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ROUNDTABLE

Bankruptcy in the Americas

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ROUNDTABLE

BANKRUPTCY IN THE AMERICAS

Troubled companies across the Americas continue to struggle under the weight of their debts, though general trends are dependent upon location and sector. While corporate bankruptcy filings in the US have declined, for instance, in Argentina they have risen in the last 18 months. One thing is consistent across the region, however: creditors are determined to recover as much value as possible against insolvent debtors, and bankruptcy proceedings are increasingly litigious. ▸▸

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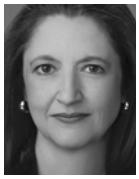

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Redmond: How would you describe the general trend in corporate bankruptcies and insolvencies in your region over the last 12-18 months? Are more businesses failing in general? Are they choosing bankruptcy, and why?

Russell: Overall, the economy in Texas is strong. Corporate bankruptcies and insolvencies have continued to decline in Texas in 2012 and the first two quarters of 2013. The three largest cities in Texas – Houston, Dallas and San Antonio – are among the lowest in the nation in terms of consumer bankruptcies, reflecting the region's relatively strong employment and housing markets. However, with a continued decline in natural gas prices, the region has seen several large Chapter 11 filings by natural gas exploration and production companies. In the exploration and production (E&P) world, companies must 'drill or die'. Thus, liquidity is key.

Chatz: Corporate bankruptcies filed in the US Bankruptcy Court are certainly on a decline and that trend is continuing. Businesses are failing but the utility of a process overseen by a Federal Court is in question. Given the usual circumstances wherein the secured lenders of a business organisation are, in these times, materially undersecured, non-court liquidation processes are more of the norm. Those debtors whose assets are the subject of guarantees by the principals are often liquidated and the principals are many times relieved of their guaranty obligations in consideration of an expedited liquidation process. In addition, the sale by many lending institutions of their non-performing collateral pools to third parties, have also led to expedited, out of court liquidation processes with guarantors being relieved of their obligations.

Diamond: In the southwest part of the US, and, Texas, specifically, we have witnessed a significant downward trend in corporate bankruptcies in the last 12-18 months. The emphasis on oil and gas business in Texas, the continued low interest rates, and the improving housing and rental market have all contributed to smaller and fewer corporate bankruptcies. In addition, the unavailability of 'exit financing' has made a lot of companies look at out of court alternatives as a better choice than filing Chapter 11 bankruptcies. We also have seen very limited ancillary bankruptcy filings under US Bankruptcy Code Chapter 15 related to non-US main insolvency proceedings. Nationally, we have seen a declining number of large corporate bankruptcy filings not involving pre-packaged agreements regarding financial creditors and Section 363 sales.

Jimenez: While the level of corporate bankruptcies in Latin America remains off the peak we experienced during the last decade, the last six months has seen a spike in the number of Mexican restructurings, evidenced by the cross-border Chapter 11 case of MaxCom Telecomunicaciones and a number of Mexican home builders, including Urbi and Homex.

McGuinness: As the filing statistics have shown, there has been a downward trend in the number of corporate bankruptcies. This downward trend is certainly driven by access to the capital markets for lower rated credits and the abundance of liquidity at an attractive interest rate. According to the Securities Industry and Financial Markets Association (SIFMA), high-yield issuance in 2012 was at $328bn, 46 percent higher than 2011, while 2013 issuance activity through the end of the second quarter is at $176.3bn. While there may be performance challenges and inefficiencies with respect to operations and in some instances management, companies have been able to secure their own out of court solutions evidenced by the decrease in Chapter 11 filings.

Insolvencies have been down in the United States year over year since 2012. The economy has continued its slow and delicate recovery.

VAN DURRER

Trust: The number of large companies filing for Chapter 11 protection in the US has declined over the last several years. A number of factors have contributed to the decline, including low interest rates that have made it easier for companies to refinance their debt and the collective willingness of lenders to 'kick the can down the road' by agreeing to, among other solutions, 'amend and extend' their existing financing. However, the decrease in Chapter 11 filings does not detract from its crucial role in the distressed arena where it provides a framework for restructuring negotiations.

Hernández: In the last decade Argentina has experienced the most active corporate reorganisation period in its history, due to the financial crisis in 2001. After the end of almost all post-crisis reorganisations, by the end of the 2000s the number of bankruptcy and reorganisation filings dropped substantially to annual historical averages. For example, during 2010 there were a total of 37 bankruptcy filings and a total of 198 reorganisation filings. This also represented a substantial drop in comparison with filings made during 2009. During the last 18 months, however, the numbers of bankruptcy and reorganisation filings has begun to rise again, slightly. The main factor contributing to the increase is Argentina's macroeconomic conditions.

Durrer: Insolvencies have been down in the United States year over year since 2012. The economy has continued its slow and delicate recovery. Liquidity in the capital markets has helped fuel refinancings. In fact, we have seen a flurry of dividend recapitalisations – refinancings where so much liquidity is available, that the corporate is able to fund a dividend to shareholders at closing. Nonetheless, time has run out for certain companies in the second half of 2013, and we are seeing a slight pick up in filings.

Redmond: In your experience, are any particular sectors demonstrating structural weaknesses leading to more restructuring activity?

Chatz: Generally, there is not any one specific sector that one ▸▸

can point to for structural weakness. There are, as construction projects are being undertaken, certain weak links within the project stream that we have seen suffer economic duress. The cases involving businesses that have been impacted by the fraud and misdeeds of their principals also continue to occur.

Diamond: The areas where we see most weaknesses are in highly leveraged shale gas plays in the southwest; hospitals and clinics and other medical services businesses which are struggling with implementation of Obamacare; professional service firms – law firms and accounting firms; and global shipping businesses suffering severe reductions in day rates. Note that there were a significant number of oil and gas drilling companies, and related oil field service company bankruptcies, following the BP oil spill a few years ago, but the sector as a whole today is quite financially strong.

Jimenez: With the expiration of a government program designed to increase home ownership in Mexico, Mexican home builders and related industries have become stressed as they face a decreased income stream from which to service the high levels of debt they incurred during the boom in Mexican home construction.

McGuinness: All industries are faced with bankruptcy as an alternative to shed underperforming balance sheets. Over the last five years, manufacturing, retail and energy have led the industries for the most Chapter 11 filings. While businesses within declining industries continue to face economic headwinds, the accessibility to utilise capital markets in order to refinance is still available. However, I believe it is only a matter of time until the two notions of a declining industry and access to capital markets will collide to create major restructurings.

Trust: We have seen significant restructuring activity in the shipping industry, and, specifically, the dry bulk sector where the combination of new vessel construction and historically low rates has caused many companies to experience financial distress and in several instances commence Chapter 11 cases in the US. Outside of the shipping industry, we have continued to be involved with several companies in the print media space, particularly throughout Europe, that are experiencing various degrees of financial distress. Many of these companies have highly leveraged balance sheets that were arranged shortly before the 2008 financial crisis. As a result, some of these companies are undergoing their second or third restructurings, whether in-court or out-of-court, over the past four or five years.

While businesses within declining industries continue to face economic headwinds, the accessibility to utilise capital markets in order to refinance is still available.

DEIRDRE A. MCGUINNESS

Hernández: We are seeing more restructuring activity. In addition to the macroeconomic conditions affecting debtors' general payment capacity, in Argentina public utility companies are being subject to particular conditions that are leading them to an insolvency situation. Public utilities are managed by private companies under concession agreements with the federal government and provincial state governments. The federal government generally fixes the utilities' tariffs that the utility companies can charge to the customers. In many cases – for instance in electricity and gas transportation and distribution – the federal government has frozen the tariffs applied more than 10 years. With an average annual inflation of 20 or 30 percent, utility companies' operative costs increase annually at the inflation rate, but their income is frozen at 2002's tariffs. The creditors in many of these companies are withholding action and supporting the company's reorganisation proposals in a 'wait and see' scenario.

Durrer: The sequester arising as a result of mandatory federal budget cuts last fall is starting to have an impact on industries that historically rely on government contracts or subsidies. These include healthcare, defence and green energy. In addition, imminent sunsets on troop deployments in former hotspots, such as Afghanistan, will also cause distress among security firms. Lastly, financial institutions which received TARP funding from the US Treasury in 2009 will experience escalations in their dividend rates in the coming months – from 5 to 9 percent – forcing some of them to expedite balance sheet restructurings.

Russell: In the energy sector, natural gas heavy exploration and production companies, and coal companies continue to show significant structural weakness. Companies focused on alternative energy such as solar and ethanol – previously impacted by lower fossil fuel prices – have still not recovered and there have been a number of significant liquidation proceedings in the sector. On a national level, the manufacturing sector continues to be challenged by government regulation and relative labour costs. We have seen multiple manufacturing companies in financial distress, some filing bankruptcy or engaging in major out-of-court restructurings for the second or third time since 2008.

Redmond: To what extent are troubled companies able to refinance and renegotiate existing debt structures in the current market? Are banks relatively supportive or have they reduced their appetite to extend a distressed situation?

Diamond: If the financial issue is identified before the crisis hits and if there is enough running room left on existing facilities, most lenders will listen to and be proactive about a restructuring outside of formal proceedings. More importantly, the key issue, front and centre more than ever before, are values of the collateral. Lenders now will either lend or extend further credit only when there is almost a 100 percent guarantee of sufficient collateral coverage or only make additional credit on a far smaller basis than the stated fair market value of the underlying collateral. Most companies are not able to find alternative financing other than their existing pre-petition facilities ▸▸

either to restructure or seek a DIP financing. With respect to the financial challenges and struggles of professional firms, including global law firms, lenders are willing to work with them to a significant extent unless and until there is a significant flight of talent and 'rainmakers'.

Jimenez: A significant amount of the debt incurred by Mexican home builders was US dollar denominated unsecured bond debt issued in the US. Given the perceived risk and uncertainty associated with a Mexican insolvency proceeding under Mexico's *Ley de Concurso Mercantiles*, bondholders and other creditors of these Mexican homebuilders may be incentivised to agree to a consensual restructuring rather than risk a significantly lower recovery under a Mexican insolvency proceeding.

McGuinness: If a company has been a regular consistent issuer in capital markets, signs of distress would not necessarily prohibit the ability to refinance and put in place a new, more advantageous debt structure. Where we are seeing Chapter 11 today, are those middle market companies that historically have not consistently refinanced their capital structure and are experiencing challenges in securing refinancing. Of the current money-centre banks, there are a handful that are supportive in a distressed situation. Partly because they can underwrite the risk but they also have long-term banking relationships with the company. Given the current regulatory environment and future regulatory changes with respect to capital reserves, distressed lending will continue among those few money-centre banks. That is the reason non-traditional lenders are then able to come in and provide a comprehensive financial solution.

Trust: In our recent experience, financially distressed companies still have access to the capital markets and relatively low interest rates, which has allowed them to refinance their existing debt. In situations where those solutions may be unavailable, troubled companies are working with their existing stakeholders to reach a mutually acceptable solution to their financial problems. The opportunity to renegotiate an existing debt structure is often particularly attractive to alternative credit providers, such as private equity funds and hedge funds. These lenders might have acquired the debt at less than par and perceive an opportunity to obtain equity in a company with upside. In that sense, alternative credit providers are eager to work with a company and its management to assist in the turnaround of the business.

Hernández: Since the renegotiation of Argentina's public debt, the lack of a solution on holdouts and the lack of payment of certain debts with multilateral financial institutions by the federal government is restricting Argentina's access to international financing and is, therefore, restricting the access of Argentine companies to such financing. The domestic financing market is relatively small and not sufficient to satisfy certain debtors' financial needs in many cases. In almost all post-2001 crisis reorganisations, the debtors were able to renegotiate large cuts or extensions of terms on the original indebtedness and also to negotiate debt to equity exchanges. Under the current market conditions, even though creditors are not as permissive as in the post crisis reorganisations, creditors are relatively more supportive of the debtors' reorganisation proposals.

Durrer: Across several sectors, we have noticed that lenders are less likely to accede to requests to 'amend and extend' non-performing or distressed loans. Our view is that this is driven in part by lenders being aware of capital available in the markets to refinance existing loans as well as lenders' growing willingness to write down distressed loans. Lenders seem to me more willing to put loans into default because their own balance sheets have improved with the overall improvement in the economy.

The opportunity to renegotiate an existing debt structure is often particularly attractive to alternative credit providers, such as private equity funds and hedge funds.

ROBERT TRUST

Russell: With US interest rates at current levels and the amount of liquidity in the markets, many troubled companies have been able to refinance or renegotiate existing debt structures with traditional US banks. These banks appear very reluctant to force borrowers into bankruptcies. This year, we have represented several companies in out-of-court restructurings in which the company was able to pay off existing bank debt at a discount with new money from investment funds seeking both a debt and equity position – and board representation. A company whose debt is held by an investment fund faces more difficulty in renegotiating, particularly when the fund has made a 'loan to own' and is not reluctant to take over ownership or management of the company.

Chatz: This depends upon the nature of the business enterprise and the value of the collateral relating thereto. Certain areas are seeing an increase in collateral valuation, collateral such as commercial real estate and residential apartments. The notion that there is a general rule in this regard is not applicable. Certain financial institutions continue to undertake to liquidate less than highly performing credits in order to move them off their balance sheets when the question of valuation of assets of the existing client is an issue. Sometimes banks are supportive in distressed situations, sometimes they are not depending upon the nature of the collateral, the nature of the borrower and its history of goodwill with the lending institution and the agenda of a bank to minimise its less than high level of collateral within its portfolio.

Redmond: What methods are creditors in your country using to assert their claims against insolvent debtors and recover as much value as possible?

Jimenez: With the perceived uncertainty surrounding Mexican law insolvency proceedings, one avenue to which US creditors of Mexican debtors have resorted is the commencement of a ▸▸

US involuntary bankruptcy proceeding to employ a US style process and protocol to govern the amount and priority of distributions to be made to these creditors. It remains to be seen whether US creditors of debtors in other Latin American countries will employ this same strategy.

McGuinness: We have seen non-traditional lenders purchasing debt on the secondary market to increase their exposure to allow them to 'drive' the reorganisation process by converting their debt to equity. Given the regulatory restrictions in deploying capital by money centre banks, these non-traditional lenders have provided needed liquidity but with a view towards ownership not repayment. We have also seen very aggressive terms in credit agreements for debtor-in-possession financing such as deadlines for asset depositions and forced liquidation provisions.

Trust: The diminishing role of money-centre banks combined with the ascent of alternative credit providers has led to a dramatic change in the dynamics of restructuring negotiations both within and among the lender group and in negotiations with the company. Whereas money-centre banks generally are focused on being repaid at or close to par – particularly in situations outside the US where such banks still often comprise a large segment of the original lender group – alternative credit providers frequently arrive at a distressed situation with a focus on enhancing recoveries by converting debt to equity. Given the scarcity of new Chapter 11 filings of large US companies, these alternative credit providers are now shifting their attention to Europe and other regions where there may be more distressed opportunities.

Hernández: In order to recover as much value as possible against insolvent debtors, unsecured creditors in Argentina generally try to obtain the best possible reorganisation proposal from the debtor and avoid the debtor's liquidation. In Argentina the petition for reorganisation can only be filed by the debtor. Hence, if the debtor does not file a reorganisation petition, one of the more common methods to force it to make such filing is through the filing of a bankruptcy petition. Upon the filing of the bankruptcy petition the debtor may either make the payment of the unsecured claim; or file for a reorganisation petition.

Russell: Clearly the traditional and preferred position continues to be that of a secured creditor with a blanket lien on all assets of the insolvent debtor. While traditional US banks have restrictions which limit their ability to also have equity positions and board representation, investment funds often have such positions which enhance their ability to recover value. Several recent court decisions indicate that a company can agree through its formation documents to limit its ability to subsequently file bankruptcy. Given the costs associated with corporate bankruptcy filings, the ability of a lender to restrict a filing and force a restructuring or liquidation out of court can ultimately result in enhanced recovery for the lender. In the structuring of transactions and individual contracts today, we are seeing more analysis regarding the impact of a future bankruptcy.

Chapter 11 has become highly litigious, with fewer and fewer parties negotiating to cut up the pie.

ALLAN DIAMOND

Chatz: The efforts of creditors in the US are diverse and their success depends upon their layering within the stack of debt that may encumber the debtor's business operations. Secured lenders have their rights under their security agreements and otherwise, as do bondholders and other entities that have securitised their indebtedness. Unsecured creditors, including unions and wage claimants, have their rights usually based upon state law remedies which allow them to seek judgments or other recoveries under state law. There is nothing particularly new relating to the remedies available to creditors in the US.

Diamond: Chapter 11 has become highly litigious, with fewer and fewer parties negotiating to cut up the pie. Moreover, in the past 10 years there has been a trend where the majority of recovery has been suits to recover assets from third parties under fraudulent conveyance or preference suits or D&O suits. Other than secured creditors; most unsecured creditors must now rely on the success of these suits to obtain more than a meagre recovery from a debtor.

Redmond: Have you seen an uptick in distressed M&A activity? Do these deals seem to be concentrated in any particular industry or sector?

McGuinness: I have not seen an uptick in the distressed M&A world. Assets are currently being sold under Section 363 of the bankruptcy code in a variety of industries, and they are generally on a case by case basis. We've seen assets in Kodak, Hostess and RG Steel broken up and sold to investors, but the general M&A activity has not increased.

Trust: The amount of distressed M&A activity has remained steady. Financially distressed companies are frequently utilising the Chapter 11 plan process or Section 363 sale process to sell their assets. The protections afforded to a purchaser in an M&A transaction approved by the US bankruptcy court often induce buyers to make the highest and best offer to consummate an M&A transaction with a distressed company. In some cases, the existing secured lenders benefit from those processes as they credit bid their debt to acquire a company. In other cases, companies are able to sell their assets to multiple buyers in an effort to maximise recoveries for stakeholders. Recent examples include the attempted merger of American Airlines and US Airways, and the asset sales consummated by companies as varied as Blockbuster, Borders, ATP Oil & Gas and Hostess Brands.

Hernández: In the post-financial crisis reorganisations of the last decade there was a great deal of distressed M&A activ- ▸▸

ity. Many major post crisis debtors held large debts the main portion of which was represented by securities trading in international capital markets. The trading of the debt facilitated the acquisition of the debt by the investors in the capital markets at high discounts. Creditors then used their positions in the securities to reach a blocking position to gain control over the debtor's reorganisation proceedings. In some cases the reorganisation proceedings involved the takeover of the debtor by the creditors through cash to equity exchange reorganisation proposals. After the post-crisis reorganisations, distressed M&A activity has reduced considerably. However, in the last few months there has been a modest increase, particularly in the public utilities sector.

Russell: While the first half of 2013 has not been as robust as 2012, we continue to see levels of M&A activity. However, distressed M&A activity has been relatively flat for the last 18 months. Clients are still taking advantage of strategic acquisitions when opportunities arise but in a truly distressed situation they have come to prefer acquisitions through Bankruptcy Code Section 363 sale or plan process as they not only cleanse assets of liabilities but also avoid litigation down the road. Our distressed M&A activity has been concentrated in the energy industry but we have worked on acquisitions in other sectors, including telecom, manufacturing and hospitality to name a few.

Chatz: We have seen an uptick in all M&A activity whether distressed or otherwise. The concept of distressed M&A activity may be an oxymoron relating to the unclear valuation of certain assets in this very fluid economy where values of collateral appear to be rising as demand for goods and services appears to be increasing.

Jimenez: I have not seen an uptick in distressed M&A deals in the Latin American region. If this level does begin to rise, one interesting issue will be to what extent assets can be sold in a particular Latin American jurisdiction free of liabilities much like a sale under Section 363 of the US Bankruptcy Code.

Redmond: Have there been any major legal and regulatory developments, including court decisions, that will have a significant impact on bankruptcy processes in your region going forward?

Trust: An important recent legal development in US bankruptcies has been the use of Chapter 11 by non-US companies. Recent cases have confirmed that there is no minimum amount of property, nor minimum amount of time that such property must be located in the US, for a company to be eligible to file for Chapter 11. These court decisions provide non-US companies with a viable alternative to restructure their debt outside of their home jurisdiction. Chapter 11 and its lower voting thresholds can be employed as leverage to persuade recalcitrant creditors to accept a restructuring supported by other stakeholders. In addition, from a company's perspective, Chapter 11 provides an attractive mechanism for distressed companies to restructure their balance sheet while management remains in control of the business and many employees keep their jobs.

Hernández: Major developments have occurred during the last decade, including the binding effect of the out-of-court reorganisation process – *acuerdo preventivo extrajudicial* (APE) – *vis à vis* non-consenting creditor upon court endorsement. More recently, in 2011 there was an amendment to the Argentine Bankruptcy Law by which the debtor's employees increased their rights in insolvency proceedings, including the right to appoint a representative in the creditors' committee; the right to – incorporated as a Labor Cooperative – bid for the acquisition of the debtor in the event of a cram-down proceeding and in the bankruptcy. In addition, the Labor Cooperative may request the suspension of the enforcement of claims filed by secured creditors for a two-year period, and may be appointed as successor to all managerial powers of the debtor.

In 2011 there was an amendment to the Argentine Bankruptcy Law by which the debtor's employees increased their rights in insolvency proceedings.

FERNANDO HERNÁNDEZ

Russell: The Texas economy has benefited from the relatively new process of hydraulic fracturing or 'fracking' in which fluid is injected into the ground at a high pressure in order to fracture shale rock to release the natural gas and oil inside. The US Interior Department's proposed regulation of fracking on federal lands could lead to production delays and thus negatively impact both exploration and production companies, and oil field services companies. The Texas Railroad Commission, which regulates the Texas oil and gas industry, has adopted new fracking regulations which become effective in 2014. Although the regulations were supported by the Texas Oil and Gas Association, concerns were raised that regulatory compliance will increase drilling costs, putting further financial pressure on smaller companies. Increased costs and production delays often lead to financial distress. Regulatory developments in fracking could impact bankruptcies in Texas and other oil and gas producing states.

Chatz: The filing of bankruptcy by the City of Detroit, Michigan and its potential impact upon bondholders as well as potentially retired individuals who are due pension and healthcare obligations from the City may have a material impact upon the viability and undertaking of the utilisation of the bankruptcy due process by other governmental entities going forward. As to legal matters, the *Stern* decision by the US Supreme Court continues to create battles regarding jurisdictional rights of the US Bankruptcy Courts with respect to litigation matters and the Supreme Court's decision to grant certiorari in the case *Law v. Siegel* (Case No. 12-5196) has practitioners and courts nervous of potential changes to well-established bankruptcy jurisdiction and processes.

Diamond: The Fifth Circuit has a series of cases, ranging from disallowance of attorneys' fees when no success can be demonstrated – what is known as the pro-snax problems – to some difficult disclosure issues in plan and disclosure statement, just two among many, that have a bearing on whether to file corporate bankruptcy in our region. The US Trustee's Office has also promulgated new fee guidelines for certain 'mega' cases that may result in fewer firms wanting to work in the Chapter 11 arena. On the other end of the spectrum, there are court decisions in Texas that are very helpful to trustees for debtors involving any application of the *in pari delicto* defence asserted by third party defendants to suits brought by trustees for the benefit of debtor estates. There is also law favourable to trustees with respect to various claims brought by trustees for bankrupt professional firms, including law firms.

Jimenez: One decision that is likely to affect the debtor and creditor dynamic in how insolvency proceedings are carried out in the Latin American region is the recent decision by the Fifth Circuit Court of Appeals in *Vitro*, where the appellate court affirmed a bankruptcy court decision refusing to recognise and extend comity to a plan of reorganisation approved by the Mexican courts in Vitro's Mexican insolvency proceeding. In the case of a Latin American debtor with debts governed by US law, this decision will impact whether such a debtor can successfully go through a proceeding in its home country and then have US courts recognise that result in order to prevent the enforcement of remedies against such debtor in the US.

Redmond: Disputes and litigation are a major part of today's bankruptcy process. What themes have been particularly common in recent years?

Hernández: In recent years, Argentine courts have been reluctant to liquidate debtors ruled as bankrupt. The Argentine Bankruptcy Law allows the court to continue the running of the debtors' business under certain exceptional circumstances – for instance, to keep the employees' jobs. This power has been widely used by Argentine courts which, in some cases, kept bankrupt debtors' businesses going for more than 10 years under the management of the court's trustee. Another major common theme is the calculation of the court fee in the reorganisation proceeding. Argentine debtors are obliged to pay a court fee in connection with a reorganisation proceeding that is calculated on the outstanding aggregate amount of the debtor's indebtedness. In reorganisation proceedings involving the reorganisation of the debtor and its guarantors, the Argentine tax authorities have claimed that the court fee must be paid by each debtor. Recent court precedents have resolved that a single court fee must be paid in such circumstances.

Russell: The most prevalent theme I have seen in bankruptcy litigation in recent years is what I would call 'gross unconscionability' in business dealings. The defendant got a deal that was 'too good to be true'. While recent court decisions are making it increasingly difficult to recover on constructive fraudulent conveyance claims based on failed corporate transactions, courts are showing a willingness to look more closely at actual fraud claims where the defendant appears to have not practiced what I would characterise as 'good business ethics'. Bankruptcy trustees and postconfirmation litigation trusts are filing suits against parties who entered into transactions with the debtor in which they took unfair advantage of their actual or constructive control over the debtor or they benefited from the debtor's financial distress or lack of sophistication. Courts are more receptive to holding defendants accountable rather than concluding that the debtor was simply out negotiated.

Chatz: The battles continue to relate to the rights of secured lenders with respect to real estate assets within the bankruptcy context. The battles continue to be along the same themes of valuation of collateral, rights of the debtor to maintain possession of collateral during a Chapter 11 battle with respect to relief from stay, or other claims sought by the secured lender and the fruitless attempts given the lack of valuation of collateral by debtors to maintain their real estate assets. As certain areas of the real estate arena gain value, particularly residential apartment collateral, borrowers may find that they have better traction given that secured lenders may soon be in an over-secured position. Litigation always continues relating to preference and fraudulent conveyance matters and the rights relating to those who may have been injured in ponzi schemes or other fraudulent activity continue to be litigated throughout the Bankruptcy Courts.

Diamond: The single most common issue involved in litigation brought by trustees and estate representatives is the application of imputation and *in pari delicto* defences where the debtors' insiders were involved in some type of wrongdoing, including fraud and ponzi scheme cases and accounting defalcations or malpractice. In ponzi scheme cases, myriad issues arise in litigation asserting fraudulent transfers, including the good faith defence and transferee inquiry notice issues. More generally, the 2011 US Supreme Court decision in *Stern v. Marshall* has generated an enormous amount of litigation involving a panoply of issues related to the bankruptcy courts constitutional jurisdiction to hear, and render either final judgment or report and recommendations, on various types of 'core' bankruptcy claims.

Jimenez: Two issues that have received a significant amount of press in Latin American insolvency proceedings are the use of insider claims to confirm a plan of reorganisation and the release of non-debtor guarantors under a plan of reorganisation. The *Vitro* case is a good example of both issues. In that case, Vitro was able to use claims against it held by various non-debtor related companies and vote those claims in favour of ▸▸

The battles continue to relate to the rights of secured lenders with respect to real estate assets within the bankruptcy context.

BARRY A. CHATZ

Vitro's plan of reorganisation to offset votes cast by US bondholders against the plan. Similarly, Vitro's plan of reorganisation included a release in favour of certain companies related to Vitro which were either co-obligors with Vitro on the US dollar denominated bonds or had guaranteed Vitro's obligations under the bonds. The Mexican court overseeing Vitro's reorganisation proceeding approved the provision in Vitro's plan of reorganisation that discharged the co-obligors and guarantors, which spawned a great deal of litigation both in Mexico and the US. Given the structure of many of the debt instruments issued by Latin American debtors to US creditors, this will continue to be an issue that is highly contested.

Trust: US bankruptcy courts are increasingly being asked to decide disputes that hinge on complicated contractual provisions, whether in loan documentation where a company has agreed to pay a make-whole or similar type of premium payment, in intercreditor agreements where junior creditors have waived certain rights, or even in asset purchase agreements and related documents where court approval has been obtained. For example, some of the most significant bankruptcy-related litigation in the last few years involved disputes about which assets were sold by Lehman to Barclays, or the scope of successor liability assumed by the successors to General Motors and Chrysler. Given that the court's analysis begins – and frequently ends – with its interpretation of the plain meaning of the language in the applicable contracts, lawyers and clients must be careful in the drafting of those contracts, whether in connection with a transaction that is being consummated long before a bankruptcy is contemplated or in the hectic days and hours before a case is filed.

McGuinness: Given the depressed restructuring market, we have seen an increase in bankruptcy litigation and time required for adjudication or settlements has increased. There will always be anticipated types of litigation such as fraudulent conveyance and preferential transfers, but we are now seeing more substantive objections to plans of reorganisation. Specific examples would include Hostess, ResCap, and we've seen most recently a lot of activity around the city of Detroit. The bankruptcy process is intended to be transparent and under the bankruptcy code stakeholders have a right to be heard. As such, you can predict an increase in litigation as well as an increase in substantive objections to the debtor's efforts to reorganise.

Redmond: Are disgruntled creditors more likely to target directors and officers in post-bankruptcy litigation? What types of claims are they bringing against D&Os, and with what level of success?

Durrer: We have seen increased claims and suits against directors and officers in recent sale and liquidation cases in Chapter 11. The typical plaintiffs include disenfranchised unsecured creditors in cases where the primary beneficiary of the Chapter 11 process was a secured creditor with a lien over substantially all of the assets of the debtor. In these cases, there is little value left for unsecured creditors, and so the debtor is sometimes forced to allow unsecured creditors to pursue whatever insurance might be available to satisfy claims against directors and officers. Unfortunately, this has tended to create unnecessary litigation, which is also underfunded in any event. A better solution for these cases may be conversion, where an independent trustee can make a determination as to whether to pursue litigation.

Disgruntled creditors have and will continue to target directors and officers in post-bankruptcy litigation for self-dealing and breach of fiduciary duties.

ROBIN RUSSELL

Russell: Disgruntled creditors have and will continue to target directors and officers in post-bankruptcy litigation for self-dealing and breach of fiduciary duties. For unsecured creditors, recovery against the D&Os is often their only source of payment. Obviously, insurance coverage is key. The larger the policy and the more layers of coverage, the more likely it is that suit will be filed. For this reason, insurance policies are more carefully drafted to limit coverage in the event of a bankruptcy and it has become increasingly difficult for a bankruptcy trustee or a post-confirmation litigation trust established for the benefit of creditors, to recover. Defence costs eat away at the policy amount and policies frequently have 'waterfall' provisions which require that monies first be spent to pay defence costs for individual officers and directors. We frequently see insurers settling within policy limits but often not until the proverbial 'courthouse steps' are reached.

Chatz: In general terms, plans of reorganisation provide directors and officers in successful reorganisation circumstances with releases that will protect them from director and officer liability going forward. The business judgment rule has been supported by particularly the chancellors in the Delaware courts. Recent claims either have not been brought or are generally not successful.

Diamond: Disgruntled creditors are more likely to target directors and officers. Director and officer litigation is present in the vast majority of bankruptcy actions where there is any kind of alleged fiduciary duty breach or negligent representation to creditors. The challenge for such creditors is to identify breach of loyalty claims or breach of the duty of care where the conduct was reckless or grossly negligent. Otherwise, both business judgment and director protection statutes may provide a safe haven for officers and directors.

Jimenez: The use of an attack by creditors on the directors and officers of a distressed or insolvent company to increase a creditors' leverage or recovery is a strategy that remains untested in Latin American insolvency proceedings. Moreover, since the law governing any such claims would be the law of the Latin American country under which such debtor company is organised, it is unclear whether such claims would have any merit or success.

Trust: Creditors are more likely to target directors and offi- ▸▸

cers, particularly in light of the fact that the enterprise value of many Chapter 11 debtors is insufficient to pay the secured debt in full, often leaving junior creditors without the prospect of a meaningful recovery in the Chapter 11 case. As a result, many Chapter 11 cases require parties to work creatively to reach a consensual deal between battling stakeholders, in particular the senior creditors versus out-of-the-money junior creditors. In order to bridge the gap, senior creditors can provide different forms of consideration to the junior creditors, including the right to recover from certain litigation. These litigations are often funded with seed money and target various potential defendants, including those who might have received a preferential or fraudulent transfer and directors and officers who allegedly breached fiduciary duties or engaged in other malfeasance.

Hernández: In Argentina, disgruntled creditors may target directors and officers in pre or simultaneous insolvency litigation. This litigation may also involve criminal actions. Many of those actions are mainly in connection with the reorganisation process, the reorganisation plan, and the affectation of secured creditors' rights as a consequence of the proposed reorganisation plan.

Redmond: Are you seeing any particular trends in cross-border or multijurisdictional insolvencies? If so, what additional challenges do such engagements present?

Russell: We have seen an increase in the US of filings by non US companies whose assets are principally abroad, particularly companies in the shipping industry. With Europe home to many shipping companies and Asia home to many shipbuilders, the decline in shipping has hit both continents. The automatic stay afforded to debtors under the US Bankruptcy Code has attracted shipping companies whose ships had or were on the verge of being seized by creditors in ports around the world. These engagements are particularly challenging when representing non-US creditors who have never before encountered a US bankruptcy court or the Bankruptcy Code – which is much more debtor friendly than insolvency laws in Europe – and thus have overly optimistic expectations as to the speed with which their collateral can be recovered or claims will be paid. These cases obviously present logistical challenges as well.

Countries in Latin America may become less likely to recognise US insolvency proceedings under a rationale that there is an absence of comity between the US and Latin American countries.

PEDRO A. JIMENEZ

Diamond: The Southern District of Texas is now seeing many more cross-border and multijurisdictional insolvencies. Just last month, TMT shipbuilders filed Chapter 11 in the United States. TMT is a Taiwanese company, with the only nexus to Houston being a retainer paid by the Taiwanese owners to a Houston law firm. The banks holding liens against the vessels sought to dismiss the case as a bad faith filing. The Southern District of Texas Bankruptcy Court conditioned the retention of the case on the principals of the shipping company from Taiwan placing certain assets in the US to protect creditors against further diminution in value. In bankruptcies involving global professional firms, we have seen cross-border insolvency proceedings in many different countries. Trustees, receivers, administrators and other court representatives have worked together in marshalling global assets. Enforcement of US and foreign judgments in courts of other countries, however, are complex, expensive and challenging.

Jimenez: The trend to keep an eye out for in cross-border insolvencies is the effect, if any, that the Fifth Circuit Court of Appeals decision in *Vitro* will have on future cross-border restructurings both in the US and in Latin America. From a US perspective, it is unclear whether US courts outside of the Fifth Circuit will adopt the reasoning given by the Court of Appeals in affirming the decision of the bankruptcy court refusing to recognise Vitro's plan of reorganisation approved by the Mexican court overseeing Vitro's insolvency proceeding. Since recognition of a plan is, often times, an important reason to commence a cross-border proceeding in the US, whether *Vitro* becomes the law in other circuits outside of the Fifth Circuit will be a key issue that remains to be decided. Similarly, countries in Latin America may become less likely to recognise US insolvency proceedings under a rationale that there is an absence of comity between the US and Latin American countries if courts in the US are not going to extend comity to the decisions and results of insolvency proceedings in Latin America.

McGuinness: According to Bloomberg Briefs, in 2012, a total of 35 companies filed Chapter 15 petitions in the US, including some large companies with pre-petitions liabilities greater than a billion. If problems in the global economy persist, it could lead to more Chapter 15 filings as non-US companies seek to protect its US-based assets. Bankruptcy laws in most foreign jurisdictions are both challenging and complex, and debtors seek to file under Chapter 15 in US courts due to the established process of insolvency as a strategic alternative to reduce balance sheets and restructure operations.

Trust: In the last few years we have seen many non-US companies seek the protections afforded by the US Bankruptcy Code, whether under the auspices of Chapter 15 or Chapter 11. It is becoming more commonplace for non-US companies that are involved in an insolvency process in their home jurisdiction to employ Chapter 15 to obtain the benefits of the automatic stay and a US court order that recognises and enforces the decisions of the foreign court. There has also been a recent uptick in the number of non-US companies that choose to file pre-packaged Chapter 11 cases to implement a balance sheet restructuring. The US Bankruptcy Code provides an attractive option in light of its often lower, more favourable voting thresholds and the binding, extraterritorial effect of the automatic stay and US bankruptcy court orders.

Hernández: Argentina has not yet adopted the Model Law on Cross-Border Insolvency of the United Nations Committee on International Trade Law (UNCITRAL). According to the Argentine Bankruptcy Law, foreign insolvency proceedings are not recognised in Argentina except as evidence for the filing of a bankruptcy petition in Argentina. Therefore, the enforcement of any foreign insolvency proceeding against the debtor or debtor's assets in Argentina can only be achieved through the filing of a local reorganisation or liquidation proceeding before the Argentine courts. There is no current debate in Argentina in connection with the adoption of the Model Law. On the other hand, Argentine private debtors have, in several cases, filed an application for, and actually obtained, protection under Chapter 15 of the US Bankruptcy Code in respect of US creditors.

Durrer: There has been a growing trend for companies with largely foreign operations coming to the US to reorganise. As long as a company has assets located within the US, it technically qualifies for Chapter 11 relief. Due to the maturity of the US insolvency system, there is predictability, and the judiciary is sophisticated. This creates an environment, where, even though it may be logistically difficult to attend hearings or communicate with advisers in the US, parties can rest assured that restructuring transactions can be consummated on a timely and efficient basis. We expect to see continuing growth in this area.

Redmond: Looking ahead, what developments do you expect to see in restructuring and bankruptcy activity in the months ahead?

Chatz: As values increase potentially for collateral throughout the business and real estate sectors, corporate and business bankruptcy may increase as loans become due and debtors become less apt to seek a non-bankruptcy liquidation alternative, at the behest of their lenders. Bankruptcy lawyers and their financial partners will be able to provide advice to their clients that is not just based upon hope and a prayer but instead is based upon the ability to maintain value for the debtor's principals as well as other creditors in the stack of indebtedness. It is not clear when precisely they will see the valuation shift from undersecured, secured creditors to oversecured, secured creditors. However, the increase in valuation of residential apartment collateral in the real estate area as well as the growth and value in some communities in the areas of office and retail real estate collateral, may change the power structure back to that which will generate benefits for debtors and other creditors versus a value quotient directed by the secured lenders.

Diamond: If the price of oil stays the same or goes lower, many companies in the shale industry will face insolvency proceedings. Once this happens, it will affect the other businesses associated with the shale industry. Healthcare entities, clinics, hospitals and other businesses dependent on Medicare and Medicaid reimbursement for their revenues, will need to seek restructuring of their balance sheet. Companies in the business of producing computers – now replaced by smart phones and tablets – will need to restructure and reinvent their businesses. Professional service firms whose traditional business models have involved a pyramidal structure reliant upon growth in size will need to reconsider and restructure their partnerships and economic models to meet the challenges of contracting US business due to globalisation, advances in technology, outsourcing and increasing alternative fee arrangements.

McGuinness: Unfortunately, I do not see an uptick in the amount of Chapter 11 filings through 2013 and most likely well into 2014. Until economic conditions deteriorate and access to liquidity narrows, I'm afraid we will continue in this restructuring trough. There will always be companies within industries that are declining, coupled with weak management teams and inefficient operations. Those companies will always be candidates for an out-of-court or in-court restructuring. The restructuring industry itself is always looking for its own improvements and efficiencies. For example, we are always looking to explore areas of efficiencies for the benefit of our clients such as electronic proof of claims filing to reduce cost and improve data integrity.

Trust: We expect to continue to see Chapter 11 being an important tool for companies to use as leverage to bring recalcitrant lenders to the bargaining table, particularly for foreign businesses where the businesses often have very few alternatives in a distressed scenario in their home jurisdiction, other than liquidation. For all companies facing financial distress, we expect that those companies will continue to be reluctant to consider filing for Chapter 11 protection unless the company has the requisite consents from its stakeholders that permit it to file a shorter pre-arranged or pre-packaged case. Long stays in Chapter 11 may become the province of companies facing liquidation such as Lehman or MF Global.

Hernández: Argentina is currently facing adverse macroeconomic conditions. In October 2013 there are mid-term elections for the election of members of Congress and the House of Representatives, as well as governors of some provincial states. It is hard to predict whether the federal government will address the required changes in public policies after the election. However, if the federal government does not address certain macroeconomic problems after the election, the filing of reorganisation and bankruptcy petitions may increase in the months ahead, in comparison with prior months. In addition, public utilities companies have had their tariffs frozen since 2002, which is putting those companies in insolvency situations. If the federal government does not authorise the increase of utilities tariffs, there may also be an increase in the filing of reorganisation and bankruptcy petitions by these companies.

Durrer: There is no doubt anymore that in the 'new normal', as some have coined it, bankruptcy cases in the US will be very short in duration. Chapter 11 cases will involve a prompt sales process, followed by conversion to Chapter 7, or a short prepackaged reorganisation plan, designed to implement a transaction negotiated before bankruptcy. There has been a combination of factors driving this result: a maturity of the system in the US allowing parties to better predict outcomes, plus a reduced tolerance for the transaction costs of a protracted 'traditional' Chapter 11 process.

Russell: I think we will continue to see distress in the manufacturing sector and in companies heavily invested in coal and gas, particularly when the fallout from the new fracking regulations becomes clear. Exploration and production companies will continue to need liquidity which some will be unable to access, particularly if the Federal Reserve increases interest rates. ■