergers and Acquisitions*, *The Guide to Restructuring* and *The Guide to Corporate Compliance,* and our new tool providing overviews of regulators in Latin America.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.

CHAPTER 9

US Bankruptcy Proceedings for Latin American Corporates

Andrew G Dietderich, James L Bromley and Fabio Weinberg Crocco[1]

Rising interest rates, supply chain disruptions and political instabilities in connection with local elections have weighed on economic activity in Latin America. The financial stability and outlook of many corporates in the region have been adversely affected by recent events. In this challenging environment, while several Latin American corporates facing severe liquidity issues have turned to domestic insolvency proceedings to restructure their debts and operations, some companies have turned to Chapter 11 of the US Bankruptcy Code to restructure their balance sheets and obtain access to liquidity.

The ongoing challenging environment has demonstrated that business professionals and non-US practitioners dealing with potential insolvencies of Latin American companies should carefully consider whether US law can provide them with useful reorganisation tools, either in the form of plenary Chapter 11 proceedings or ancillary Chapter 15 proceedings supporting a home country reorganisation. Recent experiences have shown that, while companies that lack a significant operational presence in the United States might not look to restructure there in the first instance, the US Bankruptcy Code is extraterritorial and allows US courts to assist actively in international restructurings of companies operating predominantly outside the United States. This chapter provides an overview of Chapter 11 and Chapter 15, and discusses how Latin American corporates can benefit from the tools available under each of these regimes.

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Chapter 11

Historically, the United States has taken a different view towards corporate restructuring from other nations. The corporate reorganisation provisions of the Bankruptcy Code, which we can, for convenience, call 'Chapter 11', were not written for or by the banking community in the United States for the primary benefit of creditors. Indeed, the main objective of Chapter 11 is to prevent liquidation and preserve long-term corporate value, not the punishment of bankrupts or even the maximisation of immediate creditor recoveries. In the US 'bankruptcy' does not mean liquidation, but rather encompasses both liquidation (rarely) and restructuring (usually). For this reason, Chapter 11 has several essential elements that sometimes surprise non-US professionals. These elements can make Chapter 11 an attractive option for restructuring companies operating in Latin America.

For example:

- a company need not be organised in, nor predominantly operating in, the United States, to file for Chapter 11;
- a company may be solvent and file for Chapter 11;
- the board and management remain in control during the Chapter 11 case;
- the internal affairs of the company in Chapter 11 are governed by the laws of the jurisdiction in which the company is organised;
- immediately and automatically upon filing a Chapter 11 petition, a broad worldwide stay prevents creditor enforcement action and the termination of contracts during the Chapter 11 case in any jurisdiction, even those contracts that expressly give counterparties termination rights upon an insolvency filing;
- to run its business, the company may borrow money and incur debts after a Chapter 11 filing on a basis that is senior to its old debts, ignoring restrictive covenants;
- the board and management have the exclusive right, for a substantial period, to propose a plan of reorganisation to exit the Chapter 11 case; creditors may not do so; the plan of reorganisation may repay creditors in many forms, including 'take-back' paper and equity, so long as certain rules are followed;
- the debtor may undertake avoidance actions under state and federal law in an attempt to claw back value for the benefit of the estate;
- the debtor can sell assets free and clear of claims and encumbrances, using the power of the court to provide clean title to purchasers;
- the debtor can assume, assign or reject certain contracts with material unperformed obligations as a means of restructuring its operations;
- at the end of a successful reorganisation, debts are discharged and the board and management are exculpated from liabilities relating to the restructuring;

- courts may grant injunctions channelling claims against the debtor and specified third parties to a trust funded for the benefit of claimants, enjoining plaintiffs from asserting claims against the parties protected by the injunction and compelling plaintiffs to seek recovery from the trust instead; and
- Chapter 11 is overseen, not by generalist commercial courts, but by special courts with specific expertise in corporate reorganisation and a broad mandate to play an active role in the progress of the restructuring.

This Chapter 11 'toolbox' is made even more attractive for non-US debtors because of two principles of deference running through US jurisprudence: deference to non-US law and respect for non-US creditors. The Bankruptcy Code defers to non-bankruptcy law to determine most of the substantive rights of parties. As a result, the fiduciary duties of a board of directors, the value of a contract, the rights and obligations of parties under an agreement, the validity and priority of liens and the vast majority of other issues that arise in a Chapter 11 case are all resolved by non-US law for international debtors. For example, the question of whether a creditor properly perfected his or her lien over real estate located in Brazil will be governed by Brazilian law, and the question of whether a party to an Ecuadorian contract has a claim against the debtor for failure to perform will be governed by Ecuadorian law. Equally important, courts have developed a set of principles to respect the rights of non-US creditors during a US bankruptcy case. For example, in a US bankruptcy case involving a non-US debtor, it is commonplace for the court to grant a special order exempting employees and trade creditors outside the United States from the application of the 'automatic stay', thereby allowing non-US employees and trade creditors to be paid in full while financial creditors or US creditors are substantially impaired.

The benefits of US restructuring law are available to companies organised in, and predominantly operating in, other jurisdictions. Unlike most of the laws in the United States, Chapter 11 is expressly extraterritorial. There is no requirement that a debtor be organised in the United States. The technical jurisdictional requirement – including for a plenary Chapter 11 proceeding as well as for a Chapter 15 ancillary proceeding – is merely that the company have some property in the United States, and courts have interpreted the property requirement to be satisfied by a single bank account in New York City. Notwithstanding this low threshold, once a debtor is in Chapter 11, the orders of the court in the United States have global reach. For example, the moratorium on creditor action created by the filing of a Chapter 11 petition in the United States (the automatic stay) prohibits creditor action anywhere in the world, instantaneously on the first day of the case and without a requirement for international recognition.

Any global company of sufficient size is likely to have US creditors and US stockholders, incur debts under US law, conduct business in US dollars and keep at least part of its money in US banks, even in the absence of direct US operations. The ubiquity of corporate contacts with the United States makes US jurisdiction feasible for a surprising number of non-US debtors. Although a US court may not accept a Chapter 11 case where critical court orders cannot be enforced, few internationally active companies are in a position where they do not have some assets or operations subject to the jurisdictional reach of the United States. This is equally true in many pre-insolvency situations, referred to in the United States as 'pre-packaged' or 'prearranged' Chapter 11 cases, where the parties affected are internationally active financial creditors and businesses with multinational operations in dollars. Accordingly, Chapter 11 may be a very attractive option for multinationals looking to undertake a balance sheet or operational restructuring.

Chapter 15

Even where a company decides not to pursue a plenary Chapter 11 in the United States, it may very well wish to commence an ancillary Chapter 15 proceeding to recognise and give support to a primary proceeding in its home country, so long as it meets the technical jurisdictional requirements discussed above. Chapter 15 of the United States Bankruptcy Code was added in 2005 and represents the adoption by the US of the Model Law on Cross-Border Insolvency (the Model Law) created by the United Nations Commission on International Trade Law. The Model Law has now been adopted by 59 states (as of October 2023). The principal goal of Chapter 15 is to promote legal certainty in international reorganisations and the efficient administration of such proceedings as between US courts and courts of non-US jurisdictions. Chapter 15 accomplishes this by providing judicial aid and relief to non-US insolvency proceedings, mostly after a formal recognition process.

While Chapter 15 does not provide a non-US debtor with the full toolbox of statutory powers provided to a Chapter 11 debtor, there are a number of useful benefits that are still available, particularly once the non-US proceeding has been recognised. These benefits are especially valuable to companies with significant creditor constituencies or assets in the United States. They include:

- a stay that prevents creditor action on assets within the territorial jurisdiction of the United States;
- access to the United States court system, including the ability to bring suit and to request discovery;
- US court supervision of the administration or realisation of US assets;

- the recognition and enforcement of non-US restructuring plans approved by a non-US court in a fair process, even if the relief provided by those non-US plans exceeds the relief that a US court could provide on its own;
- authorisation to examine witnesses and conduct bankruptcy discovery in the United States; and
- other relief at the discretion of the court (US courts have broad latitude to grant and tailor relief in Chapter 15 cases).

Chapter 15 can, therefore, be valuable to use either as a sword, to pursue valuable litigation claims on behalf of the reorganising company, or as a shield, to protect the non-US debtor from creditor actions under a US jurisdictional umbrella. Just as in a Chapter 11 proceeding, a participant in a Chapter 15 can expect a United States court to defer to the laws of the home proceeding absent compelling circumstances. Such deference, in fact, underpins the purpose and function of the statute.

Limitations on United States proceedings

Both Chapter 11 and Chapter 15 are subject to limitations. These limitations must be carefully considered by business professionals and practitioners before deciding to proceed with a US case.

Cost

Chapter 11 can be expensive. The debtor must pay for its own attorneys and financial advisers during the pendency of a restructuring proceeding, and also for the professional advisers to any official committees appointed for the benefit of creditors. Depending on the targeted timeline, the aggregate case cost can be significant. Chapter 15 proceedings are significantly less expensive, as they involve neither statutory creditor committees nor (at least, typically) the involved motion practice associated with a Chapter 11.

However, the costs of Chapter 11 are reduced substantially to the extent that a company is able to negotiate a pre-packaged or pre-arranged restructuring with key creditor constituents – and in addition the company is prepared to pay employees and most ordinary course trade creditors in full over the ordinary course of business. In cases where the restructuring plan is straightforward and reflects a strong creditor consensus – for example, in a case where international bonds are converting to equity, a substantial majority of bondholders support the plan and other creditors are unaffected – Chapter 11 cases have been completed in a matter of days and with minimal costs incremental to those that would apply to a negotiated 'out-of-court' transaction.

Jurisdiction

As noted above, limited jurisdictional requirements do apply to bankruptcy proceedings brought in the United States and, to file for Chapter 11 or Chapter 15, non-US debtors must have some property that is located in the United States. The bar is low – a single bank account with a few thousand dollars is sufficient – but care must be taken that jurisdiction is not manufactured. United States judges are empowered to, and do, dismiss both Chapter 11 and Chapter 15 cases that are brought in bad faith, including where jurisdiction has been manufactured for the purpose of gaming the system. Non-US debtors must avoid attempting to baldly manufacture US jurisdiction where none exists.

Abstention

United States courts have significant leeway to abstain from hearing Chapter 11 cases. A bankruptcy court's abstention powers may be less broad in a Chapter 15, but nonetheless, US judges will attempt to avoid situations where they know that, as a practical matter, their orders may be ineffective or interfere with the national or political interests. There are some examples of judges exercising their bankruptcy abstention powers to avoid hearing cases when they could potentially be viewed as interfering in issues of national importance in other countries, or where they believe that the non-US debtor or its property is not realistically subject to regulation by a US court.

Practical limitations on enforcement

Even when a US court is willing to provide relief, there can be significant practical limitations inherent in enforcing US orders in other nations. There are non-US jurisdictions where US court orders carry little weight. This issue tends to be less significant with respect to creditors that have substantial connections to the United States, such as global financial institutions. However, a non-US debtor may have difficulties enforcing the automatic stay and other court orders, such as priming lien orders or orders governing the rejection of executory contracts, against creditors or contractual counterparties with little or no connection to the United States, such as trade creditors and local employees.

Furthermore, even in jurisdictions that may ultimately be willing to recognise and enforce US court orders, there can be procedural and substantive hurdles to satisfy before obtaining relief. While Chapter 15 compels judges to limit the scope of their orders to assets within the territorial jurisdiction of the United States, no such limitation exists for Chapter 11 relief. Non-US debtors considering a plenary Chapter 11 proceeding should review the location of their asset and creditor base and decide, with non-US counsel as appropriate, whether

Chapter 11 proceedings can serve as practical bulwarks to creditor action. This is an area where effective partnership between US and non-US advisers is paramount to success.

Manifestly contrary to public policy

In Chapter 15 cases, courts are empowered to deny recognition and refuse enforcement of non-US orders, and may deny other forms of relief, if such relief would be 'manifestly contrary' to the public policy of the United States. This is a narrowly tailored exception, sometimes referred to as a 'safety valve', the limits of which have not been fully explored. There is, accordingly, at least a theoretical risk that a court will not recognise or enforce non-US orders that raise previously untested issues in US courts.

Information sharing

A Chapter 11 debtor must publish wide-ranging information on its business as well as provide creditors and their advisers substantial access to information on a confidential basis. A company accustomed to keeping its financial information private may find it unpleasant and burdensome to share its confidential financial information with its creditors and other interested stakeholders.

Unfair process

As a practical matter, US judges considering relief in Chapter 15 cases will also be hesitant to enforce and uphold non-US orders that they believe were obtained through a fundamentally unfair process. If objecting parties identify fundamental concerns over due process or credible evidence of fraud or misconduct in connection with the non-US proceeding, US judges will hesitate to give force to non-US orders resulting from such proceedings.

Considering your options

Designing and implementing an effective strategy to restructure a balance sheet, address liquidity constraints or implement an operational reorganisation is a highly fact-dependent exercise. This is an area where cookie-cutter solutions do not work and good results start with good process and planning, especially with respect to addressing liquidity needs. As a result, a company faced with a potential insolvency will need to spend significant time with its financial and legal advisers, considering its particular facts and circumstances before making any decision – and any one company's particulars are beyond the scope of this chapter.

Nonetheless, there are some good rules of thumb to keep in mind when considering whether the best restructuring pathway involves Chapter 15, Chapter 11, a non-US proceeding or some combination thereof.

Chapter 15 proceedings can be useful and efficient restructuring tools for non-US corporations with a significant US creditor base or with outstanding debt instruments governed by US law. Chapter 15 is attractive especially where access to the full Chapter 11 'toolbox' is unnecessary or unwarranted. This includes cases in which high levels of creditor consents may mean that a non-US debtor has no need to utilise the Bankruptcy Code's cramdown features, or where sufficient levels of liquidity will allow the non-US debtor to proceed with a restructuring without the need for priming financing. This also includes cases where the tools available in the non-US debtor's home jurisdiction can allow the company to achieve its restructuring objectives. In these cases, it may make sense for a company to proceed with a main proceeding in its home location, along with an ancillary US proceeding. The ancillary proceeding will serve to enforce the outcome of the non-US proceeding in the United States and against US creditors, so long as the scheme is not manifestly contrary to the public policy of the United States.

A Chapter 11 proceeding, however, may be useful where a non-US debtor has a significant US presence or creditor base and wishes to use more of the helpful features of the Bankruptcy Code. For instance, a company considering filing may need liquidity to implement a desired restructuring, and so may turn to Chapter 11 to borrow money on a priming basis. Alternatively, a company may have meaningful preference claims against counterparties in the United States and wish to use a Chapter 11 to pursue those claims effectively. A company may also wish to reject or renegotiate burdensome contracts to complete an operational restructuring. Further, the utility of Chapter 11's cramdown features cannot be overstated. Cramdown provides an effective pathway to consummating a restructuring plan over the objections of one or more classes of dissenting creditors, a pathway that is frequently unavailable in other jurisdictions. While companies are certainly not permitted to manufacture a Chapter 11 case for the purpose of evading creditor consent requirements of other jurisdictions, large multinationals often have multiple legitimate reorganisation pathways available to them, and cramdown powers are an important factor to consider when choosing the right jurisdiction.

Sometimes, a company may wish to proceed with dual plenary proceedings – a Chapter 11 case for some entities in the corporate family, as well as a bankruptcy proceeding in one or more local jurisdiction's local laws for others. Dual plenary proceedings are particularly useful where the debtor has a significant asset base in both the United States and abroad, and the debtor wishes to undertake an operational restructuring. Dual plenary proceedings may also occur as a result of multi-jurisdictional creditor actions against a non-US multinational. In the United States, creditors may attempt to file an involuntary proceeding under the Bankruptcy Code against the non-US multinational's US subsidiaries or subsidiaries operating in the United States. Depending on the facts and circumstances, these involuntary proceedings can frequently be converted to a voluntary Chapter 11, allowing the debtor to retain control of the bankruptcy, obtain the benefits of the automatic stay and eventually use the Chapter 11 proceeding to implement a global restructuring plan negotiated in the jurisdiction of its main interests.

Of course, there are times when it simply does not make sense to file any proceeding in the United States at all. A company with minimal US contacts, or one that has obtained a very high level of creditor consent to a proposed restructuring plan, may rightly feel that the marginal benefits of an ancillary proceeding do not outweigh the costs.