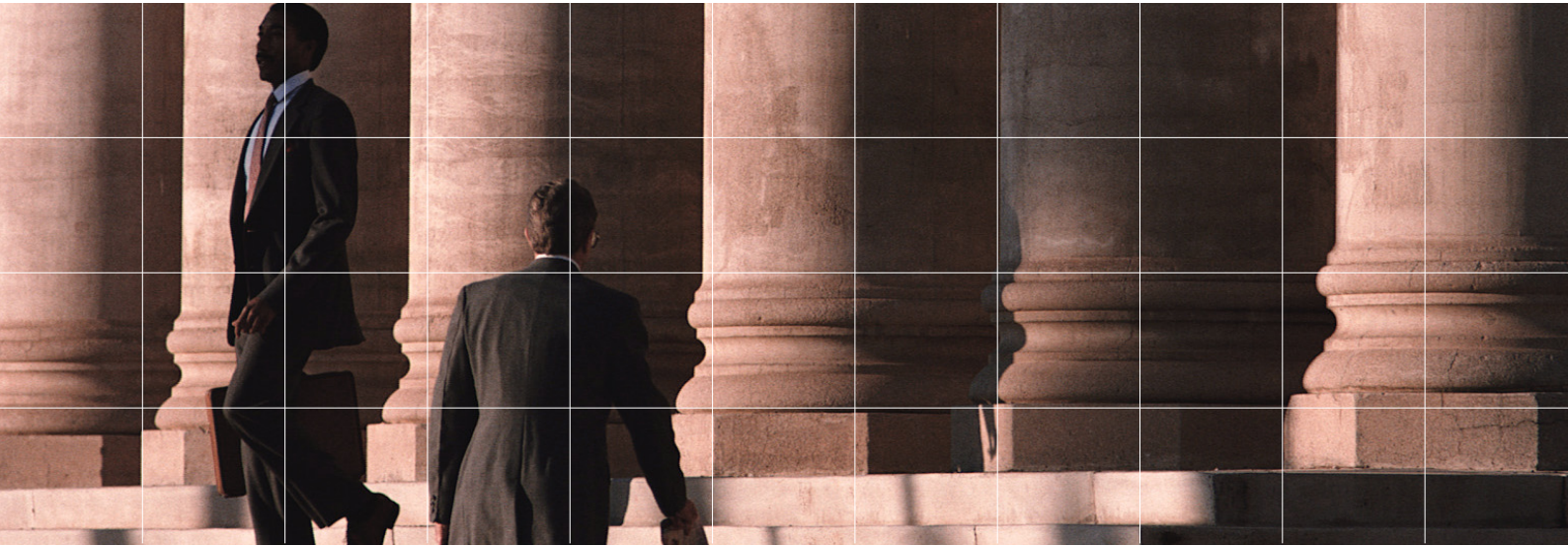




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Comparison of Chapter 11 of the United States Bankruptcy Code with

- The System of Administration in the United Kingdom,
- The Rescue Procedure in France,
- Insolvency Proceedings in Germany, and
- The Extraordinary Administration for Large Insolvent Companies in Italy

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COMPARISON OF CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE

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**COMPARISON OF CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE
AND THE SYSTEM OF ADMINISTRATION IN THE UNITED KINGDOM**

A BACKGROUND

Chapter 11 - US Bankruptcy Code

Chapter 11 focuses on preserving reorganization or going concern value over liquidation value. As a corollary, Chapter 11 assumes that the most efficacious way to achieve that result is to retain management and enable multiple outcomes either through a plan of reorganization, a series of going concern sales and even a liquidating plan. Chapter 11 enables a wide range of proposals to be put into a reorganization plan, including having the company and its management survive the process. Chapter 11 cases fall into two general categories: the “freefall” case or a pre-packaged or pre-negotiated case.

In the former, relief is sought under Chapter 11 of the Bankruptcy Code without having an agreed exit strategy among the company and at least a critical mass or core group of creditors. The latter is characterized by commencing a Chapter 11 case following the development of a consensus on the outcome of the case. Under both scenarios, Chapter 11 plans embrace:

1. a “standalone” plan, which essentially connotes that the creditors, secured and unsecured, and, if applicable, the company and its equity-holders, agree on a reorganization without the intervention of a third party or a sale of the business, relying instead on what may be termed a “composition” plan under which at least some unsecured creditors agree to accept less than 100% payment or agree to take a combination of debt and equity issued by the reorganized company in return for their claims; or
2. a plan which effects a sale of all or substantially all of the assets as a going concern and distributes the consideration or proceeds of sale to the creditors;
3. a plan which relies upon a capital infusion from an investor;
4. a liquidating plan which sells all of the assets of the company and provides for a distribution of proceeds to creditors;
5. a plan which, in part, contemplates a litigation trust to pursue and prosecute causes of action belonging to the company; or
6. a combination of the above.

UK Administration - Schedule B1 of the Insolvency Act 1986

The concept of administration was conceived by the Insolvency Act 1986 as a method of ensuring the survival of the company as a going concern with the benefit of a moratorium in respect of the administration debts. The aim was to rehabilitate the business of the company and to give it time to reassess its future rather than leaving it to face liquidation or administrative receivership (the process by which the holder of a “floating charge” over the assets of the company can appoint a receiver to run and ultimately sell the assets). The administration procedure has recently been reformed by the Enterprise Act 2002. The key reform is that an administrative receiver may only be appointed in respect of certain specified cases:

1. Capital market transactions if debt is, or is expected to exceed £50m;
2. Finance projects if debt is or is expected to exceed £50m and there are step in rights;
3. Utilities projects;
4. Public private partnerships;
5. Financial Markets Transactions; and
6. Registered Social Landlords.

Instead, holders of qualifying floating charges will be given the right to obtain an order for the appointment of an administrator on the occurrence of an event of default under the banking facilities - usually a failure to meet a payment deadline but it could be for a breach of another covenant.

The proposals are consistent with the Government’s wish to promote a rescue culture in the field of corporate insolvency, and with its preference for insolvency procedures that aim to maximise the benefits for all creditors, rather than for a specific class of interest. The effective abolition of administrative receivership will mean that holders of floating charges will be encouraged to focus less on a disposal of assets as a means of recouping value (although this option will be open to them under the administration procedure), and more on an approach which achieves an outcome that benefits all stakeholders in the debtor company. One of the Government’s particular aims is to help owner-managed companies where for those directors saving the company is much more important than selling the assets to a new company, for example.

Reforms under the Enterprise Act 2002

The Enterprise Act 2002 became effective on 15 September 2003 and (amongst other things):

1. virtually abolishes the concept of administrative receivership by preventing holders of floating charges from blocking the appointment of an administrator;
2. allows administrators to be appointed out of court by the holder of a qualifying floating charge, the directors or the company in certain circumstances. In the UK, directors can incur personal liability for trading whilst insolvent ("*wrongful trading*") and must file for an insolvency process at the time the company cannot avoid insolvency. By filing for administration, this gives the directors 'breathing space' free of creditor pressure to try to put a rescue plan together;
3. emphasises that the main objective of administration is rescuing the company as a going concern. Only if that primary objective cannot be achieved may the administrator then break up or sell the whole of the business or realise property in order to make a distribution to secured or preferential creditors (see later); and
4. the administrator now owes a duty to protect the interests of all creditors - compared to administrative receivership where the receiver owed a primary duty to the secured lender who appointed him.

COMMENT

The objective of both procedures is the creation of breathing space during which the debtor company is given time to formulate plans for a reorganization. Chapter 11 also has provisions which enable a company to stabilize its business by, among other things, authorizing the borrowing of loans, the rejection of executory contracts, and the re-negotiation of union and retiree obligations.

B PROCEDURE

Chapter 11 - US Bankruptcy Code

A typical Chapter 11 case begins when the debtor company voluntarily files a petition with a bankruptcy court, accompanied by:

1. a list of creditors; and
2. a summary of assets and liabilities.

Technically there is no requirement of 'insolvency'. Companies may have a number of reasons, other than insolvency, to file for bankruptcy relief: the company is faced with massive tort liabilities (e.g. Dow Corning when a global settlement with plaintiffs broke down), an adverse outcome in a litigation (e.g. Texaco when faced with a multi-billion dollar damages award), and anticipated liquidity issues (e.g. a number of U.S. energy companies).

But applications must be in 'good faith' and with the intention of reorganization or to effect a liquidation or sale of the company, and creditors may apply to have petitions dismissed where this is not the case. For example, in the SGL Carbon Corporation case (200 F.3d 154), the court dismissed the company's Chapter 11 case because of bad faith demonstrated by a lack of "reorganization purpose".

A large company may also be involuntarily pushed into a Chapter 11 case if three creditors holding unsecured non-contingent undisputed claims aggregating more than \$12,300 file an involuntary petition against the company and if the company is "generally not paying [its] debts as such debts become due". The company may contest the petition and if the above standard is not met, may file suit against the filing creditors for costs and/or reasonable attorneys fees or, if filed in bad faith, damages, including punitive damages.

Usually it is the company not the creditors who file for Chapter 11 protection (see Section E: Control of the company). However, secured lenders may effectively force a company to file for relief under Chapter 11 by threatening to enforce liens.

UK Administration - Schedule B1 of the Insolvency Act 1986

Administration can be commenced out of court by a secured creditor who holds a "qualifying floating charge", by the company itself or by its directors. Otherwise general creditors must apply to court.

Court Procedure

The application must state that:

1. the company is or is likely to become insolvent (on assets/liability test or inability to pay debts grounds); AND
2. it is reasonably likely that the following can be achieved:
 - the rescue of the company as a going concern or as much of its business as is "reasonably practicable"; or, if this is not practicable;
 - a better result for the company's creditors as a whole than would be likely if the company were to be wound up; or, if this is not practicable;
 - the realisation of the company's property on a break-up basis in order to make a distribution to one or more secured or preferential creditors, but "without unnecessarily harming" the interests of unsecured creditors.

The application must be supported by a statement from the proposed administrator confirming that it is reasonably likely that the purpose of the administration will be achieved, providing details of the company's financial position, details of creditors' security and any other relevant matters must be provided.

Out of Court

The holder of a qualifying floating charge may appoint an administrator out of court and the appointment takes effect once the holder of a floating charge has filed the necessary papers at court. As with the court procedure, the proposed administrator must make a statement that the purpose of the administration is reasonably likely to be achieved.

The administrator must satisfy himself that the first two objectives (referred to above) are not practicable, before proceeding with the third objective, namely realising assets for distribution to secured creditors. The company or its directors may also appoint an administrator out of court.

COMMENT

In the court procedure, the UK court has discretion as to whether to grant the administration order. Using the out of court route, the holder of a qualifying floating charge is entitled to appoint an administrator as of right, as are the directors and company if there is no holder of a qualifying floating charge or the holder of the qualifying floating charge consents. There are no similar “gating” or entry issues under Chapter 11. The debtor has a legal right to enter the procedure, although a Chapter 11 case may be dismissed if the court determines that it was filed in “*bad faith*”.

C MORATORIUM

Chapter 11 - US Bankruptcy Code

Immediately upon the filing of a bankruptcy petition, a moratorium or “*automatic stay*” stays all litigation and prevents the enforcement of judgements and of security without leave of the court.¹ This includes staying the continuation of any existing actions that were commenced before the filing.

A party who takes any action in violation of the automatic stay risks contempt of court actions and penalties. Also, any act done in contravention of the stay is retroactively made void or voidable by the court. The stay is effective during the entire time the case is pending but creditors and other parties may make motions to lift or modify the stay.²

The Bankruptcy Code gives the debtor the exclusive right to formulate a plan of reorganization for 120 days from the date of filing. This “*exclusivity period*” can be extended if sufficient reasons are established, but no extension can be granted beyond 18 months after the Chapter 11 filing date.³ In most instances the debtor company will first take actions to stabilize its operations and formulate its business plan and thereafter proceed to formulate a plan of reorganization.

COMMENT

Commentators have criticised Chapter 11 because, in theory, debtors could use it as a delaying tactic in dealings with actual or potential creditors and opponents in litigation. The potential for abuse of this kind prompted the U.S. Congress to amend the Bankruptcy Code in 2005 to include an 18 month “*drop-dead date*” for exclusivity in Chapter 11 cases. This relatively short leash on a debtor’s exclusive control over the plan formulation process should mollify creditor concerns regarding routine and repeated extensions in large Chapter 11 cases. In most cases, it should benefit all stakeholders because speed is an essential element of a successful reorganization.

Delay can have severe negative impacts upon the debtor’s business, directors, management, employees, suppliers, customers, and, most importantly, its creditors. Thus, the exclusivity issue rarely became an obstacle in large U.S. reorganizations, even before the law was changed to create a fixed outside limitation on extensions.

UK Administration - Schedule B1 of the Insolvency Act 1986

The moratorium takes effect from the date on which an application is made to the court for the appointment of an administrator or when the notice of appointment of the administrator is filed at court in the out of court procedure. The moratorium stays all litigation, and prevents the enforcement of judgements and of security without the leave of the court or the consent of the administrator. This includes staying the continuation of any pre-existing actions. There are no exceptions to this moratorium.

1. Bankruptcy Code paragraph 362(a)

2. Bankruptcy Code paragraph 362(d)

3. Bankruptcy Code paragraph 1121

D LIFTING THE STAY

Chapter 11 - US Bankruptcy Code

Generally, an affected party can apply to court at any time after the filing of a bankruptcy petition for relief. Once such a motion is made the stay will expire after 30 days unless within such time a court continues the stay pending a final hearing or the movant consents to such continuation pending a hearing. The court may terminate the stay, modify it or subject it to conditions.⁴ The court may lift the stay for cause, but is generally reluctant to do so during the initial stages of a Chapter 11 case because of the general presumption that a debtor should be given a chance to reorganize and prepare a plan.

Motions to lift or modify the stay are based on the following:

1. a court may lift or modify the stay upon a showing of “cause”, which includes the lack of adequate protection of an interest in property; or
2. with respect to property securing a lien, (i) the stay will be lifted if the debtor company does not have equity in such property and (ii) such property is not necessary to an effective reorganization. There are also special rules for single asset real estate cases and Chapter 11 debtors who are individuals. Also, the automatic stay may not stay in effect when applied to certain protected creditors, such as certain aircraft lessors and lenders and vessel lessors and mortgagees. In this context, a lack of adequate protection focuses on whether the creditor is being injured by continuation of the stay due to, among other things, a deterioration in value of its collateral or consumption of collateral by the company. To counter this potentially negative impact of the stay, a debtor company must provide adequate protection, which may take the form of:
 1. periodic cash payments to cover any depreciation during the stay; or
 2. additional or replacement liens or substitute security to the extent of any deterioration in value, and other relief that will amount to ‘indubitable equivalent’, a flexibly interpreted concept.⁵

COMMENT

Both jurisdictions show a reluctance to lift the stay unless there are good reasons for doing so.

UK Administration - Schedule B1 of the Insolvency Act 1986

A creditor can make an application to the court for the stay on taking legal action or enforcing its security to be lifted. The burden is on the creditor concerned to show that the leave should be given. Where the applicant can show that the giving of leave would not impede the administration then leave will generally be granted. Otherwise it is a balancing exercise to be carried out by the court.

Alternatively, administrators can grant consent to the commencement of proceedings against the company. These are more usually actions by commercial landlords to recover property.

4. Bankruptcy Code paragraph 362(d)(2)

5. Re Alyulan Interstate Corporation 12 BR 803 at 809

E CONTROL

Chapter 11 - US Bankruptcy Code

In Chapter 11, whether voluntary or involuntary, there is a presumption that control remains with the debtor's management through the concept of "*debtor in possession*" ("**DIP**") (subject to certain safeguards regarding disposal of assets outside the ordinary course of business). To many commentators this smacks of leaving the fox in charge of the hen house. Nevertheless, there are instances where the difficulty is due to exogenous and unexpected events (e.g. Texaco). More importantly, perhaps, is the impression that management provides the most economical and efficient means to reorganize under the oversight of the bankruptcy court, and creditors' committees. Significantly, many companies hire special financial advisors or turnaround management consultants to assist them in their restructuring. Often the creditors, especially the secured creditors, will condition their cooperation on the hiring of such an expert or chief restructuring officer. Such consultants or specialists nevertheless remains responsible to the board of the company, the bankruptcy court and the creditors. Often they will be in place as part of any out of court restructuring. Although there is a Bankruptcy Code provision to appoint a trustee, such an appointment is rare and only happens where there is some suspicion of misfeasance/fraud/wrongdoing/risk to assets, or because it is the interests of creditors.

When there is a debtor in possession, a party in interest may request the appointment of an Examiner to investigate the debtor's affairs. Although it is mandatory to grant such request where the debtor has unsecured, liquidated debts in excess of \$5 million, the bankruptcy court may limit the scope of the Examiner's investigation to guard against a "*fishing expedition*".

As soon as is practicable after the order for relief, the United States Trustee (a government official with a duty to protect all creditors) appoints a creditors' committee, usually made up of the seven largest unsecured creditors willing to serve.⁶ The supervisory role and powers of the committee are more extensive than in some jurisdictions, and they can incur the expense of attorneys and other advisors with court approval. Such expenses are funded out of the estate of the debtor.⁷ The United States Trustee may also appoint other committees as needed (e.g. a Tort Claimants Committee, a Bondholders Committee, etc.). Although the creditors' committee may employ advisers and may be remunerated from the bankruptcy estate, in smaller cases there may be insufficient financial incentive for there to be a committee formed. This negates the potentially important role the committee has in Chapter 11 proceedings.

UK Administration - Schedule B1 of the Insolvency Act 1986

Control passes to an insolvency practitioner (the administrator) on his appointment. The day to day management of the company is conducted by the administrator who acts as agent of the company (and without personal liability). The administrator's powers are set out in the Insolvency Act 1986. The administrator is also an 'officer' of the court and as such must act in good faith. The directors owe statutory duties to assist the administrator.

6. Bankruptcy Code paragraph 1102-1103

7. Bankruptcy Code paragraph 1103(a)

COMMENT

Opinion diverges over who is best placed to run the company (presuming there is not mismanagement or dishonesty). It is arguable that many insolvency cases are caused by some weakness in management. Moreover, the historical link between the insolvency to the displacement of management is very strong. This link continues, in part, through the applicability to UK officers and directors of the concept of wrongful trading and civil liability for the debts incurred by the company in financial distress, such that the UK insists that an insolvency practitioner be in control. Ironically, the UK has not really had experience with substantive stand alone reorganizations and perhaps the new legislation will highlight whether an insolvency practitioner can manage a business back to health and reorganization.

However, the alternative is to identify the management weakness and intervene with expert advisors or help which in many ways mirror the skills of the insolvency practitioner. Perhaps the presumption in favour of a debtor in possession operates as intended only in the context of the intended level of creditor and court oversight in Chapter 11. There is no comparable day to day oversight by the court or creditors in the UK. The insolvency practitioner is the creditors' oversight.

In the US, debtor in possession management certainly has considerable incentive to manage the operations and business well. Otherwise creditors will seek to terminate the debtor's exclusive right to file a plan and file their own plan or move to convert the case to a liquidation under Chapter 7.

The loss of control by directors in the UK may explain why it is much more common in the US for the directors to file for Chapter 11, where directors will continue to be responsible to all constituents, including equity, and may act to maximize the values for all, including negotiating on behalf of existing equity-holders. US directors know that filing for Chapter 11 will safeguard their position, provide them with the exclusive right to propose a plan or sale of assets, while providing the company the protection of Chapter 11. It is often critical to the outcome that a company seek Chapter 11 relief early enough to effect a sensible reorganization rather than consume its balance sheet and exhaust the potential for reorganization. In some respects the presumption in favour of a debtor in possession furthers the reorganization objective by not penalizing management for seeking relief under Chapter 11.

The potential for UK directors to be personally liable for losses suffered by creditors as a result of the company continuing to trade while it was insolvent (Section 214 of the Insolvency Act 1986) provides an incentive for directors to file for administration, despite their resulting loss of control, as doing so may relieve them of potential personal liability.

It has become routine in large Chapter 11 cases to induce existing management to remain with the company throughout the course of the reorganization process by offering generous compensation and severance incentives. The Bankruptcy Code was amended in 2005 to restrict significantly the circumstances under which such incentives can be granted. At this juncture, it remains to be seen what impact such restrictions will have on the inclination of pre-bankruptcy management to remain at the helm after the company files for Chapter 11 protection.

F CONTRACTS

Chapter 11 - US Bankruptcy Code

The debtor or trustee may assume a contract or lease even if it contains a clause that provides for termination in the event of insolvency, provided the debtor cures any default, and if the debtor had been in default, provides adequate assurance of future performance by itself or its assignee. Alternatively, the debtor may reject any such lease or executory contract, giving rise to breach as of the petition day, leaving the non-debtor party to such lease or contract with a prepetition claim for breach. Certain unsecured claims, such as those of landlords and executives, are limited by the Bankruptcy Code.

The trustee or the debtor in possession has the valuable ability to extract value from favourable contracts by assuming and then assigning these contracts regardless of whether the contracts themselves prohibit or condition such assignment.

Special rules and exceptions apply to certain kinds of contracts, including collective bargaining agreements and intellectual property assignments.

COMMENT

Chapter 11 provides the debtor with wide-ranging and valuable powers with which it can disclaim, adopt or assign contracts. This power, especially when combined with the ability to sell assets and borrow money, enables the debtor in possession to address its business and operational issues, including its relationship with unions and its pensions. The UK administration procedure has no equivalent.

UK Administration - Schedule B1 of the Insolvency Act 1986

There is no power to disclaim onerous contracts for an administrator (unlike a liquidator) in the UK, and the making of an administration order does not, of itself, terminate a contract unless the contract provides.

G PROPOSALS TO CREDITORS

Chapter 11 - US Bankruptcy Code

For the first 120 days after the order for relief only the debtor (if there is no trustee) may propose reorganization plans. The debtor also has an exclusive right for 180 days from the petition date in which to solicit acceptances from impaired creditors and shareholders. The court may extend or reduce the exclusivity period for cause, but in no case more than 18 months following the Chapter 11 filing date. After the end of this period the creditors' committee or any individual creditor can propose its own reorganization plan.

Before solicitation of approval for the plan, the debtor or trustee must prepare a disclosure statement and have it approved by the court as containing adequate information⁸ to allow a reasonable hypothetical creditor to be able to consider the plan.

At least 25 days' notice of the hearing to consider the disclosure statement must be given to creditors⁹. If the court approves the statement it will also fix voting procedures and set a confirmation hearing date on at least 25 days' notice to creditors. As a practical matter once a plan is timely filed, exclusivity is likely to be extended. This is more likely if the disclosure statement has been approved and the plan has been sent out for vote.

Chapter 11 requires creditors to be designated into classes and for each class whose rights have been impaired to vote in favour by a majority in number and two-thirds in amount of those actually voting¹⁰. The minority is bound by the class vote, provided that the plan provided to each creditor is at least what it would have received in a liquidation of the debtor. This is the "*best interest*" test.

The classification of creditors is based upon the premise that claims that are substantially similar should be classified together. It is well established that secured creditors holding liens with different priorities on the same collateral are to be separately classified. As a general rule unsecured creditors are classified in one class. There may, however, be reasons why certain unsecured creditors should be treated differently. Some variation in plan treatment, as among creditors having a *pari passu* right against the debtor, is permitted, provided that such difference does not "*unfairly discriminate*" against a class of creditors. Generally, the classification scheme is part of the debtor's plan proposal. There has been litigation regarding classification, primarily involving the deficiency claim of a secured creditor.

Confirmation of a Chapter 11 plan requires that there be cash to pay administrative expenses and most priority claims, and to make the cash payments provided for in the plan.

UK Administration - Schedule B1 of the Insolvency Act 1986

Within 8 weeks of the administrator's appointment (or such longer period as the court or creditors may allow), the administrator must present his proposals for achieving the purposes of the administration to a meeting of creditors.

The meeting may accept, reject or accept with modifications the proposals. Any modifications must be approved by the administrator.

Acceptance of the proposals requires a simple majority in value of those creditors present and voting, although a resolution will not be passed against the wishes of a majority of non-connected creditors. If the proposals are accepted, with or without modifications, the administrator must manage the affairs of the company in accordance with those proposals. If the proposals are rejected, then the court may discharge the administration, or make such other order as it thinks fit. An administration will expire after 12 months unless the creditors consent to an extension (up to a maximum of 6 months) or the court makes an order extending the administration.

8. Bankruptcy Code paragraph 1125(a)(1)

9. BR 2002 (b)

10. Bankruptcy Code paragraph 1126(c)

Only those creditors who are going to have their rights impaired (modified) by the plan can vote. Once the voting has taken place the court will consider whether or not to confirm the plan in the light of the votes. If there is a dissenting class of claims and at least one class of impaired claims that has accepted the plan, the plan proponent may nevertheless request confirmation of the plan if the plan conforms to the “*absolute priority*” rule and is “*fair and equitable*” with respect to the dissenting class and all junior classes of claims and interests. When the court confirms a plan in such a case it is known as a “*cramdown*”.

With respect to a class of unsecured creditors, a plan is fair and equitable only if (i) such class receives full value for its claims or (ii) no junior class receives or retains any value. Hence, absent full satisfaction of a class of dissenting unsecured claims, there can be no value distributed or retained by any junior claim or interest. A no vote by a class of unsecured creditors usually means wiping out equity.

Once the plan is confirmed it binds all creditors and the property vests in the debtor company clear of all prepetition claims (and subject to any of the terms of the plan¹¹). Where a debtor is unable to confirm a plan, the Chapter 11 case may be dismissed or converted to a Chapter 7 case.¹²

COMMENT

In both jurisdictions some level of creditor consent is required to the proposals. The US voting requirements are much more complex, and court approval is required. The scope of the plan however is very broad and can also address settlements of litigation, asset sales, rejection of contracts, etc. Chapter 11 also has provisions which integrate securities and insolvency laws. These provisions permit debtors to issue public securities under a plan, subject to certain exceptions, that are exempt from the registration process upon issuance and subsequent sale. In the US, tax laws are also integrated with Chapter 11. This provides an ability to monetize tax benefits. In some respects this result can be captured in the UK through an administration followed by a scheme of arrangement

11. Bankruptcy Code paragraph 1141

12. Bankruptcy Code paragraph 1121(b)(c)

H COSTS

Chapter 11 - US Bankruptcy Code

The US system requires court involvement and the associated high costs this brings. The creditors' committee may also appoint advisers who may be remunerated from the estate of the debtor. The potential expense often encourages constituents to try to reach a consensus outside of Chapter 11 and commence the case as a pre-negotiated or prepackaged Chapter 11 case.

COMMENT

At a time when the company is suffering severe financial problems, the legal and other costs associated with the attempted rescue using the available legal provisions should not suffocate the company further and prevent survival.

In both cases the costs involved mean that small companies may not be able to attempt a rescue.

UK Administration - Schedule B1 of the Insolvency Act 1986

There are greater costs incurred in using an insolvency practitioner (and his/her "team") (in the UK), rather than the existing management of the company (in the US). The company's creditors and members will also in effect pay for the 'learning curve' of the insolvency practitioner in managing the business.

I EXIT ROUTES

Chapter 11 - US Bankruptcy Code

Plan confirmation discharges the debtor's pre-existing obligations to unsecured and secured creditors other than as provided for in the plan, irrespective of whether they actually accepted it themselves.

In cases where a plan is not confirmed it is usual for the court to order conversion to Chapter 7 bankruptcy proceedings.¹³ However, as there is no insolvency requirement under Chapter 11, failure to confirm a plan will not necessarily lead to liquidation. There is no prohibition against re-filing for Chapter 11 (except if the debtor is an individual, in which case certain restrictions apply). This is true even if a case is dismissed, or even if a case ends with a confirmed plan. The second Chapter 11 case, or 'Chapter 22' as it is sometimes called, is not unusual.

UK Administration - Schedule B1 of the Insolvency Act 1986

Under the Insolvency Act 1986 there are a number of ways in which the administration can cease to have effect:

1. effluxion of time after one year, unless extended;
2. on administrator's application where the purpose of the administration has been achieved, in which case the administrator will seek to exit the administration through a scheme of arrangement or company voluntary arrangement if there are remaining assets for distribution. If not, the administrator will place the company into liquidation or dissolution; or
3. on administrator's application if he considers that the purpose of the administration cannot be achieved in which case the company is placed directly into liquidation.

13. Bankruptcy Code paragraph 1112

J FINANCES

Chapter 11 - US Bankruptcy Code

The Bankruptcy Code gives lenders incentives to provide finance to the debtor (called '*Debtor in Possession*' or '*DIP Financing*'). The lender may be given a lien over assets that are not pledged to other lenders. The court may also authorize liens superior to certain priority claims in the bankruptcy process or even grant new senior liens on collateral already pledged to another party, subject to ensuring that the existing lender has "*adequate protection*" for the value of its pre-bankruptcy liens.

COMMENT

Chapter 11 funding is more advanced and imaginative than in the UK. Without the introduction of equivalent provisions governing priority lending, it is questionable whether the new reforms will lead to more corporate rescues.

UK Administration - Schedule B1 of the Insolvency Act 1986

The company is more likely to continue to look to its existing lenders or other finance providers for continued support. Whilst an administrator has the power to borrow and encumber assets, no special priority is given to post-administration lenders.

K SUMMARY

Chapter 11 - US Bankruptcy Code

No court discretion over order for relief under Chapter 11 - legal right of the debtor.

Ease of access to the procedure.

Technically, although no party has veto powers, the prohibition on using cash collateral without the consent of the lienholder or court approval gives an undersecured creditor with liens on current assets significant leverage in Chapter 11 cases though the negotiation of the “cash collateral” order.

Imposition of broad automatic stay upon the filing of a Chapter 11 petition, lasting until confirmation of a plan, gives the debtor virtual assurance of a stay for at least the period that the debtor has the exclusive right to file a plan, i.e. 120 days.

The debtor remains in possession.

Court approval is required for any action outside the ordinary course of business: sales of assets, assumption or rejection of contracts, borrowing money, etc.

Debtor given exclusive period of 120 days (as it may be extended for cause) to negotiate plan with creditors.

Power to ‘cherry-pick’ contracts and leases.

Plan accepted by class vote and may be confirmed by the court upon request of a plan proponent provided that (i) at least one class of impaired creditors votes yes; (ii) the plan is “fair and equitable” to any dissenting and junior classes; (iii) provides each creditor at least what it would have received in liquidation; (iv) is feasible; and (v) meets the other requirements of a plan and Chapter 11.

An approved plan binds all creditors and equityholders.

UK Administration - Schedule B1 of the Insolvency Act 1986

Can appoint out of court or through court, in which case it is in the court’s discretion to grant an administration order.

Moratorium triggered on filing of application (court route) or filing of appointment documents (out of court route).

Insolvency practitioner (usually an accountant) appointed to manage company.

Loss of control by directors.

Once in administration the company’s business is conducted almost entirely outside court supervision.

Costs.

Proposals accepted when majority of creditors vote in favour.

Administrator manages the company in accordance with the approved proposals.

COMMENT

In the US there is a robust market for securities issued by troubled companies, as well as for bank debt of troubled companies. There are “*distressed investors*” active in the debts and securities of financially troubled companies, including companies in Chapter 11. The level and duration of this market confirms that distressed investors provide liquidity and optionality to banks and par buyers of securities, as well as trade creditors. In fact, they create a more efficient marketplace for distressed securities and debt while providing flexibility to debtors and creditors, alike. Often, distressed investors seek recovery in excess of their investment, usually at a fraction of face or par value. Distressed investors have positively influenced the Chapter 11 process. They often bring flexibility and creativity to the process that improves the composition or extension of debts. They also bring time pressure and market sensitivity to the process, thereby creating proper incentives for all parties. However, every constituent has a different concept of “success”. For some, the trading value of the reorganized securities is a focus. For others, it is the prospect for continuing business or it is the advent of a healthy borrower or employer.

Empirical evidence based on all Chapter 11 cases filed in the US may be misleading because it includes numerous small, closely-held companies which were essentially in liquidation at the time of filing (so-called ‘dead on arrival’ companies). Hence, certain statistics that suggest the overwhelming majority of US cases end in a liquidation, may not reflect the Chapter 11 experience of the financial institutions overall. Their exposure is often concentrated in large companies and the likelihood of a confirmed plan is greater in such cases.

**COMPARISON OF CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE
AND THE RESCUE PROCEDURE IN FRANCE**

A BACKGROUND

Chapter 11 - US Bankruptcy Code

Chapter 11 focuses on preserving reorganization or going concern value over liquidation value. As a corollary, Chapter 11 assumes that the most efficacious way to achieve that result is to retain management and enable multiple outcomes either through a plan of reorganization, a series of going concern sales and even a liquidating plan. Chapter 11 enables a wide range of proposals to be put into a reorganization plan, including having the company and its management survive the process. Chapter 11 cases fall into two general categories: the “freefall” case or a pre-packaged or pre-negotiated case.

In the former, relief is sought under Chapter 11 of the Bankruptcy Code without having an agreed exit strategy among the company and at least a critical mass or core group of creditors. The latter is characterized by commencing a Chapter 11 case following the development of a consensus on the outcome of the case. Under both scenarios, Chapter 11 plans embrace:

1. a “standalone” plan, which essentially connotes that the creditors, secured and unsecured, and, if applicable, the company and its equity-holders, agree on a reorganization without the intervention of a third party or a sale of the business, relying instead on what may be termed a “composition” plan under which at least some unsecured creditors agree to accept less than 100% payment or agree to take a combination of debt and equity issued by the reorganized company in return for their claims; or
2. a plan which effects a sale of all or substantially all of the assets as a going concern and distributes the consideration or proceeds of sale to the creditors;
3. a plan which relies upon a capital infusion from an investor;
4. a liquidating plan which sells all of the assets of the company and provides for a distribution of proceeds to creditors;
5. a plan which, in part, contemplates a litigation trust to pursue and prosecute causes of action belonging to the company
6. a combination of the above.

COMMENT

The objective of both Chapter 11 and the Rescue Procedure is the creation of a breathing space during which the debtor company is given time to formulate plans for reorganization.

The Rescue Procedure, France

The Rescue Procedure is one of the major breakthroughs of the Rescue Act dated 26 July 2005, which came into force on 1 January 2006 and reformed the treatment of businesses in difficulties under French Law. It aims to help distressed companies to overcome their difficulties thanks to a procedure which imposes a court supervision which is lighter than in traditional proceedings such as a Judicial Restructuring (“**redressement judiciaire**”) or a Judicial Liquidation (“**liquidation judiciaire**”) proceedings.

According to the Rescue Act, the purpose of the Rescue Procedure, which can only be triggered when “*there exists a serious likelihood of saving the business*”, is “*to facilitate the reorganization of the business in order to allow the continuation of the economic activity, the maintenance of employment and the continuation of activities*”. Indeed, the Rescue Procedure is meant to favor, at an early stage of difficulties, a more consensual restructuring than in the context of a traditional restructuring procedure, while still providing for a stay of pre-insolvency judgements, actions and payments.

Once started, the Rescue Procedure should lead to the preparation by the management of the debtor of a plan called the Rescue Plan (“**Plan de Sauvegarde**”). After the plan has been proposed to the creditors and voted on the court adopts it.

The Rescue Procedure normally provides for a reduction of the debts of the company and a payment of the uncanceled portion of the liabilities over the duration of the plan, which can be as long as ten years. In addition, various share capital and liability restructuring (such as debt to equity swaps, incoming new investors, etc.) can be built into the plan.

B PROCEDURE

Chapter 11 - US Bankruptcy Code

A typical Chapter 11 case begins when the debtor company voluntarily files a petition with a bankruptcy court, accompanied by:

1. a list of creditors; and
2. a summary of assets and liabilities.

Technically there is no requirement of 'insolvency'. Companies may have a number of reasons, other than insolvency, to file for bankruptcy relief: the company is faced with massive tort liabilities (e.g. Dow Corning when a global settlement with plaintiffs broke down), an adverse outcome in a litigation (e.g. Texaco when faced with a multi-billion dollar damages award), and anticipated liquidity issues (e.g. a number of U.S. energy companies).

But applications must be in 'good faith' and with the intention of reorganization or to effect a liquidation or sale of the company, and creditors may apply to have petitions dismissed where this is not the case. For example, in the SGL Carbon Corporation case (200 F.3d 154), the court dismissed the company's Chapter 11 case because of bad faith demonstrated by a lack of "reorganization purpose".

A large company may also be involuntarily pushed into a Chapter 11 case if three creditors holding unsecured non contingent undisputed claims aggregating more than \$12,300 file an involuntary petition against the company and if the company is "generally not paying [its] debts as such debts become due". The company may contest the petition and if the above standard is not met, may file suit against the filing creditors for costs and /or reasonable attorneys fees or, if filed in bad faith, damages, including punitive damages.

Usually it is the company not the creditors who file for Chapter 11 protection (see Section e: Control of the company). However, secured lenders may effectively force a company to file for relief under Chapter 11 by threatening to enforce liens.

The Rescue Procedure, France

Conditions to meet to be eligible for the Rescue Procedure:

1. Conditions relating to the legal form of the debtor:

Except for banks and insurances companies, virtually all entities carrying out a business activity can be subject to the Rescue Procedure regardless of their legal form.

Therefore:

- (1) private law entities, such as companies or partnerships;
- (2) merchants;
- (3) craftsmen;
- (4) farmers; or
- (5) individuals running an independent professional activity (such as physicians, attorneys, accountants...);

can all request the application of the Rescue Procedure.

However, any debtor already subject to Rescue Procedure, judicial restructuring or liquidation proceedings can not be eligible to a new Rescue Procedure, if the operations and the plan instituted by such proceedings have not been terminated or closed.

2. Conditions relating to the financial condition of the debtor:

The Rescue Procedure is available to debtors facing difficulties that they are unable to overcome on their own or that would lead to a *cessation des paiements*, characterized as a state of affairs when the debtor is not able to pay its matured debts with its available assets. However eligible debtors must not be in *cessation des paiements* when filing a petition for a Rescue Procedure.

Filing of the petition:

The debtor must file a petition before the Commercial Court ("**Tribunal de Commerce**") if it conducts a commercial activity or before the Civil Court ("Tribunal de Grande Instance") in other cases. The procedure can only be initiated by the management of the debtor which is facing difficulties. In other words, the Rescue Procedure is only available by way of voluntary petition filed by the debtor, and cannot be started by creditors.

The court shall issue an order officially opening the procedure after having heard or duly summoned to a first hearing in the Judge's chamber ("**Chambre du Conseil**"), the debtor, the representatives of the work's council (if absent, the employee's delegates) and any person that the court deems useful to hear.

The court will then appoint an administrator ("**administrateur**") whose mission is to supervise the company's management and a judicial agent ("**mandataire judiciaire**") who will act on behalf of the creditors and represent their interests.

The Rescue Procedure begins with a six-month observation period ("**période d'observation**"), during the early part of which an assessment is made by the administrator as to the financial, economic and employment situation of the debtor for the purpose of determining whether or not the debtor can be rescued. Where necessary, the court can extend the observation period up to 18 months in order for the debtor to finalize and implement the Rescue Procedure.

Indeed, the main goal of the observation period is to ascertain whether the debtor is likely to be successfully restructured, and, when that is the case, the debtor, in collaboration with the administrator, must create a Rescue Plan which will be submitted to a creditors' vote for approval.

This Rescue Plan is very flexible and may contain provisions dealing with:

1. the employees and, as the case may be, a reduction in the workforce;
2. amendments to the by-laws of the debtor;
3. the granting of additional advances and facilities by third parties and/or shareholders;
4. debt-equity conversions;
5. write-off of claims;
6. the sale of one or several activities;
7. some modification to the share capital;
8. the rescheduling and reductions of certain debts; or
9. a lock-up of some of the debtor's assets.

C MORATORIUM

Chapter 11 - US Bankruptcy Code

Immediately upon the filing of a bankruptcy petition, a moratorium or “automatic stay” stays all litigation and prevents the enforcement of judgements and of security without leave of the court.¹⁴ This includes staying the continuation of any existing actions that were commenced before the filing.

A party who takes any action in violation of the automatic stay risks contempt of court actions and penalties. Also, any act done in contravention of the stay is retroactively made void or voidable by the court. The stay is effective during the entire time the case is pending but creditors and other parties may make motions to lift or modify the stay.¹⁵

The Bankruptcy Code gives the debtor the exclusive right to formulate a plan of reorganization for 120 days from the date of filing. This “exclusivity period” can be extended if sufficient reasons are established, but no extension can be granted beyond 18 months after the Chapter 11 filing date.¹⁶ In most instances the debtor company will first take actions to stabilize its operations and formulate its business plan and thereafter proceed to formulate a plan of reorganization.

COMMENT

The stay of all pre-petition claims is vital to a successful Rescue Procedure. Indeed, the purpose of the Rescue Procedure is to give the debtor a “breathing space” during the time it is encountering difficulties.

The Rescue Procedure, France

During a Rescue Procedure, all pre-petition creditors are subject to a stay resulting in a prohibition in pursuing any claims or initiating any legal actions against the debtor.

The debtor is prohibited from paying pre-petition receivables and creditors.

However, notwithstanding the stay, receivables which arose (i) after the opening of the procedure and (ii) either as a compensation for services supplied to the debtor for the purposes of its operations or which are necessary for the purposes of the procedure or the observation period, will be paid on maturity. Those are indeed necessary for the debtor to continue its operations during the observation period and safeguard its chance to restructure successfully.

It should be noted that the stay, however, will not prevent the set-off of pre-petition and post-petition liabilities as long as they are deemed to be connected to each other (“**créances connexes**”).

14. Bankruptcy Code paragraph 362(a)

15. Bankruptcy Code paragraph 362(d)

16. Bankruptcy Code paragraph 1121

D LIFTING THE STAY

Chapter 11 - US Bankruptcy Code

Generally, an affected party can apply to court at any time after the filing of a bankruptcy petition for relief. Once such a motion is made the stay will expire after 30 days unless within such time a court continues the stay pending a final hearing or the movant consents to such continuation pending a hearing. The court may terminate the stay, modify it or subject it to conditions.¹⁷ The court may lift the stay for cause, but is generally reluctant to do so during the initial stages of a Chapter 11 case because of the general presumption that a debtor should be given a chance to reorganize and prepare a plan.

Motions to lift or modify the stay are based on the following:

1. a court may lift or modify the stay upon a showing of “cause”, which includes the lack of adequate protection of an interest in property, or
2. with respect to property securing a lien, (i) the stay will be lifted if the debtor company does not have equity in such property and (ii) such property is not necessary to an effective reorganization. There are also special rules for single asset real estate cases and Chapter 11 debtors who are individuals. Also, Further, the automatic stay may not stay in effect when applied to certain protected creditors, such as certain aircraft lessors and lenders and vessel lessors and mortgagees. In this context, a lack of adequate protection focuses on whether the creditor is being injured by continuation of the stay due to, among other things, a deterioration in value of its collateral or consumption of collateral by the company. To counter this potentially negative impact of the stay, a debtor company must provide adequate protection, which may take the form of
3. periodic cash payments to cover any depreciation during the stay;
4. additional or replacement liens or substitute security to the extent of any deterioration in value, and other relief that will amount to ‘indubitable equivalent’, a flexibly interpreted concept.¹⁸

The Rescue Procedure, France

French Law does not provide for any lifting of the stay as all creditors must be treated equally as a matter of public policy.

17. Bankruptcy Code paragraph 362(d)(2)

18. Re Alyulan Interstate Corporation 12 BR 803 at 809

E CONTROL

Chapter 11 - US Bankruptcy Code

In Chapter 11, whether voluntary or involuntary, there is a presumption that control remains with the debtor's management through the concept of "*debtor in possession*" ("**DIP**") (subject to certain safeguards regarding disposal of assets outside the ordinary course of business). To many commentators this smacks of leaving the fox in charge of the hen house. Nevertheless, there are instances where the difficulty is due to exogenous and unexpected events (e.g. Texaco). More importantly, perhaps, is the impression that management provides the most economical and efficient means to reorganize under the oversight of the bankruptcy court, and creditors' committees. Significantly, many companies hire special financial advisors or turnaround management consultants to assist them in their restructuring. Often the creditors, especially the secured creditors, will condition their cooperation on the hiring of such an expert or chief restructuring officer. Such consultants or specialists nevertheless remains responsible to the board of the company, the bankruptcy court and the creditors. Often they will be in place as part of any out of court restructuring. Although there is a Bankruptcy Code provision to appoint a trustee, such an appointment is rare and only happens where there is some suspicion of misfeasance/fraud/wrongdoing/risk to assets, or because it is the interests of creditors.

When there is a debtor in possession, a party in interest may request the appointment of an Examiner to investigate the debtor's affairs. Although it is mandatory to grant such request where the debtor has unsecured, liquidated debts in excess of \$5 million, the bankruptcy court may limit the scope of the Examiner's investigation to guard against a "*fishing expedition*".

As soon as is practicable after the order for relief, the United States Trustee (a government official with a duty to protect all creditors) appoints a creditors' committee, usually made up of the seven largest unsecured creditors willing to serve.¹⁹ The supervisory role and powers of the committee are more extensive than in some jurisdictions, and they can incur the expense of attorneys and other advisors with court approval. Such expenses are funded out of the estate of the debtor.²⁰ The United States Trustee may also appoint other committees as needed (e.g. a Tort Claimants Committee, a Bondholders Committee, etc.). Although the creditors' committee may employ advisers and may be remunerated from the bankruptcy estate, in smaller cases there may be insufficient financial incentive for there to be a committee formed. This negates the potentially important role the committee has in Chapter 11 proceedings.

COMMENT

The principle under which the management of the debtor stays in possession is one of the major features of the Rescue Act. Since the Rescue Procedure can only be initiated by a voluntary petition of the debtor, the management should be encouraged to have recourse to the new Rescue Procedure and restructure the debtor earlier by being generally in control of the entire procedure rather than being displaced.

The Rescue Procedure, France

The management will remain in possession and will therefore continue to act on behalf of the debtor. The court appointed administrator will only have limited authority in most cases (supervision role only) but may, in certain instances, be requested by the court and/or the management to assist the debtor in all or some of the management operations (in such a case, both the signatures of the administrator and the management will be necessary to bind the company).

19. Bankruptcy Code paragraph 1102-1103

20. Bankruptcy Code paragraph 1103(a)

F CONTRACTS

Chapter 11 - US Bankruptcy Code

The debtor or trustee may assume a contract or lease even if it contains a clause that provides for termination in the event of insolvency, provided the debtor cures any default, and if the debtor had been in default, provides adequate assurance of future performance by itself or its assignee. Alternatively, the debtor may reject any such lease or executory contract, giving rise to breach as of the petition day, leaving the non-debtor party to such lease or contract with a prepetition claim for breach. Certain unsecured claims, such as those of landlords and executives, are limited by the Bankruptcy Code.

The trustee or the debtor in possession has the valuable ability to extract value from favourable contracts by assuming and then assigning these contracts regardless of whether the contracts themselves prohibit or condition such assignment.

Special rules and exceptions apply to certain kinds of contracts, including collective bargaining agreements and intellectual property assignments.

COMMENT

The Rescue Procedure offers the debtor in possession a wide-range of valuable powers and prerogatives all aimed at facilitating the early restructuring of the debtor.

The Rescue Procedure, France

The administrator is entitled to decide whether or not the contracts entered into by the debtor before the Rescue Procedure should be assumed or rejected. If the administrator elects to assume contracts, he must ascertain beforehand that the debtor's operations will generate sufficient cash to pay any amounts thereunder as they became due.

If the administrator has not given his opinion on a contract, the contract shall be automatically terminated once a formal notice has been sent to the administrator by the co-contracting party and has remained unanswered for one month.

Special rules and exceptions apply to certain kinds of contracts including work and lease contracts.

G PROPOSALS TO CREDITORS

Chapter 11 - US Bankruptcy Code

For the first 120 days after the order for relief only the debtor (if there is no trustee) may propose reorganization plans. The debtor also has an exclusive right for 180 days from the petition date in which to solicit acceptances from impaired creditors and shareholders. The court may extend or reduce the exclusivity period for cause, but in no case more than 18 months following the Chapter 11 filing date. After the end of this period the creditors' committee or any individual creditor can propose its own reorganization plan.

Before solicitation of approval for the plan, the debtor or trustee must prepare a disclosure statement and have it approved by the court as containing adequate information²¹ to allow a reasonable hypothetical creditor to be able to consider the plan.

At least 25 days notice of the hearing to consider the disclosure statement must be given to creditors²². If the court approves the statement it will also fix voting procedures and set a confirmation hearing date on at least 25 days notice to creditors. As a practical matter once a plan is timely filed, exclusivity is likely to be extended. This is more likely if the disclosure statement has been approved and the plan has been sent out for vote.

Chapter 11 requires creditors to be designated into classes and for each class whose rights have been impaired to vote in favour by a majority in number and two-thirds in amount of those actually voting²³. The minority is bound by the class vote, provided that the plan provided to each creditor at least what it would have received in a liquidation of the debtor. This is the "best interest" test.

The classification of creditors is based upon the premise that claims that are substantially similar should be classified together. It is well established that secured creditors holding liens with different priorities on the same collateral are to be separately classified. As a general rule unsecured creditors are classified in one class. There may, however, be reasons why certain unsecured creditors should be treated differently. Some variation in plan treatment, as among creditors having a *pari passu* right against the debtor, is permitted, provided that such difference does not "*unfairly discriminate*" against a class of creditors. Generally, the classification scheme is part of the debtor's plan proposal. There has been litigation regarding classification, primarily involving the deficiency claim of a secured creditor.

Confirmation of a Chapter 11 plan requires that there be cash to pay administrative expenses and most priority claims, and to make the cash payments provided for in the plan.

The Rescue Procedure, France

Within a 30-day period after the beginning of the procedure, and if the debtor has net sales exceeding EUR 20 million or employs more than 150 employees, the administrator has to set up two creditors' committees to which the Rescue Plan will be submitted for approval.

The first committee is composed of credit institutions that have lent money to the debtor.

The second committee is composed of the main suppliers of the debtor. Only suppliers whose receivables exceed 5% of the aggregate amount of the debtor's liabilities should be members of the committee unless the administrator, who has the option to allow other suppliers below this threshold to join the committee, has decided to do so in order to give the restructuring a broader basis.

The Rescue Plan has to be submitted to both committees within two months of their creation, such period being renewable for two additional months at the request of the debtor or the administrator. Once submitted, the plan must be approved or rejected by the committees within a 30-day period by a majority at least equal to the two thirds of the aggregate amount of the debtor's indebtedness and two thirds of each committees' members.

Should the plan be rejected or the committees fail to vote within the above-mentioned 30-day period, the plan will have to be submitted to the creditors on an individual basis.

21. Bankruptcy Code paragraph 1125(a)(1)

22. BR 2002 (b)

23. Bankruptcy Code paragraph 1126(c)

Only those creditors who are going to have their rights impaired (modified) by the plan can vote. Once the voting has taken place the court will consider whether or not to confirm the plan in the light of the votes. If there is a dissenting class of claims and at least one class of impaired claims that has accepted the plan, the plan proponent may nevertheless request confirmation of the plan if the plan conforms to the “*absolute priority*” rule and is “*fair and equitable*” with respect to the dissenting class and all junior classes of claims and interests. When the court confirms a plan in such a case it is known as a “*cramdown*”.

With respect to a class of unsecured creditors, a plan is fair and equitable only if (i) such class receives full value for its claims or (ii) no junior class receives or retains any value. Hence, absent full satisfaction of a class of dissenting unsecured claims, there can be no value distributed or retained by any junior claim or interest. A no vote by a class of unsecured creditors usually means wiping out equity.

Once the plan is confirmed it binds all creditors and the property re vests in the debtor company clear of all prepetition claims (and subject to any of the terms of the plan²⁴). Where a debtor is unable to confirm a plan, the Chapter 11 case may be dismissed or converted to a chapter 7 case.²⁵

COMMENT

In these jurisdictions, some level of creditor consent is required for the proposals.

24. Bankruptcy Code paragraph 1141

25. Bankruptcy Code paragraph 1112(b)(c)

H COSTS

Chapter 11 - US Bankruptcy Code

The US system requires court involvement and the associated high costs this brings. The creditors' committee may also appoint advisers that may be remunerated from the estate of the bankruptcy. The expense potential often suggests that constituents try to reach a consensus outside of Chapter 11 and commence the case as a pre-negotiated or prepackaged Chapter 11 case.

The Rescue Procedure, France

The French Rescue Procedure requires a light court involvement and the associated costs should therefore be limited.

A Decree of December 23 2006 provides that the administrator's fees cannot exceed EUR 100,000 and the judicial agent's fees cannot exceed EUR 75,000.

I EXIT ROUTES

Chapter 11 - US Bankruptcy Code

Plan confirmation discharges the debtor's pre-existing obligations to unsecured and secured claimants other than as provided for in the plan, irrespective of whether they actually accepted it themselves.

In cases where a plan is not confirmed it is usual for the court to order conversion to Chapter 7 bankruptcy proceedings.²⁶ However, as there is no insolvency requirement under Chapter 11, failure to confirm a plan will not necessarily lead to liquidation. There is no prohibition against re-filing for Chapter 11 (except if the debtor is an individual, in which case certain restrictions apply). This is true even if a case is dismissed, or even if a case ends with a confirmed plan. The second Chapter 11 case, or 'chapter 22' as it is sometimes called, is not unusual.

The Rescue Procedure, France

If the Rescue Procedure fails, the court may either:

1. order the disposal of part of the business;
2. open a Restructuring Procedure of the debtor; or
3. if the debtor is not viable, a Liquidation Procedure.

If, during the implementation of the Rescue Procedure, the debtor fails to meet its obligations as provided for under the Rescue Procedure or becomes unable to pay its debts as they fall due ("**cessation des paiements**"), the court may ex officio, or at the request of the creditors, or on application of the public prosecutor or the officer in charge of supervising the performance of the plan, terminate the plan and open a judicial restructuring or liquidation procedure if the conditions of such a procedure are fulfilled.

The maximum duration of the plan is limited to 10 years.

J FINANCES

Chapter 11 - US Bankruptcy Code

The Bankruptcy Code gives lenders incentives to provide finance to the debtor (called Debtor in Possession or DIP Financing). The lender may be given a lien over assets that are not pledged to other lenders. The court may also authorize liens superior to certain priority claims in the bankruptcy process or even grant new senior liens on collateral already pledged to another party, subject to ensuring that the existing lender has “adequate protection” for the value of its pre-bankruptcy liens.

The Rescue Procedure, France

French Law grants a special privilege to the creditors whose receivables arose (i) after the opening of the procedure and (ii) either as a compensation for services supplied to the debtor for the purposes of its operations or which are necessary for the purposes of the procedure or the observation period. If such creditors are not paid, they are granted a priority ranking for payment which ranks them after the payment of the employees, the legal costs and expenses and the conciliation privilege (“**privilège de conciliation**”) benefiting to creditors who have brought new money to the company during the conciliation proceedings, another early stage restructuring process.

K SUMMARY

Chapter 11 - US Bankruptcy Code

1. No court discretion over order for relief under Chapter 11 - legal right of the debtor.
2. Ease of access to the procedure.
3. Technically, although no party has veto powers, the prohibition on using cash collateral without the consent of the lienholder or court approval gives an undersecured creditor with liens on current assets significant leverage in Chapter 11 cases though the negotiation of the “cash collateral” order.
4. Imposition of broad automatic stay upon the filing of a Chapter 11 petition, lasting until confirmation of a plan, gives the debtor virtual assurance of a stay for at least the period that the debtor has the exclusive right to file a plan, i.e. 120 days.
5. The debtor remains in possession.
6. Court approval is required for any action outside the ordinary course of business: sales of assets, assumption or rejection of contracts, borrowing money, etc.
7. Debtor given exclusive period of 120 days (as it may be extended for cause) to negotiate plan with creditors.
8. Power to ‘cherry-pick’ contracts and leases.
9. Plan accepted by class vote and may be confirmed by the court upon request of a plan proponent provided that (i) at least one class of impaired creditors votes yes; (ii) the plan is “*fair and equitable*” to any dissenting and junior classes; (iii) provides each creditor at least what it would have received in liquidation; (iv) is feasible; and (v) meets the other requirements of a plan and Chapter 11.
10. An approved plan binds all creditors and equityholders.

The Rescue Procedure, France

1. A debtor is eligible for a Rescue Procedure only if it is not insolvent (“**cessation des paiements**”) but is facing difficulties likely to result in such *cessation des paiements*.
2. The procedure can only be initiated by the debtor.
3. The management remains in possession.
4. An automatic stay applies except for creditors whose receivables arose (i) after the opening of the procedure and (ii) either as a compensation for services supplied to the debtor for the purposes of its operations or which are necessary for the purposes of the procedure or the observation period.
5. The Rescue Plan is subject to the main creditors’ approval.
6. The Rescue Plan can last as long as 10 years.

COMMENT

The court’s decision to open the Rescue Procedure is made public through several official publications. The judgement is recorded in the public trade registry in the jurisdiction of which the debtor has its registered office and in the BODACC (a legal announcements publication). Prior to the opening of a Rescue Procedure the debtor must bear in mind that the procedure is not confidential, which may significantly alter its creditworthiness.

**COMPARISON OF CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE
AND INSOLVENCY PROCEEDINGS IN GERMANY**

A BACKGROUND

Chapter 11 - US Bankruptcy Code

Chapter 11 focuses on preserving reorganization or going concern value over liquidation value. As a corollary, Chapter 11 assumes that the most efficacious way to achieve that result is to retain management and enable multiple outcomes either through a plan of reorganization, a series of going concern sales and even a liquidating plan. Chapter 11 enables a wide range of proposals to be put into a reorganization plan, including having the company and its management survive the process. Chapter 11 cases fall into two general categories: the “freefall” case or a pre-packaged or pre-negotiated case.

In the former, relief is sought under Chapter 11 of the Bankruptcy Code without having an agreed exit strategy among the company and at least a critical mass or core group of creditors. The latter is characterized by commencing a Chapter 11 case following the development of a consensus on the outcome of the case. Under both scenarios, Chapter 11 plans embrace:

1. a “standalone” plan, which essentially connotes that the creditors, secured and unsecured, and, if applicable, the company and its equity-holders, agree on a reorganization without the intervention of a third party or a sale of the business, relying instead on what may be termed a “composition” plan under which at least some unsecured creditors agree to accept less than 100% payment or agree to take a combination of debt and equity issued by the reorganized company in return for their claims; or
 2. a plan which effects a sale of all or substantially all of the assets as a going concern and distributes the consideration or proceeds of sale to the creditors;
 3. a plan which relies upon a capital infusion from an investor;
 4. a liquidating plan which sells all of the assets of the company and provides for a distribution of proceeds to creditors;
 5. a plan which, in part, contemplates a litigation trust to pursue and prosecute causes of action belonging to the company
- a combination of the above.

COMMENT

A purchase of the debtor's business as a going concern in insolvency proceedings can provide a number of advantages to an investor when compared to an ordinary acquisition outside of insolvency. In general, the debts of the business are left behind with the insolvent entity. Since the insolvency administrator has extensive powers to reject contracts unfulfilled as of the opening date, contracts that the investor wants to assume for business reasons are frequently re-negotiated and more favourable terms agreed on. Most importantly, while employees are, in principle, assumed by the purchaser by operation of law, insolvency provides the opportunity to restructure the workforce and to negotiate terms with trade unions that would not be possible in an acquisition outside of insolvency.

The plan of restructuring, which may be used to restructure the insolvent company itself is a fairly new instrument, which was only established by the Insolvency Code. The structure of proceedings for plans of restructuring has been influenced significantly by Chapter 11. In practice, plans of restructuring have been used in relatively small number of cases so far. Among those, however, were large proceedings that attracted the attention of the media (Herlitz, Ihr Platz), and which may serve as models in the future.

Insolvency Proceedings, Germany

Insolvency proceedings (*Insolvenzverfahren*) pursuant to the German Insolvency Code are the only judicial proceedings available in Germany for the bankruptcy of companies. The Insolvency Code came into force on 1 January 1999 and replaced the three separate legislative regimes previously in force, the Bankruptcy Act (*Konkursordnung*) and the Composition Act (*Vergleichsordnung*) for debtors situated in former West Germany and the Joint Execution Act (*Gesamtvollstreckungsordnung*) for debtors located in former East Germany.

The aim of insolvency proceedings is not to protect the corporate debtor from its creditors, but to maximize the insolvency dividend payable to the creditors. To achieve this aim, proceedings may be directed either at a liquidation of the company's business or at a reorganization of the company itself by means of a plan of restructuring (*Insolvenzplan*). In the event of a liquidation, the company's business operations may be sold as a going concern to an investor or the business may be wound up and the individual assets sold. The proceeds of such sales are then turned out to the creditors in accordance with the regulations laid down in the Insolvency Code. The law assumes that the creditors themselves are in the best position to decide on how the insolvent's assets may be utilized most efficiently to satisfy their claims to the largest extent possible. It is therefore the creditors themselves who can determine as a group the direction of the insolvency proceedings.

Usually, insolvent larger businesses are sold as a going concern by means of an asset deal to an investor (*übertragende Sanierung*). A better purchase price is usually obtained for the creditors if the business as a whole is sold to an investor. Value is destroyed if the individual assets of the business are sold since usually only liquidation values can be obtained. The creditors will normally only choose to wind up the business if it cannot be sold as a going concern to an investor or restructured by means of a plan of restructuring.

Alternatively the creditors may agree on a plan of restructuring for the company. Such plan may provide for measures to cure the insolvency of the company and to allow the company to continue its business. A plan of restructuring can also provide for a liquidation, although this can usually be achieved more easily without a plan.

B PROCEDURE

Chapter 11 - US Bankruptcy Code

A typical Chapter 11 case begins when the debtor company voluntarily files a petition with a bankruptcy court, accompanied by:

1. a list of creditors; and
2. a summary of assets and liabilities.

Technically there is no requirement of 'insolvency'. Companies may have a number of reasons, other than insolvency, to file for bankruptcy relief: the company is faced with massive tort liabilities (e.g. Dow Corning when a global settlement with plaintiffs broke down), an adverse outcome in a litigation (e.g. Texaco when faced with a multi-billion dollar damages award), and anticipated liquidity issues (e.g. a number of U.S. energy companies).

But applications must be in 'good faith' and with the intention of reorganization or to effect a liquidation or sale of the company, and creditors may apply to have petitions dismissed where this is not the case. For example, in the SGL Carbon Corporation case (200 F.3d 154), the court dismissed the company's Chapter 11 case because of bad faith demonstrated by a lack of "reorganization purpose".

A large company may also be involuntarily pushed into a Chapter 11 case if three creditors holding unsecured non-contingent undisputed claims aggregating more than \$12,300 file an involuntary petition against the company and if the company is "generally not paying [its] debts as such debts become due". The company may contest the petition and if the above standard is not met, may file suit against the filing creditors for costs and/or reasonable attorneys fees or, if filed in bad faith, damages, including punitive damages.

Usually it is the company not the creditors who file for Chapter 11 protection (see Section e: Control of the company). However, secured lenders may effectively force a company to file for relief under Chapter 11 by threatening to enforce liens.

COMMENT

The opening of insolvency proceedings pursuant to the German Insolvency Code requires that a ground for the opening of proceedings exists. Such reasons are illiquidity, overindebtedness and imminent illiquidity. While in case of illiquidity and overindebtedness both the company's management as well as the creditors can file an insolvency application (and management frequently has an obligation to do so), only the company's management itself has a right (not an obligation) to file an application based on imminent illiquidity.

Insolvency Proceedings, Germany

Insolvency proceedings commence upon an application of the insolvent company or a creditor to the insolvency court (*Insolvenzgericht*). Insolvency proceedings may only commence if one of the following grounds for the opening of proceedings (*Eröffnungsgrund*) has occurred:

1. The insolvent company is unable to meet its payment obligations that have become due and payable (illiquidity, *Zahlungsunfähigkeit*). This is usually the case if the insolvent company has suspended payments on more than a temporary basis.
2. The insolvent company will be unable to meet existing payment obligations as and when they fall due (*imminent illiquidity, drohende Zahlungsunfähigkeit*).
3. Finally, insolvency proceedings can be commenced with respect to companies (including partnerships) if they are "overindebted". The insolvent company is overindebted if its liabilities exceed the value of its assets. This is not a ground for opening insolvency proceedings with respect to certain partnerships.

If the company is illiquid or overindebted, the company's management is obligated to file an insolvency application within a maximum period of three weeks. A violation of such duty may have severe consequences, including criminal prosecution.

In case of imminent illiquidity only the company's management, not a creditor, may file for the opening of proceedings. This contributes to an early opening of the insolvency procedure and increases the chances of a reorganization of the insolvent company.

For the period of time from the filing of the insolvency application to the court's opening decision, by which insolvency proceedings are formally commenced, so-called opening proceedings (*Eröffnungsverfahren*), the insolvency court may implement all measures that are necessary to secure the insolvent company's estate. The court usually appoints an interim insolvency administrator (*vorläufiger Insolvenzverwalter*) who will assist the insolvency court in establishing whether proceedings can be opened. In addition, the insolvency court can order that the management of the insolvent company must not, or may only with the consent of the interim administrator, dispose of any assets.

Even if one of the above grounds for the opening of proceedings is established, the insolvency court has to reject the insolvency application if the value of the insolvent company's assets is not sufficient to cover the expected costs of the proceedings. It will not reject the application if a creditor provides sufficient funds to cover the costs.

If the conditions for the opening of insolvency proceedings have been met, the insolvency court will pass an opening decision (*Eröffnungsbeschluss*) and thus formally commence insolvency proceedings.

In its opening decision the insolvency court appoints an insolvency administrator (*Insolvenzverwalter*) to take charge of the insolvent company's estate. Usually the interim administrator is appointed as insolvency administrator.

C MORATORIUM

Chapter 11 - US Bankruptcy Code

Immediately upon the filing of a bankruptcy petition, a moratorium or “*automatic stay*” stays all litigation and prevents the enforcement of judgements and of security without leave of the court.²⁷ This includes staying the continuation of any existing actions that were commenced before the filing.

A party who takes any action in violation of the automatic stay risks contempt of court actions and penalties. Also, any act done in contravention of the stay is retroactively made void or voidable by the court. The stay is effective during the entire time the case is pending but creditors and other parties may make motions to lift or modify the stay.²⁸

The Bankruptcy Code gives the debtor the exclusive right to formulate a plan of reorganization for 120 days from the date of filing. This “*exclusivity period*” can be extended if sufficient reasons are established, but no extension can be granted beyond 18 months after the Chapter 11 filing date.²⁹ In most instances the debtor company will first take actions to stabilize its operations and formulate its business plan and thereafter proceed to formulate a plan of reorganization.

COMMENT

The stay of debt enforcement pursuant to the German Insolvency Code does not aim at giving the insolvent company “*breathing space*”, but its purpose is to ensure a just distribution of the insolvent's estate and to avoid the premature sale of assets that are necessary for the continuation of business operations, so that the insolvent company's assets may be utilized in the best possible manner.

Insolvency Proceedings, Germany

To secure the insolvent company's assets during the opening proceedings the insolvency court usually implements a temporary stay of debt enforcement with respect to the insolvent company's movables. The temporary stay also covers the enforcement of security interests. As regards the insolvent's immovable assets, a temporary stay may not be ordered by the insolvency court, but only by the court in charge of the enforcement proceedings (*Vollstreckungsgericht*). It requires an application of the interim insolvency administrator.

Upon the opening of insolvency proceedings, there is an automatic stay of debt enforcement for the ordinary creditors (*Insolvenzgläubiger*). All pending legal disputes will be suspended. The insolvency administrator can continue all suits where the insolvent company is the plaintiff and certain suits where the insolvent company is the defendant. With respect to security interests over movables, the right to realization usually rests with the insolvency administrator, who will pay out the realization proceeds to the secured creditors (*absonderungsberechtigte Gläubiger*) after deduction of costs and a contribution to the estate. With regard to security interests over the insolvent company's immovable assets, the insolvency administrator may again apply for a temporary stay at the court in charge of the enforcement proceedings.

27. Bankruptcy Code paragraph 362(a)

28. Bankruptcy Code paragraph 362(d)

29. Bankruptcy Code paragraph 1121

D LIFTING THE STAY

Chapter 11 - US Bankruptcy Code

Generally, an affected party can apply to court at any time after the filing of a bankruptcy petition for relief. Once such a motion is made the stay will expire after 30 days unless within such time a court continues the stay pending a final hearing or the movant consents to such continuation pending a hearing. The court may terminate the stay, modify it or subject it to conditions.³⁰ The court may lift the stay for cause, but is generally reluctant to do so during the initial stages of a Chapter 11 case because of the general presumption that a debtor should be given a chance to reorganize and prepare a plan.

Motions to lift or modify the stay are based on the following:

1. a court may lift or modify the stay upon a showing of "cause", which includes the lack of adequate protection of an interest in property, or
2. with respect to property securing a lien, (i) the stay will be lifted if the debtor company does not have equity in such property and (ii) such property is not necessary to an effective reorganization. There are also special rules for single asset real estate cases and Chapter 11 debtors who are individuals. Also, Further, the automatic stay may not stay in effect when applied to certain protected creditors, such as certain aircraft lessors and lenders and vessel lessors and mortgagees. In this context, a lack of adequate protection focuses on whether the creditor is being injured by continuation of the stay due to, among other things, a deterioration in value of its collateral or consumption of collateral by the company. To counter this potentially negative impact of the stay, a debtor company must provide adequate protection, which may take the form of
3. periodic cash payments to cover any depreciation during the stay;
4. additional or replacement liens or substitute security to the extent of any deterioration in value, and other relief that will amount to 'indubitable equivalent', a flexibly interpreted concept.³¹

COMMENT

The creditors in insolvency proceedings usually do not have a right to have the general stay of debt enforcement lifted, as this would not be in line with the purpose of proceedings, which is to ensure a just distribution of the insolvency estate and to avoid the premature sale of assets that are necessary for the continuation of business operations.

Insolvency Proceedings, Germany

The creditors cannot have the general stay of debt enforcement lifted, except for a temporary stay with regard to the insolvent company's immovable assets. As regards the latter, a creditor may apply for the stay to be lifted if it is no longer necessary, for example, if the stay is no longer required to allow the insolvent company's assets to be utilized in the best possible manner.

Secured creditors may demand payment of interest if the realization of their security interests is delayed due to the stay. If the respective assets are used for the insolvency estate the insolvency administrator also has to compensate the secured creditors for a loss in value. Similar rights of the creditors exist in the case of a temporary stay of debt enforcement with regard to immovable assets.

30. Bankruptcy Code paragraph 362(d)(2)

31. Re Alyulan Interstate Corporation 12 BR 803 at 809

E CONTROL

Chapter 11 - US Bankruptcy Code

In Chapter 11, whether voluntary or involuntary, there is a presumption that control remains with the debtor's management through the concept of "*debtor in possession*" ("**DIP**") (subject to certain safeguards regarding disposal of assets outside the ordinary course of business). To many commentators this smacks of leaving the fox in charge of the hen house. Nevertheless, there are instances where the difficulty is due to exogenous and unexpected events (e.g. Texaco). More importantly, perhaps, is the impression that management provides the most economical and efficient means to reorganize under the oversight of the bankruptcy court, and creditors' committees. Significantly, many companies hire special financial advisors or turnaround management consultants to assist them in their restructuring. Often the creditors, especially the secured creditors, will condition their cooperation on the hiring of such an expert or chief restructuring officer. Such consultants or specialists nevertheless remains responsible to the board of the company, the bankruptcy court and the creditors. Often they will be in place as part of any out of court restructuring. Although there is a Bankruptcy Code provision to appoint a trustee, such an appointment is rare and only happens where there is some suspicion of misfeasance/fraud/wrongdoing/ risk to assets, or because it is the interests of creditors.

When there is a debtor in possession, a party in interest may request the appointment of an Examiner to investigate the debtor's affairs. Although it is mandatory to grant such request where the debtor has unsecured, liquidated debts in excess of \$5 million, the bankruptcy court may limit the scope of the Examiner's investigation to guard against a "*fishing expedition*".

As soon as is practicable after the order for relief, the United States Trustee (a government official with a duty to protect all creditors) appoints a creditors' committee, usually made up of the seven largest unsecured creditors willing to serve.³² The supervisory role and powers of the committee are more extensive than in some jurisdictions, and they can incur the expense of attorneys and other advisors with court approval. Such expenses are funded out of the estate of the debtor.³³ The United States Trustee may also appoint other committees as needed (e.g. a Tort Claimants Committee, a Bondholders Committee, etc.). Although the creditors' committee may employ advisers and may be remunerated from the bankruptcy estate, in smaller cases there may be insufficient financial incentive for there to be a committee formed. This negates the potentially important role the committee has in Chapter 11 proceedings.

COMMENT

Despite the insolvency courts' reluctance to allow self-administration it can be expected that the number of cases where the debtor is left in possession will increase. The approach has proved valuable in large and complex insolvencies involving groups of companies, since the specific restructuring expertise of a reorganization specialist appointed to the board just prior to insolvency is combined with the knowledge and experience of existing management.

Insolvency Proceedings, Germany

As mentioned, for the period of time from the filing of the insolvency application to the opening decision, the insolvency court usually appoints an interim insolvency administrator. The company's management will require the consent of the interim insolvency administrator to transfer any assets. Even though the management is not removed from office, it is, in practice, the interim insolvency administrator who is in charge of the company's business.

In its opening decision the insolvency court then normally appoints an insolvency administrator. This is usually the same person who was appointed as interim administrator. The administrator is in charge of the business and responsible for its management going forward, thus taking control away from the company's managers. The insolvency administrator is a natural person, appropriately qualified and independent of the creditors and the insolvent company. He is the central person in administering the insolvent company in insolvency proceedings.

While an administrator is appointed in the vast majority of cases, the Insolvency Code allows for the company's management to apply for self-administration (*Eigenverwaltung*), meaning that the debtor is left in possession and is merely supervised by a creditors' trustee (*Sachwalter*). The court may only leave the debtor in possession if it is convinced that this will not disadvantage creditors. In practice, the courts have been very reluctant to pass an order of self-administration. The view is widely held that management which was not able to avert insolvency in the first place can hardly be deemed capable of coping with the crisis, once proceedings have commenced. However, there has been self-administration in some of the spectacular insolvency cases of the recent past involving groups of companies with international activities. The most prominent example is Kirch Media.

32. Bankruptcy Code paragraph 1102-113

33. Bankruptcy Code paragraph 1103(a)

F CONTRACTS

Chapter 11 - US Bankruptcy Code

The debtor or trustee may assume a contract or lease even if it contains a clause that provides for termination in the event of insolvency, provided the debtor cures any default, and if the debtor had been in default, provides adequate assurance of future performance by itself or its assignee. Alternatively, the debtor may reject any such lease or executory contract, giving rise to breach as of the petition day, leaving the non-debtor party to such lease or contract with a prepetition claim for breach. Certain unsecured claims, such as those of landlords and executives, are limited by the BC.

The trustee or the debtor in possession has the valuable ability to extract value from favourable contracts by assuming and then assigning these contracts regardless of whether the contracts themselves prohibit or condition such assignment.

Special rules and exceptions apply to certain kinds of contracts, including collective bargaining agreements and intellectual property assignments.

COMMENT

The insolvency administrator's right to reject contracts that were not fulfilled as of the date of the opening decision often allows him to renegotiate contracts and agree on more favourable terms, which in turn can make the debtor's business more attractive for an investor or contribute to a reorganization of the insolvent company itself by means of a plan of restructuring.

Insolvency Proceedings, Germany

The insolvency administrator can choose to assume or reject a reciprocal agreement that has not, or not completely, been fulfilled by either party. If he does so, he can demand performance from the other party. If he chooses to reject an agreement, the other party may claim damages as an ordinary creditor. The administrator's right to reject an agreement does not extend to the insolvent company's rental and lease agreements with respect to immovable property or premises. These will continue to be in effect. This applies also to such rental or lease agreements which the insolvent company entered into as lessor with respect to objects that have been transferred for security purposes to third parties who financed the acquisition or production thereof. As compensation for having to perform for an insolvent company, the reciprocal claim of the insolvent's counter-party will be privileged. After the filing of the insolvency application, a lessor may not terminate rental and lease agreements with the insolvent company by reason of a payment default from the time before the filing of the insolvency application.

G PROPOSALS TO CREDITORS

Chapter 11 - US Bankruptcy Code

For the first 120 days after the order for relief only the debtor (if there is no trustee) may propose reorganization plans. The debtor also has an exclusive right for 180 days from the petition date in which to solicit acceptances from impaired creditors and shareholders. The court may extend or reduce the exclusivity period for cause, but in no case more than 18 months following the Chapter 11 filing date. After the end of this period the creditors' committee or any individual creditor can propose its own reorganization plan.

Before solicitation of approval for the plan, the debtor or trustee must prepare a disclosure statement and have it approved by the court as containing adequate information³⁴ to allow a reasonable hypothetical creditor to be able to consider the plan.

At least 25 days notice of the hearing to consider the disclosure statement must be given to creditors³⁵. If the court approves the statement it will also fix voting procedures and set a confirmation hearing date on at least 25 days notice to creditors. As a practical matter once a plan is timely filed, exclusivity is likely to be extended. This is more likely if the disclosure statement has been approved and the plan has been sent out for vote.

Chapter 11 requires creditors to be designated into classes and for each class whose rights have been impaired to vote in favour by a majority in number and two-thirds in amount of those actually voting³⁶. The minority is bound by the class vote, provided that the plan provided to each creditor at least what it would have received in a liquidation of the debtor. This is the "best interest" test.

The classification of creditors is based upon the premise that claims that are substantially similar should be classified together. It is well established that secured creditors holding liens with different priorities on the same collateral are to be separately classified. As a general rule unsecured creditors are classified in one class. There may, however, be reasons why certain unsecured creditors should be treated differently. Some variation in plan treatment, as among creditors having a *pari passu* right against the debtor, is permitted, provided that such difference does not "unfairly discriminate" against a class of creditors. Generally, the classification scheme is part of the debtor's plan proposal. There has been litigation regarding classification, primarily involving the deficiency claim of a secured creditor.

Confirmation of a Chapter 11 plan requires that there be cash to pay administrative expenses and most priority claims, and to make the cash payments provided for in the plan.

Insolvency Proceedings, Germany

The creditors determine at the information hearing (*Berichtstermin*) the course that insolvency proceedings should take. The information hearing is usually convened by the insolvency court within six weeks, and at the latest within three months, of the opening of insolvency proceedings. As mentioned above, the creditors will have to decide between a sale of the insolvent company's business as a going concern or a winding-up, unless a plan of restructuring is proposed. Creditors will frequently follow the administrator's recommendation. In order for the creditors to make a decision, a resolution requiring a majority (calculated on the basis of sums of claims) of the creditors voting at the hearing must be passed.

Only the insolvency administrator or the company's management may propose a plan of restructuring. However, the creditors may instruct the insolvency administrator during the information hearing to draw up a plan of restructuring. Management can submit a proposal as a pre-packaged plan upon filing for insolvency. There are few rules about the contents of a plan of restructuring, as it can be freely arranged and include all provisions that could be made in an individual contract; these can include, *inter alia*, waivers and deferrals of claims as well as limitations of security rights.

A plan of restructuring usually provides for a reorganization of the insolvent company. The creditors are divided into groups according to their legal position. The Insolvency Code provides that at least the following groups are established: secured creditors, if their rights are affected; ordinary creditors; and the different ranking groups of subordinated creditors (*nachrangige Insolvenzgläubiger*), if their claims are not deemed to be waived. In addition, the plan of restructuring can provide for a further division of the groups of creditors of the same legal position according to their economic interests. As voting on the adoption of the plan of restructuring is done within these groups, the determination of the creditors' groups will influence whether the plan of restructuring is adopted.

In the event that a plan of restructuring is proposed, the insolvency court will call a creditors' assembly for a hearing during which the plan of restructuring and the voting rights of the creditors (including the division into groups) will be discussed. The voting on the plan of restructuring will follow this discussion (either in the same hearing or a separate later hearing). The creditors vote in their respective groups on the plan of restructuring. The plan will only be accepted if all groups agree. In each group the majority of creditors must consent (by headcount) and the sum of their claims must constitute more than half of the sum of the claims of creditors voting in this group. The plan will be adopted without the consent of a group of creditors if the majority of groups have agreed and the insolvency court establishes that the creditors of the non-consenting group are not disadvantaged by the plan, as compared to their position without the plan, and that they have a reasonable share in the economic outcome of the plan.

34. Bankruptcy Code paragraph 1125(a)(1)

35. BR 2002 (b)

36. Bankruptcy Code paragraph 1126(c)

Only those creditors who are going to have their rights impaired (modified) by the plan can vote. Once the voting has taken place the court will consider whether or not to confirm the plan in the light of the votes. If there is a dissenting class of claims and at least one class of impaired claims that has accepted the plan, the plan proponent may nevertheless request confirmation of the plan if the plan conforms to the “*absolute priority*” rule and is “*fair and equitable*” with respect to the dissenting class and all junior classes of claims and interests. When the court confirms a plan in such a case it is known as a “*cramdown*”.

With respect to a class of unsecured creditors, a plan is fair and equitable only if (i) such class receives full value for its claims or (ii) no junior class receives or retains any value. Hence, absent full satisfaction of a class of dissenting unsecured claims, there can be no value distributed or retained by any junior claim or interest. A no vote by a class of unsecured creditors usually means wiping out equity.

Once the plan is confirmed it binds all creditors and the property re vests in the debtor company clear of all prepetition claims (and subject to any of the terms of the plan³⁷). Where a debtor is unable to confirm a plan, the Chapter 11 case may be dismissed or converted to a chapter 7 case.³⁸

COMMENT

In insolvency proceedings the creditors determine the course that insolvency proceedings should take, although they will often follow the recommendation of the insolvency administrator. A plan of restructuring may be presented only by the insolvency administrator or the company's management, however the creditors may instruct the insolvency administrator to draw up a plan of restructuring. The company's management can submit a proposal as a pre-packaged plan upon filing for insolvency.

If the creditors consent to the plan, it will be confirmed by the insolvency court and then become effective. The insolvency court will terminate insolvency proceedings and the different groups of creditors will be paid as provided for in the plan. The plan can also provide for post-approval supervision of the company by the insolvency administrator if it is intended that management not regain total control of its affairs immediately.

37. Bankruptcy Code paragraph 1141

38. Bankruptcy Code paragraph 1112(b)(c)

H COSTS

Chapter 11 - US Bankruptcy Code

The US system requires court involvement and the associated high costs this brings. The creditors' committee may also appoint advisers that may be remunerated from the estate of the bankruptcy. The expense potential often suggests that constituents try to reach a consensus outside of Chapter 11 and commence the case as a pre-negotiated or prepackaged Chapter 11 case.

Insolvency Proceedings, Germany

The costs of insolvency proceedings include the court's fees as well as the remuneration and expenses of the interim insolvency administrator, the insolvency administrator and the members of the creditors' committee. The costs of insolvency proceedings are difficult to estimate in advance, as the insolvency court has a certain scope of discretion with regard to the insolvency administrator's fees. Generally speaking, the insolvency administrator is paid a certain fraction of the insolvent company's assets, but this fraction may then be increased or decreased by the court, depending on the complexity of the specific case. The costs of insolvency proceedings are paid out of the insolvent company's assets with priority over the claims of ordinary creditors.

COMMENT

The costs involved with insolvency proceedings may make an out of court restructuring seem more favourable in some cases. However, since the management is frequently obligated to file an insolvency application within a period of three weeks once the company has become insolvent, an out of court restructuring will often require that an existing illiquidity or overindebtedness is cured first, for example by way of a subordination of claims or a bridge financing.

Chapter 11 - US Bankruptcy Code

Plan confirmation discharges the debtor's pre-existing obligations to unsecured and secured claimants other than as provided for in the plan, irrespective of whether they actually accepted it themselves.

In cases where a plan is not confirmed it is usual for the court to order conversion to Chapter 7 bankruptcy proceedings.³⁹ However, as there is no insolvency requirement under Chapter 11, failure to confirm a plan will not necessarily lead to liquidation. There is no prohibition against re-filing for Chapter 11 (except if the debtor is an individual, in which case certain restrictions apply). This is true even if a case is dismissed, or even if a case ends with a confirmed plan. The second Chapter 11 case, or 'chapter 22' as it is sometimes called, is not unusual.

Insolvency Proceedings, Germany

Insolvency proceedings are terminated by the insolvency court once the insolvency administrator has realized the assets of the insolvent estate and a final distribution of the proceeds to the creditors has been made, unless a plan of restructuring has been proposed.

In the case of a plan of restructuring, the insolvency court will terminate insolvency proceedings once the plan has been confirmed. The different groups of creditors will be paid as provided for in the plan. The execution and performance of the plan of restructuring is not part of the insolvency proceedings.

Insolvency proceedings usually last between two to three years. There is no fixed time limit, though, so proceedings may take longer or - in particular, in case of a pre-packaged plan of restructuring - may complete in a shorter time.

39. Bankruptcy Code paragraph 1112

J FINANCES

Chapter 11 - US Bankruptcy Code

The Bankruptcy Code gives lenders incentives to provide finance to the debtor (called Debtor in Possession or DIP Financing). The lender may be given a lien over assets that are not pledged to other lenders. The court may also authorize liens superior to certain priority claims in the bankruptcy process or even grant new senior liens on collateral already pledged to another party, subject to ensuring that the existing lender has “adequate protection” for the value of its pre-bankruptcy liens.

COMMENT

To be able to continue the insolvent company's business it is often the interim insolvency administrator who has to try to obtain new financing immediately. In this regard, the person of the administrator, his reputation and his contacts with the banks are crucial.

Insolvency Proceedings, Germany

If the insolvency administrator borrows money to continue the company's business operations, the respective creditor will be a preferred creditor (*Massegläubiger*), whose claim will be satisfied before the claims of the ordinary insolvency creditors. The same can usually be achieved for a credit taken up by an interim insolvency administrator. Regardless of such priority there is a substantial risk for the creditor who grants a loan to the insolvency administrator that the assets of the insolvent company do not suffice to satisfy the preferred claims. There is no super-priority lending in the sense that the lender would also rank prior to other preferred creditors, such as, for example, landlords with their claims for the time after the opening of proceedings. For this reason, creditors will often insist on the granting of security interests.

K SUMMARY

Chapter 11 - US Bankruptcy Code

1. No court discretion over order for relief under Chapter 11 - legal right of the debtor.
2. Ease of access to the procedure.
3. Technically, although no party has veto powers, the prohibition on using cash collateral without the consent of the lienholder or court approval gives an undersecured creditor with liens on current assets significant leverage in Chapter 11 cases though the negotiation of the “cash collateral” order.
4. Imposition of broad automatic stay upon the filing of a Chapter 11 petition, lasting until confirmation of a plan, gives the debtor virtual assurance of a stay for at least the period that the debtor has the exclusive right to file a plan, i.e. 120 days.
5. The debtor remains in possession.
6. Court approval is required for any action outside the ordinary course of business: sales of assets, assumption or rejection of contracts, borrowing money, etc.
7. Debtor given exclusive period of 120 days (as it may be extended for cause) to negotiate plan with creditors.
8. Power to ‘cherry-pick’ contracts and leases.
9. Plan accepted by class vote and may be confirmed by the court upon request of a plan proponent provided that (i) at least one class of impaired creditors votes yes; (ii) the plan is “*fair and equitable*” to any dissenting and junior classes; (iii) provides each creditor at least what it would have received in liquidation; (iv) is feasible; and (v) meets the other requirements of a plan and Chapter 11.
10. An approved plan binds all creditors and equityholders.

Insolvency Proceedings, Germany

1. Insolvency proceedings may be directed either at a liquidation of the company's business or at a reorganization of the company by way of a plan of restructuring. A liquidation may occur by means of a sale of the company's business as a going concern or as a winding-up.
2. The creditors as a group determine the direction of insolvency proceedings.
3. A sale of the company's business as a going concern is still the most common way to rescue a business in insolvency proceedings. Plans of restructuring seem to be becoming more important, though.
4. The opening of insolvency proceedings requires that the company is illiquid or overindebted or that illiquidity is imminent. In case of illiquidity or overindebtedness management usually has to file within three weeks.
5. For the period of time from the filing of an insolvency application to the opening decision the court usually appoints an interim insolvency administrator.
6. In the opening decision an insolvency administrator is normally appointed by the insolvency court, who is in charge of managing the company. The court may also leave the debtor in possession.

**COMPARISON OF CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE
AND THE EXTRAORDINARY ADMINISTRATION FOR
LARGE INSOLVENT COMPANIES IN ITALY**

A BACKGROUND

Chapter 11 - US Bankruptcy Code

Chapter 11 focuses on preserving reorganization or going concern value over liquidation value. As a corollary, Chapter 11 assumes that the most efficacious way to achieve that result is to retain management and enable multiple outcomes either through a plan of reorganization, a series of going concern sales and even a liquidating plan. Chapter 11 enables a wide range of proposals to be put into a reorganization plan, including having the company and its management survive the process. Chapter 11 cases fall into two general categories: the “freefall” case or a pre-packaged or pre-negotiated case.

In the former, relief is sought under Chapter 11 of the Bankruptcy Code without having an agreed exit strategy among the company and at least a critical mass or core group of creditors. The latter is characterized by commencing a Chapter 11 case following the development of a consensus on the outcome of the case. Under both scenarios, Chapter 11 plans embrace:

1. a “standalone” plan, which essentially connotes that the creditors, secured and unsecured, and, if applicable, the company and its equity-holders, agree on a reorganization without the intervention of a third party or a sale of the business, relying instead on what may be termed a “composition” plan under which at least some unsecured creditors agree to accept less than 100% payment or agree to take a combination of debt and equity issued by the reorganized company in return for their claims; or
2. a plan which effects a sale of all or substantially all of the assets as a going concern and distributes the consideration or proceeds of sale to the creditors;
3. a plan which relies upon a capital infusion from an investor;
4. a liquidating plan which sells all of the assets of the company and provides for a distribution of proceeds to creditors;
5. a plan which, in part, contemplates a litigation trust to pursue and prosecute causes of action belonging to the company; or
6. a combination of the above.

Extraordinary Administration, Italy

Extraordinary administration aims to facilitate the financial restructuring of a troubled company. However, bankruptcy is the most common insolvency proceeding in Italy, in recent years the extraordinary administration procedure has been increasingly availed of by leading Italian corporate groups.

In 1979 the Italian Government introduced the extraordinary administration for large insolvent companies, or the so-called “Prodi Law”, an administrative-driven restructuring procedure aimed at satisfying creditors’ claims, protecting the business activity of the company and employees’ interests.

In 1999 the extraordinary administration was amended by the Legislative Decree No. 270/1999 in the new extraordinary administration for large insolvent companies or the so-called “Prodi bis Law”, as the Prodi Law was in conflict with European Union’s prohibitions against State aids. The Prodi bis Law amended the procedures for large insolvent companies by granting government-appointed administrators additional powers to save troubled companies by preserving the business as a going concern. The procedure is implemented through a debt restructuring plan with a maximum duration of two years, or through a plan for sale of the business as a going concern with a maximum duration of one year.

In the wake of recent financial crisis that hit some of Italy’s leading corporate groups the Decree-Law 347/2003, ratified by Law 39/2004 (amended by Decree-Law 281/2004 ratified by Law 6/2005) or the so called “Marzano Law” or the “Parmalat Decree” partially amended and supplemented the extraordinary administration procedure set out in the Prodi bis Law.

According to the new provisions, insolvent companies meeting certain requirements may apply to the Minister of Productive Activities (the “Minister”) for immediate admission to the extraordinary administration procedure and for the appointment of an extraordinary administrator.

In particular, the Prodi bis Law applies to companies with at least 200 employees and debts equalling at least two-thirds of the total balance sheet assets and revenues in the preceding financial year; while the Marzano Law applies only to companies with, individually or as a whole (with reference to a corporate group established in the preceding year), at least 500 employees in the preceding year and total debts - including those arising from the issuance of guarantees - of at least EUR 300 million.

The extraordinary administration procedure set out in the Prodi bis Law is the default procedure which is generally applied to major insolvent companies unless specifically superseded by the Marzano Law.

In the course of this document we will make reference to the extraordinary administration as the procedure regulated by the Prodi bis Law as amended by the Marzano Law.

B PROCEDURE

Chapter 11 - US Bankruptcy Code

A typical Chapter 11 case begins when the debtor company voluntarily files a petition with a bankruptcy court, accompanied by:

1. a list of creditors; and
2. a summary of assets and liabilities.

Technically there is no requirement of 'insolvency'. Companies may have a number of reasons, other than insolvency, to file for bankruptcy relief: the company is faced with massive tort liabilities (e.g. Dow Corning when a global settlement with plaintiffs broke down), an adverse outcome in a litigation (e.g. Texaco when faced with a multi-billion dollar damages award), and anticipated liquidity issues (e.g. a number of U.S. energy companies).

But applications must be in 'good faith' and with the intention of reorganization or to effect a liquidation or sale of the company, and creditors may apply to have petitions dismissed where this is not the case. For example, in the SGL Carbon Corporation case (200 F.3d 154), the court dismissed the company's Chapter 11 case because of bad faith demonstrated by a lack of "reorganization purpose".

A large company may also be involuntarily pushed into a Chapter 11 case if three creditors holding unsecured non-contingent undisputed claims aggregating more than \$12,300 file an involuntary petition against the company and if the company is "*generally not paying [its] debts as such debts become due*". The company may contest the petition and if the above standard is not met, may file suit against the filing creditors for costs and/or reasonable attorneys fees or, if filed in bad faith, damages, including punitive damages.

Usually it is the company not the creditors who file for Chapter 11 protection (see Section e: Control of the company). However, secured lenders may effectively force a company to file for relief under Chapter 11 by threatening to enforce liens.

Extraordinary Administration, Italy

A company which meets the requirements must apply to the Minister of Productive Activities for immediate admission to the procedure and the appointment of an extraordinary administrator, while at the same time filing a petition with the bankruptcy court in order to confirm its insolvent status. It is the Minister, rather than the bankruptcy court, that has chief responsibility for supervising the procedure; the bankruptcy court is requested only to confirm the company's insolvent status and to verify the lawfulness of proceeding with respect to the verification of claims. In contrast, in case of extraordinary administration under Prodi bis Law, the admission of the company to the procedure is declared by the bankruptcy court of the locality in which the company has its registered office and follows the issuance of an insolvency declaration by the same bankruptcy court.

The Minister will issue a decree immediately admitting the company to the extraordinary administration procedure and will appoint an extraordinary administrator. Following the appointment of the extraordinary administrator and the notification to the bankruptcy court, the bankruptcy court will declare the company insolvent, on the basis of a report prepared by the extraordinary administrator within 60 days from the Minister's decree (further 60 days may be allowed) showing the balance sheet of the company and various other financial information.

If a company is admitted to the procedure, other insolvent companies in the same corporate group may also participate, even if they do not satisfy the relevant requirements. The extraordinary administrator also has 60 days from the decree to request that the Minister admit other group companies to the procedure.

The extraordinary administration is based on the implementation of a two-year reorganization plan aimed at the company's economic and financial restructuring and subject to the Minister's approval. In contrast, in case of extraordinary administration under Prodi bis Law, the procedure is carried out through a one-year business continuation plan, providing for the divestiture of the subject company's asset as one or more going concerns.

Within 180 days from his appointment, the extraordinary administrator is requested to file the restructuring plan with the Minister, as well as to lodge before the bankruptcy court a report containing a description of the causes of the company's insolvency, together with a list of the relevant creditors.

The Minister may formally authorize a restructuring plan within 30 days of filing. However, if the Minister does not issue a formal authorization within 90 days of submission, the plan is deemed approved.

C MORATORIUM

Chapter 11 - US Bankruptcy Code

Immediately upon the filing of a bankruptcy petition, a moratorium or “*automatic stay*” stays all litigation and prevents the enforcement of judgements and of security without leave of the court.⁴⁰ This includes staying the continuation of any existing actions that were commenced before the filing.

A party who takes any action in violation of the automatic stay risks contempt of court actions and penalties. Also, any act done in contravention of the stay is retroactively made void or voidable by the court. The stay is effective during the entire time the case is pending but creditors and other parties may make motions to lift or modify the stay.⁴¹

The Bankruptcy Code gives the debtor the exclusive right to formulate a plan of reorganization for 120 days from the date of filing. This “*exclusivity period*” can be extended if sufficient reasons are established, but no extension can be granted beyond 18 months after the Chapter 11 filing date.⁴² In most instances the debtor company will first take actions to stabilize its operations and formulate its business plan and thereafter proceed to formulate a plan of reorganization.

Extraordinary Administration, Italy

From the time of admission to extraordinary administration, creditors of the company may not initiate or continue any individual enforcement actions with respect to their claims.

40. Bankruptcy Code paragraph 362(a)

41. Bankruptcy Code paragraph 362(d)

42. Bankruptcy Code paragraph 1121

D LIFTING THE STAY

Chapter 11 - US Bankruptcy Code

Generally, an affected party can apply to court at any time after the filing of a bankruptcy petition for relief. Once such a motion is made the stay will expire after 30 days unless within such time a court continues the stay pending a final hearing or the movant consents to such continuation pending a hearing. The court may terminate the stay, modify it or subject it to conditions.⁴³ The court may lift the stay for cause, but is generally reluctant to do so during the initial stages of a Chapter 11 case because of the general presumption that a debtor should be given a chance to reorganize and prepare a plan.

Motions to lift or modify the stay are based on the following:

1. a court may lift or modify the stay upon a showing of “cause”, which includes the lack of adequate protection of an interest in property, or
2. with respect to property securing a lien, (i) the stay will be lifted if the debtor company does not have equity in such property and (ii) such property is not necessary to an effective reorganization. There are also special rules for single asset real estate cases and Chapter 11 debtors who are individuals. Also, Further, the automatic stay may not stay in effect when applied to certain protected creditors, such as certain aircraft lessors and lenders and vessel lessors and mortgagees. In this context, a lack of adequate protection focuses on whether the creditor is being injured by continuation of the stay due to, among other things, a deterioration in value of its collateral or consumption of collateral by the company. To counter this potentially negative impact of the stay, a debtor company must provide adequate protection, which may take the form of
3. periodic cash payments to cover any depreciation during the stay;
4. additional or replacement liens or substitute security to the extent of any deterioration in value, and other relief that will amount to ‘indubitable equivalent’, a flexibly interpreted concept.⁴⁴

Extraordinary Administration, Italy

Upon the admission of the company to the procedure of extraordinary administration the actions of both secured and unsecured creditors are automatically stayed without exception.

43. Bankruptcy Code paragraph 362(d)(2)

44. Re Alyulan Interstate Corporation 12 BR 803 at 809

E CONTROL

Chapter 11 - US Bankruptcy Code

In Chapter 11, whether voluntary or involuntary, there is a presumption that control remains with the debtor's management through the concept of "*debtor in possession*" ("**DIP**") (subject to certain safeguards regarding disposal of assets outside the ordinary course of business). To many commentators this smacks of leaving the fox in charge of the hen house. Nevertheless, there are instances where the difficulty is due to exogenous and unexpected events (e.g. Texaco). More importantly, perhaps, is the impression that management provides the most economical and efficient means to reorganize under the oversight of the bankruptcy court, and creditors' committees. Significantly, many companies hire special financial advisors or turnaround management consultants to assist them in their restructuring. Often the creditors, especially the secured creditors, will condition their cooperation on the hiring of such an expert or chief restructuring officer. Such consultants or specialists nevertheless remains responsible to the board of the company, the bankruptcy court and the creditors. Often they will be in place as part of any out of court restructuring. Although there is a Bankruptcy Code provision to appoint a trustee, such an appointment is rare and only happens where there is some suspicion of misfeasance/fraud/wrongdoing/risk to assets, or because it is the interests of creditors.

When there is a debtor in possession, a party in interest may request the appointment of an Examiner to investigate the debtor's affairs. Although it is mandatory to grant such request where the debtor has unsecured, liquidated debts in excess of \$5 million, the bankruptcy court may limit the scope of the Examiner's investigation to guard against a "*fishing expedition*".

As soon as is practicable after the order for relief, the United States Trustee (a government official with a duty to protect all creditors) appoints a creditors' committee, usually made up of the seven largest unsecured creditors willing to serve.⁴⁵ The supervisory role and powers of the committee are more extensive than in some jurisdictions, and they can incur the expense of attorneys and other advisors with court approval. Such expenses are funded out of the estate of the debtor.⁴⁶ The United States Trustee may also appoint other committees as needed (e.g. a Tort Claimants Committee, a Bondholders Committee, etc.). Although the creditors' committee may employ advisers and may be remunerated from the bankruptcy estate, in smaller cases there may be insufficient financial incentive for there to be a committee formed. This negates the potentially important role the committee has in Chapter 11 proceedings.

COMMENT

Legal frameworks in Italy contrast sharply with the Chapter 11 framework, which emphasizes the role of management, rather than administrators, in developing consensual restructuring plans, and grants to separate creditors and stakeholders the legal right to appeal and contest management-driven plans.

Extraordinary Administration, Italy

Upon appointment, the extraordinary administrator takes possession of, and control over, the subject company's assets. However, certain transactions must be authorized by the Minister. Debts incurred in connection with the continuation of the company's business are satisfied with priority over existing claims.

The Marzano Law enables the extraordinary administrator:

1. to initiate claw-back actions for the benefit of creditors during the implementation of a restructuring plan. In contrast, in case of extraordinary administration under Prodi bis Law, claw-back actions are possible only where a sale plan is established;
2. upon authorization of the Minister, to enter into transactions for the sale or utilization of assets of the company, to the extent that such transactions are instrumental to the restructuring (sales must be limited to non-core assets);
3. until the authorization of the restructuring plan, to request the Minister to authorize the carrying out of transactions necessary to safeguard the continued business activity of the group.

45. Bankruptcy Code paragraph 1102-1103

46. Bankruptcy Code paragraph 1103(a)

F CONTRACTS

Chapter 11 - US Bankruptcy Code

The debtor or trustee may assume a contract or lease even if it contains a clause that provides for termination in the event of insolvency, provided the debtor cures any default, and if the debtor had been in default, provides adequate assurance of future performance by itself or its assignee. Alternatively, the debtor may reject any such lease or executory contract, giving rise to breach as of the petition day, leaving the non-debtor party to such lease or contract with a prepetition claim for breach. Certain unsecured claims, such as those of landlords and executives, are limited by the Bankruptcy Code.

The trustee or the debtor in possession has the valuable ability to extract value from favourable contracts by assuming and then assigning these contracts regardless of whether the contracts themselves prohibit or condition such assignment.

Special rules and exceptions apply to certain kinds of contracts, including collective bargaining agreements and intellectual property assignments.

Extraordinary Administration, Italy

In general, the extraordinary administrator may elect to terminate any outstanding contract, other than employment contracts or lease contracts (if the company is the lessor). If the extraordinary administrator elects to continue a contract, the company will have to perform the contract in accordance with its terms, including paying the entire consideration due to its counter-party.

G PROPOSALS TO CREDITORS

Chapter 11 - US Bankruptcy Code

For the first 120 days after the order for relief only the debtor (if there is no trustee) may propose reorganization plans. The debtor also has an exclusive right for 180 days from the petition date in which to solicit acceptances from impaired creditors and shareholders. The court may extend or reduce the exclusivity period for cause, but in no case more than 18 months following the Chapter 11 filing date. After the end of this period the creditors' committee or any individual creditor can propose its own reorganization plan.

Before solicitation of approval for the plan, the debtor or trustee must prepare a disclosure statement and have it approved by the court as containing adequate information⁴⁷ to allow a reasonable hypothetical creditor to be able to consider the plan.

At least 25 days notice of the hearing to consider the disclosure statement must be given to creditors⁴⁸. If the court approves the statement it will also fix voting procedures and set a confirmation hearing date on at least 25 days notice to creditors. As a practical matter once a plan is timely filed, exclusivity is likely to be extended. This is more likely if the disclosure statement has been approved and the plan has been sent out for vote.

Chapter 11 requires creditors to be designated into classes and for each class whose rights have been impaired to vote in favour by a majority in number and two-thirds in amount of those actually voting⁴⁹. The minority is bound by the class vote, provided that the plan provided to each creditor at least what it would have received in a liquidation of the debtor. This is the "best interest" test.

The classification of creditors is based upon the premise that claims that are substantially similar should be classified together. It is well established that secured creditors holding liens with different priorities on the same collateral are to be separately classified. As a general rule unsecured creditors are classified in one class. There may, however, be reasons why certain unsecured creditors should be treated differently. Some variation in plan treatment, as among creditors having a *pari passu* right against the debtor, is permitted, provided that such difference does not "unfairly discriminate" against a class of creditors. Generally, the classification scheme is part of the debtor's plan proposal. There has been litigation regarding classification, primarily involving the deficiency claim of a secured creditor.

Confirmation of a Chapter 11 plan requires that there be cash to pay administrative expenses and most priority claims, and to make the cash payments provided for in the plan.

Extraordinary Administration, Italy

The restructuring plan must indicate, *inter alia*, those business activities to be continued and those to be dismissed, the economic and financial forecasts connected with the restructuring process, the methods for covering financial requirements, the possible recapitalization plan, as well as the timing and methods for the settlement of creditors' claims, whether through plans aimed at rescheduling the company's obligations or by means of a composition with the creditors.

The restructuring plan is subject to the approval of the Minister. Should the Minister reject the restructuring plan, the extraordinary administrator is still entitled to ask the Minister to approve a plan based on the disposal of the company's assets; otherwise the extraordinary administration is converted into a bankruptcy procedure.

A relevant innovation introduced by the Marzano Law is the provision of a new form of composition (*Concordato*) with the creditors as part of the restructuring plan. In particular, the composition may provide for:

1. the subdivision of creditors into different classes, according to their legal priorities;
2. different treatment for creditors belonging to different classes;
3. satisfaction of creditors' claims through any technical or legal means, including through assumption of debts, merger or other corporate transactions, and issuance of stock or bonds, including bonds convertible into shares or other financial and/or debt instruments;
4. the transfer of the assets of the insolvent company to a contracting party (*Assuntore*). The creditors, or companies in which they have holdings, may also act as contracting party, as well as companies established *ad hoc* by the extraordinary administrator, whose shares are to be allocated to the creditors. The composition may also provide for the transfer to the contracting party of the claw-back actions.

The composition is approved if it is passed by creditors representing the majority of claims admitted to vote; if there are different classes of creditors, the composition is approved if it is passed by the vote of creditors representing the majority of creditors admitted in each class. Creditors who do not deliver their vote by the deadline fixed by the judge, will be deemed to vote in favour of the composition.

The bankruptcy court may approve the composition notwithstanding that the majority in one or more classes of creditors have not voted in favour of the composition, if (i) the majority of the classes voted in favour of the composition, and (ii) the bankruptcy court believes that the creditors who belong to the dissenting classes will receive a distribution which is at least as favourable as through any other feasible alternative. Once approved by the requested majorities and ratified by the bankruptcy court, the composition is binding also on dissenting and non voting creditors.

50. Bankruptcy Code paragraph 1141

51. Bankruptcy Code paragraph 1112(b)(c)

Only those creditors who are going to have their rights impaired (modified) by the plan can vote. Once the voting has taken place the court will consider whether or not to confirm the plan in the light of the votes. If there is a dissenting class of claims and at least one class of impaired claims that has accepted the plan, the plan proponent may nevertheless request confirmation of the plan if the plan conforms to the “*absolute priority*” rule and is “*fair and equitable*” with respect to the dissenting class and all junior classes of claims and interests. When the court confirms a plan in such a case it is known as a “*cramdown*”.

With respect to a class of unsecured creditors, a plan is fair and equitable only if (i) such class receives full value for its claims or (ii) no junior class receives or retains any value. Hence, absent full satisfaction of a class of dissenting unsecured claims, there can be no value distributed or retained by any junior claim or interest. A no vote by a class of unsecured creditors usually means wiping out equity.

Once the plan is confirmed it binds all creditors and the property re vests in the debtor company clear of all prepetition claims (and subject to any of the terms of the plan⁵⁰). Where a debtor is unable to confirm a plan, the Chapter 11 case may be dismissed or converted to a chapter 7 case.⁵¹

COMMENT

Notwithstanding a clear shift in the composition of creditors over the last several years, the insolvency culture in Italy, even with the event of the Marzano Law, continues to limit the ability of management to orchestrate consensual restructuring with creditors. Unlike Chapter 11, the Marzano Law remains a management-displacing and administration-driven framework where creditors are only consulted as a whole.

H COSTS

Chapter 11 - US Bankruptcy Code

The US system requires court involvement and the associated high costs this brings. The creditors' committee may also appoint advisers that may be remunerated from the estate of the bankruptcy. The expense potential often suggests that constituents try to reach a consensus outside of Chapter 11 and commence the case as a pre-negotiated or prepackaged Chapter 11 case.

Extraordinary Administration, Italy

The amount of payment due to the extraordinary administrator is determined according to the rules set out in a ministerial decree, but it is a company's responsibility.

Chapter 11 - US Bankruptcy Code

Plan confirmation discharges the debtor's pre-existing obligations to unsecured and secured claimants other than as provided for in the plan, irrespective of whether they actually accepted it themselves.

In cases where a plan is not confirmed it is usual for the court to order conversion to Chapter 7 bankruptcy proceedings.⁵² However, as there is no insolvency requirement under Chapter 11, failure to confirm a plan will not necessarily lead to liquidation. There is no prohibition against re-filing for Chapter 11 (except if the debtor is an individual, in which case certain restrictions apply). This is true even if a case is dismissed, or even if a case ends with a confirmed plan. The second Chapter 11 case, or 'chapter 22' as it is sometimes called, is not unusual.

Extraordinary Administration, Italy

At any time during the extraordinary administration, the bankruptcy court, ex officio or upon the extraordinary administrator's request, may convert the proceedings into ordinary bankruptcy proceedings if the extraordinary administration can no longer be usefully carried out. The conversion may also be ordered after the completion of the restructuring plan if the subject company has not been restored to solvency.

In addition, the bankruptcy court may terminate the extraordinary administration in the event that:

No creditor has filed claims within the deadlines set forth in the insolvency declaration;

The judgement relating to a composition procedure becomes definitive;

The company has been restored to solvency as provided for in the restructuring plan.

52. Bankruptcy Code paragraph 1112

J FINANCES

Chapter 11 - US Bankruptcy Code

The Bankruptcy Code gives lenders incentives to provide finance to the debtor (called Debtor in Possession or DIP Financing). The lender may be given a lien over assets that are not pledged to other lenders. The court may also authorize liens superior to certain priority claims in the bankruptcy process or even grant new senior liens on collateral already pledged to another party, subject to ensuring that the existing lender has “*adequate protection*” for the value of its pre-bankruptcy liens.

Extraordinary Administration, Italy

Lenders providing new money have statutory priority and their claims will be settled on a priority basis as long such claims:

1. relate to acts performed after the declaration of insolvency;
2. qualify as costs and expenses incurred in the continuation of business activities and the management of the company's assets.

K SUMMARY

Chapter 11 - US Bankruptcy Code

No court discretion over order for relief under Chapter 11 - legal right of the debtor.

Ease of access to the procedure.

Technically, although no party has veto powers, the prohibition on using cash collateral without the consent of the lienholder or court approval gives an undersecured creditor with liens on current assets significant leverage in Chapter 11 cases though the negotiation of the “cash collateral” order.

Imposition of broad automatic stay upon the filing of a Chapter 11 petition, lasting until confirmation of a plan, gives the debtor virtual assurance of a stay for at least the period that the debtor has the exclusive right to file a plan, i.e. 120 days.

The debtor remains in possession.

Court approval is required for any action outside the ordinary course of business: sales of assets, assumption or rejection of contracts, borrowing money, etc.

Debtor given exclusive period of 120 days (as it may be extended for cause) to negotiate plan with creditors.

Power to ‘cherry-pick’ contracts and leases.

Plan accepted by class vote and may be confirmed by the court upon request of a plan proponent provided that (i) at least one class of impaired creditors votes yes; (ii) the plan is “fair and equitable” to any dissenting and junior classes; (iii) provides each creditor at least what it would have received in liquidation; (iv) is feasible; and (v) meets the other requirements of a plan and Chapter 11.

An approved plan binds all creditors and equityholders.

Extraordinary Administration, Italy

The Extraordinary Administration is the insolvency proceeding intended to assist major companies to restructure their business. The default procedure which is generally applied to major insolvent companies is provided by the Prodi bis Law unless specifically superseded by the recent modifications introduced by the Marzano Law applicable to larger companies that satisfy the following criteria:

1. at least 500 employees in the preceding year;
2. total debts, including those arising from the issuance of guarantees, of at least EUR 300 million.

The main features of the modified regime introduced by the Marzano Law with respect to the Prodi bis Law are:

1. the absence of an interim judicial stage, which is replaced by an immediate admission to the extraordinary administration and the appointment of an extraordinary administrator;
2. the power of the extraordinary administrator to conduct urgent disposals or take any steps necessary to protect the continuity of the group's activities at any stage before or after Minister's approval of the restructuring plan;
3. the emphasis on a restructuring and reorganization of the company rather than a break-up of its business;
4. the extension of powers of the extraordinary administrator intent on achieving the restructuring plan to reverse transactions and recover assets, powers which are, under the Prodi bis Law regime, only available in the context of a disposal plan.

Despite its ad hoc development in response to the Parmalat collapse, the Marzano Law represents a real step towards rehabilitative insolvency solutions for distressed companies. It appears to herald a new approach that focuses on corporate reorganization and restructuring rather than liquidation of the debtor's assets. In particular, the possibility to provide for arrangements through composition is important. Composition allows for the swift satisfaction of creditors' claim without any need for a lengthy insolvency procedure, which is always detrimental to the debtor's business, its value on the market and the creditors' interests. This improvement brings the Italian legislation further into the line with the most advanced insolvency regimes.

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