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RESTRUCTURING & INSOLVENCY 2024

Contributing editors
Catherine Balmond and Katharina Crinson
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Quick reference guide enabling side-by-side comparison of local insights, including a general overview; types of liquidation and reorganisation processes; insolvency tests and filing requirements; directors' and officers' regime; stays of proceedings and moratoria; doing business during reorganisations; asset sales;creditor remedies, involvement and proving claims; security; clawback and related-party transactions; treatment of groups of companies; international cases; and recent trends.

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Explore on **Lexology**

USA

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GENERAL

Legislation

1 | What main legislation is applicable to insolvencies and reorganisations?

In the United States, business entities and individuals can either utilise state insolvency and reorganisation laws or invoke Title 11 of the United States Code (the Bankruptcy Code). As a federal statute, the Bankruptcy Code takes precedence over state laws concerning insolvency and the restructuring of debtor-creditor relationships. As a result, the vast majority of insolvency proceedings in the United States are governed by the Bankruptcy Code.

Excluded entities and excluded assets

2 | What entities are excluded from customary insolvency or reorganisation proceedings and what legislation applies to them? What assets are excluded or exempt from claims of creditors?

Certain types of entities may not be debtors under the Bankruptcy Code, including insurance companies, domestic banks and certain small business investment companies licensed by the Small Business Administration. Bank holding companies can file for bankruptcy protection, but banking institutions are subject to separate regimes under federal or state laws, as applicable. The scope of eligible debtors encompasses individuals, corporations, partnerships and other business organisations. In addition, there are specific Bankruptcy Code provisions that cater to municipalities, railways, stockbrokers, commodity brokers, clearing banks, family farmers and fishers. To be eligible for relief under the Bankruptcy Code, a debtor must have a domicile, residence, place of business or property located in the United States.

Initiating a bankruptcy case, excluding those involving municipalities or proceedings under Chapter 15 of the Bankruptcy Code, immediately establishes a bankruptcy estate incorporating all legal or equitable interests of the debtor in their property, regardless of location. The definition of 'property of the estate' in the Bankruptcy Code is expansive and covers various forms of property, both tangible and intangible, along with causes of action. In general, initiating a bankruptcy case brings substantially all the property of the debtor under the jurisdiction of the applicable bankruptcy court where the case is filed.

Individual debtors can exempt certain property from becoming part of the bankruptcy estate, protecting it from the claims of most pre-petition creditors. Such exemptions exist both under the Bankruptcy Code as well as state law. Exemptions may include an interest in the debtor's primary residence, a motor vehicle, personal jewellery, household items and professional tools. Whether under the federal or state system, exempted property remains susceptible to specific types of claims, such as alimony or support obligations that cannot be discharged, unavoidable liens and non-dischargeable taxes.

Public enterprises

3 What procedures are followed in the insolvency of a government-owned enterprise? What remedies do creditors of insolvent public enterprises have?

Chapter 9 of the Bankruptcy Code governs municipal bankruptcies. The municipality must seek voluntary protection under Chapter 9 of the Bankruptcy Code. An entity can qualify as a debtor under Chapter 9 if:

- it is a municipality, defined in the Bankruptcy Code as a political subdivision or public agency or instrumentality of a state;
- it must be specifically authorised to be a debtor by state law or by a governmental officer or organisation empowered by state law to authorise the entity to be a debtor under Chapter 9;
- it is insolvent;
- it wants to effect a plan to adjust its debts; and
- it either:

- obtains the agreement of creditors holding at least a majority in amount of the claims of each class that the debtor intends to impair under a plan in a case under Chapter 9;
- negotiates in good faith with creditors and fails to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that the debtor intends to impair under a plan;
- is unable to negotiate with creditors because it is impracticable; or
- reasonably believes that a creditor may attempt to obtain a preference.

Where a municipality qualifies for Chapter 9 protection, the case's progression mirrors that of a Chapter 11 reorganisation case. The municipal debtor must file a list of creditors and may assume or reject executory contracts while having the power to negotiate a restructuring plan in collaboration with stakeholders. One significant difference between Chapter 9 cases and cases filed under other chapters of the Bankruptcy Code is that the bankruptcy court cannot interfere with the operations of the municipality or with its use of property and revenues since there is no estate and thus no property of the estate in a Chapter 9 case. Notably, the criteria for confirming a Chapter 9 plan of reorganisation for a municipality greatly diverges from the standards used in a restructuring governed by Chapter 11 of the Bankruptcy Code. While creditors maintain many similar remedies as those available in traditional bankruptcy cases, general unsecured obligations do not. They are subject to restructuring and impairment, with specific provisions applying to certain obligations, including special revenue bonds, and a creditors' committee is not automatically appointed. Ultimately, seeking dismissal of the Chapter 9 case often serves as the strongest remedy for a creditor.

If an entity is merely owned by a governmental entity, it may still be able to file for Chapter 11 bankruptcy, as long as the entity itself is not a governmental unit.

Protection for large financial institutions

4 Has your country enacted legislation to deal with the financial difficulties of institutions that are considered 'too big to fail'?

The Dodd-Frank Wall Street Reform and Consumer Protection Act, passed in 2010 in response to the 2008 global financial crisis, sought to make the US financial system safer for consumers and taxpayers. The Dodd-Frank Act addresses multiple facets of the financial system in efforts to mitigate systemic financial risks. For example, the Dodd-Frank Act established:

- the Consumer Financial Protection Bureau, dedicated to preventing predatory, abusive practices relating to financial products like mortgages and credit cards; and
- the Financial Stability Oversight Council, tasked to monitor the financial stability of major financial firms that is comprised of federal financial regulators and industry participants.

Furthermore, the Dodd-Frank Act enacted legislation to address the challenges posed by 'too big to fail' financial institutions. These include:

- the establishment of an orderly liquidation mechanism empowering the Federal Deposit Insurance Corporation to unwind failing systemically important financial institutions (SIFIs) outside the scope of bankruptcy;
- the requirement that SIFIs create 'living wills' outlining strategies for swift and systematic shutdowns in the event of financial distress; and
- the introduction of the Volcker Rule, which restricts how banks can invest, limits speculative trading and eliminates proprietary trading. The Volcker Rule imposes trading limitations on financial institutions with the goal of separating their investment banking, private equity and proprietary trading divisions from their retail and consumer lending divisions.

However, since its enactment, there have been efforts to dilute its regulatory impact. Most noteworthy is the Economic Growth, Regulatory Relief and Consumer Protection Act, enacted in May 2018. The new law eased the most stringent post-financial-crisis regulatory requirements of the Dodd-Frank Act for smaller banks with assets below US$250 billion. Recent turmoil among smaller US banks has demonstrated a willingness by the federal reserve to step in and seize failing banks before they can introduce systemic risk to the banking system.

Courts and appeals

5 What courts are involved? What are the rights of appeal from court orders? Does an appellant have an automatic right of appeal or must it obtain permission? Is there a requirement to post security to proceed with an appeal?

The bankruptcy courts hold jurisdiction over insolvencies and reorganisations conducted under the Bankruptcy Code, functioning as units of the federal district courts with limited jurisdiction. They can issue final orders and judgments in specific 'core' matters, which either involve substantive rights under the Bankruptcy Code or uniquely arise in bankruptcy proceedings. For non-core matters, those not reliant on bankruptcy law and which can be addressed outside bankruptcy settings, the bankruptcy court can only submit proposed findings of fact and conclusions of law for de novo review by the district court. However, parties can consent to bankruptcy court jurisdiction.

Appeals from bankruptcy court rulings are heard by the federal district court within the relevant district in which the bankruptcy court sits. District court decisions are appealed to the federal circuit court of appeals for the relevant jurisdiction. Further appeals are to the US Supreme Court. The US Supreme Court has discretion whether to hear an appeal, and most requests for an appeal are not heard. An issue of state law may also be heard by state courts in certain circumstances, and the state court decision is then applied by federal courts.

A litigant has an automatic right to appeal a final bankruptcy court order; however, a party may appeal an interlocutory (non-final order) only with leave of the court. Final decisions end litigation on the merits, leaving only execution of the judgment to the court, whereas interlocutory orders address specific case aspects, necessitating further steps for full adjudication. District courts exhibit flexibility in assessing finality in bankruptcy cases, recognising the nature of discrete and numerous disputes in bankruptcy that could be finally adjudicated for appeal purposes. To appeal an interlocutory order, on the other hand, filing of a motion for leave and filing of a notice of appeal is necessary. District courts can review these orders if they involve a controlling legal question with substantial room for differing opinions, and if immediate appeal could materially advance the bankruptcy proceedings or termination of the case. Interlocutory appeals are the exception and generally disfavoured.

An appellant is not required to post a bond or security for an appeal unless seeking a stay of the bankruptcy judge's order pending appeal. Courts determining whether a bond is required and the amount of the bond will focus on certain factors, including the potential decrease to property value and any loss that may be incurred.

TYPES OF LIQUIDATION AND REORGANISATION PROCESSES

Voluntary liquidations

6 What are the requirements for a debtor commencing a voluntary liquidation case and what are the effects?

To initiate a Chapter 7 voluntary liquidation, a debtor must file a petition in the bankruptcy court in the judicial district where the entity is incorporated or has its principal place of business or assets (for an individual, where they have a domicile or residence). In addition to the petition, the debtor must also file with the court:

- schedules of assets and liabilities;
- a schedule of current income and expenditures;
- a statement of financial affairs; and

- a schedule of executory contracts and unexpired leases.

When a Chapter 7 petition is filed, the bankruptcy estate is established. In addition, the automatic stay is immediately triggered, which prohibits substantially all creditor enforcement actions or the continuation of any litigation.

A trustee is then appointed to take control of the debtor's assets. The trustee will act to maximise the value of the estate and to implement the liquidation. Management is typically displaced by the trustee. The trustee will collect all the assets of the debtor, file any avoidance actions or other litigation to recover any available assets for the estate, and collect and review all claims of creditors. Once the assets and claims are determined, the trustee will pay creditors their appropriate portion of the estate assets.

Both companies and individuals can also liquidate by filing a Chapter 11 plan of liquidation. A liquidating Chapter 11 case will proceed in much the same way as a typical Chapter 11, except the debtor will liquidate and distribute its assets pursuant to the plan and will not reorganise. A Chapter 11 debtor can also convert the bankruptcy case to a Chapter 7 liquidation if reorganisation proves to be impossible. Conversion to Chapter 7 can also result from a request by creditors or other parties in interest and an order from the bankruptcy court.

Voluntary reorganisations

7 | What are the requirements for a debtor commencing a voluntary reorganisation and what are the effects?

A debtor must be eligible and may commence a Chapter 11 case by filing a relatively simple and straightforward petition with the bankruptcy court. Insolvency is not a requirement for the debtor to file a Chapter 11 petition, but the debtor (an individual, partnership or corporation) must have a domicile, residence, place of business or property (however de minimus) in the United States.

The filing of a Chapter 11 petition establishes the bankruptcy estate and immediately triggers the automatic stay. Creditors cannot take any actions to collect or enforce existing judgments or liens against the debtor, and cannot advance any litigation against the debtor without permission of the bankruptcy court. Usually, existing management remains in control of the management and financial affairs of the debtor's businesses as the 'debtor-in-possession'. The debtor-in-possession then has several duties under the Bankruptcy Code, including to file schedules of all assets and debts, and propose and file a plan of reorganisation.

Successful reorganisations

8 | How are creditors classified for purposes of a reorganisation plan and how is the plan approved? Can a reorganisation plan release non-debtor parties from liability and, if so, in what circumstances?

For successful Chapter 11 plan approval, the plan must meet various criteria, including:

- it is presented in good faith and is not forbidden by law;
- it categorises all claims and interests into classes, where each class includes claimants whose claims are substantially similar;
- it outlines the treatment for each class of claims or interests, specifying if they are impaired or unimpaired;
- it includes, if at least one class of claims is impaired by the plan, at least one accepting class of impaired claims (determined without including acceptances by insiders);
- it provides adequate means for the plan's implementation;
- it is 'feasible' (ie, not likely to be followed by the need for liquidation or another financial reorganisation); and
- with respect to each impaired class of claims or interest, it provides that each holder of a claim or interest in the class either has voted to accept the plan or will receive or retain under the plan on account of the claim or interest, property of a value as of the effective date of the plan that is not less than the amount that the holder would receive or retain if the debtor were liquidated under Chapter 7 of the Bankruptcy Code (known as the 'best interests of creditors test').

Under Chapter 11 procedures, creditors are categorised based on the nature of their claims, which permits a structured approach to the reorganisation process. They are often classified into classes, ranked from highest priority to lowest:

- secured claims;
- unsecured priority claims;
- unsecured non-priority claims; and
- equity interests.

If a creditor possesses multiple claims, each with different rights, the individual claims can be classified into different classes. A secured claim holds collateral or a lien on property or assets belonging to the debtor. Secured claims may be classified as different classes if their collateral or priorities vary significantly. For example, creditors with first liens on assets and those with second liens may constitute two different classes. In contrast, an unsecured claim is one that does not hold collateral or a lien and are not guaranteed payment, as the class will only receive recovery from the debtor's estate after distributions are made to the secured creditors. This can include unsecured priority claims and non-priority claims. Examples of unsecured priority claims include administrative expenses incurred during the course of the bankruptcy case, tax claims and employee claims. Unsecured non-priority claims are usually all grouped together, mixing creditors who do not hold collateral or security interests. Equity interests are the holders who possess stock equity or ownership in the debtor and often do not obtain a return on their investment. The classification of claimants and interest holders allows the bankruptcy court to address the interests of different groups in a more organised and fair manner, while facilitating negotiations and decisions during the reorganisation process.

Unimpaired classes of creditors are treated as having accepted the plan and cannot vote on the plan. Unimpaired classes of creditors are creditors whose claims are fully reinstated under the bankruptcy plan. Classes that receive no distribution under the plan are similarly unable to vote on the plan, as it is considered that they have rejected the plan. Those who hold impaired claims or interests have the right to vote on the plan. If the plan has been accepted by creditors, in any given class, that hold more than two-thirds in amount and more than 50 per cent in number of the allowed claims of the class held by voting creditors, the class of claims is considered to have accepted the plan.

If all impaired voting classes accept the plan, it is approved. If any impaired class rejects the plan, as long as one impaired voting class has accepted the plan, the plan can potentially still be confirmed through non-insider cramdown. This has certain requirements for approval of the plan, including that the plan does not 'discriminate unfairly' and is 'fair and equitable' to each impaired, non-accepting class. The plan must group similar claims together and treat them comparably. The plan must uphold the 'absolute priority rule' that senior claims in dissenting classes must be fully satisfied before junior claims or interests can receive or maintain any property under the plan.

The issue of whether a plan of reorganisation can incorporate releases by creditors and other parties in interest in favour of non-debtors, commonly known as third-party releases, is a contentious and actively litigated issue. Bankruptcy courts have different standards for third-party releases, with some courts allowing them in limited circumstances and other courts not allowing them. There are also constitutional concerns related to whether bankruptcy courts can order third-party releases. The issue may be addressed by the US Supreme Court later in 2023.

In general, courts only allow third-party releases to the extent they are necessary and fair. Most courts have held that 'deemed releases', releases by creditors of third parties based on the creditor's unimpairment or failure to elect not to grant a release, are not permissible. Courts have generally held that releases and exculpations are permissible for the debtor's officers, directors and other professionals, along with the statutory committees and their advisers, for actions and omissions stemming from or connected to the Chapter 11 case itself. Significant stakeholders, in certain cases, who contributed substantial consideration to the reorganisation (including lenders) and their advisers, may also be released and exculpated under a plan.

The Nondebtor Release Prohibition Act of 2021 was introduced in the US Senate and House of Representatives in July 2021, in response to perceived abuse of nondebtor releases in opioid and other mass tort bankruptcy cases. If passed, the legislation would ban non-consensual third-party releases. At the time of writing, the Senate Judiciary Committee is still considering the bill, and the House Judiciary Committee voted that the bill be considered by the full House, though a vote has yet to be scheduled.

Involuntary liquidations

9 What are the requirements for creditors placing a debtor into involuntary liquidation and what are the effects? Once the proceeding is opened, are there material differences to proceedings opened voluntarily?

Creditors can initiate an involuntary Chapter 7 liquidation against debtors who otherwise would be eligible to file a voluntary case. This excludes certain categories of debtors, including farmers, railways and not-for-profit corporations. Typically, the involuntary petition requires signatures from three or more creditors that have good faith, non-contingent unsecured claims against the debtor totalling at least US$16,750. A single creditor may also file a petition for involuntary bankruptcy if they are owed US$16,750 and the debtor has fewer than 12 unsecured creditors in total.

If the debtor contests the involuntary filing, the bankruptcy court will determine if the bankruptcy case is appropriate if the debtor is not paying debts as they become due. The debtor has the option of converting an involuntary Chapter 7 case into a voluntary Chapter 7 or voluntary Chapter 11 case. A debtor may prefer a voluntary Chapter 11 to maintain some control over the bankruptcy process.

Filing an involuntary petition 'automatically stays' most collection actions against the debtor or debtor's property. If the bankruptcy court grants the petition for the Chapter 7 bankruptcy, the case will follow the same trajectory as a voluntary Chapter 7 case, in which a trustee is appointed to administer the estate and liquidation. However, while the involuntary petition is contested, the debtor can continue controlling its business, although the court has discretion to appoint an interim trustee for cause.

The danger for a creditor seeking to place the debtor in involuntary bankruptcy is, if the court dismisses the action, the court may award attorney's fees, costs or damages to the debtor.

Involuntary reorganisations

10 What are the requirements for creditors commencing an involuntary reorganisation and what are the effects? Once the proceeding is opened, are there any material differences to proceedings opened voluntarily?

To secure involuntary Chapter 11 relief, creditors must satisfy the same requirements as those for an involuntary Chapter 7 case. The case then follows the same trajectory of a voluntary Chapter 11 case once the court grants the involuntary petition.

Expedited reorganisations

11 Do procedures exist for expedited reorganisations (eg, 'prepackaged' reorganisations)?

The Bankruptcy Code allows for 'prepackaged' reorganisations, where a distressed corporation reaches an agreement on the terms of the Chapter 11 plan with its key creditors and solicits acceptance for that plan before filing for Chapter 11 relief. Similarly, 'pre-arranged' plans are permissible, in which the debtor negotiates the terms of the reorganisation in advance of the bankruptcy, but does not formally solicit actual votes for the plan of reorganisation until after filing for Chapter 11 protection.

Courts have approved prepackaged plans in as little as one day after the debtor files for bankruptcy, but such swift timelines are uncommon. In successful 'pre-arranged' cases, confirmation of the plan of reorganisation can occur in as little as 60 to 90 days after filing the Chapter 11 case.

Unsuccessful reorganisations

12 | How is a proposed reorganisation defeated and what is the effect of a reorganisation plan not being approved? What if the debtor fails to perform a plan?

To be approved by the bankruptcy court, the Chapter 11 plan must fulfil the necessary confirmation requirements (described previously). If the debtor's Chapter 11 plan is not approved, the debtor will usually propose and solicit a revised plan if within the exclusivity period.

If there is a material default under an approved plan, or the debtor cannot consummate its approved plan, the bankruptcy court would likely allow revised or new plans to be submitted and solicited. If the court cannot confirm any plan, the Chapter 11 case must either be dismissed or converted to Chapter 7.

Corporate procedures

13 | Are there corporate procedures for the dissolution of a corporation? How do such processes contrast with bankruptcy proceedings?

Per state law, a corporate entity seeking dissolution has the option to dissolve or liquidate. Corporate statutes commonly dictate that after a corporation dissolves, its directors can distribute assets to shareholders only once they have discharged or made reasonable agreements to pay all creditors. State procedures do not mandate creditors' committees and there is no automatic collective creditor action similar to bankruptcy. Directors and officers that dissolve a corporation using state law procedures may face personal liability under state law for improper asset distributions or failure to adequately provide for creditor claims. In contrast, dissolution or liquidation through a bankruptcy proceeding has advantages. This includes the automatic stay of litigation and enforcement proceedings, and a court order sanctioning the distribution of assets to creditors. Bankruptcy offers heightened clarity to stakeholders and guarantees a stronger layer of liability protection for directors and officers. This may come at the expense of more administrative cost, a longer timeline and more court oversight.

Conclusion of case

14 | How are liquidation and reorganisation cases formally concluded?

Chapter 7 liquidation cases are formally concluded once the trustee has fully liquidated all the assets, paid out the available assets to the creditors and filed a final report certifying this

with the court. Unless a party objects to the final report, the court discharges the trustee of its duties and enters an order closing the case.

Chapter 11 cases are concluded when the confirmed plan has been consummated according to its terms (usually including that all or substantially all the property proposed to be transferred has been transferred; the debtor or its successors has assumed management of all or substantially all of the property addressed in the plan; and distribution of the plan has begun). Once the plan has been confirmed and consummated, the reorganised debtor can operate without court oversight. There will then be a final report and accounting filed and the bankruptcy court will enter an order closing the case.

INSOLVENCY TESTS AND FILING REQUIREMENTS

Conditions for insolvency

15 | What is the test to determine if a debtor is insolvent?

US courts generally utilise one of two methods for determining insolvency:

- balance-sheet test: insolvent when the value of the entity's assets is less than the value of the entity's liabilities on a balance-sheet basis; or
- cash-flow test: insolvent when the entity is unable to meet its financial obligations as they come due.

The US Bankruptcy Code defines insolvency as the 'financial condition such that the sum of such entity's debts is greater than all such entity's property, at a fair valuation'. This is a balance-sheet test and it is generally favoured by bankruptcy courts. The Bankruptcy Code uses the term 'insolvent' with respect to a limited number of concepts – including preference claims, fraudulent transfers, set-off rights and reclamation rights. It also contains exceptions: a municipality is only insolvent under the Bankruptcy Code if it is not meeting its financial obligations as they come due (ie, applying the cash-flow test). Unlike in many countries, an entity does not need to meet an insolvency test to file for bankruptcy relief. However, recent court decisions have challenged whether a solvent corporation can file for bankruptcy to address liabilities. In practice, bankruptcy courts use many valuation metrics used by financial professionals to test insolvency when relevant for avoidance litigation or other purposes and frequently utilise a combination of insolvency tests.

Mandatory filing

16 | Must companies commence insolvency proceedings in particular circumstances?

There is no requirement under US law that a company commence a bankruptcy proceeding in any circumstance. The board of directors must act in good faith to maximise the value of the company and may do so by either commencing a bankruptcy proceeding or pursuing alternative reorganisation strategies.

DIRECTORS AND OFFICERS

Directors' liability – failure to commence proceedings and trading while insolvent

17 If proceedings are not commenced, what liability can result for directors and officers? What are the consequences for directors and officers if a company carries on business while insolvent?

Directors and officers generally owe fiduciary duties to the corporation and its shareholders. However, those fiduciary responsibilities are broadened to encompass the interests of creditors, as well as shareholders, when a company is insolvent. As long as the company operates in good faith, there are typically no further consequences if it continues its business activities while insolvent. Courts generally believe that creditors in such situations possess adequate safeguards through their contractual agreements with the company along with fraudulent transfer and avoidable transfer laws. Creditors who believe a company should be in a bankruptcy proceeding can file an involuntary petition for bankruptcy. Secured creditors may also have contractual rights to seize their collateral to the extent secured or can pursue judgments against the company.

Directors' liability – other sources of liability

18 Apart from failure to file for proceedings, are corporate officers and directors personally liable for their corporation's obligations? Are they liable for corporate pre-insolvency or pre-reorganisation actions? Can they be subject to sanctions for other reasons?

Under US law, there is no obligation to initiate bankruptcy proceedings when an entity is insolvent. Consequently, corporate officers and directors cannot be held personally liable for 'failure to file for proceedings'.

Officers and directors generally are not personally liable for the debts and liabilities of the corporations they serve, as long as they adhered to proper corporate formalities. Similarly, unless officers and directors are found to have breached their fiduciary duties, they will not face personal liability for actions taken prior to bankruptcy.

Some legal theories may seek to impose the debts of the corporation onto officers and directors, including through breach of fiduciary duty claims, or piercing the corporate veil or alter-ego theories of liability if an officer or director is also a controlling shareholder. Officers or directors classified as 'control persons' may bear responsibility for certain state and federal payroll taxes. Again, mere insolvency or operation of a corporation while insolvent is not grounds for liability.

Officers and directors may face civil or criminal prosecution for crimes like fraud, securities law violations and other offences linked to business conduct.

Directors' liability – defences

19 What defences are available to directors and officers in the context of an insolvency or reorganisation?

In the context of insolvency or reorganisation, directors and officers maintain the same corporate law defences as they do outside of this framework. Directors and officers have the protection of the business judgment rule, which protects directors and officers from suit as long as their actions fall within the duty of care and duty of loyalty owed to the corporation. The applicable business judgment rule is a matter of non-bankruptcy corporate state law. This applies to actions taken when the corporation is insolvent, in determining whether to file for bankruptcy protection and during the bankruptcy.

Further, during the bankruptcy case, most actions taken by a director or officer outside the ordinary course of business require bankruptcy court approval. Following the order from the bankruptcy court will shield the director or officer from liability. These court orders usually include determinations that the transactions were undertaken in good faith and in the best interests of the debtor and its estate. A reorganisation plan may also include releases and exculpations from actions and omissions connected to or arising from the Chapter 11 case for directors and officers of the debtor, thus shielding directors and officers.

Shift in directors' duties

20 Do the duties that directors owe to the corporation shift to the creditors when an insolvency or reorganisation proceeding is likely? When?

When a corporation becomes insolvent or approaches insolvency, directors and officers owe fiduciary duties not only to the corporation and its shareholders but to the corporation's creditors as well. The extent to which duties 'shift' from the corporation to creditors is a matter of state law and varies depending on the state. Many courts have expanded the time when directors and officers owe fiduciary duties to creditors to include the period when the corporation is in the vicinity of insolvency, the 'zone of insolvency'. Delaware courts have rejected the 'zone of insolvency', and instead require that directors and officers must at all times maximise value for all stakeholders (continue to exercise their business judgement in the best interests of the corporation for the benefit of its shareholders). One result is that creditor standing to sue directors and officers for actions taken may shift depending on the relevant state law.

Directors' powers after proceedings commence

21 What powers can directors and officers exercise after liquidation or reorganisation proceedings are commenced by, or against, their corporation?

After the initiation of a Chapter 11 case, directors and officers usually remain in control of the management and financial affairs of the business and act as the 'debtor-in-possession'. The debtor-in-possession continues to run the corporation and administer the bankruptcy case for the benefit of creditors. Directors and officers maintain their regular powers and responsibilities in the ordinary course of business. If the directors and officers want to take

any action outside the ordinary course of business, they need to seek bankruptcy court approval.

Bankruptcy courts typically will refrain from intervening in corporate governance decisions unless 'clear abuse' is demonstrated. The Bankruptcy Code predominantly leaves state corporate governance laws unaffected, and bankruptcy courts typically avoid taking sides in corporate governance disputes.

A bankruptcy court has the authority to appoint a Chapter 11 trustee to take control of the business from the debtor-in-possession directors and officers 'for cause' or if the appointment is in 'the interests of creditors, any equity security holders, and other interests of the estate'. Some reasons 'for cause' include fraud, incompetence or gross mismanagement of the affairs of the debtor by current management. Courts assess numerous factors when deciding whether to appoint a trustee, including:

- The debtor's trustworthiness;
- the debtor-in-possession's past and present performance and prospects for rehabilitation;
- the level of confidence of the business community and creditors in present management; and
- the advantages versus costs of appointing a trustee.

The appointment of a Chapter 11 trustee is a rare exception, rather than standard practice.

In contrast, an independent trustee is appointed and the board typically resigns in a Chapter 7 case. The trustee's primary purpose in this case is to swiftly collect, liquidate and distribute estate property in a manner that aligns with the best interests of involved parties. Only in rare cases does a Chapter 7 trustee continue operating the debtor's business to maximise its liquidation value.

MATTERS ARISING IN A LIQUIDATION OR REORGANISATION

Stays of proceedings and moratoria

22 What prohibitions against the continuation of legal proceedings or the enforcement of claims by creditors apply in liquidations and reorganisations? In what circumstances may creditors obtain relief from such prohibitions?

The filing of a petition to initiate a bankruptcy proceeding under Chapter 11 or Chapter 7 of the Bankruptcy Code (although not a petition for ancillary relief under Chapter 15) automatically initiates a stay of all enforcement actions and litigation. There is no need for a court order; the stay is automatic upon filing. The automatic stay encompasses nearly all creditor actions against the debtor or its estate's assets. There are some specific statutory exceptions to this stay, such as criminal proceedings against the debtor, enforcement of governmental police or regulatory powers, a non-debtor's ability to close out most securities and financial contracts and defined actions taken by certain parties. Such defined actions include banks temporarily freezing a debtor's account that owes the institution money and

recoupment actions. The automatic stay generally does not stay related creditor actions against non-debtor third parties to which the debtor is not a party.

Upon a creditor's request, a bankruptcy court can, following notice and a hearing, lift the automatic stay to allow a creditor to take certain actions under specific circumstances. These include instances where the creditor has demonstrated 'cause'. One example of cause may be if the creditor can show that the stay needs to be lifted to allow the creditor to protect its property interest in collateral. Additionally, a secured creditor can show the debtor does not have any equity in property (ie, secured claims against the property surpass its value), and the property is not necessary for the debtor's effective reorganisation. In this case the court may allow the secured creditor to exercise remedies under applicable state law to obtain possession of the property serving as collateral.

Doing business

23 When can the debtor carry on business during a liquidation or reorganisation? Is any special treatment given to creditors who supply goods or services after the filing? What are the roles of the creditors and the court in supervising the debtor's business activities?

Debtors in a Chapter 11 bankruptcy, through existing officers and directors, can continue to operate their business in the ordinary course unless otherwise ordered by the bankruptcy court. There are no specific conditions governing a debtor's ordinary course of business operations and typically, the court does not involve itself in the debtor's day-to-day management. However, the debtor-in-possession assumes the role of an officer of the court and is entrusted with a fiduciary duty to safeguard and manage the estate's assets in the best interests of its creditors. If the debtor wants to do something outside the ordinary course of its business (for example selling a large asset or business unit), the debtor will need court approval. Court approval is also required for the use of a secured lender's cash collateral (without their consent), compromises and settlements and debtor-in-possession financing. The court must also grant approval for the debtor to retain and compensate professional advisors. Even if court approval is required, the court typically considers the debtor's business judgement. If the court believes the debtor is mismanaging the business or is engaged in fraud, it may appoint a Chapter 11 trustee to take control of the business affairs.

Creditors providing goods or services after the petition is filed are typically paid promptly for such goods or services. If creditors are not paid immediately, they are entitled to an administrative expense claim. Administrative expenses have a high priority over pre-filing claims, and typically payment in full of all administrative expense claims is a prerequisite for the debtor's emergence from Chapter 11.

Official and unofficial committees of creditors, as well as the US Trustee Program (a division of the Department of Justice) oversee the debtor throughout the bankruptcy case. The creditors and US Trustee Program will review the debtor's bankruptcy filings and requests during the bankruptcy to ensure that the debtor is operating to maximise recoveries for creditors. Also, in certain circumstances, the court may appoint an examiner to investigate the debtor for claims of fraud, dishonesty, incompetence or severe mismanagement.

Post-filing credit

24 May a debtor in a liquidation or reorganisation obtain secured or unsecured loans or credit? What priority is or can be given to such loans or credit?

A debtor in Chapter 11 reorganisation can obtain secured or unsecured loans or credit. The most common form of credit for a Chapter 11 debtor is a secured, superpriority loan known as debtor-in-possession (DIP) financing or a DIP loan. A DIP loan is typically requested early in the bankruptcy case and used by the debtor to finance business operations during the pendency of the bankruptcy case. DIP loans are usually secured with collateral and DIP creditors have a superpriority status over other creditors. The DIP loans are often provided by the debtors existing secured creditors, who allow the superpriority lien to be placed on collateral that may already be subject to liens. The DIP loans are structured similarly to traditional loans, either as revolving loans or as funded term loans.

Payment of superpriority DIP loans take precedence over (and thus get paid before) administrative expenses and general unsecured claims, except for the payment of administrative expenses in a superseding Chapter 7 case.

A debtor who is unable to get DIP financing from existing secured creditors may ask the court to order that DIP financing from a new lender be granted a priming lien on collateral that is already subject to the liens of secured creditors. A debtor has a high burden to show that such a lien on collateral already subject to a secured creditor lien will not disadvantage the existing secured creditor. Senior or equal liens may be granted only if the debtor can demonstrate its inability to secure credit through other means, while also ensuring adequate protection for the interests of the existing lienholder. For this reason, non-consensual priming liens are uncommon.

To the extent a debtor wants to incur debt in the ordinary course of its business (likely unsecured debt) it does not need court approval. Any debt incurred outside the ordinary course of business requires court approval.

In Chapter 7 liquidation cases, additional funding is rare. However, a Chapter 7 trustee can obtain secured or unsecured loans or credit to run the business during the liquidation with court approval.

Sale of assets

25 In reorganisations and liquidations, what provisions apply to the sale of specific assets out of the ordinary course of business and to the sale of the entire business of the debtor? Does the purchaser acquire the assets ‘free and clear’ of claims or do some liabilities pass with the assets?

Section 363 of the Bankruptcy Code governs the sale of assets outside the ordinary course of business (the sale of significant assets or all or substantially all of the debtor’s business). A debtor must support a proposed sale or use of property with an articulated business reason. The business judgement standard used by the court is flexible, and courts consider all salient factors pertaining to the proposed sale when determining whether the

business justification satisfies the standard. Additionally, a debtor can sell its assets or entire business through a Chapter 11 plan. Section 1123 of the Bankruptcy Code governs sales under a plan of reorganisation.

Typically, the purchaser of assets in a bankruptcy acquires the assets free and clear of any claims or interests. For this reason, asset sales through bankruptcy are often favoured by purchasers that want court-ordered assurances that they are purchasing the assets free of liabilities. The liabilities or claims can proceed against the estate of the debtor and the proceeds of the asset sale.

Exceptions can exist for certain liabilities such as environmental claims or for future claims (where the harm has not yet occurred). For example, future claims related to product liability or similar wrongful conduct. Depending on the nature of the asset sale, the wording of the sale order or the bankruptcy plan, and the extent to which the purchaser and seller knew or should have known of such future claims, future litigants may be able to seek recovery from the seller in a bankruptcy sale. Some bankruptcy plans of reorganisation set up trusts to pay future claims and include injunctions to block successor liability claims.

Negotiating sale of assets

26 | Does your system allow for 'stalking horse' bids in sale procedures and does your system permit credit bidding in sales?

While not specifically set forth in the Bankruptcy Code, asset sale processes typically involve consent approved bidding or sale procedures that may include stalking horse bidders. As the initial bidder, the stalking horse often sets the baseline price, contract terms and transaction structure. The court initially approves the terms of this stalking horse bid as well as the buyer protection provisions like a breakup fee, expense reimbursement fee or topping fee. Future bidders generally bid using the transaction structure set by the stalking horse bidder. If another 'qualified bidder' is accepted, an auction may occur, which typically would take place outside of the courtroom.

The Bankruptcy Code allows credit bidding by secured creditors, and credit bidding is very common in bankruptcy asset sales. Secured creditors can bid up to the full amount of their secured claims when purchasing debtors' assets during a bankruptcy case. On rare occasions, a court will limit a secured creditor's ability to credit bid for 'cause'. Courts may limit a secured creditor's credit bidding rights in cases where the creditor's lien is not fully perfected or where the court finds there has been collusion or fraud. In rare cases, courts have restricted credit bidding where the credit bid would hinder the bidding process and suppress the sale price.

Courts generally permit the debtor to determine which bid for assets is the highest and best offer, including if that offer is a credit bid. That the credit bidder is an assignee of the original secured creditor typically will not impact the assignee's right to credit bid, unless collusion or bad faith is involved.

Rejection and disclaimer of contracts

27 Can a debtor undergoing a liquidation or reorganisation reject or disclaim an unfavourable contract? Are there contracts that may not be rejected? What procedure is followed to reject a contract and what is the effect of rejection on the other party? What happens if a debtor breaches the contract after the insolvency case is opened?

Section 365 of the Bankruptcy Code governs the assumption and rejection of executory contracts, which generally involve the contracts in which performance obligations remain for both the debtor and non-debtor parties. Subject to court approval, a debtor has the power to reject nearly any pre-petition executory contract or lease. There are exceptions for collective bargaining agreements (union contracts), which can only be rejected or modified in accordance with specific rules under section 1113 of the Bankruptcy Code, and for certain retiree insurance benefits, which can only be modified or rejected under section 1114 of the Bankruptcy Code.

Courts will generally defer to a debtor's business judgement in whether to reject a contract and approve the debtor's determination unless made in bad faith or abuse of discretion.

The debtor must assume or reject an executory contract or lease in its entirety. The rejection of a contract or lease is treated as a pre-petition breach that gives rise to an unsecured claim for damages. Rejection relieves both the debtor and the non-debtor party from the obligation of ongoing performance under the contract. If a debtor elects to assume a contract, it is obligated to cure any monetary or non-monetary defaults (other than the defaults arising from the commencement of the bankruptcy case), compensate the non-debtor for actual financial loss caused by the default and assure future performance.

If a DIP opts to continue receiving benefits from a non-debtor contract counterparty under an executory contract while deciding whether to assume or reject the contract, the DIP is required to pay for the reasonable value of those services. Consequently, claims from contract counterparties who provide goods or services to a DIP under a contract that has not been rejected are afforded administrative priority to the extent that the consideration was exchanged for the claim during the reorganisation process.

Intellectual property assets

28 May an IP licensor or owner terminate the debtor's right to use the IP when a liquidation or reorganisation is opened? To what extent may IP rights granted under an agreement with the debtor continue to be used?

The automatic stay prevents intellectual property (IP) licensors from terminating debtors' rights to use the licensed intellectual property without court approval. A court order is required for non-debtors to terminate debtors' rights in the licence. Violations of the automatic stay result in payment of actual and punitive damages.

Typically, bankruptcy courts view IP licences as executory contracts, allowing the debtor to continue using the IP throughout Chapter 11 proceedings if it continues to make royalty payments and complies with other terms outlined in the licence agreement. Debtors may assume the licence agreement and continue performance, assume the licence and assign to third parties or reject the licence agreement. There may be restrictions on

the assumption, or assumption and assignment, of licences by debtors in certain US jurisdictions.

If a debtor is the licensor and decides to reject the IP licence, the licensee may still have options to preserve its rights under the IP licence. The licensee can typically preserve the licence as it existed before the start of the bankruptcy case provided that the licensee continues to make royalty payments and waives any set-off and administrative claims arising from the licence agreement.

Personal data

29 Where personal information or customer data collected by a company in liquidation or reorganisation is valuable, are there any restrictions in your country on the use of that information or its transfer to a purchaser?

The Bankruptcy Code restricts the sale or lease of 'personally identifiable information' (PII). PII is broadly defined and encompasses information that can be used to identify, locate or contact an individual. This information encompasses details like an individual's name, address, contact information, social security number, birth date and similar data. Restrictions on the sale of PII may apply if the debtor had a policy in effect on the date of the bankruptcy petition that would prohibit the transfer of such information, or if the sale would violate relevant non-bankruptcy laws.

Sometimes, the bankruptcy court will direct the US trustee to appoint a consumer privacy ombudsman (CPO) to ensure that PII is appropriately handled. The CPO is an impartial individual compensated by the debtor's estate, and their role is to assist the court in evaluating the facts and circumstances surrounding the proposed sale or lease, particularly with regard to the potential impact on consumer privacy loss, associated harm and cost. This ensures that consumer privacy rights and legal compliance are appropriately addressed in the bankruptcy process.

Generally, the court will consider the facts, circumstances and conditions of the sale or lease or any PII, and determine whether the sale is permissible and that it does not harm the PII individuals or violate relevant non-bankruptcy laws.

Arbitration processes

30 How frequently is arbitration used in liquidation or reorganisation proceedings? Are there certain types of disputes that may not be arbitrated? Can disputes that arise after the liquidation or reorganisation case is opened be arbitrated with the consent of the parties?

If the debtor was party to a binding arbitration agreement before filing for bankruptcy, the bankruptcy court will treat it much like any other litigation. The automatic stay prevents the continuation of ongoing arbitrations against a debtor that were initiated before the bankruptcy filing. A counterparty to an arbitration can request that the court lift the automatic stay to continue the arbitration with the debtor and reduce their claim to an arbitration judgment that can then be filed as a claim against the debtor's estate.

Even if the debtor is subject to an arbitration agreement, arbitration of certain matters may not be permitted by the court. A court may deny arbitration if the dispute is vital to the debtor's reorganisation efforts or if arbitration would conflict with the Bankruptcy Code. For example, courts will deny arbitration over fundamental bankruptcy protections, such as the automatic stay and the discharge injunction.

Arbitration or mediation of disputes that arise after the liquidation or reorganisation case is opened are permitted with the consent of the parties or by order of the bankruptcy court. Court-ordered mediation of bankruptcy disputes is more common than court-ordered arbitration.

In large and complex Chapter 11 cases, court-approved ADR procedures are often customised to address the unique complexities of the case. There are no specific types of insolvency disputes categorically exempt from arbitration or mediation. In fact, bankruptcy courts can appoint a mediator to facilitate any number of disputes in a bankruptcy case, from litigation matters to issues concerning a reorganisation plan.

CREDITOR REMEDIES

Creditors' enforcement

31 Are there processes by which some or all of the assets of a business may be seized outside of court proceedings? How are these processes carried out?

Prior to the commencement of a bankruptcy proceeding, article 9 of the Uniform Commercial Code provides methods where creditors with a security interest in collateral can repossess or sell collateral. Under some circumstances secured lenders can keep collateral in satisfaction of a debt, in other circumstances the secured lender can sell the collateral to recoup the debt via a public or private sale. This is referred to as 'self-help' methods of obtaining recovery on a debt and can only be done if the creditor does not 'disturb the peace' in repossessing the assets, provides reasonable notice of the sale and acts in a commercially reasonable manner. Repossession of collateral can also occur with the consent of the debtor. If not executed properly self-help is prohibited, and the creditor may be found to have committed the tort of conversion.

Once an entity commences a bankruptcy proceeding, creditors must use the bankruptcy court procedures to seek recovery of their assets. The commencement of a bankruptcy proceeding initiates the automatic stay, which prevents creditors from enforcing judgments or otherwise acting against the debtor's property without permission from the court.

Unsecured credit

32 What remedies are available to unsecured creditors? Are the processes difficult or time-consuming? Are pre-judgment attachments available?

Generally, unsecured creditors' only remedy against a debtor is through the enforcement of a court judgment. The timeline of a debt-collection action in courts depends on the

complexity of the case – they can range from a few months to much longer for complex and contested matters. The complexity of the source of the debt will also determine how complex or time-consuming enforcement may be. For example, a lender who holds a promissory note from the debtor may be able to get a judgment on its debt quickly. In certain situations, such as when there is an immediate threat that the debtor may dispose of the property or abscond with the property, creditors may also seek a pre-judgment order from the court to protect their interest in the property. This can take the form of a writ of attachment, an order for garnishment, or an order for replevin. Once an entity commences a bankruptcy proceeding, unsecured creditors must use the bankruptcy court procedures to seek recovery.

CREDITOR INVOLVEMENT AND PROVING CLAIMS

Creditor participation

33 During the liquidation or reorganisation, what notices are given to creditors? What meetings are held and how are they called? What information regarding the administration of the estate, its assets and the claims against it is available to creditors or creditors' committees? What are the liquidator's reporting obligations?

In a liquidation or reorganisation, creditors are provided with notices of several key steps in the case, including, but not limited to:

- case commencement: known creditors are mailed notices when the bankruptcy case is initiated;
- bar date for filing claims: a debtor, on motion to the bankruptcy court and following notice and a hearing, will seek to establish the deadline by which creditors must submit their proofs of claim against the debtor. Creditors are notified of the deadline to file the 'proof of claim', which is an official form evidencing the validity and amount of the debt owed to the creditor;
- dates for the meeting of creditors: creditors are informed of the dates for meeting of creditors. At this meeting, the creditors may seek to be appointed to an official committee of creditors and may have the opportunity to question or examine the debtor;
- proposed sale, use or lease of property: plans for the sale, use or lease of assets outside the ordinary course of business;
- notice of the disclosure statement, plan of reorganisation, deadline to vote on a plan and ballot: the debtor must notify creditors of all materials related to plan solicitation, provide a ballot and deadlines for voting; and
- motions or court hearings: creditors may request to be notified of all motions from debtors or parties in interest and hearings before the bankruptcy court, including motions seeking approval for asset sales, financings, assumption and or rejection of contracts and fee applications submitted by debtors and creditors' committee professionals.

Shortly after a bankruptcy case is filed, the US trustee arranges a meeting between the creditors and the debtor to determine whether an official committee of creditors should be formed, and if so to form the committee. During the bankruptcy case, the creditors' committee (which is comprised only of unsecured creditors) may meet as often as needed and the frequency depends on the size and complexity of the case. In larger cases and depending on the status of the case, committees will meet at least once a month to review outstanding matters, the progress of the case and strategy.

Numerous reporting obligations are in place. The debtor (or trustee) is required to file operating and financial reports that provide details about the debtor's business and financial performance while in bankruptcy. The debtor will file a significant amount of information related to its finances and operations on the court docket, which can be reviewed by any party. Creditors may be able to view debtors' monthly operating statements to apprise themselves of debtors' finances. Creditors may also evaluate debtors' management and investigate debtors' affairs. However, creditors can only make recommendations to debtors and are not authorised to exercise control over the debtors' business operations, financial affairs and management. The debtor is also obligated to maintain records that document the receipt and disposition of assets. In Chapter 11 cases, the debtor must report financial information concerning entities in which it holds a controlling interest. These reporting obligations ensure transparency and accountability throughout the bankruptcy process.

Creditor representation

34 What committees can be formed (or representative counsel appointed) and what powers or responsibilities do they have? How are they selected and appointed? May they retain advisers and how are their expenses funded?

In Chapter 11 bankruptcy cases, the US trustee is responsible for appointing a committee of creditors holding unsecured claims. Additionally, the US trustee has the option to appoint additional committees, such as those representing equity holders, mass tort claimants or employees. Typically, a committee consists of five to seven members selected from the debtor's 20 largest creditors who have expressed a willingness to serve.

Creditors' committees act as fiduciaries for unsecured creditors as a whole and perform an oversight role. They have the authority to investigate various aspects of the debtor's financial situation and business operations, including its acts, conduct, assets, liabilities, financial condition, business operations and any other matter relevant and more, all of which are pertinent to the case and the formulation of a reorganisation plan. These committees, subject to court approval, can retain legal counsel, financial advisers and other professionals, with the debtor paying their approved fees and expenses.

Separately, unofficial or ad hoc committees, representing various interests like secured lenders, equity holders, noteholders and trade creditors can also play significant roles in the reorganisation process. Ad hoc committees are typically formed by interested parties themselves and operate independently. They have the legal standing to present their views on most issues within the case, file motions and participate actively in the restructuring process. Ad hoc committees commonly engage attorneys and financial advisers. Ad hoc committees are not entitled to reimbursement of their expenses unless they can prove

they made a substantial contribution to the bankruptcy proceeding, although through the negotiating process the debtors may agree to the payment of fees and expenses.

Enforcement of estate's rights

35 If the liquidator has no assets to pursue a claim, may the creditors pursue the estate's remedies? If so, to whom do the fruits of the remedies belong? Can they be assigned to a third party?

Individual creditors may not pursue remedies on behalf of the debtor. However, the court may grant a creditor or a creditors' committee derivative standing to pursue actions on behalf of the debtor or its estate. If granted, litigation proceeds are directed to the estate for the benefit of all constituents. Alternatively, the trustee may retain an attorney on a contingency fee basis. Under this arrangement the attorney receives a fixed percentage of the recovery and the excess reverts to the estate of the debtor. With court approval, a debtor's secured lenders or stakeholders may fund the debtor's prosecution of a valuable estate claim for the benefit of the estate. Proceeds flow to the estate and are distributed to creditors in accordance with their claims and priority.

Claims

36 How is a creditor's claim submitted and what are the time limits? How are claims disallowed and how does a creditor appeal? Can claims for contingent or unliquidated amounts be recognised? Are there provisions on the transfer of claims and must transfers be disclosed? How are the amounts of such claims determined?

Debtors in a bankruptcy case must file schedules of assets and liabilities and classify them as 'disputed', 'unliquidated' or 'contingent' where appropriate. Separately, creditors submit to the court proofs of claims detailing their claims and rights to receive a distribution from the bankruptcy estate. A creditor does not need to file a proof of claim if it believes the debtor's schedule of its claim is accurate. The debtor will file a motion to set a bar date for claims and, once approved by the court, send a notice of the bar date to creditors. Creditors will have until the bar date to file their proofs of claim.

Claims are allowed unless the debtor or another interested party objects to the claim. The debtor or an interested party may object to the claim for many reasons, including that:

- the claim is contingent, unliquidated or the amount is incorrect;
- there is a dispute about the validity of the claims;
- the creditor fails to attach adequate supporting documents;
- the creditor files the claim against the wrong entity or debtor; or
- the claim is filed after the bar date.

After a party objects to the claim, the creditor must timely respond to the objection. If the bankruptcy court upholds an objection to a claim, the claim will be disallowed and not subject to recovery. The creditor can usually appeal that decision.

Claims for contingent and unliquidated amounts must be filed before the bar date. The court will then either:

- lift the automatic stay to allow the debtor and creditor to resolve the claim in another court (and return to the bankruptcy court with the liquidated judgment amount);
- hold a trial on the claim within the bankruptcy court; or
- estimate the claim for voting on the plan of reorganisation.

Courts estimate claims to reach a reasonable valuation of the claim as of the date of the bankruptcy filing and are bound by non-bankruptcy law governing the claim when making an evaluation.

Unless the court orders otherwise, parties may freely transfer bankruptcy claims. Such transactions are private transactions between buyers and sellers that courts rarely interfere with. For claims not based on publicly traded securities, the Federal Rules of Bankruptcy Procedure require a transferee to file evidence of the transfer of a claim, typically in the form of an assignment of claim. Any objection to the transfer must be filed within 21 days of mailing the notice to the transferor. In the absence of an objection, the transfer is valid. A valid claim acquired at a discount is enforced at its full value, and not the discounted purchase price. An exception to this rule is bond debt acquired with an original issue discount, a portion of which may be treated as unmatured post-petition interest. The Bankruptcy Code disallows claims for unmatured post-petition interest unless the creditor claiming the interest is a secured creditor, the value of whose security exceeds its claims, or the estates are solvent and can pay unsecured claims in full.

Set-off and netting

37 To what extent may creditors exercise rights of set-off or netting in a liquidation or in a reorganisation? Can creditors be deprived of the right of set-off either temporarily or permanently?

Creditors' set-off rights are explicitly protected under section 553 of the Bankruptcy Code. Typically, creditors holding collateral subject to set-off rights are treated as secured claims under the Bankruptcy Code. Creditors must seek relief from the automatic stay before executing a set-off.

Creditors may exercise their set-off rights in bankruptcy provided:

- there is mutuality (meaning the parties, their rights and capacity are the same);
- both debts arose at the same time in the bankruptcy process (either prepetition or postpetition but not both); and
- both debts are valid and enforceable.

Courts generally prohibit triangular set-off arrangements (ie, those between more than two parties) for lack of mutuality.

Also, the Bankruptcy Code does not recognise set-off if the creditor asserting the right acquired the claim against the debtor from another creditor either after the debtor's bankruptcy filing or within 90 days before the filing when the debtor was insolvent. There are also limitations on the recovery of specific preferential set-offs made within the 90 days immediately preceding the debtor's bankruptcy filing.

Modifying creditors' rights

38 May the court change the rank (priority) of a creditor's claim? If so, what are the grounds for doing so and how frequently does this occur?

The court has the authority to alter the treatment of creditors' claims through several mechanisms, including equitable subordination, recharacterisation and substantive consolidation. While these remedies are available, they are rarely invoked.

- Equitable subordination: equitable subordination involves lowering the priority of a creditor's claim below claims of other creditors. This is typically done when there is evidence of wrongful conduct by the claim holder that harms other creditors.
- Recharacterisation: recharacterisation focuses on the economic substance of a claim rather than its formal classification. Upon examination of the mechanics of the transaction, the bankruptcy court may reclassify debt as equity if a purported claim lacks the typical characteristics of debt and functions more like equity. Courts will exercise their authority to recharacterise to prevent equity holders from shifting the risk of equity ownership to the debtor's other creditors.
- Substantive consolidation: substantive consolidation allows the court to combine the assets and liabilities of two or more related entities in bankruptcy. It effectively merges the estates into one consolidated entity so that creditors have claims against the same combined pool of assets. This process aims to eliminate disparities in prioritisation and recovery among claimants of affiliated entities by merging their assets and liabilities.

Additionally, some courts have asserted the authority to disallow claims on equitable grounds, but such actions are typically considered rare and undertaken in exceptional circumstances.

Priority claims

39 Apart from employee-related claims, what are the major privileged and priority claims in liquidations and reorganisations? Which have priority over secured creditors?

In both liquidations and reorganisations, certain non-employee-related unsecured claims are entitled to priority treatment. These include, but are not limited to:

- expenses of administering the debtor's estate: this category covers the costs associated with managing the debtor's estate, including administrative expenses, goods and services purchased by the debtor during the pendency of the bankruptcy case, and judicial fees;
- certain goods sold to the debtor: claims for the value of goods received by the debtor up to 20 days before the filing of the bankruptcy case, provided these goods were sold to the debtor in the ordinary course of its business;
- claims arising during the involuntary gap period: the 'involuntary gap period' spans from the time an involuntary petition is filed against a debtor until the court enters an order granting the involuntary petition and putting the debtor into bankruptcy;
- consumer deposits: claims for certain types of consumer deposits, subject to a statutory cap;
- taxes and customs duties: claims for taxes and customs duties, as well as related liabilities assessed within a specific pre-petition time frame; and
- depository institution capital-maintenance commitments: certain claims arising from the debtor's depository institution.

Except for priming liens approved in connection with debtor-in-possession financing, only claims directly related to the preservation or disposition of a secured creditor's collateral, to the extent it benefits the secured creditor, take priority over a secured creditor's lien.

Employment-related liabilities

40 What employee claims arise where employees' contracts are terminated during a restructuring or liquidation? What are the procedures for termination? (Are employee claims as a whole increased where large numbers of employees' contracts are terminated or where the business ceases operations?)

Generally, non-bankruptcy law governs employee claims for termination. Claims such as those for wrongful termination, severance or unpaid wages would be made under applicable state contract and labour law, regardless of whether termination occurred before or during the bankruptcy case. Employees of the debtor may have a priority claim for pre-petition wages, commissions, vacation, severance and sick leave earned within six months of the filing date, up to a capped amount. Similarly, non-bankruptcy labour law, including the federal Worker Adjustment and Retraining Notification Act, may impose damages or fines on a company for terminating large numbers of employees without adequate notice.

Often debtors will file a motion at the beginning of the case requesting explicit permission from the court to continue paying wages. Employee wages earned post-petition, or claims that arise post-petition, are generally administrative expenses with a high priority. Special provisions exist for terminating collective bargaining agreements and qualified employee pension plans, or for modifying certain retiree benefits.

Pension claims

41 What remedies exist for pension-related claims against employers in insolvency or reorganisation proceedings and what priorities attach to such claims?

Most private-sector pension plans are governed by the Employee Retirement Income Security Act (ERISA), a federal statute. ERISA requires minimum funding levels for qualified registered employee pension plans. The Pension Benefit Guaranty Corporation (PBGC) is the federal agency responsible for enforcing ERISA and managing the mandatory government insurance programme that protects covered pensions. In addition, section 1113 of the Bankruptcy Code provides the exclusive means by which a Chapter 11 debtor can assume, reject or modify a collective bargaining agreement, including any additional pension related obligations under the agreement.

ERISA allows the bankruptcy court some flexibility to order modifications in pension plans to the extent required for the debtor's reorganisation. If a debtor terminates an ERISA-governed pension plan in bankruptcy, the PBGC may assume the role of creditor and pursue claims for both the amount of any underfunding as well as any unpaid contributions. In bankruptcy, the PBGC's claims for withdrawal liability or unpaid pension plan contributions are considered generally pre-petition unsecured claims without priority treatment. Unpaid pension contributions incurred post-petition, but before plan termination, may be treated as administrative expense priority claims. Section 507(a)(5) of the Bankruptcy Code grants priority to claims up to a limited statutory cap for pre-petition contributions to employee benefit plans.

Unlike private-sector pensions, public pensions (ie, those sponsored by states or municipalities) are governed by state and local law, not ERISA. Public pension benefits have constitutional limits on the public employer's ability to reduce or modify public pension benefits inside and outside of bankruptcy. The extent to which a municipality can utilise Chapter 9 to modify its public pension obligations is largely untested.

Environmental problems and liabilities

42 Where there are environmental problems, who is responsible for controlling the environmental problem and for remediating the damage caused? Are any of these liabilities imposed on the insolvency administrator personally, secured or unsecured creditors, the debtor's officers and directors, or on third parties?

Debtors must abide by all applicable environmental laws and regulations before and after bankruptcy. The exercise of the government's police power to enforce such laws and regulations is generally not constrained by the bankruptcy. Thus, a company that owns environmentally contaminated property cannot use bankruptcy as an excuse to circumvent its obligations. It must remediate the property in accordance with applicable laws, regulations, consent decrees, judgments and similar requirements. Furthermore, an owner-operator of contaminated property may not be able to escape owner-operator liability after emerging from bankruptcy subject to applicable environmental laws.

Generally, claims by the government and potentially responsible third parties to recover the cost of remediation work on sites formerly owned by the debtor and fines and penalities associated with pre-filing violations of regulatory requirements are environmental obligations that can be discharged in bankruptcy. Statutory reclamation fees for unfunded remediation costs, statutory claims that came into effect pre-petition and obligations to prevent ongoing harm to human health are non-dischargeable. Whether such claims travel with the assets or can be asserted against successor entities or third parties depends on the facts of the individual case. However, absent criminal conduct, fraud or other misconduct, the debtor's officers and directors are typically not held personally liable for environmental remediation claims.

Liabilities that survive insolvency or reorganisation proceedings

43 | Do any liabilities of a debtor survive an insolvency or a reorganisation?

Confirmation of a Chapter 11 reorganisation plan typically results in the discharge of pre-petition debts. Liquidations that do not result in any ongoing business typically do not include a discharge. This includes a Chapter 11 liquidating plan and Chapter 7 liquidation bankruptcy cases. In Chapter 7, the debtor's assets are liquidated and only a corporate shell remains for satisfying claims. For individual debtors, bankruptcy generally discharges most of their debts, subject to certain statutory exceptions.

Some classes of claims may not be dischargeable, including certain claims for fraud, claims related to criminal conduct and, notably, some categories of environmental claims. Whether a particular environmental obligation can be discharged in bankruptcy depends on if it qualifies as a 'claim' under the Bankruptcy Code or if it represents a form of injunctive relief that cannot be reduced to a 'right to payment'. Environmental liabilities that constitute a claim (eg, regulatory fines or claims for reimbursement) may be dischargeable in bankruptcy. However, remedial obligations (eg, obligations to take action to address ongoing pollution regardless of the cost) may not be discharged. The distinction between dischargeable and non-dischargeable environmental obligations is often unclear, leading to inconsistent case law.

Distributions

44 | How and when are distributions made to creditors in liquidations and reorganisations?

A Chapter 11 plan specifies the time and manner of distributions. A Chapter 7 trustee generally does not make distributions until they have liquidated estate assets, including completion of any litigation to bring assets into the estate. Interim distributions may be made if sufficient liquid assets exist. Payment on account of administrative or priority claims, like wage claims or fully secured claims, may be made during the pendency of the case with court approval.

SECURITY

Secured lending and credit (immovables)

45 | What principal types of security are taken on immovable (real) property?

In the United States, mortgages are the most commonly used method to secure interests on real property. Pursuant to certain state laws, the borrower may grant a lender a security interest in real property via a deed of trust instead of a mortgage, and some states also permit security by a land sale contract. The mortgage will need to be filed with the appropriate local or state officials to have effect against third parties.

Secured lending and credit (movables)

46 | What principal types of security are taken on movable (personal) property?

A creditor takes a security interest (or lien) in personal property, which provides the creditor with a legal claim to the property. In order to be legally valid, the security interest must attach to the collateral, which generally involves the grantor executing a security agreement. Certain categories of property may require possession or control for the security interest to attach. The creation, attachment and perfection (putting other creditors on notice of the security interest so as to secure a priority claim to the collateral) of a security interest of most property is governed by the Uniform Commercial Code (UCC). Exceptions include a security interest over vehicles (governed by state law), most intellectual property (governed by federal law) and aircraft and water vessels (governed by federal law). In general, a creditor enters into a security agreement with the debtor over certain personal property. The creditor then files a UCC statement in the appropriate recordation office to put others on notice of its security in the collateral. This 'perfects' the security interest in the collateral and gives the creditor greater rights to the collateral than any future claimholders.

CLAWBACK AND RELATED-PARTY TRANSACTIONS

Transactions that may be annulled

47 | What transactions can be annulled or set aside in liquidations and reorganisations and what are the grounds? Who can attack such transactions?

In liquidations and reorganisations, the debtor will attempt to recover assets for the estate of the debtor to benefit the creditors of the estate. These claims can be brought by the debtor (or trustee) for the estate, or by a creditors' committee acting on behalf of the estate as long as the committee has been specifically authorised by the bankruptcy court. Actions to recover pre-petition transfers generally fall into two categories: preferential transfers and fraudulent transfers.

A preferential transfer (a payment or granting of security) is made by a debtor to any creditor, on account of antecedent debt, that results in a recovery higher than the creditor

would receive if the debtor were liquidating its assets in a liquidation proceeding. The look-back period for avoiding a preferential transfer is 90 days prior to the commencement of the bankruptcy proceeding for most creditors, and one year for creditors that were insiders of the debtor. Preference payments have to be returned to the estate and preferential security interests will be deemed invalid. The creditor will then recover on account of its debt as all other similarly situated claimants in the bankruptcy proceeding.

There are two types of transfers that can result in a fraudulent transfer:

- a transfer made with the actual intent to hinder, delay or defraud creditors;
- a transfer made for less than reasonably equivalent value where, at the time of the transfer, the debtor was either insolvent or rendered insolvent as a result of the transfer.

Some courts have also looked at whether the debtor made the transfer while it had unreasonably small capital or if it intended to incur debts beyond its ability to pay. The general look-back period for a fraudulent transfer under the United States Bankruptcy Code (ie, federal law) is two years, but can be much longer under certain state laws (as long as six years).

When preferences or fraudulent transfers are avoided, the transfer is generally unwound and either the property itself or its equivalent value reverts to the debtor's estate. This is also referred to as a 'clawback'. After the transferee returns an avoided transfer, they may be granted a claim against the estate for the legitimate amount of their debt.

Equitable subordination

48 Are there any restrictions on claims by related parties or non-arm's length creditors (including shareholders) against corporations in insolvency or reorganisation proceedings?

In the United States, bankruptcy courts apply heightened scrutiny to transactions made to related parties or 'insiders', but such transactions are not per se invalid. An insider of a debtor entity is:

- a director or officer of the debtor;
- a person in control of the debtor;
- a partnership in which the debtor is a general partner;
- a general partner of the debtor; or
- a relative of any of the above individuals.

The foregoing list is non-exhaustive, and an insider also includes more generally any individual that has a close relationship or control over the debtor such that it cannot be said that the transaction was negotiated at arm's length, though the bar for 'control' and 'close relationship' is high.

A bankruptcy court has certain tools and discretion to deal with transactions considered unfair or value-destructive to the debtor. The heightened scrutiny applied to an insider transaction means insider transactions are more susceptible to the following risks:

- equitable subordination: the bankruptcy court can subordinate the insider-creditors' claims to similarly situated claims if doing so would remedy misconduct; and
- recharacterisation: the bankruptcy court can recharacterise debt from an insider-creditor as equity (which has a lower priority recovery) if a debt claim more closely resembles equity.

Insider status is an important factor for both an equitable subordination and recharacterisation claim.

Additionally, transactions with insiders can have further impacts on the bankruptcy proceeding. Insider transactions are subject to a longer look-back period for preferential transfers (one year as opposed to 90 days). Pre-petition transfers to insiders can be considered fraudulent transfers if made under an employment contract not in the ordinary course of business, even if the debtor was solvent at the time of transfer. If insiders participate in a sale of the debtor's assets, the transactions are more closely scrutinised for fairness and ensuring no special preference was given to the insider. Insider votes are also not counted to accept a Chapter 11 plan (confirmation of which requires the affirmative vote of at least one class of impaired, non-insider creditors) – the debtor must obtain a vote from non-insiders to ensure fairness.

Lender liability

49 | Are there any circumstances where lenders could be held liable for the insolvency of a debtor?

Under US law lenders cannot be held directly liable for the insolvency of debtors. However, there are circumstances under which lenders can be held liable for harm related to the ultimate insolvency of the debtors. For example, if the lender is exercising excessive control over the borrower, fiduciary duties may be applied to the lender and the lender may be found liable for violating the duty of loyalty by acting in self-interest. A lender exercising too much control over the borrower can also be held liable under breach of contract claims, and tort claims such as duress, fraud or tortious interference, if the lender's actions caused the debtor's insolvency.

Lenders face a variety of consequences if found liable: in a bankruptcy proceeding, their claim may be invalidated or equitably subordinated to the claims of the other creditors. Outside of a bankruptcy proceeding (or in an adversary proceeding following commencement of the bankruptcy case), lenders may owe damages.

GROUPS OF COMPANIES

Groups of companies

50 | In which circumstances can a parent or affiliated corporation be responsible for the liabilities of subsidiaries or affiliates?

In the United States, a parent or affiliated entity is generally not liable for the actions or debt of other affiliated entities unless a court orders that there was an agency relationship, an alter ego relationship or successor liability that serves to impose liability on the parent or affiliate. There may also be a contractual obligation, such as a guarantee agreement or contractual language implicating affiliated entities. Furthermore, absent a specific agreement to the contrary, affiliated entities do not share assets or liabilities – thus, recovery is generally limited to the assets of the indebted entities.

Parent entities can be held liable for the debts of a subsidiary under certain state laws, as well as under the common law theories of:

- alter ego, where the court finds that the subsidiary lacks a separate identity from the parent;
- piercing the corporate veil, the remedy in which a court can order a parent pay the debts of the subsidiary where the subsidiary is the alter ego of the parent or where the parent closely controls the subsidiary;
- single business enterprise, where the court finds that the actions of the enterprises are sufficiently intertwined to blur the lines between the multiple entities; and
- agency, where the subsidiary was acting on behalf of the parent entity.

The legal standards under all the various statutes and theories for holding a parent entity liable for the debts of its subsidiary are dependent on each cause of action, but they share the following basic elements:

- a showing that the activities of the two entities are closely connected such that the parent effectively controls the subsidiary;
- a showing of improper conduct; and
- that the improper connection caused some level of harm or loss to the entity.

In a bankruptcy case, the bankruptcy court can use substantive consolidation to combine the assets and liabilities of all debtor entities. Creditors can seek an 'offensive' substantive consolidation where, if there is substantial overlap between the identity of the entities and there would be sufficient harm but for consolidation, the assets and liabilities of multiple entities are pooled for the benefit of creditors. This remedy is granted only in extraordinarily rare circumstances. Occasionally, the bankruptcy court can also decide to substantively consolidate the assets and liabilities of multiple debtor entities for efficiency in overseeing the proceedings. Generally, a court considers the following factors in deciding to substantively consolidate entities:

- whether the entities have separately identified their assets and liabilities;
- whether each entity is adequately capitalised;
- whether transactions between entities are made at arm's length; and
- whether benefits of substantive consolidation outweigh the harms.

Combining parent and subsidiary proceedings

51 In proceedings involving a corporate group, are the proceedings by the parent and its subsidiaries combined for administrative purposes? May the assets and liabilities of the companies be pooled for distribution purposes?

In a US bankruptcy proceeding, the proceedings of entities in one corporate group can be combined for both administrative and substantive purposes. Administrative consolidation in bankruptcy allows the court to conduct proceedings over all the debtor entities at once, but the assets and liabilities remain separate. Debtors routinely request administrative consolidation as it makes the bankruptcy proceeding more efficient. Conversely, the bankruptcy court can substantively consolidate the proceedings of a corporate group using its equitable powers, which causes the assets and liabilities to pool together. Sometimes substantive consolidation is requested by the debtor for administrative convenience; at other times, it is requested by creditors to remedy a harm. The test a bankruptcy court uses to decide whether a proceeding should be substantively consolidated depends on the jurisdiction, but there are four common factors:

- whether the entities have separately identified their assets and liabilities;
- whether each entity is adequately capitalised;
- whether transactions between entities are made at arm's length; and
- whether benefits of substantive consolidation outweigh the harms.

INTERNATIONAL CASES

Recognition of foreign judgments

52 Are foreign judgments or orders recognised, and in what circumstances? Is your country a signatory to a treaty on international insolvency or on the recognition of foreign judgments?

US courts grant strong deference to foreign judgments, though in general US courts will not recognise penal judgments of other countries, nor judgments for fines or taxes. Judgment recognition and enforcement is typically state-law dependant, though most state laws are modelled after the Uniform Foreign-Country Money Judgments Recognition Act and rely on the common law principles of comity. Chapter 15 of the Bankruptcy Code recognises foreign insolvency proceedings and regularly enforces foreign insolvency judgments and orders. The United States is not a signatory to any treaties or conventions pertaining to the recognition or enforcement of foreign judgments.

UNCITRAL Model Laws

53

Have any of the UNCITRAL Model Laws on Cross-Border Insolvency been adopted or is adoption under consideration in your country?

The United States has adopted the UNCITRAL Cross-Border Insolvency Model Law, with some modifications, as Chapter 15 of the Bankruptcy Code. As of this publication, the United States has not adopted the Model Law on Enterprise Group Insolvency or the Model Law on Recognition and Enforcement of Insolvency-Related Judgments. In a Chapter 15 proceeding (an ancillary proceeding to the insolvency proceeding commenced by the debtor in a foreign court), the US bankruptcy court recognises the foreign insolvency proceeding and grants various rights and remedies available under the Bankruptcy Code to a 'foreign representative' of the foreign entity with respect to the debtor's assets and operations in the United States. This includes granting the foreign representative the ability to:

- administer and potentially distribute the assets of the foreign debtor;
- conduct discovery in the United States;
- impose a stay with respect to debtor's property in the United States; and
- operate the debtor's US business.

The foreign creditors of the debtor are also granted the right to participate in the US bankruptcy proceeding.

Foreign creditors

54 | How are foreign creditors dealt with in liquidations and reorganisations?

Foreign creditors are typically offered the same rights and protections in a US bankruptcy as domestic creditors.

Cross-border transfers of assets under administration

55 | May assets be transferred from an administration in your country to an administration of the same company or another group company in another country?

Chapter 15 of the Bankruptcy Code allows the US bankruptcy court to recognise and enforce a foreign insolvency proceeding and subsequently grant the foreign representative the ability to realise, administer and distribute the debtor's assets that exist within US jurisdiction, as long as the US court is satisfied that in doing so the interests of US creditors are protected. In certain circumstances, a majority of US courts will permit the use of non-debtor assets to satisfy the debts of a debtor (through the process of substantive consolidation). This remedy is not frequently granted, but if under consideration, the bankruptcy court will weigh the benefit to the creditors of consolidating assets against the harm posed to the debtors.

COMI

56 What test is used in your jurisdiction to determine the COMI (centre of main interests) of a debtor company or group of companies? Is there a test for, or any experience with, determining the COMI of a corporate group of companies in your jurisdiction?

The centre of main interests (COMI) concept is not expressly defined in the Bankruptcy Code, though it is used in Chapter 15 cases to determine whether the foreign insolvency proceeding is a 'foreign main proceeding' or a 'foreign non main proceeding' (an important distinction, as the standard to obtain a stay is much lower in the former, but the bankruptcy court has discretion to grant the automatic stay in the latter). The Bankruptcy Code states that the location of the debtor's registered office is presumed to be the debtor's COMI, absent evidence to the contrary. The bankruptcy court considers a number of factors as evidence when determining the debtor's COMI, including:

- the location of the headquarters of the debtor;
- the location of the managers;
- key employees or others who control the debtor's activities;
- the location of a substantial amount of the debtor's creditors;
- the jurisdiction of law that applies to most of the debtor's disputes;
- the location to which the debtor's activities are generally directed and controlled from; and
- the location of other relevant activities (such as where liquidation activities have taken place or where administrative functions occur).

COMI is determined as of the Chapter 15 petition date.

The Bankruptcy Code does not address the COMI of a corporate group of debtors. Some, but not all, US bankruptcy courts rely on a 'nerve centre' or 'principal place of business' test (a test used for determining the 'home' of an entity that operates in many jurisdictions for purposes of determining general jurisdiction) to determine the COMI of a corporate group for Chapter 15 purposes. The nerve centre is generally the location where the officers (or other individuals in control of the company) 'direct, control, and coordinate the corporation's activities'. In practice, this is often the entity's headquarters, but not always. For example, if most of the business activities of the entity takes place in one location and the headquarters is used merely for hosting occasional meetings, then the nerve centre would be the location where most of the entity's activity is concentrated. An entity only has one nerve centre, and thus it can be difficult to pinpoint where the operations of an entity are centralised if an entity has significant operations in multiple jurisdictions. Not all US bankruptcy courts use the nerve centre test, and US law for determining the COMI of a corporate group is dependent on the jurisdiction of the bankruptcy case. How bankruptcy courts in Chapter 15 cases interpret COMI is a constantly evolving.

Cross-border cooperation

57 Does your country's system provide for recognition of foreign insolvency proceedings and for cooperation between domestic and foreign courts and domestic and foreign insolvency administrators in cross-border insolvencies and restructurings? Have courts in your country refused to recognise foreign proceedings or to cooperate with foreign courts and, if so, on what grounds?

The primary objectives of Chapter 15 of the Bankruptcy Code include promoting cooperation between US courts and foreign courts in insolvency proceedings and providing a mechanism for fair and efficient distribution of assets in cross-border insolvencies. There are three basic requirements for a US court to recognise a foreign insolvency proceeding:

- the foreign proceeding must meet the Bankruptcy Code's definition of foreign proceeding;
- a foreign representative (the administrator or trustee of the foreign insolvency proceeding) meets the Bankruptcy Code's requirements for a foreign representative and applies for recognition; and
- the petition for Chapter 15 meets the Bankruptcy Code's procedural requirements.

The first requirement, that the foreign proceeding must be a proper foreign proceeding, is broken out into two types of proceedings: a foreign main proceeding, in which the debtor's COMI is the country where the foreign proceeding is pending, and a foreign non-main proceeding, in which the debtor's insolvency is proceeding in a jurisdiction where the debtor is established but is not the debtor's COMI.

The Bankruptcy Code allows for broad deference to recognising foreign insolvency proceedings. Generally, recognition is denied only in situations where the bankruptcy court determines the foreign proceeding is neither a main nor non-main proceeding. Once the foreign proceeding is recognised, the US court grants comity and any available and necessary relief to the foreign representative, absent a showing that granting such relief would be manifestly contrary to the public policy of the United States. The public policy exception is narrowly tailored and rarely invoked. A US bankruptcy court may invoke the public policy exception where:

- the foreign proceeding was procedurally unfair; or
- the Chapter 15 relief, if granted, would severely violate a US constitutional or statutory right, or otherwise frustrate the court's ability to carry out the purpose of the Chapter 15 proceeding.

The public policy exception is only upheld in extreme circumstances. For example, a US court refused to recognise foreign proceedings where the Chapter 15 proceeding was commenced exclusively for gaining access to a debtor's email account stored on a US server, which violated US criminal law and goes beyond the rights given to debtors under US bankruptcy law. Another US court refused to recognise a foreign proceeding in Chapter 15 where the foreign receivers were appointed in violation of a Chapter 11 automatic stay imposed by the same court against the same debtors. Similarly, US courts have refused to grant relief with respect to the debtor's US assets in Chapter 15 proceedings where the foreign representative requested relief that would not be available under US law, such as extinguishing the guarantee claims of certain objecting creditors or allowing the debtor to

reject licences to the detriment of the licensee. In most Chapter 15 cases, the bankruptcy court endeavours to promote cross-border cooperation in insolvency proceedings and to effectuate the legitimate outcomes of a foreign insolvency proceeding.

Cross-border insolvency protocols and joint court hearings

58 In cross-border cases, have the courts in your country entered into cross-border insolvency protocols or other arrangements to coordinate proceedings with courts in other countries? Have courts in your country communicated or held joint hearings with courts in other countries in cross-border cases? If so, with which other countries?

Bankruptcy courts will enter orders establishing new protocols particular to the case in front of the court. Certain US bankruptcy courts, including the US Bankruptcy Court for the District of Delaware and the US Bankruptcy Court for the Southern District of New York (which handle a high volume of the US bankruptcy cases), have implemented formal Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters – a set of guidelines promulgated by judges from jurisdictions around the world, including Australia, Bermuda, Canada, the Cayman Islands, Singapore, the United Kingdom and the United States. The formal guidelines establish a set of standardised procedures, including rules for holding joint hearings or properly consulting with other courts to resolve disputes to help further the goals of cooperation and comity among jurisdictions.

Winding-up of foreign companies

59 What is the extent of your courts' powers to order the winding-up of foreign companies doing business in your jurisdiction?

A US bankruptcy court can wind up the US business operations of a foreign company if it has jurisdiction over the entity – either through a domestic Chapter 11 proceeding or a Chapter 15 bankruptcy proceeding. There are several ways a US bankruptcy court can obtain jurisdiction over a foreign entity such that the court can order the winding up of the foreign entity's business. A foreign entity conducting business in the United States is eligible to be a Chapter 11 debtor as long as the foreign entity owns property in the United States (subject to a few exceptions). The property requirement is easily satisfied, such as by maintaining funds in a US bank account, and the debtor test is applicable in both voluntary and involuntary bankruptcies of foreign entities. Once in Chapter 11, the US bankruptcy court has jurisdiction over the debtor to wind up the foreign debtor's US business operations. Furthermore, Chapter 15 of the Bankruptcy Code provides that the foreign representative may seek an order from the US bankruptcy court granting relief to the foreign representative to wind up the US business of a foreign entity.

Although it is relatively easy for foreign entities to be subject to the US bankruptcy court's jurisdiction, there are safeguards in place that allow a bankruptcy court to dismiss an improperly filed case. For example, a bankruptcy court may dismiss a bankruptcy proceeding if it finds that the best interests of the creditors and the debtor, or the purposes

of Chapter 15, would be better served by dismissal. Common law doctrines, such as *forum non conveniens* (a court's power to decline to exercise jurisdiction over a proceeding where another court or forum is more convenient for the parties and the source of the dispute) or the principles of comity also grant the court the power to dismiss a proceeding in certain circumstances where the interests of the parties are best served by a proceeding in another jurisdiction. Of course, the extraterritorial authority of US courts to enforce their orders in foreign countries is a matter of international law.

Bankruptcy courts will wind up a business as the final stage of the bankruptcy proceeding following a liquidation (in which the bankruptcy court will oversee a sale of assets to make payments to the entity's creditors or other interested parties). Bankruptcy courts rely on non-bankruptcy corporate law principles to formally wind up an entity, which generally vary by state.

UPDATE AND TRENDS

Trends and reforms

60 | Are there any emerging trends or hot topics in the law of insolvency and restructuring? Is there any new or pending legislation affecting domestic bankruptcy procedures, international bankruptcy cooperation or recognition of foreign judgments and orders?

The ongoing high interest rate environment and supply-chain issues, in conjunction with tight liquidity markets, have led to a markedv uptick in US bankruptcy filings for 2023. Cases with at least US$100 million in liabilities are at the highest level since 2016, excluding 2020 (in 2020, there was an unprecedented level of Chapter 11 filings due to covid-19 pandemic). Consumer discretionary, healthcare and communication services sectors have accounted for a large portion of the cases, but we have also seen a palpable inscrease in real estate and healthcare filings. Overall, corporate bankruptcies for the first half of 2023 are at the highest level in a decade.

There have been several notable developments in bankruptcy law related to the ability of corporations to use the bankruptcy system to resolve mass-tort litigation. Johnson & Johnson has attempted to use the bankruptcy courts to implement a US$8.9 billion settlement related to thousands of lawsuits that claim its talcum powder products caused cancer. Its subsidiary, LTL Management, had its first bankruptcy case dismissed by US Court of Appeals for the Third Circuit and its second-attempt bankruptcy case was recently again dismissed by US Bankruptcy Court for the District of New Jersey. The courts determined the lawsuits did not put LTL Management in 'imminent or immediate financial distress' sufficient to file for bankruptcy protection. These decisions put in doubt the continued viability of the 'Texas two-step' to resolve mass-tort claims. Similarly, US Supreme Court recently agreed to review the US$6 billion settlement in the Purdue Pharma bankruptcy between the Sackler family and opioid victims, and put the settlement on hold. The Supreme Court will decide whether bankruptcy courts can insulate the Sacklers from lawsuits even when they have not filed for bankruptcy protection themselves. The US Department of Justice is arguing that bankruptcy courts lack the power to issue such third-party liability releases. The outcome of both the *Johnson & Johnson* and *Purdue*

bankruptcy cases will have a major impact on whether corporations continue to attempt to utilise the bankruptcy courts to resolve mass-tort liability.

Other notable ongoing bankruptcy litigation relates to lawsuits regarding 'liability management transactions', in which borrowers utilise flexibility within debt documents or the cooperation of a subset of the borrowers' lenders to restructure their balance sheet, often to the detriment of non-participating lenders. These transactions have been challenged on multiple fronts, but a notable area of challenge has been whether transactions that advantage some lenders to the detriment of other similarly situated lenders may violate the 'implied duty of good faith and fair dealing' found in contracts governed by New York law. An important recent decision by the US Bankruptcy Court for the Southern District of Texas confirmed that an uptiering transaction in the *Serta* bankruptcy case did not violate the implied covenant of good faith and fair dealing under New York law. That decision and decisions in other liability management litigation cases are presently on appeal and the law on this topic is continuing to evolve.

Finally, there have not been significant updates in cross-border Chapter 15 law since the important decision in *In re Modern Land (China) Co*. The recent major Chapter 15 bankruptcy case of *China Evergrande* will certainly be important to watch for ongoing developments in this area.

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