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Bankruptcy & Restructuring

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Introduction

By Jake Powers

We all may be telling each other that the issues that surrounded us in 2008 are well behind us but lawyers associated with restructuring and insolvency will tell you a very different story. The reality is the fallout from the crisis is still plaguing activities.

There seems to be agreement that one of the most significant challenges is the sheer number of legislative changes we have seen over the past 12 months. Some have been taken as a necessary response to circumstances we have witnessed over previous troubled years, but we have been hearing numerous comments on a lack of understanding of priorities in some cases by states.

A number of countries reacted to the economic crisis by immediately discussing amendments to their respective national restructuring and insolvency frameworks. Countries such as Spain, Germany and Greece updated their bankruptcy and insolvency laws. Ireland also made changes by establishing a special resolution regime for its credit institutions.

The EU is obviously still facing the challenge of attempting to harmonise insolvency law across Europe. As expecting, the institution has to hurdle a huge number of political and cultural barriers. One of the things the European Parliament released in June was a draft report identifying the specific areas where they felt national insolvency laws could be harmonised across the EU. The most significant areas including the opening of insolvency proceedings, avoidance actions, restructuring plans, filing of claims, and qualification and work of liquidators.

The general feeling however is that whilst the actions of the European Parliament are understandable and even admirable, whether they are achievable is something very different. The sheer diversity of individual member states with differing political and cultural backgrounds makes this an almost impossible task.

The Eurozone crisis is an obvious concern for all member states with all facing the reality of growth below the long-term trend. The entire situation has cast a shadow of uncertainty over the global economy with the outlook becoming more and more unpredictable. We can be certain however that growth is likely to be constrained and investment suppressed. We therefore can put an even greater importance of understanding of changes of laws and what it actually means for member states.

Europe is not alone in its recent struggles and the US has experienced some much publicised issues of its own. The bankruptcy of MF Global was extremely significant- not just for the scale of loss over a short period or the mismanagement issues but in fact the way winding down a securities firm was approached. It may have been short notice but most of the actions screamed disorganisation and misunderstanding. The US had of course introduced new rules post Lehman however the jury is out over the long term impact of these adjustments and whether more attention is needed.

We can also mention that Basel's proposed rules on winding down systematically important financial institutions certainly makes this an even more complex area of discussion- an area that desperately requires a great deal more clarity.

Whatever we see over the coming months and despite the negatively which often surrounds the subject, those involved in restructuring and insolvency matters will never be short of talking points.

The role of the insolvency profession in supporting business rescue

By Frances Coulson

The struggling economy and the subsequent impact on businesses in the UK has meant that the work of insolvency practitioners has remained in the spotlight. In 2012, this is it set to continue, with high profile cases such as La Senza, Blacks and Peacocks already having caught the attention of the press.

As the insolvency trade body, representing 97% of insolvency practitioners (IPs), R3 has been involved in a number of Government consultations and worked hard to improve the reputation of the profession and crucially, the understanding of what its members do.

One such issue for the profession is that of pre-packs. A pre-pack is an agreement for the sale of an insolvent company's business and assets, put in place before the company goes into a formal insolvency process. The speed at which this happens is necessary to preserve the value to the business; however in 2011 the Government announced that creditors will be given a three day notice period when a business is being sold to a connected party.

Earlier this year, the Government decided to reconsider the three day notice period, a decision that was welcomed by R3. Had this have gone ahead, it would have lead to more businesses closing, job losses and secured creditors losing out as more businesses would have been liquidated rather than pre-packed.

Research has found that in 92% of pre-pack cases, all of the employees were transferred to the new business, compared to 65% in a business sale and that they deliver higher returns to secured creditors than a business sale (secured creditors get 35% back compared to 33% in a business sale). We believe Government's decision to reconsider this legislation sends a positive message about business rescue in the UK.

We do however appreciate concerns about pre-packs, especially sales to connected parties and more can be done to improve the perceptions around lack of transparency. It is worth noting that safeguards against abuse are already built into the pre-pack process and under SIP 16, the administrator must justify and explain to creditors why a pre-pack was considered appropriate in the circumstances. The profession is keen to work with the Government to look into ways to allay some of the fears about pre-packs but if the UK wants to encourage an entrepreneurial society, then people must be allowed second chances and businesses must be rescued where possible.

Another key issue for insolvency practitioners and UK businesses, is that of administration expenses. R3 has long campaigned for the implementation of legislation to clarify what is an administration expense to improve the UK's business rescue culture. A recent survey of R3's members found that on average, 28% of potential trading administrations are now pre-packed or liquidated because of the uncertainty around the expenses regime.

Until recently, an administrator understood that if he was trading a business and trying to rescue it he had to pay certain trading costs (administration expenses) as a priority, but recent court rulings have thrown uncertainty on this principle. The interpretation of what is considered an administration expense has widened considerably, particularly for rent and pensions obligations, to the extent that rescuing a business through a trading administration can be too costly.

Our concern is that the UK's business rescue culture is being hampered by the Government's refusal to implement legislation to clarify what is an administration expense. If insolvency practitioners are not sure about how much it is going to cost to trade a business they may have to make the decision to close it, meaning creditors lose out and jobs are at risk.

Not only does this uncertainly have huge consequences on the ability to rescue businesses, but also on the lending culture, and returns to unsecured creditors. For these reasons, a decision on administration expenses should not be left up to judicial discretion on a case by case basis, but needs to be laid out clearly in legislation. R3 wants to see a solution as to which items of expenditure should be payable as an expense of administration and which should not to ensure costs are known, therefore giving practitioners the ability to save more businesses.

The UK's rescue culture and the cultivation of an entrepreneurial society are vital to the health of the economy. To support this, we believe that the Government also needs to look into the issue of 'ransom' payment demands from suppliers when a business enters insolvency.

We estimate that some 2,000 businesses every year could be saved if not for the opportunistic actions of suppliers that demand ransom payments, increase their prices, or cease supply as a business goes into insolvency. We would like to see an amendment of the Insolvency Act 1986 which will ensure that insolvent businesses are not denied the resources they need to trade out of their financial difficulties. Specifically, we would like to see a wider stay to hold 'ordinary terms of business' in place in the event of insolvency. This would mean that as long as contractual payments are made then suppliers still have to supply on the same, pre-insolvency, terms.

Insolvency Practitioners play in vital role in supporting businesses and contributing to the health of the economy. Research has shown that those IPs that work on corporate cases spend nearly a quarter of their time on business rescue and turnaround activity, working to prevent insolvencies. We have yet to see the volume of insolvencies that have characterised previous recessions, indicating that more is yet to come. As the economy starts to recover, we expect to see more 'zombie' businesses start to fail as part of a clear out. IPs will continue to work hard to turnaround businesses where possible or maximise returns to creditors in the event of failure. Insolvency practitioners work with the statutory tools determined by government and fulfil statutory duties. They are well placed to advise on the effects of current and proposed regimes and so we hope Government will take on board the views of the profession.

Frances Coulson, R3 President

R3 is the trade body for Insolvency Professionals, and is made up of 97% of the UK's Insolvency Practitioners from all over the UK.

R3 comments on a wide variety of personal and corporate insolvency issues. Please contact the press office, or see www.r3.org.uk for further information.

R3 promotes best practice for professionals working with financially troubled individuals and businesses; all R3 members are regulated by one of nine recognised professional bodies.

R3 stands for 'Rescue, Recovery, and Renewal' and is also known as the Association of Business Recovery Professionals.

To contact R3 please call +44 (0) 207 566 4217 or by email at r3.press@r3.org.uk.

Corporate and Insolvency Law Developments in the Republic of Ireland

By William F. O'Grady

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Personal Insolvency - the current position:

Personal Insolvency in this jurisdiction is currently governed by the 1988 Bankruptcy Act. On the 24th of June, 2011 the Government introduced the Civil Law (Miscellaneous Provisions) Bill 2011 which includes amongst its provisions certain proposed amendments to the current Bankruptcy regime.

The Memorandum of Understanding which the Irish Government has entered into with the EU/IMF states that legislation reforming the area of Personal Insolvency in this Jurisdiction must be published before the end of March, 2012. The June, 2011 Bill is the first step towards reform in this area.

The June 2011, Bill introduces, for the first time, an entitlement for a Bankrupt to be automatically discharged after 12 years. Whilst the introduction of an automatic discharge from Bankruptcy is to be welcomed, the 12 year period is still excessive and considerably longer than in other Jurisdictions, most notably the UK.

The Bill also introduces a new "5 Year Rule" which provides that a Bankrupt may be discharged from his Bankruptcy after a period of 5 years however, the finer detail of the text confirms that in order for a Bankrupt to avail of this 5 year discharge, he must have firstly:-

a) Realised his Estate in full;
b) Paid the costs, fees and expenses of the Official Assignee (OA);
c) Paid his Preferential Creditors in full;
d) Disclosed all of his after acquired property;
e) The Court must also have confirmed that it was reasonable and proper to discharge the Bankrupt.

In reality therefore, the likelihood of an individual debtor emerging from Bankruptcy under the proposed 5 Year Rule remains limited. Many individuals currently facing bankruptcy, particularly property developers who have availed of significant capital allowances which will be clawed back if they are to be declared bankrupt, will have significant Preferential Revenue debts. In the current climate, even if their Estates are fully realised, sufficient funds may not be generated to discharge the costs, fees and expenses of the OA together with the preferential debt.

It is to be remembered that the June, 2011 Bill is only an interim measure and it is acknowledged by the Government that a more radical reform of the area of Personal Insolvency (Bankruptcy) is required. The required major reform in this area will be effected through the Personal Insolvency Bill which is expected to be published in the first three months of 2012. There are suggestions that such further Legislation may follow the Recommendations of the Law Reform Commission (LRC) which published its proposals for Reform in December 2010.

The main reforms proposed by the LRC were:-

1. An automatic discharge from Bankruptcy after 3 years subject to :-

a) Leaving the Bankrupts full Estate (including any house) in the Bankruptcy and
b) Allowing the Official Assignee in Bankruptcy to order the Bankrupt to make repayments for up to 5 years.

2. An increase in the minimum debt level necessary to bring forth a Creditors Bankruptcy Petition from €1,900.00 to €50,000.00.

3. Revenue to lose its preferential status in the Bankruptcy process.

4. The introduction of a system in Personal Insolvency similar to Section 150 / Section 160 of the Companies Acts (Restriction/Disqualification of Company Directors).

While the amendments contained in the June, 2011 Bill are to be welcomed, Personal Insolvency Legislation in this Jurisdiction requires a complete overhaul. In 2009 there were 74,000 Bankruptcy Orders made in the United Kingdom. This is to be compared with 17 Orders made in Ireland during the same period and the slightly increased figure of 29 Orders in 2010. 15 Bankruptcy Orders have been made so far this year. The level of Bankruptcy Orders remains extremely low despite the enormous level of personal debt in this Jurisdiction and reflects the stark contrast between the philosophy surrounding Personal Insolvency in the UK and in Ireland. Personal Insolvency in this jurisdiction is still perceived as a form of punishment whereas the philosophy behind the UK model is that of rehabilitation and encouragement of entrepreneurship. It is not surprising therefore that many individuals facing Bankruptcy in this Jurisdiction have moved their Centres of Main Interest (COMI) to the UK to avail of a more debtor friendly Bankruptcy regime. This has become known as Forum Shopping / Bankruptcy Tourism.

It is to be hoped therefore that, when introducing further legislation in this area, the Government will take the opportunity to introduce the reforms necessary to bring Ireland into line with its European Partners and closest neighbours.

Corporate Examinership:

Up until 2009 Examinership was a much utilised tool amongst Insolvency Practitioners. However, as a result of various Supreme Court Decisions it has become clear that in the current economic climate Examinership is not an appropriate restructuring option for many Companies and in particular large Construction Companies. Examinership applications by Trading Companies have also reduced dramatically due to a lack of access to new capital which makes it difficult for some Companies to find the new Investor required in an Examinership Scheme. However, there have been some important Examinerships in the last 12 months which have led to the successful Corporate Re-structuring of such major Companies as Vera Moda Retail Stores, Irish Car Rentals Group, Jackie Skelly Fitness and the Aer Arann Airline.

> *"Receivership, Liquidation, Examinership should always be a last resort for a business and there are now many innovative options available to trading business and individuals in the form of Informal Restructuring."*

Publication of Pillar A of the Draft Companies Bill:

The Government plans to introduce a new Companies Bill to simplify existing Company Law in this jurisdiction. On the 30th May, 2011 the Minister for Enterprise Trade and Employment published a draft of Pillar A of the proposed Bill. This will represent two thirds of the future Companies Bill and contains all of the law relating to private companies limited by shares. The remainder of the proposed draft is expected to be published in 2012.

The draft Companies Bill proposes the following changes to current Company Law.

-Private Companies to hold written Annual General Meetings in place of the current requirement to hold AGM's in person.

-A Private Company will now have the option to appoint only one Director in place of the current requirement to appoint a minimum of two Directors.

-The current Memorandum and Articles of Association will be replaced by one document and the requirement to have specific internal regulations, currently in the form of Articles of Association will be removed as companies will be required to abide by the Regulations contained in the proposed law.

Succeeding during recessionary times:

Receivership, Liquidation, Examinership should always be a last resort for a business and there are now many innovative options available to trading business and individuals in the form of Informal Restructuring. There have also been major tax changes which if utilised correctly will assist in the preparations of an informal restructuring such as to avoid Insolvency and, at the same time, achieve a higher yield for Creditors.

High Profile Engagements:

O'Gradys, have been involved in a number of complex and unique assignments, National, International and Cross Border. In particular we have acted for four of the ten largest cases that have been transferred from the Irish Banks to the National Asset Management Agency ("NAMA"). We have also advised in respect of the two highest profile Personal Insolvency Cases in this jurisdiction and we are currently advising a number of clients in respect of the preparation of Informal and Formal Schemes of Arrangements, Insolvency Procedures, Bankruptcy, Corporate Re-structuring and Tax Planning.

Since establishment in 1987 O'Gradys Solicitors has concentrated upon delivering our skills in Commercial Law and the Firm now occupies a significant niche position in this area of practice. We provide a personalised service offering Corporate, Commercial, Taxation, Banking, Financial and Private Client advice.

We are dedicated to finding fast and efficient solutions to our clients' needs with an emphasis on problem solving from first consultation. In today's competitive and demanding commercial environment, speed of response is essential and this is what we strive to achieve for our clients. We recognise that we are an important service provider and that our clients appreciate sound, uncomplicated and prompt advice without the necessity of spending long hours in unproductive consultation.

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- *Taxation*
- *Wealth Management/Estate Planning*

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Lenders and distressed investors beware: key issues regarding payment subordination in Spanish insolvency proceedings

CUATRECASAS, GONÇALVES PEREIRA

By Iñigo Rubio & Ignacio Buil Aldana

Subordination agreements are very common in financing transactions. They are generally used by different classes of lenders to establish the priority of repayment rights against the borrowers and their assets, enabling certain lenders to give priority to their debts over the borrowers' debts with other creditors and to reduce their loss if a borrower defaults.

Subordination agreements are generally included in a global intercreditor agreement (which governs intercreditor relationships during the life of the financing) and typically define the intercreditor payment priority, by establishing that consideration otherwise payable to a subordinated (or junior) creditor must be paid to a senior creditor until that creditor is paid in full. In a typical capital structure where, for example, subordinated lenders enter into an agreement with senior lenders to subordinate and, subsequently, the borrower defaults, and payments are made to all creditors, all payments due to the subordinated lenders will be paid to the senior lenders until these are paid in full.

When entering into this type of contractual arrangements is key for creditors to understand how the terms of these subordination agreements will be treated in the borrower's insolvency proceeding and, in general, how they will be affected by a potential insolvency filing of the debtor. With this in mind, when determining priority among creditors of the same class, it must be considered that the insolvency laws of many legal systems worldwide carry less weight than the agreements entered into by the creditors themselves. For example, section 510(a) of the US Bankruptcy Code codifies the full enforceability of contractual subordination agreements between creditors of the same class.

However, under the Spanish Insolvency Act framework no such provisions codifying the full enforceability of contractual subordination agreements exist. In fact, section 92.2 of the act when determining which claims should be classified as subordinated claims (the act establishes the automatic—not equitable—subordination of certain classes of claims), include claims that "under a contractual arrangement, are subordinated with regards to all the other claims against the debtor." Therefore, in contrast to the US Bankruptcy Code provisions set forth above, the Spanish Insolvency Act establishes that absolute subordination (subordination vis-á-vis all creditors) is fully enforceable in bankruptcy, but not relative subordination (subordination only among creditors of the same ranking).

In practical terms, this means that in Spanish insolvency proceedings, subordination agreements between creditors of the same ranking are not enforceable and, therefore, the additional protection bargained for by senior creditors versus junior creditors is not achieved. Instead, when classifying the debtor's liabilities, the Spanish insolvency courts exclusively apply the classification of claims ranking under the Spanish Insolvency Act (which establishes that insolvency claims can only be classified as privileged—special or general privilege—, ordinary and subordinated) and do not enforce the terms of subordination agreements. Therefore, junior creditor's insolvency payment rights remain intact and unaffected by a subordination agreement in the context of the debtor's insolvency proceedings.

However, the subordination agreement, although not enforceable in the insolvency proceedings, would still be binding for the lenders who would have to honor its terms. If any party to the subordination agreement were to breach its terms, the affected lenders would be entitled to take legal action (outside of the insolvency court) against the breaching party. Therefore, if junior creditors were to breach their contractual obligations vis-à-vis senior creditors' payment priorities (by not delivering to the senior creditors any payments obtained in the context of the insolvency proceedings when the senior creditors have not been paid in full), the senior creditors would be entitled to start legal proceedings against the junior creditors, to have their contractual rights fully enforced. This, of course, can be burdensome and expensive, making subordination agreements practically ineffective when the debtor files for insolvency, forcing lenders to look for alternatives to payment subordination when structuring their financing transactions.

A possible alternative would be for senior creditors to structure transactions where priority is based on liens rather than on payments. This is accomplished through second-lien loans, which are typically subject to lien subordination rather than payment subordination. In this scenario, junior creditors would not have access to the proceeds of the shared collateral until the senior creditors are paid in full. This priority would not apply to unencumbered assets, as the proceeds resulting from those assets would be shared pro rata between the first- and second-lien lenders. Although "second lien" financing is not common in Spain, we cannot rule out the possibility of this changing in the future, given the current dynamics of the Spanish credit market and that the new financing players (i.e., mezzanine lenders) are expected to have an important role in the future.

In conclusion, lenders (when structuring their transactions) and distressed investors (when defining their position in the debtor's capital structure and designing their investment strategy) must be aware of the non-enforceability in Spanish insolvency proceedings of payment priorities under subordination agreements, so they can bargain for additional or alternative priorities to payment priority (i.e., lien priorities) or correctly assess this particularity of Spanish insolvency law when pricing the distressed credit instruments in which they intend to invest.

With almost a century of professional practice and an excellent reputation, Cuatrecasas, Gonçalves Pereira provides legal advice in all areas of business law, including advice in connection with financial restructuring processes, advising both debtors and creditors on issues including preliminary analysis of debt to be restructured and the options in a financial distress situation. In this regard, the firm participates in all stages of Spanish and cross-border complex deals involving reorganisations, restructurings, workouts, liquidations and distressed acquisitions.

For more information visit www.cuatrecasas.com.

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Mr. Rubio specializes in advising on the financing of infrastructure projects (public private partnerships and private finance initiatives) and real estate projects, whether simple, syndicated or structured (e.g., sale-and-leaseback and off-balance sheet transactions). He also has ample experience in corporate and asset finance, and debt restructuring transactions, having participated in several of the most important and complex refinancing processes in recent years. Since joining Cuatrecasas, Gonçalves Pereira in 2000, Mr. Rubio developed most of his career in the firm's Madrid office before being transferred to the London office in January 2010.

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German Debt Restructuring: Recent Trends And Developments

By Patrick Ziechmann and Stefan Schwertel

In 2009, the German economy was hit hard by the worldwide economic and financial crisis. Like most other industrial economies it suffered the biggest economic downturn for decades. However, the German economy was able to recover relatively quickly. Short-time work, the 'cash-for-clunkers-program', a strong export market and increased private consumption driven by low interest rates have supported this recovery. As a result, in 2010 Germany enjoyed its highest level of economic growth since the reunification. By Q2 of 2011 however, this growth trajectory had stalled. Due to the ongoing **sovereign debt crisis,** the outlook for 2011 and 2012 is currently very uncertain (current GDP growth predictions for Germany are c. 2-3% in 2011 and only c. 1 % in 2012).

Despite the decline in the number and volume of restructuring cases especially in the first half of 2011, the next wave of financial restructurings is already impending. Almost €100 billion of leveraged debt outstanding in Europe – with a substantial portion in Germany – is set to mature by 2016 (the **'maturity wall'**). Better quality debt may be refinanced over the bond and loan markets. However, according to Standard & Poor's, c. 90 percent of the debt maturing by 2016 is rated 'B+' or worse and these borrowers may struggle to refinance through conventional means. The peak in the maturity profile for total European leveraged debt is scheduled to occur in 2015 and it is unclear whether there will be sufficient liquidity in the market to refinance all of this debt at acceptable prices as it matures.

Additional refinancing requirements for the German market will occur from upcoming maturities of **standard mezzanine programs**. In total, €4.4bn of mezzanine debt is scheduled to mature between 2011 and 2014. According to a current study by PwC, 10-20 percent of the mezzanine financed companies will face serious refinancing problems and are likely to become restructuring cases – almost €1.0bn of total mezzanine debt. In the meantime, the first standard mezzanine program (PREPS 2004-1) reached its maturity in May 2011 – the rate of return for the investors of around 6-7% was less than expected.

In light of these upcoming refinancing challenges, we highlight some of the latest developments in the German debt restructuring environment below:

Financial restructurings in Germany are usually accompanied by a **Restructuring Opinion ("Sanierungsgutachten")** from an independent expert reflecting on the feasibility of the proposed restructuring. This mitigates the risk for lenders (collaterals and claw-backs) and is typically required before a final decision on possible restructuring options is made. IDW S6, published by the Institute of Chartered Accountants in Germany, is the established standard for Restructuring Opinions. Currently, the Institute is working on an amended version, integrating some of the feedback received by practitioners. The main amendments include: highlighting that elements of the German Supreme Court ("BGH") ruling are included; incorporation of a statement that there is no risk of insolvency within the completion period of the Restructuring Opinion; and the necessity of a statement that the company has the ability to be restructured. It is expected that this new version (IDW S6 N.F.) will be published by the end of this year.

Only in very rare occasions, German insolvency law has been viewed as an alternative instrument to an out-of-court restructuring in the past and has therefore attracted criticism, in particular during the economic crisis. Points of criticism are, inter alia, the lack of influence on the appointment of insolvency administrators by creditors and the impossibility of debt-to-equity swaps without the cooperation of the existing shareholders (only via enforcement).

In February 2011, the German Federal Government published the first draft of a new **Act Serving the further Facilitation of the restructuring and the reorganisation of enterprises ("ESUG").** The purpose of the draft act is, among others, to involve the creditors in the selection process of the (preliminary) insolvency administrator and hence to improve the reliability and predictability of insolvency proceedings. The draft act also attempts to expand the opportunities for the reorganisation of an insolvent debtor in so-called insolvency plan proceedings. Currently, the rights of the existing shareholders of an insolvent company remain unaffected by a recapitalisation of the company in connection with an insolvency plan. Thus, debt-to equity swaps in order to recapitalise the company are not possible without the cooperation of the existing shareholders. This separation of insolvency law and corporate law shall be abandoned and insolvency plans shall provide the debt-to-equity swap as an instrument to recapitalise insolvent companies. This bill of the German Federal Government (ESUG) is estimated to come into effect at the beginning of 2012.

The ESUG is clearly perceived among practitioners as a step forward in the right direction. However, how big the step really is remains to be seen as insolvency in Germany might continue to attract a significant level of stigma.

In addition, with the options of a **double-sided trusteeship**, the applicability of the **UK Scheme of Arrangement** if specific criteria are fulfilled (e.g. legal documents according to UK LMA standard) – recent examples include Telecolumbus and Rodenstock; and the possibility of **enforcement procedures** also regarding German legal entities (e.g. Primacom, Walter Services), the German toolkit for Financial Restructuring has been extended. Nevertheless, it is most likely that Germany will remain a relatively difficult jurisdiction for restructurings. Furthermore, there is clearly no "one size fits all" solution, especially also due to tax reasons.

The European Commission has recently ruled (26 January 2011) that the bail out clause ("Sanierungsklausel") constitutes unlawful state aid. This clause covers the offsetting of losses carried forward against future profits. In the case of illiquid or over-indebted companies (subject to certain conditions), this offsetting could occur despite a detrimental change in ownership if the share transfer occurred with the aim of restructuring the company.

"Our recent practical experiences in leading large and complex German debt restructurings has shown that understanding the specific jurisdictional issues as well as the varying different stakeholder mindsets even within a specific lender's syndicate is critical to reach a successful outcome ..."

Following the decision on the "Sanierungsklausel", a discussion has arisen as to whether the **German recapitalisation decree ("Sanierungserlass")** may also constitute unlawful state aid. The recapitalisation decree is currently the only possibility to offset carried forward tax losses against recapitalisation gains without the requirements of German minimum taxation, for instance as a result of debt waiver or debt-to-equity swap. According to these rules, taxable income of up to €1 million can be offset entirely, while amounts exceeding this level can be offset by losses carried forward at a rate of 60 percent. Therefore, only roughly 40 percent of recapitalization gains (covered by losses) remain taxable at a rate of c. 30 percent. In addition, the recapitalisation decree allows for the deferral and abatement of tax on recapitalisation gains to the extent such gains exceed the existing losses carried forward. Should this rule be deemed to constitute unlawful state aid, it would significantly influence future debt restructurings as certain restructuring options would be replaced by others, such as a debt waiver by e.g. a debt-pull-up.

PwC's restructuring practice is one of the largest in Europe and worldwide, enabling us to bring unrivalled knowledge, experience and expertise in restructuring advice and implementation to every case. The German branch with over 50 dedicated restructuring professionals has completed over 50 restructuring deals in 2010 including some of the key recent German financial restructuring cases.

Patrick Ziechmann is a Partner of PwC Business Recovery Services and he is leading our expert team in our Dusseldorf office. He has extensive consultancy practice in the area of corporate finance. He is specialized in developing and implementing concepts for reorganizations and business recoveries in different industries with particular focus on mechanical engineering, construction, chemistry, telecommunication and media. In this context, he focuses on strategic, operational and financial restructuring, business planning, cash management and insolvency advice. Patrick Ziechmann can be contacted on +49 211 981 7518 or by email at patrick.ziechmann@de.pwc.com.

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The New Ukrainian Insolvency Law: Key Issues

By Olexiy Soshenko & Andrii Grebonkin

CLIFFORD CHANCE

In January 2012 amendments were made to the insolvency laws in Ukraine. While the general framework for insolvency proceedings will remain the same, a number of significant amendments have been made. Below we set out a summary of the most important changes which the restated insolvency law introduces to the insolvency process. The amendments introduced will become effective on **19 January 2013.** We note that the President of Ukraine has already requested that the government revise certain sections of the amended law and so there is a likelihood that further changes of the law will occur before these changes become effective.

Changes in the status of secured creditors

Currently it is not entirely clear whether a secured creditor is able to enforce its security once insolvency proceedings have commenced and the moratorium is in place. This is due to inconsistencies between the wording of the insolvency law and the enforcement law. The amendments to the insolvency laws will resolve the issue by allowing a secured creditor to enforce its security after the commencement of insolvency proceedings, irrespective of the moratorium. However, in order to do this the secured creditor will need to obtain the consent of the insolvency court.

Under the current law there are no express rules on whether secured creditors may vote at creditors' meetings. This has resulted in different interpretations of the law by the courts. Under the amended law, secured creditors will be explicitly prevented from voting.

Under the amended law, in addition to the currently existing right to veto the amicable settlement agreement which will continue to exist in the amended law, the secured creditors will have the right to veto the rehabilitation plan if the latter is prepared during the rehabilitation stage. Under the new law, should any of the secured creditors not agree with the plan, the other secured creditors may decide either to sell the collateral and satisfy the claim of such dissenting creditor or to buy the claim. The same options will exist for unsecured creditors if a secured creditor does not agree with the plan.

Eventually, the court will decide whether or not to approve the plan if none buys out claim(s) of the dissenting secured creditor(s). The same procedure will apply to overcoming the veto of secured creditors as to an amicable settlement agreement executed during insolvency.

New concept of hardening periods

The amended insolvency law will introduce a completely new procedure for determining which transactions made before the commencement of insolvency proceedings may be set aside.

The court will be able to, following an application from the insolvency manager or any competitive creditor, invalidate any transactions made by the debtor during the period of one year before the date of the preparatory hearing, if such transaction resulted in the debtor:

- alienating its assets, incurring undertakings or waiving its proprietary claim(s) without consideration from the other party;

- performing its obligations before they became due (we note that this should not include an acceleration or mandatory prepayment of a loan but would include a voluntary prepayment of a loan);

- entering into obligations as a result of which it became insolvent. This means that if a loan agreement is invalidated on this ground, the security and guarantees/sureties provided in connection with that loan will fall away;

- alienating or acquiring assets not at their market value and as a result of which the debtor became insolvent;

- making any cash payments or receiving payments in kind at a time when the amount of creditors' claims exceeds the value of the debtor's assets. This would mean that (re)payments under loans and suretyships would potentially be challengeable in the event when the value of the debtor's assets is lower than the aggregate amount of the creditor's claims; and

- granting security.

The amended law does not require that any additional criteria for invalidation of such transactions arise, for example, it does not expressly require evidence that the transaction resulted in preferential treatment.

The result of such invalidation will be that the relevant creditor will need to release the security (if any) or return the assets it received from the debtor or compensate the debtor for the market value of such assets (should it be impossible to return them in kind) and, in the case of a loan, the debtor would need to repay the loan to the creditor.

The interesting new development in the law is that creditors who have claims against a debtor as a result of the invalidation of their transaction will rank in the first rank of creditors irrespective of whether or not they had security. In particular, this would mean that if shareholders' unsecured loans (which qualify for the 4th rank) and any secured loans are invalidated pursuant to the above provisions, then claims of both shareholders and former secured creditors would fall under the same first rank.

However, if their security has fallen away, the creditor will not be treated as a "secured creditor" and so would lose its ability to block rehabilitation plan and amicable settlement agreement. On the other hand, it is not entirely clear under the insolvency law whether such former secured creditor would be able to benefit from voting rights as a result of the mentioned transformation of the claim during insolvency.

"The new law will introduce a procedure for the replacement of a debtor's assets as one of the rehabilitation options. In order to be able to implement the replacement of assets, the creditors must ensure that such arrangement is included to the rehabilitation plan which is approved by the court."

'Piercing the corporate veil'

The new law establishes a rather revolutionary concept according to which the shareholders along with directors of the debtor may be found secondary liable before third party creditors of the insolvent party if:

the assets of the debtor are insufficient to satisfy the creditors' claims in full; and

the actions of such director, shareholder or any other person resulted in the debtor's bankruptcy.

Replacement of assets as a new restructuring method

The new law will introduce a procedure for the replacement of a debtor's assets as one of the rehabilitation options. In order to be able to implement the replacement of assets, the creditors must ensure that such arrangement is included to the rehabilitation plan which is approved by the court.

This would work by permitting a debtor, during the rehabilitation phase, to incorporate a subsidiary and become its sole shareholder. In return for the shares in such entity, the debtor will be able to contribute all its assets and all its liabilities (save the liabilities to the competitive creditors) to the share capital of such entity.

Subsequently, these shares may be sold and the proceeds received out of such sale used for satisfaction of the claims of the competitive creditors. On one hand, the described procedure could ease the process of satisfaction of the creditors' claims. However, on the other hand, it would require significant preliminary work to be carried out (e.g., incorporation of a new entity, inventorying the debtors' assets, sale of shares in the newly established subsidiary).

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Reorganisation And The Bankruptcy Administrator

By Ardjana Shehi

KALO & ASSOCIATES
ATTORNEYS AT LAW

Albanian Bankruptcy Law (No.8901 of 23 May 2002), as amended by Law No.9919 of 19 May 2008 and Law No.10137 of 11 May 2009, which is an evident adaptation of German legislation, aims to establish non-discriminatory and mandatory rules for the repayment of obligations by debtors in a bankruptcy procedure and to ensure an adequate, reliable and effective mechanism for the reorganization or liquidation of a company that is facing financial difficulties.

Corporate Rescue and Reorganisation

This Bankruptcy Law provides that the debtor has some alternatives to bankruptcy which may be agreed upon during insolvency. One of the alternatives provided by this law is corporate rescue, thus, Albanian Bankruptcy Law recognizes the principle of corporate rescue.

The law has no specific provisions for restructure of the company outside a formal procedure. However, prior to submission of the petition for the opening of the insolvency proceedings, the debtor is not prohibited to try to achieve an out-of-court restructuring. It should be highlighted that although the law does not prohibit the out-of-court reorganization, the directors of the company are obliged to request the immediate initiation of an insolvency proceeding, not later than 21 days from the date the legal entity becomes insolvent. In the case that they do not proceed with such request they will be personally responsible for the compensation of the creditors if such creditors suffer losses because of the failure to file the petition within 21 days. Note also that Albanian Legislation does not have specific provisions for an expedited restructuring of the debtor by means of a pre-packaged sale.

The law provides that the reorganization of the debtor is possible and the mechanism for implementing the principle of corporate rescue is the Reorganization Plan ('RP') approved by the Creditors' Assembly, agreed by the debtor and approved by a court judgment of the Bankruptcy Court and filed with the Court Registry. There is no draft RP available and the Bankruptcy Law merely provides about the elements (some of them mandatory) to be included in the RP. The Bankruptcy Law provides for the necessary quorum/majority for the approval of RP. This law does not have specific provisions related to the process for "cramming down" creditors who do not approve the RP. However, the law provides that RP cannot be approved by the Bankruptcy Court in the cases that this RP is objected from the majority of the bankruptcy creditors. In addition, this law provides that the creditors and the debtor, according to the Code of Civil Procedure, may initiate a special appeal related to the court decision for the approval of RP.

In addition, the Bankruptcy Law provides that the bankruptcy administrator can obtain new financing and the approval of the Creditors' Committee (if any) or of the Creditors' Meeting is indispensable. This law does not have specific provisions about the ranking of this new financing. However, according to the law, the "new financiers" are not prohibited to perfect a security for such new finance, thus, to become secured creditors and the "new financier" will be ranked in the same ranking with the other bankruptcy secured creditors (of course, in the case that the debtor does not succeed with the RP).

The law does not specifically provide for the length of RP. However, insofar as RP is important for purposes of payment of the creditors, the provisions related to termination of RP gives the lead to understand the maximum timeline the creditors ought to be paid during the implementation of the RP. The Bankruptcy Court decides on the termination of the supervision of the implementation of the RP when the creditors' claims are satisfied or their fulfilment is secured or three years from the conclusion of the bankruptcy procedure (i.e. in this case the start of the implementation of the RP) and if there has been no new petition filed with the court for initiating a new bankruptcy procedure.

this case the start of the implementation of the RP) and if there has been no new petition filed with the court for initiating a new bankruptcy procedure.

One can understand that the efforts to reorganise a debtor according to Albanian Bankruptcy Law is not an easy task. Therefore, the human resources participating in bankruptcy proceedings and especially the bankruptcy administrator(s) ought to be well-trained to perform such important duties.

Bankruptcy Administrator

According to the Bankruptcy Law, the Court may appoint the administrator who should duly and properly perform, during the whole procedure until it is closed, the duties stated in the law. The work of the Insolvency Administrator is supervised by the Insolvency Court and by the Creditors' Meeting and the Creditors' Committee (certainly, if any). With the opening of the insolvency proceedings, the debtor is deprived of his rights to dispose and manage the insolvency estate unless the court decides otherwise. It is the Insolvency Administrator who is appointed to possess and manage the insolvency estate.

The original law (i.e. prior to both amendments) did not have extended provisions with regard to bankruptcy administrator; the original law did not provide clearly specific criteria for the appointment of a bankruptcy administrator, except for the requirement that the administrator should have a background in economics. Therefore, to be appreciated is the effort to include in the law, through both recent amendments, further provisions regarding the qualities and the method of selection of the Bankruptcy Administrator. According to the existing legal provisions the bankruptcy administrator ought to be a certified auditor and independent from debtors and the creditors. The creation of the Bankruptcy Supervision Agency was a positive step forward as an institution that will be in charge to train and license the bankruptcy administrators.

However, this Agency is yet far from the graduation of first administrators who are trained to have knowledge not only with regard to liquidation but also with regard to reorganisation in bankruptcy proceedings.

The lack of qualified bankruptcy administrators especially in reorganisation is one of the reasons why the Bankruptcy Law is not used to reorganise in the Albanian jurisdiction. Especially in these times of crisis, the use of bankruptcy related legal provisions to reorganise debtors requires from the Albanian authorities to speed up the process to prepare/license the generation of bankruptcy administrators who will be able to make possible the 'fresh start' of the debtors OR most important to 'refresh' the debtor to continue the activity without any important legal interruption.

"The lack of qualified bankruptcy administrators especially in reorganisation is one of the reasons why the Bankruptcy Law is not used to reorganise in the Albanian jurisdiction."

KALO & ASSOCIATES ATTORNEYS AT LAW

KALO & ASSOCIATES has long been a leading law practice in Albania and in Kosovo. The firm provides a full range of services in all commercial and corporate law for foreign and multinational companies and agencies. The firm delivers exceptional value, providing high quality, efficient and cost-effective legal solutions bringing innovative perspectives to clients' needs.

The firm is very often a first choice as reflected by its impressive client portfolio (including a considerable number of Fortune 500 companies) of such industries as banking and financial services, aviation, energy resources, general manufacturing, health care, insurance, commercial property, retailing, sports and entertainment, technology and telecom, and transportation.

Not only a local presence, our firm also enjoys regional recognition in South Europe due to our active involvement with our partner firms in the South East Europe Legal Group – an alliance of premier national law firms from 12 jurisdictions providing seamless legal services including cross-border commercial transactions (www.seelegal.org).

Ardjana Shehi has 20 years of experience as a lawyer and an extensive working experience in commercial law. Shehi joined KALO & ASSOCIATES in January 2005 and is already promoted as Partner. She holds a MBA Master Degree from the joint program of Nebraska University USA and Tirana Faculty of Economics. Since 2006 she is part of teaching team of the School of Magistrates, Tirana, as Trainer of continuous training for judges on bankruptcy law and tax law. Ms. Shehi is a co-author of the first legal bilingual dictionary (English-Albanian/Albanian-English) published in Albania. In addition, she is co author of the Judges Manual on Bankruptcy Law, product of a World Bank project, and she is also author of many articles published in Albania and/or abroad. Shehi is a board member in several legal and non legal organizations. Ardjana can be contacted on
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Developments around insolvency and restructuring in Iceland

By Pall Eiriksson & Steinunn Holm Gudbjartsdottir

BORGARLÖGMENN
– Holm & Partners

Icelandic law has two distinct insolvency procedures

The first, composition, is primarily aimed at achieving a rescue of the business. Whilst Icelandic insolvency law is closely modelled on the Danish system, readers who are familiar with company voluntary arrangements or schemes of arrangement in the UK will also recognise some similarities with composition. It is a flexible procedure which enables the company to seek a compromise with its creditors, for example a debt for equity swap, so that it can emerge from its financial difficulties. Like an English law company voluntary arrangement a composition does not deal with secured debt unless a creditor determines that his security is unlikely to be sufficient to meet his secured debt, in which case he can chose to treat some or all of his debt as unsecured. And like an English law company voluntary arrangement it does not enable one class of creditor to cram down another; instead, it enables the majority to impose its will on the minority (notwithstanding that calculating the appropriate majority in any case can be a challenging process and that the rules for voting are complex and difficult to apply to a large estate).

The second procedure is bankruptcy. Bankruptcy is primarily intended to address the situation in which the company cannot be restructured but where the assets of the company need to be gathered in and distributed to its creditors. It is possible to implement a composition as an exit from bankruptcy.

Many of the failures around the world have raised new and interesting questions about the application of insolvency laws. The Lehman collapse has raised interesting questions about the ability of parties to terminate for insolvency on both sides of the Atlantic, bondholder litigation has thrown into question the test for balance sheet insolvency and its implications in the UK and the Nortel collapse has undermined previously held wisdom about the ranking of claims in an English administration. Similarly, the failure of a number of major Icelandic institutions has tested many areas of Icelandic insolvency law which, to date; have been applied only in the failures of small and medium-sized enterprises and even then on an infrequent basis. Our firm has been at the forefront of many of these recent cases and we believe that we are uniquely placed to understand and apply the new learning which has arisen from the crisis in Iceland.

Iceland's principal banks conducted significant amounts of their business overseas before the collapse and both retail and institutional investors invested heavily in their debt issues. This means that the failed Icelandic banks have an international creditor profile and have assets in a number of jurisdictions. In handling the estates it is, therefore, necessary to have regard to the protection of assets overseas and to understand the needs of a diverse range of creditors who are not familiar with the Icelandic legal systems when determining a way forward.

Our firm has been extensively involved in the winding up of Glitnir bank hf handling directly applications in the US courts, the Canadian courts and courts in a number of European jurisdictions in order to protect assets and to gather them in. Similarly, an international creditors' committee has been formed to provide a consultative body of representative creditors. We have gained a good understanding of how international creditors expect a committee of this type to operate and of the work which legal advisers can do to ensure that the consultation process is effective and helpful.

Our work has changed significantly in scale and complexity as a result of our involvement with Glitnir and other multi-creditor situations arising out of the collapse. Much of our current work relates to efforts to find a successful exit from winding up for Glitnir. At the same time, the wider Icelandic economy is beginning to strengthen and the focus in many other cases is similarly turning from stabilising the situation in order to prevent value erosion to seeking a suitable structure for returning value to creditors.

In common with other jurisdictions, Iceland's insolvency & restructuring laws have been tested by the unprecedented scale and complexity of many of the recent collapse. The legislature has had to balance the need to make changes and clarifications so that creditor value can be preserved with the need to have a stable and predictable legislative environment.

This has not been an easy task and some changes have taken the market by surprise. For example, until the changes introduced through amendments to the Bankruptcy Act during 2011 it was not clear that winding up of financial institutions could only act as a staging post and that, in order to make distributions to creditors, it was necessary to implement another restructuring or insolvency process.

This is similar to the position in England before the changes to the administration regime introduced by the Enterprise Act in 2002. Whilst the trend in England and elsewhere is, perhaps, towards streamlining insolvency procedures as much as possible this can raise concerns about lack of transparency and independent review. In the Icelandic context it is perhaps not surprising, therefore, that the trend is towards ensuring that there are adequate checks and balances on office holders' powers even if that occasionally makes resolution more time-consuming and costly.

Steinunn Holm Gudbjartsdottir, partner, Borgarlogmenn – Holm & Partners

Mrs. Steinunn Holm Gudbjartsdottir is an attorney of the Supreme Court of Iceland and she was appointed in 2008 by the Icelandic District Court to oversee the insolvency proceedings of Glitnir banki hf. as the "Moratorium Appointee." She is currently the Chairman of the Winding-up Board of Glitnir, which is tasked by the Icelandic District Court with supervising the liquidation of Glitnir's debts and assets.

Steinunn is an Icelandic citizen. She attended the University of Iceland and studied law. She graduated in 1988. She worked in the office of the Reykjavík County Commissioner from 1988 to 1992 as a lawyer. She was admitted as an Attorney to the District Court in 1992 and entered private practice. In 2005, she became an Attorney to the Supreme Court and since 2007 has been a Vice-Judge in the Labour Court. She lectures in law at the University of Reykjavík, predominantly in her specialist fields of bankruptcy law, litigation and inheritance law. She is a member of a number of Icelandic governmental committees. Mrs. Steinunn can be contacted at steinunn@borgarlogmenn.is

Mr. Pall Eiriksson, partner, Borgarlogmenn – Holm & Partners

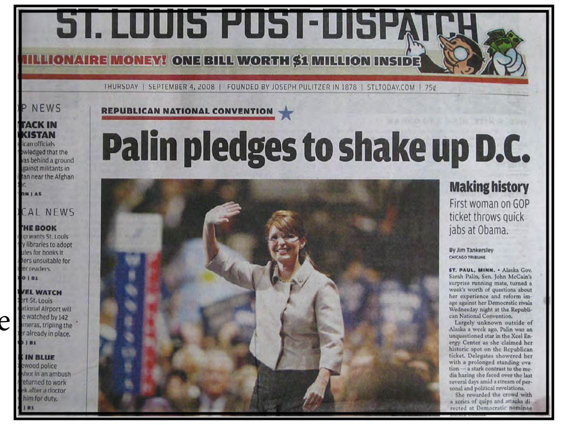
Páll is an attorney of the District Court of Iceland and was appointed in May 2009 by the Icelandic District Court to be a member of the Winding-up Board of Glitnir Banki hf.

Páll is an Icelandic citizen. He attended the University of Iceland and studied law. He graduated in 1999. He attended the University of Exeter in the United Kingdom, studying international business law, and graduated with a master's degree in that field in 2002. He was admitted as an Attorney to the District Court in 2000. He worked with Deloitte as a corporate and tax lawyer from 1999-2006. From 2006-2009 he worked at Glitnir as a lawyer. In October 2008 he was appointed the General Counsel for the Resolution Committee which took over control of Glitnir in that month and was subsequently appointed to Glitnir's Winding-up Board as described above. Mr. Eiriksson can be contacted at pall@borgarlogmenn.is

Snapshot – Top Ten US Bankruptcies in 2011

No. 10 - Lee Enterprises,

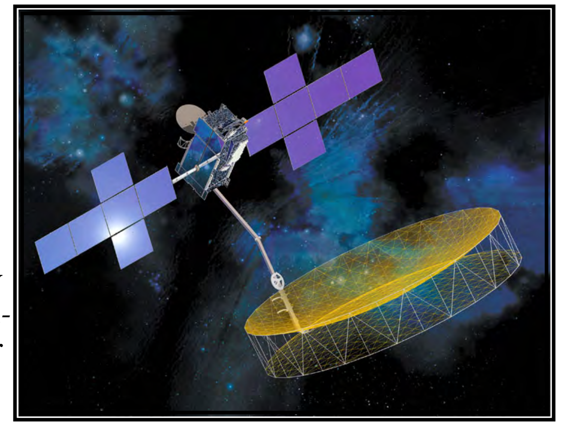
Assets: $1.15 billion,
Employees: 6,200,
Bankruptcy date: Dec. 12



Lee Enterprises is a newspaper publisher that produces over 40 dailies in 23 states across the US.

Loaded with $1 billion in debt that matures next month (April 2012), Lee filed for Chapter 11 bankruptcy protection to work with its creditors on extending debt repayments until the end of 2015.

No. 09 - Terrestar Corp,

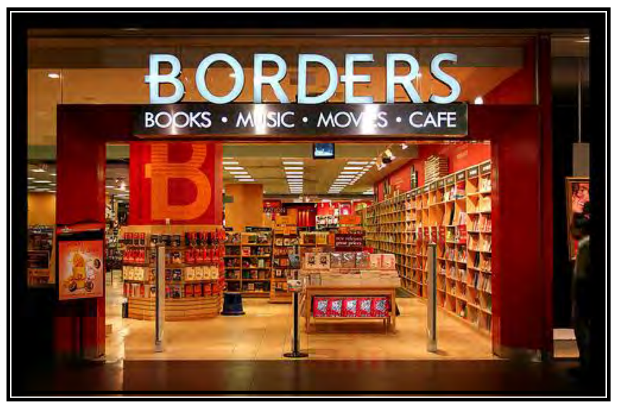


Assets: $1.38 billion,
Employees: 104,
Bankruptcy date: Feb. 16

TerreStar Corp, a mobile satellite network operator, filed for bankruptcy protection in February, several months after its subsidiary TerreStar Networks and 12 of its affiliates went in for similar restructuring in October 2010.

No. 08 - Borders Group,

Assets: $1.43 billion,
Employees: 19,500 ,
Bankruptcy date: Feb. 16



Borders Group was once the second-largest book retailer in the United States after Barnes & Noble. The 40-year-old bookstore chain, which operated over 600 stores in the U.S. and Asia Pacific, faced fierce competition with the rise of online retailers and the eBook market. Saddled with $1.3 billion in liabilities and declining book sales, Borders filed for Chapter 11 bankruptcy in February last year.

No. 07 - General Maritime Corp

Assets: $1.78 billion,
Employees: 1,137,
Bankruptcy date: Nov. 17

General Maritime is the second-largest owner of oil tankers in the U.S. The operator of a fleet of 33 vessels has been damaged by falling oil demand, multi-year low freight rates and an oversupply of oil ships.

No. 06 - Integra Bank Corp,

Assets: $2.42 billion,
Employees: 500
Bankruptcy date: July 30, 2011

Indiana-based Integra Bank operated 52 banking centers and 100 ATMs in Kentucky, Indiana and Illinois before it filed for Chapter 7 bankruptcy in July.

In August last year, Integra was ordered by federal banking regulators to increase capital ratios as they had fallen below the required levels. Integra tried to raise capital by selling some remotely located branches and by attempting to recover unpaid loans. Unable to improve its capital ratios, regulators shut Integra down.

No. 05 - NewPage Corp,

Assets: $3.51 billion,
Employees: 6,000
Bankruptcy date: Sept. 7

NewPage operates mills in the United States and Canada. Together, the mills produce about 3.5 million tons of paper a year used in printing newspapers, magazines and advertising brochures. But in recent years, declining newspaper circulation, as a result of competition from online sources, and a shift toward online advertising reduced demand for its paper. NewPage, which filed for court-supervised restructuring at the beginning of September, has received a commitment led by JP Morgan for up to $600 million of credit during its bankruptcy.

No. 04 - PMI Group

Assets: $4.21 billion,
Employees: 700,
Bankruptcy date: Nov. 23

California-based PMI Group is the United States' third-largest private mortgage insurer. Since the U.S. housing bubble burst in 2007, PMI Group has had to pay out billions to compensate lenders to whom it sold insurance.

As a result, in August, PMI's main operating unit, PMI Mortgage Insurance, coupled with another unit PMI Insurance, was ordered to halt the sale of new policies by the Arizona Department of Insurance, as its funds fell short of regulatory requirements in the state.

Two months later, PMI Mortgage Insurance along with PMI Insurance were seized by the Arizona insurance regulator because losses on mortgage defaults had drained the firm's finances.

No. 03 - Dynegy Holdings,
Assets: $9.95 billion,
Employees: 1,650
Bankruptcy date: Nov. 7

Dynegy Holdings, a unit of power producer Dynegy Inc. filed for bankruptcy last November. Since the financial crisis of 2008, Houston-based Dynegy, which operates power plants across the United States, has been suffering from falling demand for wholesale electricity as well as weak power tariffs.

No. 02 - AMR Corp
Assets: $25.09 billion,
Employees: 78,250
Bankruptcy date: Nov. 29

AMR is the parent company of American Airlines, the third-largest carrier in the United Sates. In recent years, the carrier has faced waning travel demand, souring fuel prices as well as an aging fleet.
The carrier had been in contract negotiations with pilots for many years in an effort to lower its labour costs. However when the last round of talks, which started in 2008, ended in failure, parent company AMR filed for bankruptcy.

No. 01 - MF Global Holdings,
Assets: $40.54 billion,
Employees: 2,850,
Bankruptcy date: Oct. 31

The biggest bankruptcy case of last year, derivatives broker MF Global is also the largest Wall Street firm to collapse since Lehman Brothers in September 2008.
Headed by Jon Corzine the company made risky bets on European sovereign debt which led to the firm's demise.

It was reported that in late 2010, Corzine increased the firm's exposure to European government debt from $1.5 billion to $6.3 billion. But an escalating debt crisis in the euro zone pushed the firm to the edge. In October, Moody's cut its rating on MF Global to a notch above junk.

In an attempt to save the company from collapse, Corzine attempted to sell the firm's assets. But on Oct. 30, talks with suitor Interactive Brokers fell apart.
MF Global officially filed for bankruptcy protection Oct. 31, and is currently liquidating its assets around the world, leading to mass layoffs.

Failed PRC Reverse Mergers: Strategies to Maximize Stakeholder Recoveries

By John K. Lyons and Frances Kao

Skadden

Reverse Mergers Boom and Bust

The past two years have seen the boom and bust of so-called "Chinese reverse merger" transactions. In a typical reverse merger transaction, a company operating in the People's Republic of China merges into a defunct (or nearly defunct) company that is listed on a public exchange in the US or elsewhere in order to more quickly access capital markets that would otherwise present a lengthy or unwieldy process. By merging into an existing listed entity, the Chinese operating companies avoided lengthy delays, and heightened scrutiny, associated with raising capital through initial public offerings. Unfortunately, a number of these companies have failed, resulting in billions of dollars in losses to creditors and investors, and prompting governmental investigations, regulatory rule revisions, and creditor and shareholder lawsuits. Indeed, one fourth of all securities actions filed in the United States in the first half of 2011 involved Chinese reverse merger companies.[1] Since then, many of these companies have gone private to cash out the original investors and shield them from regulations applicable to public companies.

The Aftermath

In 2011, the SEC began suspending trading of securities in certain of these companies created via reverse mergers and issued investor advice and new rules amid allegations of fraud and mismanagement at the companies. Though news reports have devoted much attention to the downfall of these companies and the resulting shareholder losses, there has been little discussion of the options available to preserve and maximize the value of the underlying operating assets after the debt or equity security prices have plunged. This is no easy matter: the Chinese operating subsidiaries are usually indirectly owned by the publicly listed holding company, typically controlled by a board of directors comprised of at least some independent directors, and may be unwilling to cooperate with their ultimate parent. In the worst cases, the management of the operating entities in China may be complicit in actual fraud. Due to differences in the manner in which corporations are regulated and corporate governance is viewed in China, it may be difficult to force action at the Chinese subsidiary level.

Gaining Control

When a product of a reverse merger goes south, both shareholders and investigators may demand to see what assets are still available to the defunct parent corporation. This is often a multi-step process, involving several foreign legal systems.

First, if financial discrepancies appear, immediate steps should be taken to form a special committee of independent directors to investigate and safeguard assets from depletion through a special resolution of the board of directors. The special committee should be empowered to take all action necessary to investigate financial discrepancies and preserve assets of the estate including, if warranted, commencing chapter 11 or similar proceedings to safeguard assets and insure transparency of the process.

If the special committee is obstructed from fulfilling its duties by management, other board members, or a controlling shareholder that may be engaged in wrongdoing, the special committee can then use its mandate to assume formal control of the company through institution of bankruptcy or insolvency proceedings. An insolvency proceeding authorized by the special committee as part of its directive to protect assets, accompanied with a request that the court recognize the special committee as the controlling entity in the proceeding, can effectively permit the special committee to fulfill its mandate under the auspices of a transparent court-supervised process that is open to all stakeholders, including creditors and investors. In addition, a bankruptcy court or similar tribunal can use its equitable power to enjoin a controlling shareholder from interfering with the conduct of the insolvency proceeding by appointing new directors or firing existing ones.

The case of ShengdaTech, Inc. is illustrative. ShengdaTech was formed through a reverse merger of a British Virgin Islands company that owned five PRC subsidiaries into a US holding company that was listed on NASDAQ. An ongoing internal investigation spearheaded by a special committee of independent board members led to evidence highly suggestive of fraud. Faced with these developments, in early August, the Chinese controlling shareholder implicated in the wrongdoing sought to add directors to the full board to obtain a majority of votes and, presumably, dissolve the special committee before it could complete its investigation.

The resolution creating the Special Committee conferred broad power upon the Special Committee to complete the internal investigation and safeguard assets. To fulfill its duties, the Special Committee filed a chapter 11 petition in the United States Bankruptcy Court in Reno, Nevada on behalf of the company to safeguard assets and to enjoin the previous owner from obstructing in the special committee's performance of its mandate. The bankruptcy court agreed and issued an injunction to prevent the controlling shareholder from altering the composition of the board or otherwise interfering in the management of the company.

Reaching Down the Chain

Once control of the listed company is secured, the special committee can take steps to secured control of intermediate companies in the corporate family that actually own the PRC operating companies under the auspices of the insolvent estate. For example, many PRC operating companies are owned by companies in the British Virgin Islands or the Cayman Islands, which then become intermediate subsidiaries following the reverse merger transaction with the listed company. The first step is thus to replace the management of the intermediate subsidiary in accordance with the corporate law of the host country. It is important to anticipate roadblocks in this process as often-times, the registered agents of the intermediate subsidiaries are operating under written instructions from the PRC controlling shareholder who is often also an officer or director of the intermediate subsidiary. Accordingly, if the registered agent refuses to recognize a duly passed resolution, litigation may be necessary at this stage for the registered agent to recognize the resolution and to alter the company registry accordingly.

Though replacing board members at the intermediate level may pose difficulties, it is in fact relatively simple compared to gaining control effective control of the PRC operating entities. Chinese corporate law still relies heavily on formalities that have been replaced in Western law by principles of agency law. In particular, Chinese companies are required to have both a legal representative and a company seal – or "chop." The legal representative must sign official corporate registration documents in order for many corporate actions may be effective.

Skadden

Problems thus arise when the legal representative is complicit in fraud or mismanagement or is otherwise uncooperative due to cultural differences or local relationships. Until a legal representative is replaced by the special committee's designee, the special committee will be powerless to exercise effective control over the PRC operating companies. The process to replace a legal representative can be costly and involve time consuming litigation. Complaints filed in Chinese civil courts must meet rigorous procedural requirements, must be filed in the province where the assets are located, and may even be rejected by courts outright as not sufficiently stating a case. Careful oversight and coordination with local PRC counsel is absolutely critical to achieve a successful and expeditious outcome.

Takeaways

Creditors, investors and independent directors of "reverse merger" companies must exercise a heightened degree of care in insuring that accurate financial reporting and operational control are in place. In addition to standard auditing controls and procedures, it is critical that independent PRC legal representatives be chosen to insure that the PRC operating companies will adhere to the direction of the operating company's ultimate legal owners if the original owner is legitimately displaced. If financial discrepancies arise, immediate action to appoint a special committee led by independent directors should be taken. Once appointed, a special committee must move swiftly to complete its investigation and, if warranted, take decisive steps to safeguard assets, including the commencement of a bankruptcy or insolvency proceeding. The process of ultimately wresting control of PRC operating assets from a wrongdoer is a highly complicated process that must be swiftly navigated with great care and cultural sensitivity in order to maximize recoveries to stakeholders.

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For example, Mr. Lyons represented the special committee of the board of directors of ShengdaTech, Inc. in its Chapter 11 case to complete the committee's investigation of ShengdaTech and to safeguard assets. His other representations include the official committee of unsecured creditors in the American Airlines Chapter 11 cases, Delphi Corporation, Verasun Energy, Einstein/Noah Bagel Corp., Exodus Communications, Interstate Bakeries Corporation, Montgomery Ward and US Airways.

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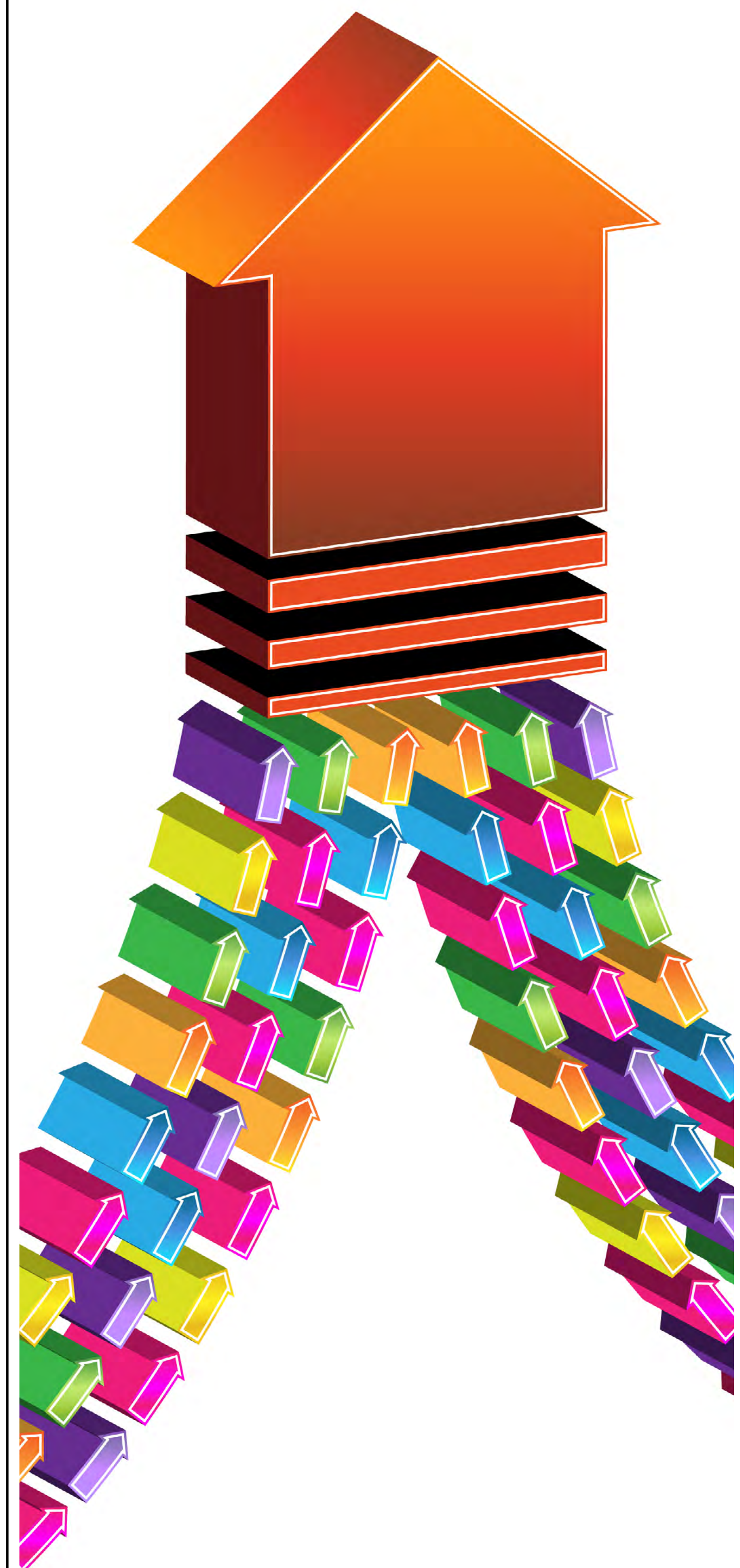

Another Set of Eyes: The Expert as Evaluator

OTTERBOURG

By Hon. Melanie L. Cyganowski (Ret.), Daniel F. Fiorillo & Lloyd M. Green

The role of the outside legal expert has evolved well beyond serving as an adjunct to court sponsored alternative dispute resolution or jury selection. Currently, expert counsel serves as an extra pair of eyes and as a valued resource in the prosecution or defense of litigation. Although not typically part of a trial team, an outside legal expert may provide added heft in forming and developing trial strategy, including whether motions should be made, opposed or settled. The outside expert may be particularly useful to in-house counsel in determining the likelihood of success. See Own Capital, LLC v. Celebrity Suzuki of Rock Hill, LLC, 2011 U.S. Dist. LEXIS 56224, at *29, n.6 (E.D. Mich. May 25, 2011) (case recognizing that outside experts may possess substantive expertise that that the court may lack).

As a third-party who is not part of the trial team, the expert may be used to evaluate the strength of contemplated legal positions, pleadings, motions and responses. For example, where billions of dollars are on the line, a party's insurer may be particularly interested in having the neutral expert evaluate where a case stands, and what the ramifications and outcomes may be if a particular strategy is pursued.

The strength of outside expert evaluation lies in its flexibility and confidentiality. Outside legal evaluation can be used at any phase of a proceeding, for as large or as limited a role as may be required. For example, an outside expert can be called to evaluate the strength of a contemplated motion to dismiss, the weaknesses or "holes" in a summary judgment motion or at the post-judgment phase of an action, where an appeal may be considered either a wise, calculated risk or a waste of a client's hard earned resources.

As for confidentiality, the expert's advice is protected under the Federal Rules of Civil Procedure. The fact that an expert legal advisor is not retained as trial counsel to a party does not, by itself, divest the expert's opinion of such protection. The disclosure requirements of the Federal Rules of Civil Procedure will generally shield the expert's views because the expert legal evaluator will not be testifying at trial.

Under Rule 26(4)(D) of the Federal Rules of Civil Procedure, the opinions of a legal expert are generally accorded the protections given to attorney work product. Rule 26(4)(D) provides in pertinent part: "a party may not, by interrogatories or deposition, discover facts known or opinions held by an expert who has been retained or specially employed by another party in anticipation of litigation or to prepare for trial and who is not expected to be called as a witness at trial."

Still, it should be noted that under Rule 26(4)(D)(i), the expert's work product is potentially obtainable "on showing exceptional circumstances under which it is impracticable for the party to obtain facts or opinions on the same subject by other means." This provision might influence parties to directly engage the expert to give rise to the more air-tight attorney-client relationship. Obviously, the factors involved in a client opting for direct retention of an expert as counsel as opposed to a third-party adjunct warrant their own separate discussion.

Similar to a court-attached early neutral evaluator, the expert evaluator should have expertise and experience commensurate with the task at hand.

An expert should possess the expertise and recognition necessary to make her opinions and evaluations taken seriously by the party and its counsel. The expert's strength depends on the confidence that others will have in her opinions. Remember, the party already has a trial lawyer.

Using standards pertaining to court-attached neutral evaluation as a guide, the expert may be expected to have as much as 15 years of experience, and in no event less than four years. Practically speaking, a paying client will be reluctant to make decisions on the basis of an attorney who is still learning the profession and the particular field of law.

The expert is most effective when called upon to evaluate and help formulate the next step in litigation. One scenario that comes to mind is where an expert is called to analyze potential motions and assist in risk assessment for the purposes of giving comfort to an insurance carrier who was the ultimate "deep-pocket," to provide the party with metrics for a contemplated and proposed settlement, and to sensitize both the party and its insurance carrier to the magnitude of a potential judgment.

Although court-affiliated early neutral evaluation ("ENE") may provide some guidance to litigants in the context of retaining a legal expert, the process may not be tailored to the needs of a specific party insofar as it is designed to lighten a court's burden. The neutral evaluator has duties to the court and to the parties. Moreover, ENE is dependent upon the cooperation of the adversary insofar as the adversary is expected to participate in ENE in good faith.

The complexity of a case may also weigh in favor a party retaining its own expert evaluator. In a bankruptcy, the ENE process may be complicated by multiple interests vying for what is likely to be a finite pot of gold.

The debtor, the unsecured creditors committee, secured creditors, bond holders and stock holders will likely come to the table with their respective versions of what is happening and their separate wish-lists. Here, the expert evaluator may be capable of bringing more than just a modicum of clarity to a party as it moves forward, and point out how the moving parts of a bankruptcy may mesh over time. This type of expertise is acquired over an entire career.

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Delaware and Business Insolvency

By Rafael X. Zahralddin-Aravena & Shelley A. Kinsella

Elliott Greenleaf

Delaware continues to be a venue of choice for parties seeking a consistent and sophisticated jurisdiction to file an insolvency proceeding, whether the case is a large bankruptcy or a midmarket bankruptcy. Companies can file in the Delaware courts because they can file bankruptcy in any jurisdiction that one of its affiliates is incorporated or where it has a principal place of business or principal asset. Delaware has a long history as the state of incorporation of choice, since the early 1900s, and has gained even more popularity because of its innovation in alternative entities, such as limited liability companies. Litigants who enter Delaware quickly gain the same appreciation that the members of the bar and their partners from outside the state have for the Delaware legal community.

Small is Good

The Delaware bar exam is only given once a year as opposed to the norm in most states in the U.S. which is twice a year. The number of lawyers admitted each year is modest, and the bar difficult, with about 150 lawyers entering the bar most years (by comparison, California has about 6300 lawyers a year entering the profession).

The intimacy of living and working in a small community leads to a very close and cordial bar in which incivility is not tolerated.1 This doesn't mean that the lawyers aren't tough or smart; they are just not allowed to take advantage of the strife inherent in a business dispute for their own gain. Many clients figure out soon enough that a litigation fueled by anything other than the facts and the law, like emotion, leads to a result where often the only parties who gain anything are the lawyers. Legal practice, whether Federal or State, is heavily influenced by the legal culture of the Delaware Supreme Court and the Delaware Court of Chancery, the preferred trial court for the resolution of corporate business disputes in the U.S. and neither court tolerates unprofessional behavior.

The District Court for the District of Delaware ("District Court"), of which the United States Federal Bankruptcy Court for the District of Delaware ("Bankruptcy Court") is a part, also require that Delaware lawyers be retained as attorney of record in Delaware cases, though admission for out of state lawyers who work with a Delaware lawyer is freely allowed. At the same time, parties who are pulled into a bankruptcy case as creditors, and, thus, might not have immediate need for a Delaware lawyer, have thirty days after filing papers in the case, or when their case is transferred to Delaware, to associate with a Delaware lawyer. This allows for the parties to negotiate before having to litigate an issue in the Delaware Courts. Once a Delaware lawyer is engaged, both Federal and State Courts in Delaware require that the lawyer be a member of the bar, maintain an office in Delaware and regularly transact business with the Court. The procedural rules in both the Bankruptcy Court and the District Court are almost identical in how they address this issue.

The Bankruptcy Local Rules note that claims can be handled without a Delaware lawyer until the point that it appears there will be extensive discovery or trial time, at which point the court may direct the party to consult with a Delaware lawyer. Other exceptions that relieve parties from having to use Delaware counsel exist for government lawyers and pro se litigants. The rules also allow the Bankruptcy Judge discretion to approve admission to a non-Delaware lawyer to practice before them without Delaware counsel, under the appropriate circumstances.

Delaware is Just Right – Both Flexible and Consistent

Much of Delaware state court practice and procedure has shaped practice in the Delaware Bankruptcy Court, whether by design or simply because the lawyers who have drafted the Bankruptcy Court's rules and procedures themselves have been influenced by the Delaware legal culture. The Chancery Court2 and the Delaware Legislature, through the Delaware General Corporation Law ("DGCL"), influences3 the Bankruptcy Court in two ways.

The first is a combination of procedural efficiency and the accommodating manner in which Delaware Judges allow parties to avail themselves of the state court. The Clerk and the Judges of the Bankruptcy Court have taken to heart the practices of the Delaware state courts4 when structuring their local procedures. The second is the flexibility and sophistication that the DGCL and other applicable corporate laws, including the law of contract under Delaware common law,5 that leads to consistency in the judge's decisions, while implementing the law in a flexible and pragmatic fashion. Delaware law is particularly helpful in this vein to support the powers already granted under Chapter 11 to a debtor-in-possession.

Bankruptcy Courts in Delaware have made it a priority to accommodate corporate bankruptcy filings, pioneering the concept of first day relief and providing access to its judicial officers and courts, moving quickly to accommodate technology, working with the bar to create consistent and uniform local rules and Chambers Procedures, leading in the way in the innovation of fair and accessible claims procedures, and in requiring transparency and consistency in disclosure of important terms in the often complex financing documents related to the funding of the bankruptcy process.

Emergency Relief and Access to the Court

It is not uncommon for a Bankruptcy Judge to put aside travel plans and adjourn a hearing for a few hours in the hope of allowing the parties to reach a settlement or "get a deal done." The accommodation of these judges to the litigants is something that is often unavailable in many other Courts and is truly to be commended.

The access by litigants to the Court is also institutionalized. The Delaware Bankruptcy Court and its Clerk have made filing an emergency Chapter 11 within two business days notice the standard and provide for leave to file a case in shorter time if the circumstances warrant it. It is notable that the Office of the United States Trustee in Delaware, the arm of the Justice Department responsible for overseeing several aspects of the bankruptcy process, also adheres to this schedule and works diligently and tirelessly on behalf of creditors until such time as an Official Committee of Unsecured Creditors can step in and watch out for the unsecureds interests.

This expediency does not sacrifice the rights of other parties. All orders entered into on an emergency basis are subject to final approval, often being approved on only an interim basis and only to the extent necessary to assist the debtor between the emergency hearing date, the "first days", and the next available hearing. Parties get a second chance even beyond the final hearing to object to any emergency relief, as relief granted on an emergency basis is subject to reconsideration after thirty days except for motions for post petition financing under Del. Bankr. L.R. 9013-1 (v).

The Delaware Bankruptcy Judges are also quick to remind a debtor that while the standards for emergency relief are a little easier on the first day, if other parties demand a further showing at a final hearing, the standards will be a lot tougher. The practice of critical vendor payments,6 for example, has come under pressure in recent years.

Debtors will often petition the Bankruptcy Court to make payments to certain essential suppliers or service providers for prepetition debts in exchange for continued provision of goods or services after the bankruptcy is filed, on the condition that the terms, or better, that existed pre-bankruptcy are continued. Critical vendor motion relief allows flexibility and ability to preserve the going concern value of debtors and free up much needed cash flow by eliminating the number of vendors who demand C.O.D. or prepayment. Critical vendors are often credited with helping to keep the business operating so that value can be preserved for all creditors. However, allowing the practice is criticized or forbidden in other jurisdictions because it violates the distribution system in bankruptcy known as the absolute priority scheme, in which higher priority creditors, such as secured lenders, are paid in full before any junior classes, like unsecured creditors, are paid. Additionally unsecured creditors who are not chosen to participate in the Debtors critical trade program also, arguably, do not get equal treatment with similarly situated unsecured critical trade vendors.

Delaware Courts have balanced the virtues of allowing the debtor a pragmatic approach to preserving its business while not ignoring the rights of objecting parties, allowing objecting parties to contest and require the debtors to justify the aggregate amounts claimed in emergency filings. Parties have been able to demand that final approval of such payments be supported with a detailed evidentiary showing at the hearing. Debtors still get emergency relief, but are not allowed unmitigated authority to spend estate funds on unsecured trade claims that could arguably be paid to other higher priority parties. In several high profile cases, this compromise approach has lead to voluntary reductions by Debtors in the amount requested for critical trade once their situations have stabilized post filing, balancing creditor rights with the debtors need for cash flow and emergency relief.

Innovators in Technology and Procedure

Bankruptcy courts across the country began implementing electronic filing in 2001 before the Federal District Courts or Federal Appellate Courts and Delaware was an early adopter. Commercial entities in Delaware began creating virtual dockets for the Delaware legal community in 1998, but the Delaware Superior Court is credited with having the first electronic case filing system in the U.S. in 1991 with the development of the Complex Litigation Automated Docket or CLAD. Electronic filing made it possible to file around the clock to accommodate the breadth of litigants from around the world. The Bankruptcy Court also freely grants both telephonic and video appearances so that creditors, other interested parties, and lawyers from all parts of the globe can participate. The Bankruptcy Court still requires, in most circumstances, that should a hearing require live testimony; the parties appear in person so that the lawyers can conduct a proper cross examination. Exceptions have been made, however, when parties are simply unable to travel the great distances involved. The Bankruptcy Court's requirements, especially in dealing with very large cases has caused an evolution in private companies that assist the Bankruptcy Court when a case reaches a certain size[7] and these private companies are further advancing technology in the insolvency process that opens and facilitates access to participants in the legal process in Delaware.

A criticism of many other jurisdictions outside of Delaware is that the judges have varied judicial Chambers procedures and the local rules are limited in scope or out of touch with the practice as it evolves. The Delaware Bankruptcy judges have all agreed to use a uniform set of chambers procedures with some few small exceptions dealing with limited elements of trial practice. These, and other permanent procedural rules, are located conveniently, and updated often, on the website for the Bankruptcy Court. The bar and the court also moved to incorporate several standing orders and existing local practice into one set of local rules about a decade ago. Many Courts in other jurisdictions do not have uniform rules that govern case procedures, which results in disjointed case by case procedural orders. Delaware sets the standard in this respect, with a vibrant set of local rules that cover the depth of most procedural issues and having a local rules committee that is not limited to Delaware Judges and lawyers, but also includes prominent and frequent practitioners who often practice in Delaware.

Two area of notes are the claims objection process in Delaware, which was drafted in order to provide a consistent treatment of claims, the most likely time that a creditor would need to appear in Delaware, and how a case is financed through either debtor-in-possession financing or requests for use of available cash flow, or cash collateral, as it is known to bankruptcy professionals.

Amendments that took effect on December 1, 2007 to the Federal Rules of Bankruptcy Procedure included limits on the use of omnibus claim objections under Rule 3007 which restricts omnibus objections to certain situations and imposes formatting standards on the motions that can be filed. The Delaware Judges opted out of the new rules because they already had their own omnibus objection procedures and the new rule seemed to be modeled on the Delaware rules. The new rules were too restrictive in some discrete areas. The main aspects of Rule 3007 and the existing Delaware rules that are consistent focus on keeping the form of the objections simple enough for claimants to follow, such as limited the types of objections that can be combined, and limiting the total number of objections that could be filed under one document, which often contained hundreds of objections and were mystifying to laypersons and professionals alike.

Another area of concern, both in terms of judicial efficiency and transparency for litigants was in there area of requests for DIP financing. Delaware Bankruptcy Judge Peter J. Walsh was frustrated with the density and lack of clarity in the debtor in possession financing requests he reviewed, especially as they often came in on an emergency basis. As a result, he wrote a carefully prepared request to the bar to highlight certain provisions in any request so that both the judge and parties reviewing the crucial financing requests could adequately analyze the papers. His letter was adopted almost entirely and incorporated in the local rules under Del. Bankr. L. R. 4001-2.

The Delaware Bankruptcy Local Rules require transparency in cross collateralization requests, findings of fact that bind the estate as to the validity of any secured lien, wavier of rights to surcharge a secured creditors collateral, any liens on estate causes of action, provisions that convert prepetition secured debt to post petition secured debt, conditions that prime (make senior) post petition debts to the detriment of existing liens, and provisions that treat creditor committee professionals different from debtors professionals in terms of financing available to pay their fees.

Highlighting these provisions for the Court and the other parties provides necessary clarity that balances the needs of a debtor in an emergency need of financing with the rights of various parties that will not appear until later in the case, allowing the Court to deny or make temporary the relief requested until a creditors' committee can come into the case and address the relevant issues. Delaware Bankruptcy Local Rule 6004-1 follows suit in requiring the same type of transparency when filing a motion to sell the debtor's assets.

State Law Insolvency

Interestingly enough Vice Chancellor Travis Laster wrote an article on the viability of the Delaware state receivership drawing many parallels to the Bankruptcy practice thriving a few short blocks from the Chancery Court. He wrote:

"The Delaware Court of Chancery can be flexible in administering a receivership proceeding. Particularly, under Delaware Court of Chancery Rule 148, the court has the power to relieve the receiver from "complying with all or any of the duties and procedures" set forth in the Court of Chancery Rules. Unlike bankruptcy cases, where parties must rigorously comply with a fairly exhaustive set of reporting requirements and procedures, the Court of Chancery may tailor the rules to the realities of the case and needs of the parties-in-interest. This can produce great savings in the cost of administering a receivership case as compared to the cost of administering a bankruptcy case.[8]"

He further discussed the powers of the Chancery Court to reject contracts and to sell property free and clear of liens under 8 Del. C. §297, assuring readers that the state law receivership can accomplish many of the same goals as a bankruptcy filing, especially for the case with circumstances that can't sustain the costs of a Chapter 11.

His article demonstrates that the state judges in Delaware are constant innovators and problem solvers and follow the market and their brother and sister judges in the federal courts just as much as federal judges in Delaware look to guidance from the history and long tradition of the Chancery Court.

The continuing evolution and flexibility of the Delaware courts, whether state or federal, all have the same thing in common, dedicated judges and lawyers unified in continuing to producing one of the best court system in the U.S.[9] if not the world.

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1 - The Court of Chancery has released new guidelines to assist those practicing before the court which includes not only rules of civility, but also practice pointers for lawyers not familiar with traditional Chancery Court practice. http://courts.state.de.us/chancery/docs/guidelines.pdf. At the heart of these guidelines is a desire for judicial efficiency and transparency that hopefully makes it easier for out of state counsel and litigants to participate in the legal process in Delaware.

The civility in public life is pervasive in politics. Brian Pettyjohn, the Republican Mayor of Georgetown, Delaware, where Return Day is held, the day which commemorates the end of the Delaware political campaign season (with a ceremonial burial of an actual hatchet), stated the following: "The Delaware Way is a realization that we live in a small state. We live in a state where you may have gone to school with your opponent. It may be your neighbor. It may be your friend, or you may be related to your opponent."

2 - The Court of Chancery's judges are the Chancellor and four Vice Chancellors, who are appointed by the Governor to serve twelve year terms.

3 - In a recent event at Columbia University on the history and influence of the Delaware Court of Chancery, Harvard Law professor Mark Roe stated that U.S. corporate law is made in two places: Washington, D.C. where "public policymakers, consumers, employees, unions, managers, and investors influenc[es] the feds—and Delaware, where a smaller circle of parties (managers, boards, and investors) influences the chancery." Catherine Dunn, Delaware Chancery Court Hears Cheers and Critiques at Columbia, Corporate Counsel November 21, 2011.

4 - There are no jury trials in the Court of Chancery, and all matters are heard by the Chancellor, a Vice Chancellor or, in some cases, a Master in Chancery, which assist the court as a magistrate would assist judges in other courts.

5 - Delaware is a "four corner" state, in which documents and other evidence outside the final signed contract are usually excluded from the judge's consideration of what the agreement is between the parties. As many business creditors will have rights in bankruptcy based in contract, this approach to contract law eliminates surprises which upend careful planning by business people.

6 - This type of emergency relief in allowed some limited jurisdictions, notably Delaware and New York, and expressly excluded in most others.

7 - So called "Mega Cases" are those cases that have at least 1000 creditors and $100 million or more in assets, or that will impose a significant burden on the court system.

8 - The Honorable J. Travis Laster, The Chancery Court Receivership is Alive and Well, Delaware Lawyer, Fall 2010.

9 - Delaware is consistently praised by the U.S. Chamber of Commerce for a litigation environment that is ranked number one in the country for fairness and judicial competence. Lawsuit Climate 2010: Ranking the States.

The 7th Circuit Considers The Indubitable Equivalent Standard–Again!

By Peter C. Blain

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On June 28, 2011, the Seventh Circuit Court of Appeals decided In re River Road Hotel Partners, LLC v. Amalgamated Bank, 651 F. 3d 642 (7th Cir. 2011). The Court addressed Section 1129 (b)(2)(A) of the United States Bankruptcy Code in connection with a Plan of Reorganization to sell substantially all of the Debtor's assets. The Court held that the indubitable equivalent prong the "cram down" provisions of section 1129(b)(2)(A)(iii) could not be used to preclude a secured creditor from credit bidding its claim under sections 363(k) and 1129(b)(2)(A)(ii) of the Code. The Seventh Circuit decision was in direct conflict with decisions by the Third Circuit in In re Philadelphia Newspapers, LLC , 599 F.3d 298(3d Cir. 2010), and the Fifth Circuit in In re Pacific Lumber Co., 584 F. 229 (5th Cir. 2009). In December of 2011 the United States Supreme Court granted a petition for certiorari to reconcile the split among the Circuits. See RadLAX Hotel Partners, LLC v Amalgamated Bank, No. 11-166, 2011 WL 3499633 (Dec. 12, 2011).

Six months later, in In re River East Plaza, LLC v. Geneva Leasing Assocs., Inc., No. 11-3233, 2012 WL 169760 (7th Cir. Jan. 19, 2012), the Seventh Circuit again addressed the indubitable equivalent standard, this time in the context of an attempted cram down of a claim of a secured creditor ("LNV") in a single asset real estate case. In River East, LNV was owed $38.3 Million for a loan relating to a commercial building in downtown Chicago, IL. The building was worth approximately $13.5 Million, leaving LNV significantly undersecured. The debtor defaulted and LNV started a foreclosure action. In response, the debtor filed a Chapter 11 petition.

Under the Bankruptcy Code, an undersecured creditor has two claims, a secured claim up to the value of the collateral, in this case $13.5 Million, and an unsecured claim under for the deficiency portion, and is entitled to distributions as both a secured and an unsecured creditor. However, in connection with a plan of reorganization, the undersecured creditor is entitled to make an election under section 1111(b) give up its unsecured claim and have its entire claim be treated as a secured claim. LNV made the election and voted against the plan.

In order for the plan to be confirmed, the plan proponent must meet the cram down provisions of section 1129(b)(2)(A). Under subsection (i) of that section, the creditor is entitled to retain its lien on the property and receive deferred cash payments equal to the total amount of its claim (in this case, $38.3 Million) with a value equal to the claimholder's interest in collateral ($13.5 Million). Under subsection (iii) of that section, the plan could also be confirmed if the creditor received the indubitable equivalent of its claim.

After LNV's election, the debtor filed a Second Amended Plan and provided that LNV's lien would be transferred from the real property to a United States Treasury Bond which would provide for the payment of $38.3 Million with the stream of payments having a present value of $18.5 Million.

The debtor argued that this met the cram down test and that proposed treatment met the indubitable equivalent of prong of section 1129(b)(2)(A), as the Treasury Bond provided to LNV was risk free.

LNV argued that the plan was not confirmable and moved to lift the stay. The bankruptcy court agreed, holding that substituting collateral was inappropriate in the face of an 1111(b) election. The debtor filed a Third Amended Plan in which LNV was provided with a lien on the Treasury Bond and retained its lien on the original collateral until the claim was fully paid. However, the bankruptcy court refused to consider the Third Amended Plan because it was filed well after the 90 days within which a plan which has a reasonable possibility of being confirmed within a reasonable time must be filed in a single asset real estate case. The Seventh Circuit accepted a direct appeal.

Judge Posner writing for the Seventh Circuit explained that a creditor is likely to make an 1111(b) election when the collateral is undervalued and likely to appreciate. If the election was not made, LNV would be entitled to $13.5 Million for its secured claim and share in whatever dividend is paid to unsecured creditors, which is likely to be little or nothing. However, by making the election, if the property appreciates in value and LNV subsequently forecloses, or if the property is sold, the benefit of the appreciation accrues to LNV up to its claim of $38.3 Million. The same result would have occurred if LNV had proceeded to foreclose its mortgage and taken title to the property in the foreclosure action. By substituting a Treasury Bond as collateral, the Court observed the debtor was trying to retain the benefit of the potentially increasing value of the property in a rising market.

The debtor argued that LNV's election was done to thwart the reorganization proceeding, implying that this was somehow improper.

The Court found nothing wrong with LNV's election, as LNV was merely using Code provisions to protect its interest and maximize its recovery. That is likely why LNV filed the foreclosure action in the first place, expecting to be the highest bidder at the foreclosure sale and gain the upside benefit when the property appreciated.

The Court then addressed the indubitable equivalent argument in the context of the attempted substitution of collateral. The Court noted that the bankruptcy court flatly banned any substitution of collateral when a creditor makes an 1111(b) election. However, the Court said that substituting collateral would be appropriate in a cram down context if the creditor was oversecured and the substituted property had sufficient value so as to not put the creditor at risk of becoming under secured in future. The Court went on to say substitution of collateral may also be appropriate when the creditor is undersecured provided that the substituted collateral was more valuable and no more volatile than the creditor's current collateral. However, the Court indicated that no rational debtor would make such a substitution because it would be making a gift to the creditor.

The Court then turned to the Treasury Bonds as the proposed substituted collateral. The Court said that while the risk of default was non- existent, if interest rates rose, the market for bonds with a lower rate would evaporate and a creditor who tried to foreclose after default would likely have to wait for the full term of the bonds to collect the amount owed. In contrast, with a retained lien on the property, upon default foreclosure could occur immediately. The Court did note that under section 1129 (b)(2)(A)(i), if the stream of payments were over 30 years and there was no default, the creditor would have to accept payment over time. However, the Court also noted that between a quarter and third of all debtors who emerge from Chapter 11 with a confirmed plan subsequently default. Finally, the Court observed that the substituted collateral may turn out to be actually more valuable than the original collateral and thereby provide LNV with even more security.

However, because of the difference in risk profiles, the two forms of collateral are not equivalent, and there is no reason why the choice of which collateral is appropriate should be made for the creditor by the debtor.

The Court's decision appears to be correct. The purpose of section 1111(b) is allow a creditor who is precluded from exercising its legal rights because of a bankruptcy to assess the strategic risks and opportunities of retaining both an unsecured claim and a secured claim, or swapping the two claims for a single secured claim in the amount of the debt. In a rising market with undervalued collateral, it would seem the swap may be the best alternative. In any event, when it comes to substituting collateral once the choice is made, the creditor is entitled to its original collateral and not replacement collateral with a different risk profile selected by the debtor.

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Dante's Third Ring: Investors Bring Adversary Proceeding in SDNY Bankruptcy Court Seeking to Enforce U.K. Court's "Flip" Clause Decision Against Lehman

By Mark Ellenberg, Doug Mintz & Kathryn Borgeson

CADWALADER

The battle over the enforceability of priority flip clauses in CDO indentures has entered a new phase. On February 8, 2012, a group of investors led by Belmont Park Investments Pty Ltd. filed an adversary proceeding against Lehman Brothers Special Financing Inc. and BNY Mellon Corporate Trustee Services Ltd. in the U.S. Bankruptcy Court for the Southern District of New York. The Investors seek recognition of a judgment entered by the High Court of Justice in England and Wales in Belmont Park Inv. Pty Ltd. & Others v. BNY Corp. Trustee Servs. Ltd., and a declaration that, as a matter of English law, the Investors have priority over LBSF, as swap provider, with respect to shared collateral securing notes issued under Lehman Brothers' "Dante Programme." The Investors filed a concurrent motion to withdraw the reference, seeking to remove the adversary proceeding from the U.S. Bankruptcy Court to the U.S. District Court.

Bankruptcy Judge James M. Peck previously found that the U.S. Bankruptcy Code prohibited enforcement of the same "flip" clause at issue here – despite the fact that the English courts had previously found the clause to be valid under English law. Judge Peck's decision not only impacted the Lehman CDOs, but roiled the entire securitization market. Flip clauses regarding payments to swap providers are common features of many securitization programs.

The Dante Programme

Lehman Brothers International (Europe) arranged the Dante Programme, which consists of multiple series of synthetic, credit-linked CDOs in the form of notes linked to credit default swaps. English law governs the transactions, and the parties agreed to jurisdiction in the English courts. The Issuers of each series of notes – including Saphir Finance Public Limited Co., Beryl Finance Limited and Zircon Finance Limited – also served as the counterparty to LBSF under the credit default swaps, and used the proceeds from the sale of the notes to purchase collateral. The Issuers then pledged the collateral to BNY, as trustee, to secure their obligations to the noteholders and LBSF.

Under the clauses at issue, money flowing out of the Issuers would first be applied to pay amounts owed to LBSF, under the swaps. However, if either LBSF or Lehman Brothers Holdings Inc. filed bankruptcy, the trust documents flipped seniority, placing LBSF at the bottom of the waterfall. The swaps incorporated the CDO waterfall.

LBHI filed for chapter 11 protection under the Bankruptcy Code on September 15, 2008. The filing triggered events of default under the credit default swaps and triggered the flip clauses, which allowed the noteholders to leapfrog LBSF and take first priority against the collateral. LBSF filed for chapter 11 protection shortly after LBHI, on October 3, 2008. Subsequently, the Issuers terminated the credit default swaps with LBSF and issued notices declaring the notes due and payable at their early redemption amount.

The English Dante Decision

In May 2009, Perpetual Trust Company, which held CDOs in two series of notes issued under the Dante Programme, commenced an action in the High Court of Justice in England, seeking a judgment requiring BNY to distribute the collateral to the noteholders in accordance with the flip clauses. In June 2009, Belmont Park brought a separate action seeking substantially the same relief, which was heard at the same time as the Perpetual action.

On July 28, 2009, the High Court issued a judgment in favor of the noteholders and against LBSF, holding that (i) LBSF committed events of default under the swap agreements on September 15, 2008 and October 3, 2008; (ii) the Issuers properly terminated the swap agreements; (iii) the flip clauses are valid, effective and enforceable under English law; and (iv) LBHI's September 15, 2008 bankruptcy filing automatically triggered the flip clauses.

On November 6, 2009, the Court of Appeal of England and Wales dismissed LBSF's appeal and affirmed the High Court judgment. On July 27, 2011, the Supreme Court of the United Kingdom affirmed the decisions of the Court of Appeal and the High Court. The High Court has taken no further action with respect to the collateral since the Supreme Court entered its judgment.

The U.S. Decision

At the end of May 2009, while the English action was pending, LBSF asked the U.S. Bankruptcy Court for a summary judgment that the ipso facto provisions of the Bankruptcy Code rendered the flip clauses unenforceable. BNY filed a cross-motion for summary judgment, arguing that the U.S. Bankruptcy Court must defer to the English courts' rulings in the Perpetual case, and that, even if the flip clauses were unenforceable ipso facto clauses, the Bankruptcy Code's safe harbor provisions permitted their enforcement.

On January 25, 2010, the U.S. Bankruptcy Court ruled that the flip clauses were unenforceable ipso facto clauses under the facts of the case, and that because the trust documents contained the flip clauses, rather than the swap agreements, the Bankruptcy Code's safe harbor provisions did not apply. BNY appealed to the U.S. District Court, but the parties settled the case before the appeal was heard.

The Investors' Adversary Proceeding

In the new adversary complaint, the Belmont Investors seek an order recognizing and enforcing the High Court's judgment on the basis of international comity. In addition, the Investors seek an order (i) declaring that the flip clauses are valid, effective and enforceable, and (ii) declaring that BNY may distribute the collateral to the noteholders in accordance with the flip clauses, without exposing itself to liability in the U.S. or under U.S. law.

The Investors cite to the English courts' determination that the flip clauses were automatically triggered by LBHI's September 15, 2008 bankruptcy filing, and argue that by the time LBSF filed for bankruptcy on October 3, 2008, it no longer possessed first priority rights in the collateral. The Investors assert that because LBSF did not possess first priority rights in the collateral as of October 3, 2008, the operation of the flip clauses does not implicate the Bankruptcy Code's automatic stay or prohibitions on ipso facto clauses. The Investors also assert that, even if LBSF's bankruptcy alone triggered the flip clauses, the Bankruptcy Code's safe harbor provisions exempt the flip clauses from both the automatic stay and the anti ipso facto provisions.

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Conclusion

For the past two years, the law regarding the enforceability of flip clauses has been in flux. The new action filed by the Investors has the potential to bring more certainty to the area, although it is also possible that the Investors could prevail on narrow grounds, specific to the facts of this case.

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Post-Acquisition Restructuring (aka "The Honeymoon is Over")

By Raymond Montero & David Wachutku

The champagne bottle is empty, and the post-acquisition giddiness of having completed the transaction has faded. Now begins the hard part - how to integrate the acquired company's operations into your own international operations.

Issues that Prompt Restructuring

There are various factors that will necessitate a reorganization of the newly combined organization. Among them are: 1) business operation synergies that can be capitalized on by combining certain business processes; 2) reducing administrative costs and minimizing risk of legal or tax non-compliance by reducing the number of legal entities in the combined group; 3) facilitating cash flow within the group, including reducing the withholding tax cost associated with such cash flows; and 4) aligning the tax posture / planning of the two companies. Some of these objectives can be achieved by merely reorganizing the legal structure of the group (e.g., inserting a new regional holding company to facilitate cash flow between non-U.S. subsidiaries without incurring incremental U.S. tax), but in some cases they will necessitate an actual movement of assets and personnel between entities either by way of sale, merger or liquidation.

Issues that Arise from Such Restructuring

As most CFOs and tax professionals are always careful not to let the "tax tail" wag the "business dog," while intra-group restructuring can achieve many tax benefits for the group, there are a host of non-tax considerations which need to be carefully analyzed and dealt with. Among these are: 1) whether there are labor law implications from moving employees from one company to another in the same country, or in a different country; 2) whether new registrations and licenses need to be obtained to continue to fully protect the intellectual property related to the manufacturing of the company's products in a more tax efficient jurisdiction; 3) whether changes to financial and accounting programs need to be made to account for differences in the intercompany pricing policies of the acquired companies and the existing Company transfer pricing policy; 4) whether the combination of activities or companies in a particular jurisdiction will require anti-trust and/or competition law clearance in that particular jurisdiction; 5) whether administrative and information systems processes need to be modified to support the reorganized group.

Given the spectrum of both tax and non-tax issues that arise in planning to reorganize the post-acquisition group, tax planning alternatives should be considered at the very beginning of any post-acquisition planning process in order to avoid unnecessary plan modifications and changes to accommodate more efficient tax structures down the road, which can be time consuming and costly.

Tax Objectives of Restructuring

While there are many tax objectives which can be accomplished with post-acquisition restructuring of a group, there are a few key objectives which should be included on the initial list of any post-acquisition restructuring plan.

U.S. Tax Basis Step-Up – In order to facilitate post-acquisition restructuring, at least from a U.S. perspective, the ability to effectuate a domestic acquisition (i.e., a domestic target company with foreign subsidiaries) as an IRC §338(h)(10) election (with §338 elections being made for the foreign affiliates), or to make a §338(g) election with regard to an acquisition of a non-U.S. target, should be considered. This will provide for a step-up, for U.S. tax purposes, of the tax basis in the various assets of the target subsidiaries, making it easier to move companies and assets around within the group without incurring incremental U.S. tax. While there may still be local country tax to deal with, depending on the jurisdiction, such tax may be significantly less then what the U.S. tax would have potentially been.

Consolidation / Grouping – One of the key objectives of post-acquisition restructuring will be to maximize the utilization of tax attributes and facilitate the movement of cash and the transfer of assets, by taking advantage of local country grouping or consolidation provisions. In many cases this will require the transfer of legal entities, or possibly merging together entities within the same jurisdiction. In addition to the normal U.S. and local country tax considerations of such share or asset transfers, the possible effect of local grouping or consolidation on the group's foreign tax credit ("FTC") position also needs to be considered. While the rules in IRC §901 related to who is the actual "taxpayer" for FTC purposes remains relatively the same, new IRC §909, the so-called FTC "splitter" rules, can apply in situations where local consolidation rules impose tax at the parent level and tax is not allocated to subsidiaries on the basis of income.

Location of Debt Financing – Another key objective of post-acquisition restructuring is to try to locate debt financing at the operating entity that is generating the related income flows. This can act as a natural foreign exchange hedge (depending on the currency of the debt), and simplifies cash flows within the group. In many instances it is possible for debt to be "pushed down" to the appropriate jurisdiction as part of intra-group share transfers or asset transfers effected to achieve consolidation or a holding company structure. In this case, key tax issues that need to be addressed are general debt-equity and thin capitalization issues, possible use of hybrid instruments, and the possible effect of IRC §§988 and 987 (which deal with the tax effect of certain foreign currency and branch transactions), on such financing arrangement.

Holding Company – Finally, an additional key objective of post-acquisition restructuring is to facilitate the movement of cash within the group without incurring incremental U.S. taxes, or to strengthen the group's position that non-U.S. earnings are not subject to U.S. deferred income taxes under the "indefinitely reinvested" criteria of ASC 740. While the usual holding company "suspects" need to be analyzed (e.g., the Netherlands, Luxembourg, Switzerland, Singapore, etc.), issues such as incremental administrative and accounting costs, "substance" concerns and the need to have local personnel, and ease of access to deal with corporate governance requirements need to be considered.

> *"there are numerous other tax and business objectives that can be accomplished by post-acquisition restructuring, including: 1) movement toward contract manufacturing; 2) close down or strip out supply contracts; 3) movement toward limited risk distributorships; 4) movement of intellectual property, and many more..."*

Once again, tax considerations such as: 1) reduced, or no, withholding taxes on dividends, interest and royalties; 2) the availability of an exemption system (or participation exemption system) on dividends and capital gains; 3) reduced or no capital duty; 4) low statutory tax rate or special tax regimes on certain flows of income (e.g., Luxembourg in the case of royalties), while important, are only a piece of the overall "pie" of business and tax considerations that need to be carefully analyzed in selecting a holding company jurisdiction.

Conclusion

In addition to the discussion above, there are numerous other tax and business objectives that can be accomplished by post-acquisition restructuring, including: 1) movement toward contract manufacturing; 2) close down or strip out supply contracts; 3) movement toward limited risk distributorships; 4) movement of intellectual property, and many more. However, the key to successful post-acquisition planning, in order to complete the successful acquisition and create a sustainable and efficient structure, is to ensure that tax objectives and planning alternatives are incorporated, on "day one," in the Company's overall post-acquisition planning analysis, and that the top Tax Executive be a key part of the internal Post-Acquisition Task Force. While a daunting task, proper post-acquisition planning with these objectives in mind will go a long way towards keeping the Dom Perignon bottles coming.

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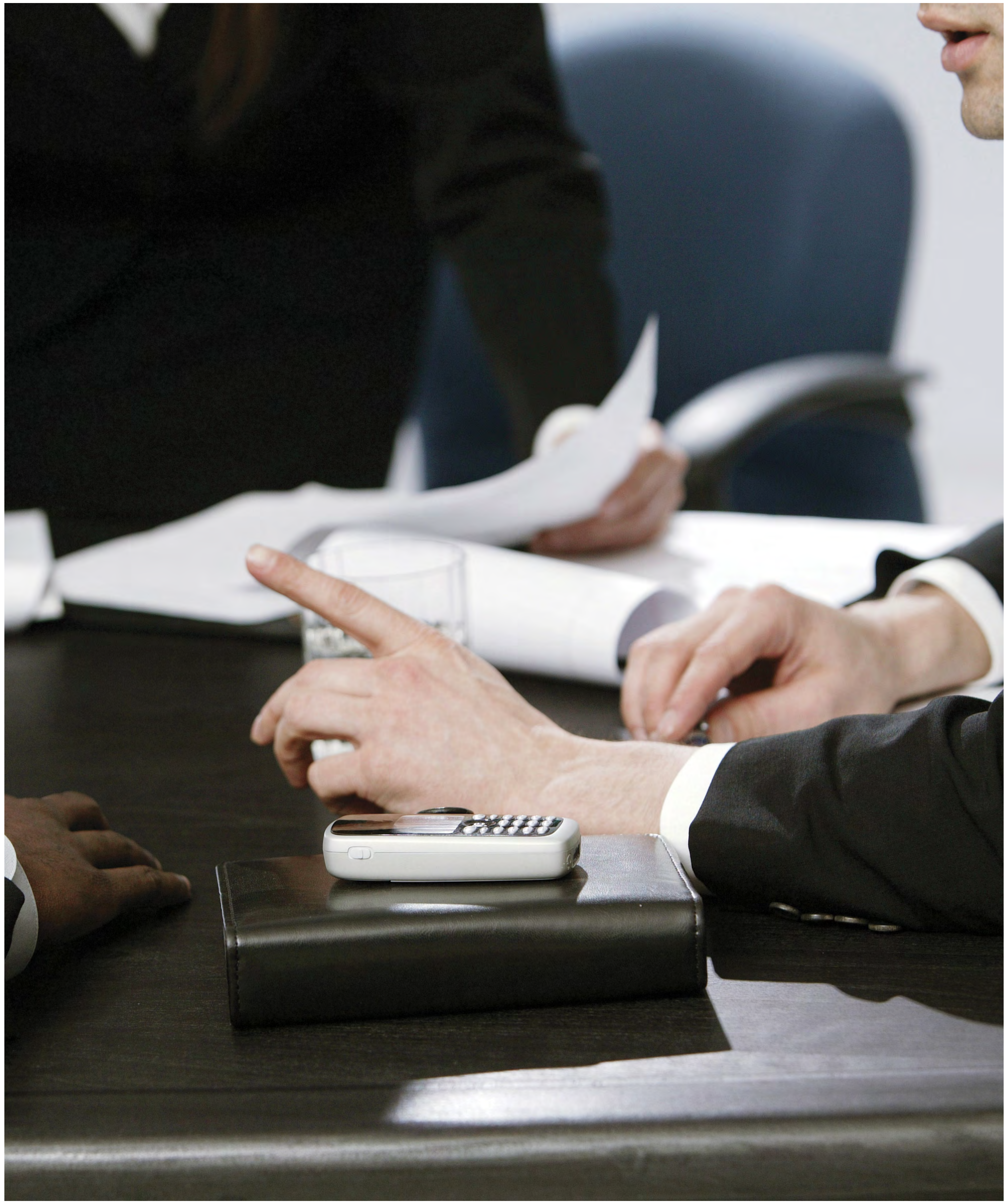

Recent Trends Regarding Mexican Insolvency Proceedings: The Pre-Packaged Bankrupcy

By Thomas S. Heather

Heather & Heather

The restructuring and insolvency activity in Mexico during the past few years has been primarily driven by the aftermath of the credit crisis originated in the United States in late 2008. The Mexican economy was rapidly and severely affected as a result, among other factors, of an important decline in exports, as over 75% of Mexican exports are destined to the United States, and a significant decrease in remittances of dollars from Mexican workers in the U.S., which still represents the second largest component of Mexican GDP. Other issues, such as the depreciation of the Mexican peso, the variations in oil prices, stock market volatility and the reduction of foreign investments due to drug related violence and instability have contributed to the deterioration of certain sectors, such as housing, although the economy has experienced modest growth and strengthening of its fundamentals during the past years.

Since its enactment in May 2000, the Concurso Law seemed to provide certain key improvements for bankruptcy proceedings, such as a better framework to carry out "equitable restructurings", through a procedure that addresses the interests of creditors and debtors alike, and specified time frames that aimed to prevent the abuses of unscrupulous debtors, which used to take advantage of the loopholes in the former law to stay in a literally endless suspension of payments. Nevertheless, recent decisions would question the modest advances.

The Concurso Law was amended in 2007 to include the possibility of a pre-packaged insolvency proceeding (concurso mercantil con plan de reestructura previo). Such Law provides that the insolvency procedure can begin directly at the conciliatory stage if the debtor and the creditors representing at least 40 percent of the credits jointly file a request with a proposed pre-packaged restructuring plan attached. The formal requirements to be included in such pre-packaged restructuring plan are set forth in the Concurso Law, which describes its required contents while specifically allowing for restructured loans to be maintained in the original currency contracted under.

To become effective, a restructuring plan must be subscribed to by the debtor and creditors representing more than 50 percent of the sum of the total amount corresponding to recognized unsecured creditors and the total amount corresponding to recognized secured or privileged creditors subscribing the plan. Any such plan, with the validation of the court, would become binding on all creditors and the insolvency proceeding will be considered as final and concluded.

Official records of the Federal Institute of Specialists in Commercial Insolvency (Instituto Federal de Especialistas de Concursos Mercantiles, known by its acronym in Spanish, IFECOM) show that during the last two quarters of 2011, formal filings for protection under the Concurso Law slightly decreased. During the aforementioned period, 15 petitions for insolvency were filed, 8 of which were involuntary petitions by creditors, and 7 were voluntary petitions, as opposed to the average of 20 petitions per semester during 2009 and 2010. Roughly the equivalent of US$60 billion in debt, with respect to 456 corporations has been subject to a concurso proceeding since the enactment of the Concurso Law in 2000. However, as the amendment that provides for a pre-packaged insolvency proceeding has been in effect for less than 5 years, only 5 significant corporations have resorted to a pre-packaged concurso filing.

Perhaps the most relevant development in the insolvency field is that the effectiveness of such pre-packaged restructuring plan has been proven. Although there have been only 5 cases filed under a pre-packaged scenario, the Controladora Comercial Mexicana and Grupo Iusacell Celular cases were highly successful, mainly because of the high rate of approval from creditors of the respective pre-packaged plans.

Unlike the first case of pre-packaged concurso mercantil, filed by Metrofinanciera, the restructuring plan proposed by Controladora Comercial Mexicana –the second corporation to file for a pre-packaged bankruptcy- was a true success. After complex negotiations with its creditors, Controladora Comercial Mexicana agreed to the restructuring of its debt pursuant to the provisions of a pre-packaged restructuring plan. The restructuring plan presented by Controladora Comercial Mexicana was supported by over 95% per cent of its creditors and was approved by the Court in a record time of three and a half months. The concurso plan provided for the issuance of new debt for a total amount of approximately US$1.6 billion in exchange for certain derivatives claims, commercial bank loans and publicly issued bonds. The Controladora Comercial Mexicana concurso proceeding was followed concurrently by a proceeding under Chapter 15 of the U.S. Bankruptcy Law.

As the next example of this trend, Grupo Iusacell Celular also petitioned for a pre-packaged concurso mercantil for the restructuring of its Notes due 2011 and 2012. The Grupo Iusacell Celular pre-packaged plan was supported by approximately 95 percent of its creditors and approved by the Court in 4 months. The concurso plan provided for the issuance of new debt for a total amount of approximately US$345 million.

We believe that these cases have set the grounds for other troubled companies to consider the protection of a pre-packaged concurso mercantil under the Concurso Law, as it has been demonstrated to be a valuable tool in the financial restructuring of companies in Mexico.

Apart from the notable developments in the insolvency field through the past years, and the improvements on related legislation, recent experiences in the delays by Mexican courts in accepting filings, the uncertainties associated with the appointment of procedure-related experts by the IFECOM, and the lack of immediate protective measures upon filing, among other compelling reasons, have led Mexican companies to turn North for protection of U.S. bankruptcy courts under Chapter 11 filings.

The recently concluded second insolvency case of SATMEX, and that of Industrias Unidas, proved to be efficient and predictable in such respect.

In conclusion, it is urgent that the Law be revised in certain key areas such as the protective aspects of filing, the pre-pack procedure generally, the rules of the IFECOM, the treatment of intercompany loans and the measures to be adopted in corporate group filings. Similarly, the form-over-substance approach typical of the Mexican legal system allows the concurso to be entangled with delaying procedural tactics that negatively affect the interests of corporate entities, of those seeking the protection afforded by insolvency statutes and ultimately, of all stakeholders.

> *"Although there have been only 5 cases filed under a pre-packaged scenario, the Controladora Comercial Mexicana and Grupo Iusacell Celular cases were highly successful, mainly because of the high rate of approval from creditors of the respective pre-packaged plans."*

Notwithstanding the existing uncertainty arising from the Compañia Mexicana de Aviación, the aforementioned problems in the insolvency field, and the fact that there is currently no pending legislation on the subject, Mexico is generally viewed as a success story in the history of concerted restructurings, having innovated solutions for both the public and private sectors. Indeed, Mexico is a mature, proven jurisdiction, supported by sophisticated legal, accounting and financial experts in the field of restructurings.

Heather & Heather

Formal filings for bankruptcy protection have been, historically, rare and few, and consensual workouts have been the norm.

The usual restructuring exercises with the creation of ad-hoc committees working with the debtor, and the implementation of techniques such as auctions, refinancing menus, capitalization options, bond exchanges and hedging support, have indeed led to significant success outside the unpredictability of the Courts, and together with the relatively recent pre-packaged bankruptcy scenario, the outlook for successful restructurings is positive.

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Insolvency Law Developments In The Caribbean

By Edmund Rahming

Introduction

The Caribbean is a region comprising over 7,000 islands and cays and consisting of a land area of almost 93,000 square miles. The region is made up of 30 jurisdictions including sovereign states, overseas territories and dependencies. Many of the jurisdictions are former or current British colonies and territories. The legal system of the Caribbean is largely based on the Common Law system with tendencies of reliance on the form, structure, substance and content of the law as expressed in England. As a result, while insolvency laws and procedures vary from one Caribbean jurisdiction to another, they are generally based on the UK Insolvency Act 1986. For the purposes of this article when referring to the Caribbean we will be referring to the major Caribbean offshore financial centres including the Bahamas, the British Virgin Islands, Bermuda and the Cayman Islands. KRyS Global maintains offices in each of these jurisdictions.

The majority of work undertaken in the Caribbean comprises court-supervised liquidations and forensic accounting engagements. The insolvency law throughout most of the Caribbean does not provide for a formal restructure or reorganization procedure such as an Administration in the U.K., or US Chapter 11 provisions. In addition, there is little restructuring work performed in the Caribbean as the majority of work stems from fraud having been committed against the company. As a result, insolvency practitioners in the Caribbean have vast experience in forensic accounting, investigations and litigation, as they seek to recover losses from responsible parties in a variety of onshore jurisdictions. Much consideration needs to be given in formulating a strategy that will allow for the maximum recovery against third parties. Given the cross-border nature of many Caribbean appointments, insolvency practitioners often have to seek recognition of their appointment in onshore jurisdictions to give them standing to pursue third party claims by litigation.

A typical scenario in the Caribbean involves a foreign owned company which is incorporated in the jurisdiction and has substantial assets and business activities located elsewhere. Aside from the incorporation of the company, there is little association within the Caribbean offshore jurisdiction. The financial services industry, from which the majority of appointments are made, is made up of hedge funds, international business companies (IBCs), captive insurance and reinsurance companies, all of which operate in any number of countries globally. Many matters are complex including the enforcement of foreign judgments, tracing claims, injunctions, contractual and shareholder disputes and professional negligence claims. Offshore liquidators have to commit a large amount of time and resources immediately following appointment to find the books and records of the company, identify and secure assets and establish a means of correspondence with the creditors/ investors.

Trends in the Caribbean insolvency arena

Given that a number of the higher profile insolvency matters in the Caribbean involve cross-border issues, we are finding that a number of the developments in the application of the laws onshore arise from Caribbean-based cases. Cases like Fairfield Sentry, Saad Finance No. 5, British American Insurance and Condor Insurance provide cutting-edge development in the recognition of foreign liquidators and the use of local statutory remedies through Chapter 15 of the US Bankruptcy Law. Litigation involving the SPhinX Funds has clarified the area of in pari delicto and the Wagoner doctrine.

New legislation related to insolvency laws – current and on the horizon

The last ten years have seen updates in the insolvency laws throughout the Caribbean. The updates have been made to modernize procedures and better facilitate international cooperation. In the British Virgin Islands, the Insolvency Act 2003 Part 18 includes sections inspired by the UNCITRAL Model Law. In the Cayman Islands, the Companies Law (2010 Revision) Part 17 was included to facilitate international cooperation. In early 2011 the Cayman Islands enacted a number of amendments to the Companies Law. These revisions include flexibility for companies to hold their own shares; refining merger and consolidation provisions to allow more flexibility; and modernizing document execution provisions. The Bahamas and Bermuda are currently drafting updates to their Companies laws and Insolvency procedure rules to address modernization of insolvency procedures and bring them in line with other jurisdictions in the region.

Insolvency professionals in the Cayman Islands are in the process of forming a local chapter of INSOL International to enhance education and development of the profession and to give the industry a voice in local regulatory reviews and international developments.

Succeeding during recessional times in the Caribbean

Liquidation is always a last resort for a business, and should be taken when all other options fail. We have found some of the alternative options to include fundraising or alleviating liquidity pressures, particularly as it applies to hedge funds, the suspension of redemptions, implementing "gate" provisions, or transferring bad assets to "side pockets" or separate corporate vehicles.

To assist businesses in navigating through recessional economic periods, we suggest companies firstly identify and assess areas of risk and address them. Where the business is suffering from lack of liquidity or poor management, it may be possible to find means to enhance profitability, improve performance, and minimize the risk of loss. Clear strategies to streamline operations and gain control of cash should be formulated. We propose remedies in the form of improved internal controls, budgetary accountability, integrity tests, sale or transfer of redundant or poor assets, and fraud prevention training to assist businesses. We would also propose companies ensure that they are up-to-date in assessing risks and areas for exposure, whether regulatory, financial, or environmental, which may affect business continuity.

"To assist businesses in navigating through recessional economic periods, we suggest companies firstly identify and assess areas of risk and address them."

High profile engagements

KRyS Global is involved in some of the larger, more complex and unique international and cross-border assignments in the Caribbean. This demonstrates our reputation for clear, decisive action, creative solutions and impartial advice, which has facilitated the growth of the firm since the onset of recession. Our larger engagements include SPhinX Group, Fairfield Sentry, and Sextant Funds. All of these engagements involve elements of fraud, cross-border litigation and highly complex issues requiring highly specialized strategies to recover assets for the benefit of creditors.

KRyS Global
Complex Issues. Resolved.

KRyS Global has over 40 professionals who work from offices in four jurisdictions: the Cayman Islands, British Virgin Islands, Bahamas and Bermuda. They specialize in providing corporate recovery, fraud investigation and forensic accounting, money laundering investigations, business advisory services, consulting and regulatory compliance services.

Edmund Rahming is the Managing Director of KRyS Global's Bahamas office. He has over 13 years of experience in providing insolvency, fraud and forensic accounting investigations, and litigation support services in various industries.

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The New Discipline of Insolvency Practitioners in India

By Sumant Batra

KDB

Opportunities & Challenges

It is now well recognized that engagement of insolvency practitioners in the insolvency process enhances the efficiency of the otherwise complex insolvency system. The absence of participation of insolvency professionals possessing appropriate knowledge and skills can impact the quality and efficiency of the entire process. Presently, the Indian law does not support effective participation of professionals. While government officials are appointed as liquidators, banks and financial institutions are appointed to prepare rehabilitation plans. This has impacted the efficiency of the rehabilitation and liquidation process. Some progress was made with the passing of the Companies (Second Amendment) Act, 2002 (Second Amendment) which provided for appointment of liquidators from a panel of firms of chartered accountants, cost & work accountants, advocates, company secretaries or others, as may be prescribed. The Second Amendment remains unimplemented due to a court challenge.

The constitution of Dr. J.J. Irani Expert Committee in 2006 offered a valuable opportunity to re-visit this subject. The committee examined the work of UNCITRAL, World Bank and INSOL International in this area and made significant recommendations for improving the insolvency law.

The government recently introduced Companies Bill in Parliament. The Bill inter alia proposes a new insolvency regime including the provisions for appointment of company liquidator in the winding up proceedings who shall be an independent person appointed out of the panel of professionals maintained by the central government. The Bill provides that such professionals must be having at least 10 years of experience in the company matters. Although the Bill seeks to introduce the concept, it falls short of providing a suitable framework for insolvency professionals.

There are no provisions in the Bill for their licensing, education and experience in insolvency or related areas. This poses the risk of easy empanelment of such professionals who may otherwise not be suitably qualified or suitable for appointment to provide the highly specialized services of insolvency. As they would be expected to discharge important functions, adequate accountability provisions are required. The proposed appointment process of insolvency practitioners as an administrator or company liquidators by court is defective.

Building framework of insolvency professionals

Building suitable framework of insolvency practitioners offers a number of challenges for the law makers. Insolvency affects the interests and rights of broad groups- creditors, employees, shareholders and debtors themselves. There is also a wider public interest in seeing that

the damage is limited and resources efficiently re-allocated to productive use, risk of systemic failure is contained; misconduct is unconsidered and pursued; confidence in market is maintained; and honest debtors get a fresh start. In the centre of this stands the practitioner who has wide powers, duties, responsibilities and functions. He acts for others – creditors and debtors in particular making him a trustee. This creates the need for their regulation; provide appropriate qualifications and experience; update knowledge and experience; prescribe a code of professional conduct and ethics covering integrity, impartiality, independence and objectivity; and introduce mechanism for overseeing their performance and conduct and for dealing with those who abuse the process. Most jurisdictions including UK and Australia have adopted a licensing regime. It is inevitable in India and the professionals should be ready for licensing.

Qualifications: Education, Knowledge & Experience

The complexity of many insolvency proceedings makes it highly desirable that the insolvency practitioners be appropriately qualified with knowledge of the law. The knowledge should not only be of insolvency law, but also relevant commercial, finance and business law. The UNCITRAL Guide notes that the qualifications required of a person who can be appointed as an insolvency practitioners may vary depending upon the design of the insolvency regime with regard to the role of the insolvency practitioners (including whether the proceedings are liquidation or reorganization) and the level of supervision of the insolvency practitioners (and of the insolvency proceedings generally) by the court.

Different systems adopt different approaches to ensure the appropriate qualification of the insolvency practitioners, including a requirement for certain professional qualifications and examinations; licensing where the licensing system is administered by a government authority or professional body; specialised training courses and certification examinations; requirements for certain levels of experience (generally specified in numbers of years) in relevant areas, for example, finance, commerce, accounting and law, as well as in the conduct of insolvency proceedings. There may also be requirements for ongoing professional education to ensure familiarity with current developments in relevant areas of law and practice. Those systems which require some form of licensing or professional qualification and membership of professional associations often also address issues of supervision and discipline, and an insolvency practitioner may be subject to regulation by the court, a professional association, a corporate regulator or other body, under legislation other than the insolvency law. In addition to having the requisite knowledge and experience, it may also be desirable that the insolvency practitioner possesses certain personal qualities, such as integrity, impartiality and good management. Integrity may require that the insolvency practitioners have a sound reputation and no criminal record or record of financial wrongdoing or in some countries, no previous insolvency or removal from a position of public administration.

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Selection and appointment of the Insolvency Practitioners

Creditors should have a role to play a role in recommending and selecting the insolvency practitioners to be appointed, provided that that person meets the qualifications for serving in the specific case. The approaches that rely upon the independent appointing authority and the creditor committee may serve to avoid perceptions of bias and assist in reducing the supervisory burden placed upon the courts. A different approach permits the debtor to appoint the insolvency practitioners in those cases where reorganization proceedings are commenced by the debtor. This approach allows discussions to take place between the debtor and other parties, such as secured creditors, before commencement of the proceedings to familiarise the prospective representative with the business and allows the debtor to select an insolvency practitioners that it considers will be best able to conduct the reorganization. Concerns may be raised, however, as to the independence of the insolvency practitioners. These may be addressed by permitting creditors, in appropriate circumstances, to replace an insolvency practitioners appointed by the

It is also necessary to ensure that the remuneration of practitioners is commensurate with their qualifications, the tasks required to perform, and achieve a balance between risk and reward in order to attract appropriately qualified professionals. Establishing a measure for the care, diligence and skill with which the insolvency practitioners is to carry out its duties and functions requires that the difficult circumstances in which they finds itself when fulfilling its duties are taken into account and balanced against payment of an appropriate level of remuneration and the need to attract qualified persons to act as insolvency practitioner. A balance is also desirable between a standard that will ensure competent performance of the duties of the insolvency practitioner and one that is so stringent it invites law suits against the insolvency practitioners and raises the costs of its services.

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