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USA: Law and Practice

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USA

Law and Practice

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Robinson & Cole LLP has approximately 275 attorneys in 15 US locations, with a global client base. The firm's bankruptcy and reorganisations practice group, with 15 attorneys located primarily in Wilmington DE, Philadelphia PA, Hartford CT and New York City, has extensive experience innovating and implementing effective strategies and providing strong, independent, tailored advice regarding the debtor–creditor relationship. The group represents diverse parties in bankruptcy cases, advising debtors through the restructuring process, assisting trade creditors with enhancing recoveries, and advocating on behalf of committees in complex, fast-moving cases. Robinson & Cole is a leader in personal injury mass tort bankruptcy cases, regularly contributing to developments in US and global jurisprudence by employing agile thinking and innovative approaches. The firm has been involved in prominent Chapter 11 cases, including Bestwall LLC, DBMP LLC, Aldrich Pump LLC, Murray Boiler LLC, SWC Industries LLC, Presperse Corp., Mariner Health Central Inc., Mallinckrodt plc, and O.W. Bunker USA.

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1. Overview of Legal and Regulatory System for Insolvency/Restructuring/ Liquidation

1.1 Legal Framework

As federal law, Title 11 of the United States Code (the "Bankruptcy Code") pre-empts any conflicting state laws regarding insolvencies, restructurings and liquidations and, as a result, is the United States' primary insolvency scheme. Chapters 1 and 3 of the Bankruptcy Code outline general provisions and terms applicable to the administration of all cases filed pursuant to it. Chapter 5 generally addresses creditor obligations and priorities, the debtor's duties and the bankruptcy estate (as further discussed herein).

Chapters 7 to 15 (Chapter 12 is the only even-numbered chapter in the Code) address specific proceedings, which are further discussed below. (Unless otherwise indicated, all citations and statutory references herein are to the Bankruptcy Code.)

The Federal Rules of Bankruptcy Procedure provide additional guidance with respect to the administration of, and procedures used in, cases pending under the Bankruptcy Code.

State-level laws provide the legal frameworks for receiverships, assignments for the benefit of creditors (ABCs), dissolutions and other types of business restructurings that serve as an alternative to a filing under the Bankruptcy Code.

1.2 Types of Insolvency

Federal Bankruptcy Code

Business bankruptcy cases filed in the United States generally are governed by either Chapter 7 or 11 of the Bankruptcy Code. Chapter 7 provides procedures for gathering all the business's assets and property into an "estate" that is then liquidated under the oversight of a court-appointed trustee. Chapter 7 contains special rules for stock and commodity brokers and clearing banks.

Chapter 11 provides procedures for businesses looking to reorganise their business or operations or restructure their debts via a court-approved reorganisation plan. Chapter 11 includes special rules for small business and domestic railroad bankruptcies. A business may also liquidate its assets pursuant to Chapter 11 using a court-approved liquidation plan.

Chapter 9 provides procedures for adjusting the debts of a US-domestic political subdivision. Chapter 12 addresses bankruptcies related to family farming or fishing operations (including family businesses). Chapter 15 recognises cross-border business insolvency cases.

State Statutory or Common Law

State-level insolvency laws are not necessarily uniform among the 50 states and may vary significantly, especially with respect to businesses that are primarily regulated by state law (eg, insurance). State law-based proceedings include:

- assignment for the benefit of creditors (ABCs) and receiverships (see **1.3 Statutory Officers**, **5.1 The**

Different Types of Liquidation Procedure and **5.2 Course of the Liquidation Procedure**);
- corporate dissolutions and wind-down proceedings (see **5.1 The Different Types of Liquidation Procedure** and **5.2 Course of the Liquidation Procedure**); and
- liquidations (state law generally governs the liquidation of insurance-related business assets).

1.3 Statutory Officers

Federal Bankruptcy Code

Bankruptcy courts/judges

The federal district courts within each of the United States' 14 federal circuits refer bankruptcy cases to bankruptcy courts sitting within those districts. Bankruptcy judges preside over cases filed under the Bankruptcy Code. Each Court of Appeals appoints bankruptcy judges within their circuit to a 14-year term.

United States Trustee

The Office of the United States Trustee (UST), appointed by the Attorney General, oversees cases filed under the Bankruptcy Code within a specific region on behalf of the US government.

Bankruptcy administrator

In jurisdictions that opted out of the UST Program, the respective Courts of Appeals appoint a bankruptcy administrator (BA) to oversee bankruptcy cases. BAs do not possess the same statutory authority as USTs and must seek such authority from the bankruptcy judge.

Debtor-in-possession (DIP)

A business that files a Chapter 11 reorganisation usually remains "in possession" and continues to operate its business and control its assets. The DIP has many of the powers of a trustee along with a fiduciary duty to manage the assets for the benefit of creditors.

Trustee

Upon a Chapter 7 petition, the UST appoints an interim Chapter 7 trustee from a list of pre-qualified trustees. The interim trustee serves until the creditors' meeting is held, at which point the creditors may elect a different trustee.

If the bankruptcy court orders the appointment of a Chapter 11 trustee, the UST will consult with parties-in-interest and select a trustee for approval by the bankruptcy court.

A trustee replaces the debtor's existing management and board of directors. In Chapter 7, the trustee liquidates estate assets and distributes the proceeds to creditors. In Chapter 11, the trustee operates the debtor's business for the benefit of the creditors and supervises the debtor's properties and the estate. The trustee files the plan of reorganisation or liquidation (the "plan").

Creditors' committee

In a Chapter 11 case, the UST, following a solicitation and a sufficient indication of interest, is required to appoint an official committee of unsecured creditors. In non-UST jurisdictions, the BA provides a list of creditors to the bankruptcy judge to approve and appoint to the committee. The committee is authorised to retain professionals and engage in all aspects of the bankruptcy case to advance the interests of all unsecured creditors. In Chapter 7 cases, the creditors themselves may elect a committee of between three and 11 creditors. An unsecured creditors' committee owes a fiduciary duty to the individual unsecured creditors to advance the interests of the unsecured creditors.

Examiner

In a Chapter 11 case, usually in lieu of a trustee, the bankruptcy court may appoint an examiner to investigate specific matters related to the debtor. If an examiner appointment is ordered, the UST will consult with parties in interest and select an examiner for approval by the bankruptcy court. The examiner will report its investigatory findings to the bankruptcy court.

State Statutory or Common Law

Assignee

In an ABC, a state court appoints an assignee to act as a creditor fiduciary. The assignee liquidates the assets and makes distributions to creditors pursuant to state law.

Receiver

In a receivership, a state court appoints a receiver to liquidate an insolvent business. A receiver is usually appointed upon the request of a creditor or shareholder. State statutory law or court orders detail the power and authority granted to a receiver.

2. Creditors

2.1 Types of Creditors

The Bankruptcy Code recognises and prioritises the following types of creditors:

- secured creditors (11 USC Section 506) – provided with first-priority payment rights to the extent of the value of their collateral, with certain procedural variations dependent on the value of the collateral vis-à-vis the value of the claim;
- administrative expense creditors (11 USC Section 503) – entities holding claims related to the "actual, necessary costs of preserving the estate", including UST fees, professional compensation and the costs of certain goods received pre-petition;
- priority unsecured creditors (11 USC Section 507) – creditors holding pre-petition unsecured claims that the Bankruptcy Code grants priority to, such as employee wages, employee benefit plans and taxes;
- general unsecured creditors – creditors holding a pre-petition debt or other obligation of the debtor that is not secured by a lien or security interest or entitled to priority;
- subordinated creditors – creditors holding pre-petition claims that are subordinated pursuant to 11 USC Section 510 or "equitably subordinated" due to creditor misconduct; and
- equity holders – equity holders recover based on their interests in the debtor only after all other creditors have been paid.

The Bankruptcy Code subordinates certain claims to general unsecured claims, including those arising contractually under a pre-existing subordination agreement, as well as certain securities-related claims. A bankruptcy court may also "equitably subordinate" creditors who engage in inequitable conduct.

2.2 Priority Claims in Restructuring and Insolvency Proceedings

See **2.1 Types of Creditors.**

Holders of administrative expense claims must be paid in full as part of a Chapter 11 plan unless those holders agree to accept a different treatment. The "actual, necessary costs of preserving the estate" (11 USC Section 503 (b)(4)) include:

- post-bankruptcy operating expenses;
- costs for goods and services;
- wages;
- taxes;
- bankruptcy court-approved professional fees;
- certain rent for non-residential real property; and
- generally, amounts payable to DIP lenders and trade creditors who provide new borrowing or trade credit during the bankruptcy case.

2.3 Secured Creditors

Outside a restructuring or insolvency context, a creditor may be entitled to claim a lien or security interest in a debtor's property (collateral) by virtue of a contractual arrangement, statutory imposition (such as liens for unpaid taxes, unpaid storage fees, or unpaid work or materials), or based on a court-ordered judgment.

Applicable state non-bankruptcy laws regarding priority, creditor rights, enforcement procedures and general remedies vary despite being generally based on the Uniform Commercial Code. Status in state court receiverships or ABCs will also be governed by state law. Intercreditor agreements may alter the status, priority, rights and available remedies, if such modifications are permitted by state law. Broadly generalising, where multiple creditors have a lien on the same collateral, the first priority on recovery will turn on whether the applicable statute favours creditors based on timing, notice or a combination thereof. Given that state law may modify this by granting "super-priority" liens (regardless of the order of lien perfection) based on policy considerations, review of applicable governing law is advised.

2.4 Unsecured Creditors

An unsecured creditor's rights outside bankruptcy are generally limited to self-help measures identified

under applicable state law, including enforcement of contract or applicable sales terms. Unsecured creditors may engage in collection efforts, either directly or by utilising a debt collection agency, and, failing self-help, may bring a state court action to recover payment.

Some states allow an unsecured creditor to seek pre-judgment attachment of a debtor's property if the creditor can satisfy certain statutory requirements and demonstrate that a debtor is unlikely to be able to satisfy any judgment. Pre-judgment attachment provides an unsecured creditor with the opportunity to secure a potential recovery while proceeding with a civil action to recover payment from the debtor, thus elevating the unsecured creditor to the status of a secured creditor.

Applicable state law or contractual agreements may also permit an unsecured creditor to cancel mutual debts owed between the debtor and the unsecured creditor (set-off). The debtor and unsecured creditor may engage in a set-off transaction without initiating formal litigation.

3. Out-of-Court Restructuring

3.1 Out-of-Court Restructuring Process

In the United States, no formal statutory requirements exist for out-of-court restructurings (OCRs). There are also no standardised agreements, terms, processes or timelines. A business may commence an insolvency proceeding under state law or a liquidation or reorganisation under Chapters 7 or 11 of the Bankruptcy Code without undergoing consensual OCR negotiations, although co-ordination with key creditors generally is recommended prior to the filing of a Chapter 11 case.

OCRs are contractual in nature, and the relationships between the debtor and its various creditors are determined by direct negotiations. Timelines depend on several factors, including the number of negotiating creditor parties, the continued availability of trade credit, the veracity of the debtor's business projections, and the willingness of new parties to bring money to the debtor.

During any OCR, creditors will conduct due diligence into the debtor's operations, financial projections, strategic plans and other relevant areas to best protect their own financial interests. Creditors then determine their own willingness to participate in an OCR and do not owe any duty either to the debtor or to other creditor groups to participate. While a creditor cannot be held liable for refusing to participate in an OCR by the debtor or another creditor, lenders that act beyond the scope of their contractual rights can be subject to liability.

Unlike bankruptcy proceedings, an OCR does not provide for a stay of existing or future litigation. A debtor may, however, negotiate a "standstill agreement" with its creditors to avoid the consequences of any default or to prevent creditors from exercising contractual or statutory remedies during the pendency of negotiations. The standstill agreement binds only signing creditors, meaning non-consenting creditors could initiate civil litigation or file an involuntary bankruptcy case.

Dissenting creditors or equity holders may impede the success of an OCR. The consensual nature of OCRs means that businesses may not forcibly bind dissenters. If an obstreperous group of dissenting creditors or dissenting equity holders must be forcibly bound, then this can be done only through the filing of a bankruptcy. See **4.5 The Position of Office Holders in Restructuring, Rehabilitation and Reorganisation.** Bankruptcy may bind non-consenting creditors if the reorganisation plan receives the statutorily required creditor votes and meets the Bankruptcy Code's other confirmation requirements.

Notwithstanding the inability to bind dissenting creditors, consensual OCRs are a viable alternative, and may:

- avoid the potentially greater costs associated with a Chapter 11 bankruptcy and the increased public financial and operational oversight required by the Bankruptcy Code;
- avoid potential bankruptcy-related litigation, including discovery into the company's finances, business operations and board-level or officer decisions;

- reduce the potential for reputational damage or business interruptions resulting from a public bankruptcy announcement; and
- provide a company with an option of filing a pre-packaged or a pre-negotiated bankruptcy case.

Companies engaging in OCR negotiations will often simultaneously prepare for a bankruptcy as a contingency.

3.2 Legal Status

As consensual, contractual arrangements, OCRs are implemented without court approval. Parties to the various restructuring agreements retain their rights to enforce the terms of these agreements through litigation.

4. Statutory Restructuring, Rehabilitation and Reorganisation Proceedings

4.1 Opening of Statutory Restructuring, Rehabilitation and Reorganisation

Voluntary Proceedings

An eligible debtor initiates a case under the Bankruptcy Code by filing a petition with the appropriate bankruptcy court (11 USC Sections 109, 301).

A company's governing body (generally its board), usually with input from key employees and advisers, has the discretion to authorise a bankruptcy filing. It is not obligated by law to do so, and a company's directors and officers will not suffer civil or criminal penalties for failing to file. Directors and officers do, however, continue to owe fiduciary duties to an insolvent company and, in certain circumstances, may be sued for breach of those fiduciary duties. Whether a director or officer would be personally liable for such breaches depends on factors such as the nature of the breach, the company's governing documents and the availability of insurance.

Involuntary Proceedings

Creditors satisfying certain statutory requirements may commence an involuntary bankruptcy case against a financially distressed company (11 USC Section 303). If a business has more than 12 creditors holding "noncontingent, undisputed claims", then three or more such creditors holding claims totalling at least USD21,050 may initiate the bankruptcy case (or one such creditor, in the case of a company with fewer than 12 such creditors).

Following the filing of an involuntary bankruptcy petition and until the bankruptcy judge enters an order for relief, the company may continue to operate and use, sell, lease or acquire assets in the ordinary course. If a company contests the petition, the bankruptcy court will grant the order for relief if the petitioning creditors can establish the following (11 USC Section 303 (h)):

- the entity is generally not paying its debts as they become due (other than debts subject to a bona fide dispute as to liability or amount); or
- a custodian, receiver or trustee was appointed to take charge of substantially all the debtor's property within 120 days before the filing of the petition.

4.2 Statutory Restructuring, Rehabilitation and Reorganisation Procedure

Typical Chapter 11 case types and procedures are described in this section. See **5. Statutory Insolvency and Liquidation Procedures** for a description of Chapter 7 liquidations.

General Overview

Chapter 11 enables companies to reorganise their debts or business operations (or both) while they continue to operate. A bankruptcy court-approved plan details how the debtor's creditors will be treated.

Types of Chapter 11 Cases

Debtors may seek to implement consensual bankruptcies through a pre-packaged or pre-negotiated Chapter 11 case. In a "pre-pack", the debtor solicits votes on a proposed plan prior to filing the Chapter 11 case. If creditors holding at least two thirds in amount and at least one half in number for each proposed creditor class vote in favour (see 11 USC Section 1126 (c)), then the debtor will file a Chapter 11 case and seek confirmation on an accelerated basis.

Where a plan is "pre-negotiated" (and most bankruptcies are at least partially so), one or more key constituents may agree to memorialise plan terms in

"restructuring support agreements" but the Chapter 11 plan may not be solicited until the Chapter 11 case files and the bankruptcy court approves the required solicitation documents. While generally not as fast as a pre-packaged Chapter 11, a pre-negotiated Chapter 11 may potentially move faster than a traditional Chapter 11 bankruptcy.

A company may seek the protection of a "traditional" or "free fall" Chapter 11 for myriad reasons, including (among others) failed OCR negotiations, unfavourable business or litigation results, looming debt maturities or other financial exigencies, and/or when the financial or business pressures facing a company outpace the time available to address them. Traditional cases can take months and even years before the reorganisation plan is confirmed and even longer for creditors to receive distributions.

Automatic Stay

A key protection of the Bankruptcy Code is the automatic stay, which, upon the filing of the petition, enjoins all creditor actions against the debtor or estate assets, wherever located (even internationally), including all litigation and collection efforts. The automatic stay provides a "breathing spell" intended to prevent a run on the debtor's assets, and instead permits the debtor to stabilise its businesses, negotiate with creditors, and formulate a plan of reorganisation and post-petition business strategy. There are exceptions to the stay, and a creditor may petition the bankruptcy court for relief from the stay in certain circumstances. (See 11 USC Section 362 (d).)

The Bankruptcy Code also permits a debtor, with the approval of a bankruptcy court, to:

- obtain post-petition DIP financing to pay for continuing operations and the costs of the bankruptcy case;
- assume (reaffirm), assign or reject (breach) unexpired non-residential leases and executory contracts;
- continue to pay ongoing obligations in the ordinary course of business, and seek authority to pay certain pre-petition obligations to avoid post-bankruptcy disruptions;
- use, sell or lease debtor property outside the ordinary course of business, or by accepting or rejecting certain types of contracts and leases;
- negotiate with creditors to formulate terms for a reorganisation plan;
- object to or litigate with creditors regarding the validity or amount of a creditor's claim;
- propose and solicit creditor acceptances of a reorganisation plan; and
- seek confirmation of the reorganisation plan.

Official Committee(s)

Upon the filing of a Chapter 11 case, with sufficient interest, the UST will appoint an official committee of unsecured creditors that acts on behalf of the entire unsecured creditor constituency (see **1.3 Statutory Officers**). An official committee may retain legal and financial professionals to advise the committee regarding the debtor's bankruptcy case and business decisions. Depending on the nature of a case, the UST may also constitute one or more other official committees, such as a committee of tort claimants in a mass tort case, or more rarely (because equity holders are last to recover and often out of the money), an official committee of equity holders. An equity committee may be appointed only if a reasonable possibility exists that equity is entitled to a recovery.

Claim Valuation

Following the filing a Chapter 11 case, the debtor must file Schedules of Assets and Liabilities and Statements of Financial Affairs providing a comprehensive financial snapshot of the debtor. The debtor must identify its creditors by name, include the outstanding claim amount, and identify whether the claim is contingent, disputed or unliquidated.

In a Chapter 11 case, creditors disagreeing with the listing in the schedules, or who are not listed, must file a proof of claim by the bankruptcy court-established claims bar date. In a Chapter 7 case where there are assets available for distribution, a creditor must file a proof of claim even if they agree with the scheduled claim amount. The claim will be allowed unless a party-in-interest objects, which may lead to an evidentiary hearing (11 USC Section 502 (a)). The Bankruptcy Code also contemplates estimation of claims for plan voting purposes (11 USC Section 502 (c)), but

a creditor retains the ultimate right to have the value determined for distribution purposes. Secured claims are determined pursuant to 11 USC Section 506.

Obtaining Credit

A DIP or trustee is authorised to operate the debtor's business, obtain unsecured credit and incur unsecured debt in the ordinary course. The court may authorise a trustee to incur unsecured debt outside the ordinary course following a hearing. This debt will be treated as a post-petition administrative expense (11 USC Section 364 (a), (b)).

If a trustee or DIP is unable to obtain unsecured credit, then, after notice and a hearing, the court may authorise the incurrence of debt that:

- has priority over any or all other allowed administrative expenses;
- is secured by a lien on property that is not subject to a lien;
- is secured by a junior lien on property that is subject to a lien; or
- is secured by a lien senior to or equal to an existing lien on estate property, but only if adequate protection is provided to the current lienholder (11 USC Section 364 (c), (d)).

A DIP may use "cash collateral" (such as cash, cash equivalents and cash proceeds from accounts receivable) with lien holder consent. Bankruptcy courts may authorise cash collateral usage without consent so long as lien holders are provided "adequate protection" (11 USC Section 363 (c), (e)).

Chapter 11 Plan

The plan is a contract between the debtor and its various creditors that resolves the debtor's pre-petition liabilities. Once confirmed by the bankruptcy court, the terms of the plan bind all creditors, equity holders and parties-in-interest. Plan terms may modify the rights of secured creditors, unsecured creditors and equity holders.

A plan must, among other things:

- designate classes of claims and interests;
- specify which classes are unimpaired;
- specify the treatment of each impaired class;
- provide the same treatment for each claim or interest in a particular class, unless the holder of a claim or interest agrees to less favourable treatment; and
- provide adequate means for implementation of the plan (11 USC Section 1123 (a)).

These plan terms may:

- impair or leave unimpaired any class of claims or interests;
- provide for the assumption, rejection or assignment of executory contracts and unexpired leases;
- provide for the sale of property and the distribution of sale proceeds; and
- modify the rights of holders of secured and unsecured claims (11 USC Section 1123 (b)).

Chapter 11 plans prohibit "non-consensual third-party releases". Consensual third-party releases of claims held by a creditor against a non-debtor are permitted. "Consent" continues to be a subject of litigation, with certain bankruptcy courts requiring creditors to affirmatively "opt in" to providing a release, and others allowing a less stringent "opt out".

Plan Timing

A DIP has the exclusive right to propose and solicit a Chapter 11 plan for the 120 days and 180 days, respectively, after filing bankruptcy. The bankruptcy court may extend this exclusive period up to 18 months after the case is filed. Following the expiration of this exclusive period, any party-in-interest (including the DIP) may file and solicit a reorganisation plan. The plan confirmation process typically takes at least 60 days, and sometimes far longer, after the proposed Chapter 11 plan is filed.

Plan Solicitation

To solicit a Chapter 11 plan for acceptance, the plan proponent must prepare and receive approval of a disclosure statement that will be sent with a copy of the proposed plan and a ballot. Disclosure statements provide creditors voting on the plan with "adequate information" about the plan and each creditor's proposed treatment under the plan (11 USC Section 1125).

Plan Confirmation

After receiving the solicited votes, a Chapter 11 plan may be confirmed consensually if all impaired classes vote to accept the plan. A class of creditors accepts a plan if holders of claims totalling at least two thirds in dollar amount and more than one half in number of those voting vote to accept the plan (11 USC Section 1126).

A Chapter 11 plan may be confirmed by "cramming down" the plan on a non-consenting creditor class if (i) at least one impaired non-insider creditor class votes to accept the plan by the requisite majorities, and (ii) the plan satisfies all other Bankruptcy Code requirements, including in 11 USC Sections 1123 and 1129 (a). Having concluded that these requirements have been met, a court may confirm the plan so long as it "does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan" (11 USC Section 1129 (b)). See **4.6 The Position of Shareholders and Creditors in Restructuring, Rehabilitation and Reorganisation.**

Assuming the plan proponent has received the necessary votes to consensually confirm the Chapter 11 plan or sufficient votes to attempt to cram-down the Chapter 11 plan on a dissenting creditor class, the bankruptcy court holds an evidentiary hearing to determine whether the plan contains the 11 USC Section 1123 (a)-required provisions and satisfies 11 USC Section 1129's requirements, including separate requirements under Section 1129 (b) that apply only in a cram-down. To confirm a Chapter 11 plan, Section 1129 (a) requires:

- the plan to comply with all applicable provisions of the Bankruptcy Code;
- the plan proponent to comply with applicable provisions of the Bankruptcy Code;
- the plan be proposed in good faith and not by any means forbidden by law;
- bankruptcy court approval of any payments made by the plan proponent, the debtor or any person issuing securities or acquiring property under the plan;
- disclosure of the identity and affiliations of any individuals who will serve as officers, as directors or in key positions following confirmation;
- approval from the governmental regulatory commission with jurisdiction of any proposed changes in post-confirmation rates (if such are charged and subject to government regulatory approvals);
- the plan to provide that any holder of a claim or interest in an impaired accepting class that did not vote to accept the plan will receive or retain property of a value not less than it would receive if the debtor were liquidated in a Chapter 7 case;
- the plan to provide any secured creditor properly electing to retain its lien and have its entire claim treated as a secured claim under Section 1111 (b)(2), with property equal to the value of the creditor's collateral as of the plan's effective date;
- each class under the plan to accept the plan or be unimpaired;
- payment in full in cash of the allowed amount of administrative expense claims and certain other priority claims, unless the holders of such claims agree to different treatment;
- one impaired class of claims accepts the plan without counting the votes of insiders;
- confirmation is not likely to be followed by the liquidation, or the need for further financial reorganisation, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganisation is proposed in the plan;
- all fees payable to the UST must be paid; and
- the continuation and payment of all retiree benefits, if required, for the duration of time the debtor has obligated itself to provide such benefits.

The terms of a confirmed Chapter 11 plan may release non-debtor parties from actual or potential claims held by the debtor against such parties, approval of which may be dependent on the bankruptcy court and jurisdiction.

4.3 The End of the Restructuring, Rehabilitation and Reorganisation Procedure

If a proposed Chapter 11 plan satisfies the Bankruptcy Code's confirmation requirements, the court will enter "Findings of Fact and Conclusions of Law" confirming the Chapter 11 plan. The debtor and other parties-in-interest then work towards a plan "effective date" –

the date on which all conditions to consummation of the Chapter 11 Plan have been satisfied (or waived).

Following confirmation, the reorganised debtor must perform the obligations set forth in the plan, including the payments of the various creditor classes (11 USC Section 1142 (a)). Any party's failure to perform according to the terms of the confirmed plan may result in the court enforcing the terms of the plan (11 USC Section 1142 (b)).

Once the confirmation order is considered final and the debtor performs the obligations set forth in the Chapter 11 Plan, the debtor seeks a "Final Decree" from the bankruptcy court that declares the estate "fully administered"; once issued, it officially closes the case and terminates any oversight by the bankruptcy court and the UST.

4.4 The Position of the Debtor in Restructuring, Rehabilitation and Reorganisation

Once a voluntary Chapter 11 petition is filed, the debtor company is automatically authorised to continue operating its business as a DIP without the need for bankruptcy court approval (11 USC Section 1108). For additional information regarding the use of assets and obtaining credit, see **4.2 Statutory Restructuring, Rehabilitation and Reorganisation Procedure**.

Under 11 USC Section 1104 (a), the bankruptcy court appoints a Chapter 11 trustee if a party-in-interest can demonstrate that current management engaged in "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor… either before or after the commencement of the case" and that such appointment is in the creditors' best interests. A Chapter 11 trustee displaces current management and operates the debtor's business. Alternatively, the bankruptcy court may appoint an "examiner", if such appointment is in the creditors' best interests, to investigate the debtor, its management or its affairs, as is appropriate and ordered (11 USC Sections 1104 (c), 1106 (b)).

4.5 The Position of Office Holders in Restructuring, Rehabilitation and Reorganisation

See **1.3 Statutory Officers** for additional information on the tasks and powers of office holders.

4.6 The Position of Shareholders and Creditors in Restructuring, Rehabilitation and Reorganisation

Under Section 1109, any party-in-interest has a right to appear and be heard "on any issue" in a Chapter 11 case. "Party-in-interest" includes, but is not limited to, "the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee".

The right to appear and be heard entitles the party-in-interest:

- to seek relief from the automatic stay;
- to request other forms of relief from the bankruptcy court;
- to object to relief sought by the debtor or other parties-in-interest; and
- to object to the plan solicitation and confirmation process.

Due to the costs associated with participating in a Chapter 11 case, individual creditors and equity holders generally do not take an active role in the case and are instead represented by any official committee appointed to represent their interests.

Secured Creditors

A claim is secured to the extent of the value of the collateral (11 USC Section 506 (a)). Secured creditors that failed to perfect their liens or security interests before the debtor filed Chapter 11 will be treated as unsecured creditors.

While Chapter 11 does place additional restrictions on a secured creditor's ability to enforce its liens or recover on its collateral, the secured creditor retains certain rights.

- *Adequate protection* – Secured creditors may be provided cash payments or replacement liens on other debtor property to protect the secured credi-

tor from any diminution in the collateral value that occurs due to the passage of time or the creation of super-priority liens on the collateral.

- *Relief from the automatic stay* – The bankruptcy court may lift or modify the automatic stay in favour of a secured creditor:
  (a) "for cause, including the lack of adequate protection" in the secured creditor's collateral; or
  (b) "the debtor does not have an equity in such property" and "such property is not necessary to an effective reorganization" (11 USC Section 362 (d)(1), (2)).
- *Enhanced cram-down treatment rights* – If cram-down of a Chapter 11 plan is sought over a dissenting secured creditor, the debtor must prove that the secured creditor receives:
  (a) full payment on the allowed amount of the secured claim over time (with a market interest rate) which equals the present value of the secured claim;
  (b) a new lien attaching to the proceeds, following any sale of collateral free and clear of the secured creditor's liens, and that the secured creditor was provided with the opportunity to credit bid its secured claim at the sale; or
  (c) the "indubitable equivalent" of the allowed amount of its secured claim, such as a receiving a lien on replacement collateral with the same or greater value and the same or lesser risk profile, receiving cash payments equal to the allowed claim value, or abandonment of the collateral to the secured creditor.

Unsecured Creditors

The general rule in bankruptcy is that all pre-petition general unsecured claims are treated the same as all other pre-petition general unsecured claims. Certain classes of trade creditors, however, may be entitled to priority treatment.

- *11 USC Section 503 (b)(9) creditors* – Trade creditors delivering goods to the debtor within 20 days of the bankruptcy filing are entitled to administrative expense priority for the value of the goods delivered during those 20 days.
- *Critical vendors* – A debtor may seek to establish a "critical vendor" protocol to protect certain vendors that provide essential goods and services that may provide for payment of pre-petition claims. This protocol, including any pre-petition payments, must be authorised by the bankruptcy court.
- *Convenience class creditors* – These claims are generally paid as part of a confirmed Chapter 11 plan. Creditors holding de minimis or smaller unsecured claims may be paid in full.

Pursuant to 11 USC Section 1112, unsecured creditors (and other parties-in-interest) may request that the bankruptcy court convert a Chapter 11 reorganisation to a Chapter 7 liquidation, dismiss the Chapter 11 case "for cause", appoint a Chapter 11 trustee or appoint an examiner, subject to the best-interests of the creditors; 11 USC Section 1112 (b)(4) provides a non-exclusive list of activities that may constitute "cause" for dismissal. Unsecured creditors may also petition to change the location of the Chapter 11 case or to dismiss the case as a "bad faith" filing based on the debtor's pre-petition actions or actions resulting in the filing of the bankruptcy.

Unsecured creditors can file a proof of claim asserting the value of their claims against the debtor. The claim amount asserted in the proof of claim is deemed valid unless a party-in-interest objects. Unsecured creditors have the right to be represented by an official committee of unsecured creditors and to receive information from the official committee, including a recommendation on whether the individual unsecured creditor should vote to accept or reject the Chapter 11 plan.

Unsecured creditors have the right to vote on accepting or rejecting the Chapter 11 plan, except in two scenarios:

- if the plan provides unsecured creditors will be paid in full; or
- if the plan provides that unsecured creditors will not receive any distribution.

To cram-down a Chapter 11 plan on dissenting unsecured creditors, the debtor must demonstrate:

- that at least one impaired creditor class has voted to accept the plan and the value provided to unsecured creditors under the plan is at least as

much as the unsecured creditor would receive in a hypothetical Chapter 7 liquidation; and
- that the plan does not discriminate unfairly against the dissenting unsecured creditor class and is "fair and equitable" to the unsecured creditors (11 USC Section 1129 (a)(7)(A)(ii) and (b)).

"Fair and equitable" requires a showing that (i) no class junior to a non-accepting unsecured creditor class receives any payment until the non-accepting class is paid in full; and (ii) no class senior to the non-accepting unsecured creditor class will receive more than the allowed amount of their claims (11 USC Section 1129 (b)(2)(B)).

Claims Trading

Unless statutorily or contractually prevented from doing so, unsecured creditors may trade or transfer their claims during the Chapter 11 case, provided notice is given to the bankruptcy court. The specific rules for claims trading are found in Bankruptcy Rule 3001 (e).

Equity Holders

Generally, a company's existing equity holders receive no distribution on account of their equity as part of a Chapter 11 case. Moreover, depending on the treatment of claims with higher priorities, existing equity holders may find their shares cancelled following confirmation of a Chapter 11 plan. The facts and circumstances of each bankruptcy case are different, and equity holders may retain their equity (especially if a shareholder provides substantial "new value" to the debtor during the bankruptcy case) or receive equity distributions as part of a plan.

Section 1129 (b)(2)(C) permits cram-down of a Chapter 11 plan on dissenting classes of equity interests so long as the debtor shows that no class junior to a non-accepting equity class will receive any payment until the non-accepting class is paid in full.

5. Statutory Insolvency and Liquidation Procedures

5.1 The Different Types of Liquidation Procedure

Voluntary and Involuntary Proceedings Under the Bankruptcy Code

Liquidation proceedings under the Bankruptcy Code are initiated in the same manner as Chapter 11 Reorganisations. See **4.1 Opening of Statutory Restructuring, Rehabilitation and Reorganisation.**

Chapter 7 Liquidations

A Chapter 7 liquidation may be preferable to a Chapter 11 reorganisation in the following circumstances:

- the debtor's business is no longer a going concern;
- the value of the debtor's properties has deteriorated beyond recovery;
- the financial liquidity to continue or restart the business is no longer available; or
- existing management is untrustworthy, unreliable or uncooperative.

Upon filing, the UST appoints an interim Chapter 7 trustee who will immediately displace the debtor's existing directors and officers (11 USC Section 701 (a)). Unsecured creditors will then meet to elect a permanent trustee (which may be the existing interim trustee) (11 USC Section 702).

A Chapter 7 trustee "investigat[es] the financial affairs of the debtor", gathers the debtor's assets, disposes of the debtor's assets, and distributes the proceeds from the sales of the debtor's property "as expeditiously as is compatible with the best interests of parties in interest" and in accordance with the priority scheme set forth in Section 726 of the Bankruptcy Code (11 USC Section 704).

Chapter 11 Liquidations

A company may choose to file a Chapter 11 liquidation if the debtor's assets have significant value such that management continuity and sales experience may maximise going-concern values or if the company's existing management possesses knowledge or experience necessary to oversee continued operation and liquidation.

The timelines and duration of Chapter 11 liquidations vary from case to case. While Chapter 11 provides maximum flexibility for a liquidation, it can also be the most expensive and time-consuming type of liquidation proceeding.

Confirmation of a liquidating Chapter 11 plan requires satisfaction of the same legal standards for confirmation of a Chapter 11 plan of reorganisation. See **4.2 Statutory Restructuring, Rehabilitation and Reorganisation Procedure.**

Inability to obtain confirmation of a Chapter 11 liquidation plan could cause the case to be dismissed or converted to a Chapter 7 liquidation. The Chapter 11 debtor may request conversion as a matter of right. Another party-in-interest may request conversion for "cause" if it can meet the statutory definition found in 11 USC Section 1112 (b). See **4.6 The Position of Shareholders and Creditors in Restructuring, Rehabilitation and Reorganisation.**

Alternatively, rather than converting to a Chapter 7 liquidation, a debtor may negotiate a "structured dismissal" of its bankruptcy case, which is a bankruptcy court-approved settlement agreement that may be used to administer the remaining estate assets faster and with less expense. Structured dismissal agreements must adhere to the Bankruptcy Code's statutory priority scheme and cannot "gift" proceeds to a lower-priority creditor class while skipping a more senior, non-consenting class.

State Law Receiverships

Receivership proceedings may be used to liquidate a business with state court supervision. The receiver has jurisdiction over all property of the entity located within the state of the receiver's appointment. Multiple receiverships may be necessary if the debtor has significant or complicated assets across multiple states. In those instances, a Chapter 7 or 11 case may be more practical. Commencement of a state law receivership proceeding does not preclude the subsequent commencement of a bankruptcy case that may supersede and stay the receivership.

ABCs

The transfer of assets by the assignor to the assignee is subject to all creditor claims and pre-existing valid liens and security interests encumbering such assets. The assignee acquires all right, title and interest in the assigned assets for the purposes of liquidating the assets as a fiduciary to all unsecured creditors. The assignee makes creditor distributions based on state law priorities. An ABC does not result in an automatic stay of creditor actions.

Dissolutions

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

5.2 Course of the Liquidation Procedure

Dispositions in Chapter 7 Liquidation

A Chapter 7 trustee must have bankruptcy court approval to sell the debtor's assets and may use 11 USC Section 363 to sell assets outside the normal course of business, so long as the trustee demonstrates the sale is necessary and will maximise the value of the estate for creditors.

Dispositions in Receiverships

In a receivership under state law, the court-appointed receiver generally has exclusive authority to negotiate and execute any sale of company assets. State law receiverships may allow for certain "free and clear" sale transactions. Generally, asset dispositions are reported to the state court.

Dispositions in an ABC

In an ABC, the assignee exercises its discretion regarding asset liquidations. Asset sales must comply with applicable state law. Sales remain subject to the liens of secured creditors unless a secured creditor consents to a sale of the asset "free and clear" of its lien. Court approval of a sale may be necessary if the ABC is court supervised.

Dispositions in Dissolutions

In state law dissolutions, the individual authorised by the company's directors to administer the dissolution and wind-up of the company's affairs will negotiate and consummate asset sales and dispositions in accordance with the company's plan of dissolution. No judicial approval is required unless the dissolution has been ordered by a court or is subject to judicial supervision. Generally, "free and clear" asset sales are not available.

5.3 The End of the Liquidation Procedure(s)

Bankruptcy Rule 5009 provides that a Chapter 7 liquidation is closed once the Chapter 7 trustee files a final report with the bankruptcy court detailing, among other things:

- the assets liquidated or abandoned;
- administrative expenses incurred;
- all claims asserted and allowed;
- any distributions made to creditors; and
- the trustee's certification that the estate has been fully administered.

The bankruptcy court will enter an order closing the Chapter 7 proceeding if no objection to the final report was filed by a party-in-interest within 30 days.

5.4 The Position of Shareholders and Creditors in Liquidation

See **2.1 Types of Creditors.**

6. Cross-Border Issues in Insolvency

6.1 Sources of International Insolvency Law

Foreign, non-US companies may seek recognition of eligible non-US insolvency proceedings by filing a petition under Chapter 15 of the Bankruptcy Code. Once recognised, an ancillary US bankruptcy case commences to assist a foreign court in a foreign insolvency proceeding.

6.2 Jurisdiction

Foreign, non-US companies are eligible to commence plenary Chapter 11 or Chapter 7 bankruptcy cases in US bankruptcy courts if the entity can demonstrate that it conducts business, or holds property located, in the United States.

A foreign representative may seek recognition of a foreign main proceeding by filing a petition under Chapter 15. A "foreign representative" means an entity "authorized in a foreign proceeding to administer the reorganization or the liquidation of the foreign debtor's assets or affairs or to act as a representative of such foreign proceeding" (11 USC Section 101 (24)). A "foreign proceeding" is a "collective judicial or administrative proceeding in a foreign country… under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation" (11 USC Section 101 (23)). To be eligible to seek recognition under Chapter 15, a non-US entity must have a US-based nexus, such as having assets, property or a place of business in the USA.

Upon a Chapter 15 filing, the bankruptcy court conducts a hearing to consider an order "recognizing" the foreign proceeding as either a foreign "main" proceeding – "a proceeding pending in the country where the debtor has its center of main interest" (or COMI) – or a foreign "non-main" proceeding – "a proceeding other than a foreign main proceeding, pending in a country where the debtor carries out a nontransitory economic activity". Recognition as a foreign main proceeding (i) triggers the automatic stay to protect the foreign debtor's USA-based assets and pause any litigation pending against the debtor in US courts, and (ii) allows the foreign representative to operate the debtor's US business, among other relief. Conversely, recognition as a foreign non-main proceeding means that the bankruptcy court has the discretion to determine what relief will apply.

The bankruptcy court may presume a debtor's COMI is the location of the debtor's registered office (11 USC Section 1516 (c)), unless the presumption is rebutted. In determining COMI, a US bankruptcy court may also consider which foreign jurisdiction's laws will apply to most disputes between the debtor and its creditors.

6.3 Applicable Law

Subject to 11 USC Section 1506's public policy exception, US courts generally respect the decisions and procedures of foreign jurisdictions and tribunals. Section 1506 provides that "nothing in [Chapter 15] prevents the court from refusing to take an action governed by [Chapter 15] if the action would be manifestly contrary to the public policy of the United States". To date, this exception has been narrowly construed.

6.4 Recognition and Enforceability

While a signatory, the USA has not ratified the Convention of 2 July 2019 on the Recognition and Enforcement of Foreign Judgments in Civil or Commercial Matters. Moreover, no bilateral or multilateral treaties exist between the USA and any other country providing for the reciprocal recognition and enforcement of judgments. Therefore, the recognition and enforcement of foreign judgments is generally a matter of state law, while recognition of foreign insolvency proceedings occurs via Chapter 15. See **6.2 Jurisdiction.**

6.5 Co-Ordination in Cross-Border Cases

Chapter 15 aims to encourage co-operation between US courts and their non-US counterparts. US courts employ several procedures with varying degrees of formality to facilitate such co-operation and clarify the responsibilities and communication methods between each court. A bankruptcy court may appoint a person or entity to act at the direction of the bankruptcy court, enter into a cross-border protocol or cross-border agreement with a non-US court, or conduct joint hearings with a non-US court. Less formal arrangements include communication of information and developments by methods considered appropriate by the bankruptcy court, including statements made on the record at the relevant proceedings by the parties-in-interest.

6.6 Foreign Creditors

Foreign creditors are treated the same as domestic creditors.

7. Duties and Liability of Directors and Officers

7.1 Duties of Directors

State and federal laws, business entity governing documents and judicial decisions impose fiduciary duties on directors, officers and managers (DOMs), which are owed to the entity's equity holders. At the federal level, the Sarbanes-Oxley and Dodd-Frank Acts (along with other legislation) enhance these existing fiduciary duties, requiring DOMs of publicly traded companies to provide additional oversight and statutorily mandated certifications, especially when a company experiences financial distress.

Fiduciary duties apply regardless of whether a company is in an insolvency proceeding. DOMs may face personal liability if they breach these duties. While only owed to equity holders of solvent business entities, these duties expand when a company is insolvent to also include its creditors. While a 50-state survey of fiduciary duties governing DOMs of business entities is beyond the scope of this summary, each US state has codified some variation of the following.

- *Duty of loyalty* – requires directors and officers to act in the best interests of the corporation and prohibits them from engaging in self-dealing or preferring their own financial interests to those of the corporation. The duty of loyalty also includes a duty of oversight.
- *Duty of care* – requires DOMs to be fully informed of all material information reasonably available prior to making decisions affecting a business entity, with the degree of a reasonably prudent person in similar circumstances.
- *Other duties*, including the duty of *good faith* and the duty of *disclosure* – these are subsets of the duties of loyalty and care.

Fiduciary duties may arise statutorily, under a state's jurisprudence, or, where state law permits, by contract or document, where a business entity's by-laws or governing agreements either expand, restrict or eliminate certain traditional fiduciary duties. Unless state laws otherwise require, if a business entity's governance documents are silent regarding fiduciary duties,

a court will infer the existence of traditional fiduciary duties.

Generally, when a corporation is solvent, DOMs owe fiduciary duties to the corporation's shareholders. This general rule holds even when a corporation approaches insolvency. It is only when a corporation becomes actually insolvent that the focus of the fiduciary duty shifts to a corporation's residual claimants (which includes creditors as well as shareholders).

7.2 Personal Liability of Directors

Failure of directors to satisfy applicable fiduciary duties may result in personal liability.

Directors and officers may be sued for breach of fiduciary duty directly or derivatively. To assert a direct breach of fiduciary duty, a shareholder must establish that:

- a fiduciary relationship existed;
- the fiduciary breached a duty to the shareholder; and
- the breach resulted in losses or damages that were personal or unique to the shareholder.

If the corporation generally suffered damages and losses not unique to the shareholder, then the shareholder must bring a derivative suit for the benefit of the corporation.

If the corporation is insolvent, creditors may bring a derivative suit on behalf of the corporation for breach of fiduciary duty; creditors generally are not entitled to bring direct actions against the directors or officers for breach of a fiduciary duty. Typically, this right is vested in the debtor; if the debtor refuses to act, an official committee may seek permission or "standing" from the bankruptcy court.

7.3 Duties and Personal Liability of Officers

Officers generally have the same fiduciary duties – and the same potential personal liability – as directors. Under some state laws, governance documentation may exculpate these individuals.

7.4 Other Consequences for Directors and Officers

See 7.2 Personal Liability of Directors.

8. Setting Aside or Annulling a Transaction

8.1 Circumstances for Setting Aside a Transaction or Transfer

A trustee or a DIP can seek recovery of fraudulent transfers (11 USC Section 544, 548) and preferential transfers (11 USC Section 547) made to third parties.

Fraudulent Transfers

A trustee (or DIP) may avoid any transfer made within two years before the bankruptcy filing date, where the debtor made the transfer:

- with the "actual intent to hinder, delay, or defraud" its creditors; or
- in exchange for less than "reasonably equivalent value", at a time when the transferor:
  - (a) was insolvent;
  - (b) was undercapitalised;
  - (c) was generally unable to pay its debts as they came due; or
  - (d) made the transfer to an insider under an employment contract outside the ordinary course of business.

While the look-back period is two years under 11 USC Section 548, Section 544 allows a trustee or DIP to borrow any longer state-law fraudulent transfer look-back period, which could be up to four or six years after the transfer was consummated.

Transferees who "take for value" and in "good faith" may have a defence to fraudulent transfer actions (11 USC Section 550 (b)). The word "value" in this context is defined as "property, or satisfaction or securing of a present or antecedent debt of the debtor"; 11 USC Section 546 also provides a broadly construed safe harbour for settlement payments "made by, to, or for the benefit of certain financial entities".

Preferential Transfers

A trustee or DIP may avoid any transfer of the debtor's property made:

- to or for the benefit of a creditor;
- for or on account of an antecedent debt owed by the debtor before such transfer was made;
- while the debtor was insolvent;
- on or within 90 days before the date of the filing of the petition – or between 90 days and one year before the date of the filing of the petition, if such creditor was an insider at the time of the transfer; and
- that enables the creditor to receive more than it would receive if the case were a case under Chapter 7 of the Bankruptcy Code (11 USC Section 547).

Section 547 (c) provides certain affirmative defences to preferential transfers. The most common affirmative defences include:

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

These defences are fact intensive, and the burden is on the transferee to prove each element of a claimed defence by a preponderance of the evidence.

8.2 Claims to Set Aside or Annul a Transaction or a Transfer

Only a trustee in a Chapter 7 case or a DIP (or Chapter 11 trustee) in a Chapter 11 case has standing to assert voidable transfer or preference claims. A bankruptcy court may authorise "derivative standing" for the creditors' committee (or even an individual creditor) if the court believes that:

- the asserted claims are "colorable";
- the debtor has unjustifiably refused to prosecute the claims; and
- pursuing the claims would likely benefit the bankruptcy estate.

Derivative claims are brought in the debtor's name for the benefit of all creditors. Avoidance actions may also be assigned to an estate representative (such as a litigation trustee or liquidation trustee) pursuant to the terms of a Chapter 11 reorganisation (or liquidation) plan.

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