International/Secured Credit

Collateral Protection and Competing Priorities: Secured Credit in the International Arena

Rebecca A. Roof
AlixPartners LLP; New York

E. Patrick Shea
Gowlings; Toronto

Fredric Sosnick
Shearman & Sterling LLP; New York

Prof. Jay L. Westbrook
University of Texas School of Law; Austin

COMMITTEE EDUCATIONAL SESSION

2015

AMERICAN BANKRUPTCY INSTITUTE

DISCOVER

interactive code&rules
law.abi.org

Start Your Research Here

Your Interactive Tool Wherever You Go!

With ABI's Code & Rules:

- **Search for a specific provision of the Bankruptcy Code and related Rules**
- **Access links to relevant case law by section (provided by site partner, LexisNexis®)**
- **Retrieve a Code section or case summary – even on your mobile device**
- **Personalize it with bookmarks and notes**
- **Receive it FREE as an ABI member**

Current, Personalized, Portable
law.abi.org

66 Canal Center Plaza • Suite 600 • Alexandria, VA 22314-1583 • phone: 703.739.0800 • abi.org

Join our networks to expand yours:

Introduction

- Three post-default objectives of a secured creditor:
  - Enforcement
  - Priority and scope
  - Leverage

1

SULLIVAN & STERLING LLP

Enforcement Outside Insolvency Proceeding

- Civil law: Often judicial, difficult, expensive
  - Debtor protective
- British & Commonwealth: Often easy, fast
- May provoke insolvency filing

SULLIVAN & STERLING LLP

Enforcement During Insolvency Proceeding

- Many countries permit enforcement, but an increasing number have stays
- Model law on cross-border insolvency
  - 22 countries
    - Automatic stay for COMI proceeding
  - U.S. Bankruptcy Code 1520(a)(1)

3

SULLIVAN & STERLING LLP

Scope

- The scope of collateral legally available is often narrow. Marie Eva Kieninger surveys European secured credit systems, including scope:
  - SECURITY RIGHTS IN MOVABLE PROPERTY IN EUROPEAN PRIVATE LAW (2004)

4

SULLIVAN & STERLING LLP

Priority

- Choice of Law
- The dominant choice of law rule around the world is that the law of the situs governs security interests or "charges"
- E.g., EU Regulation arts. 7(2)(i), 8
- UCC 1-301, 9-301-07:
  - The UCC rule is unusual in using the debtor's "location" (most often state of incorporation) as the usual place of filing, with *situs* and other rules for the law governing different types of collateral (UCC 301, 307)

5

SULLIVAN & STERLING LLP

Choice of Law

- UCC 1-301 is the foundational rule and severely limits agreed choice of law for security interests, cross referencing 1-301-07 for governing rules
- Note that choice of law for validity and scope may be different than for perfection and enforcement. (e.g. UCC 9-301 c. 2.)

SULLIVAN & STERLING LLP

Priming Priorities (Labor & Liens)

- Labor priorities fairly often prime security interests, especially in Latin America. Janis Sarra reports labor priorities for 62 different countries:
  - EMPLOYEE AND PENSION CLAIMS DURING COMPANY INSOLVENCY: A COMPARATIVE STUDY OF 62 JURISDICTIONS (2008)
- SEE also the Kieninger book *supra* for labor and liens

7

SULLIVAN & STERLING LLP

Preference

- As in the United States, a late grant of a security interest may be a preference

SULLIVAN & STERLING LLP

Insolvency Laws

- Liquidation only in many countries
- But reorganization is growing
  - Must have secured stay or fail
  - Older laws often pro-debtor (L.A.)

SULLIVAN & STERLING LLP

Partitioning

- Potential substitute for security
  - By isolating assets in a particular entity (SPV) and restricting its capacity to transfer assets (e.g. by a captive board), one can achieve a sort of priority

SULLIVAN & STERLING LLP

Problems Include

- The difficulty of enforcing unsecured promises not to convey and the risk such promises do not defeat the validity of conveyances
- Problematic enforcement of fraudulent conveyance and similar avoiding powers

SULLIVAN & STERLING LLP

Re Nortel (Canada)

- As a prime example, positive and negative
  - Creditors with guarantees had privileged access to two entities in group and did substantially better than others
  - Courts' treatment of IP assets as owned by the group as a whole reduced their recoveries substantially

International Texts

- A number of international texts have been adopted or are pending concerning security interests:
- In Force for the United States:
- Capetown (UNIDROIT) Entry into force: **01.03.2006** Contracting States: **68**
- See also, http://www.unidroit.org/ aircraft, space, rail protocols

Other Texts

- UNCITRAL Legislative Guide on Secured Transactions (2007)
- UNCITRAL Legislative Guide on Secured Transactions: Supplement on Security Rights in Intellectual Property (2010)
- Model Law on Cross Border Insolvency
- Guide to Enactment and Interpretation (2013)

SULLIVAN & STERLING LLP

Key Proposed or Pending Laws & Guides

- United Nations Convention on the Assignment of Receivables in International Trade (New York, 2001) (4 signatures including US but only 1 ratification (not US) and not in force (takes 5)
- Draft Amended Guide on Secured Transactions
- UNCITRAL Legislative Guide on Insolvency Law, Part Three: Treatment of enterprise groups in insolvency (2010)

SIDLEY AUSTIN & STERLING LLP

- Other pending texts at:
  http://www.uncitral.org/uncitral/en/uncitral_texts/security.html
- Additional References at:
  https://law.utexas.edu/faculty/jwestbrook/ABI Winter References.pdf

16

Sovereignty and Domestic Policies of the Individual States in Secured Transactions

- In the area of secured transactions more than in other areas of commercial law, issues of sovereignty remain central
- Many of the rules governing the enforcement of security rights reflect deep policy interests external to the credit relationship itself
  - For instance, when non-consensual statutory creditors receive a preferential position over secured creditors, it is because that preference is deemed necessary to achieve a particular social goal (such as obtaining the payment of accrued wages to employees)
- While some of these policies may be common to many jurisdictions (permitting, for example, the creation of a lien against property for the benefit of workers who contributed materials or labor toward its improvement), others may not be (permitting, for example, the creation of a lien against certain property for the benefit of innkeepers)

SULLIVAN & STERLING LLP

Sovereignty and Domestic Policies of the Individual States in Secured Transactions

- The effect of debtor insolvency on security interests creates an additional layer of policy issues; under bankruptcy regimes as under secured credit regimes, the rules governing priority in the distribution of debtor assets reflect local social goals
- The deep-seated and often divergent State policies and interests implicated in this field will continue to draw issues of sovereign power into the harmonization debate
- Harmonization might flounder simply due to general differences in approach to property rights
  - These include some differences that affect security law directly, such as the question whether to accord proceeds the status of property, but also broader differences concerning the relationship between possession and property interests

SULLIVAN & STERLING LLP

Collateral Enforcement as a Matter of Local Law

- Issues arising as a result of non-uniform secured transactions laws:
  - The uncertainty and transaction costs imposed on lenders in determining and attempting to comply with differing and conflicting laws;
  - The inability of some national regimes to deal with international transactions;
  - The need to modernize and facilitate international commerce;
  - The need to reduce transaction costs and risks created by non-uniform laws; and
  - Providing a neutral choice of law

19

SULLIVAN & STERLING LLP

Collateral Enforcement as a Matter of Local Law

- In an international context, it is not enough to have theoretical rights under the law
- The critical question is whether one can enforce those rights, recognizing that the legal system granting the rights may not be the same as the one in which enforcement occurs
  - The method of determining which jurisdiction's law is to be treated as controlling may vary from one jurisdiction to another
    - Moreover, the law of one jurisdiction may be treated as governing some aspects of the transaction and that of another jurisdiction as the controlling law for other aspects of it

Collateral Enforcement as a Matter of Local Law

- The law of the foreign jurisdiction dictates the types of enforcement actions available to the lender
  - In some jurisdictions, for example, the self-help remedies (e.g. direct collection from account debtors) to which U.S. lenders are accustomed are not available
- A myriad of local laws of the foreign jurisdiction may affect the ability of the lender to realize on its collateral
- Insolvency proceedings and practices vary from jurisdiction to jurisdiction and may be very different from U.S. bankruptcy proceedings
- The lender needs to understand the availability of remedies and insolvency procedures of the foreign jurisdiction in determining whether and how to lend in that jurisdiction

SULLIVAN & STERLING LLP

Collateral Enforcement as a Matter of Local Law

- The lender needs to know whether there is legislation in the foreign jurisdiction similar to the UCC that generally renders ineffective any term in an agreement between an account debtor and the borrower that prohibits or restricts the assignment of, or creation of a security interest in, an account receivable
- The lack of such legislation can mean that a secured party seeking to enforce against an account debtor might be faced with the defense that the borrower breached its contract by assigning to the lender the right to payment from the account debtor
- In these jurisdictions, the lender may need to require its borrower to obtain consent of the account debtor to the security interest

SULLIVAN & STERLING LLP

Collateral Enforcement as a Matter of Local Law

- In addition to seeking the advice of local lawyers and obtaining an opinion of local lawyers that a lien is enforceable, practical questions about enforcement should be explored
- The actual costs of enforcement should be understood
  - May include legal costs, taxes, and other costs that may make the liens economically unenforceable
- As a practical matter, enforcement remedies may be almost nonexistent in some countries
  - Enforcement may be limited to public auction
  - Possession of the collateral as a remedy may not be permitted

SULLIVAN & STERLING LLP

Collateral Enforcement as a Matter of Local Law

- Enforcement Risk Areas
  - Each foreign jurisdiction will have its particular enforcement risks that the secured lender will need to understand and address in its loan documentation and structuring
    - *I.e.* priming claims, title retention clauses (e.g. a conditional sale agreement or financing lease), and anti-assignment provisions
  - The lender will want to establish borrowing base reserves or consider obtaining insurance or consider alternative structures to address priming claims

Intercreditor Issues

- The U.S. Bankruptcy Code provides many restructuring tools
  - Automatic stay on steps to enforce claims
  - Valuation principles
  - Ability to sell bankrupt business free and clear of remaining claims
  - DIP financing
- In the absence of consistent equivalent statutory provisions across Europe, the European intercreditor agreement provides for many of these principles contractually (many of which also appear in U.S. intercreditor agreements)
  - Meant to address the continuing concern that insolvency processes in Europe have the potential to destroy the value of a company
    - European debtors and creditors retain a far greater sensitivity to the negotiating leverage that various creditor classes have to force an insolvency filing, thus potentially threatening the whole restructuring and the likely recovery of all creditors

SULLIVAN & STERLING LLP

Intercreditor Issues

- To address the absence of a chapter 11 framework, typical European intercreditor agreements explicitly provide, by contract, for a number of features that local European commercial and insolvency laws do not consistently provide:
  - Standstill
    - With respect to liens on assets
    - With respect to making claims on the underlying direct debt obligations and guarantees
  - Scope of creditors
    - More extensive range of creditors included as parties to the agreement

SULLIVAN & STERLING LLP

Intercreditor Issues

- Additional provisions typically included by contract in Europe
  - Release of junior debt claims
    - Automatic upon the occurrence of "distressed dispositions"
      - Typically accompanied by forced transfer provisions in which, as an alternative to outright release of the claims, the security trustee can acquire the creditors' claims (to avoid the tax consequences that otherwise might result from outright forgiveness)
  - Limitations on amendment
    - Restrictions on modifications of the tranches of debt that are subject to the intercreditor arrangements
  - Debt purchase option
    - At par upon, and in some cases prior to, enforcement

SULLIVAN & STERLING LLP

Intercreditor Issues

- Significant European Differences
  - Collateral package issues
    - Complex and variable collateral packages across Europe reflect several issues that mean collateral packages in some jurisdictions often can be incomplete
      - In some jurisdictions, such as the UK and Ireland, comprehensive collateral is easily available
      - In others, collateral may be limited either due to cost or practicability
  - Fear of bankruptcy
    - The continuing concern, despite some changes in bankruptcy laws, that being subject to a formal bankruptcy proceeding is likely to destroy value
  - Personal liability
    - Board members may be personally liable if the company continues to incur debts while insolvent
  - Typical bankruptcy protections inconsistent
    - Standstill and release provisions may now be more available by operation of law in certain jurisdiction since the time European intercreditor agreements first began developing, but not sufficiently consistent to avoid the need to adopt explicit contractual protections in intercreditor agreements

Intercreditor Issues

- Unexpected Differences Between European and U.S. Practice
  - Single point of enforcement
    - The enforcement sale of the business by first lien creditors often is the principal tool to establish leverage against both the equity owners and junior creditors, whose claims would be released pursuant to the automatic release provisions contained in European-style intercreditor agreements
    - For this reason, a "single point of enforcement" often is critical from a structuring perspective
      - I.e. the ability to sell the business by enforcing a stock pledge over a single entity high enough up in the group structure to capture the value of the business as a going concern
    - Enforcement of an equity pledge in many European jurisdictions is a means of realizing value, often not subject to bankruptcy or statutory rules (*i.e.* automatic stay)
    - Moreover, exercising such enforcement rights may be necessary in order to trigger the debt claim and security release provisions contained in European-style intercreditor agreements

SULLIVAN & STERLING LLP

Unexpected Differences Between European and U.S. Practice

- Addressing the issue of holdouts
  - The emphasis on out-of-court consensual processes requiring amendment and waivers under the governing documents results in senior creditor groups availing themselves of local law processes outside bankruptcy to bolster their positions in restructuring scenarios, in particular to stand up to holdouts
    - For example, a UK scheme of arrangement can be used to override provisions that require unanimous lender vote under English law credit agreements, through a debtor-led procedure requiring the approval of at least 75% in amount and a majority in number of the relevant class of creditors

SULLIVAN & STERLING LLP

Cross-Border Insolvency Agreements

- Cross-border insolvency agreements are most commonly referred to in some States as “protocols”, although a number of other titles have been used, including “insolvency administration contract”, “cooperation and compromise agreement” and “memorandum of understanding”
- Agreements may be oral or written, intended to facilitate the coordination of cross-border insolvency proceedings and cooperation between courts, between courts and insolvency representatives and between insolvency representatives, sometimes also involving other parties in interest

SULLIVAN & CROMWELL LLP

Cross-Border Insolvency Agreements

- A comparison of a number of insolvency agreements entered into in recent years reveals that there are some more generic or "standard" agreements which resemble each other and contain the same provisions, addressing:
  - background, purpose and goals;
  - comity and independence of the courts;
  - cooperation, including provisions on the procedure of communication, such as joint hearings;
  - retention and compensation of insolvency representatives;
  - notice;
  - recognition of stays of proceedings;
  - rights to appear and be heard;
  - effectiveness; and
  - modification and procedure for resolving disputes under the insolvency agreements and preservation of rights

SULLIVAN & STERLING LLP

Cross-Border Insolvency Agreements - Examples

- AbitiBowater (2009)
  - Multinational enterprise that operated through its various subsidiaries and affiliates in the United States, Canada and other countries
  - Filed in US and Canada
  - United States and Canadian proceedings were separate proceedings, an insolvency agreement was developed to implement administrative procedures to coordinate certain activities; to protect the rights of parties; to ensure the maintenance of the courts' respective independent jurisdictions; and to give due effect to any applicable doctrines, including comity
    - Included provisions common to a "standard" insolvency agreement
    - Provided for respective court copies of all or any orders, decisions, opinions or similar papers issued by the other court in the reorganization proceedings be shared
    - States explicitly that the agreement should not abrogate the requirements of a particular provision of law
    - Incorporates the Court-to-Court-Guidelines

SULLIVAN & STERLING LLP

Cross-Border Insolvency Agreements - Examples

- Calpine (2007)
  - Multinational enterprise that operated through various subsidiaries and affiliates in the United States, Canada and other countries
  - Filed in US and Canada, with the respective debtors being separate and distinct but memorandums of understanding being concluded on specific issues
  - In recognition of the close relationship between the companies, for example they were each the largest creditors of the other, an insolvency agreement was developed, inter alia, to coordinate and harmonize the proceedings
  - Was initially rejected by Canada court as premature but subsequently approved
  - Main goals were to avoid duplication of activities, to honor the sovereignty of the courts involved and to facilitate the fair, open and efficient administration of the insolvency proceedings

SULLIVAN & STERLING LLP

Cross-Border Insolvency Agreements - Examples

- SemCanada Crude Company (2009)
  - Separate insolvency proceedings for different enterprise group members in Canada and the United States
  - Became apparent that the businesses were closely integrated with the United States
  - Insolvency agreement was developed to implement basic administrative procedures and cross-border guidelines to coordinate certain activities in the proceedings, including the coordination of steps required to finalize, seek required approvals and implement the United States plan of reorganization in conjunction with the Canadian plans, including with respect to identifying creditors, calling and holding the required meetings of creditors
- Madoff (2009)
  - Insolvency proceedings commenced in England and the United States
  - Insolvency representatives concluded two insolvency agreements and sought approval by the United States court in June 2009; the basis of both agreements was the close relationship between the two companies and the fraud committed
    - First agreement (the "cross-border agreement") included right to appear, costs, comity, amendment, effectiveness, and communication, preservation of assets and intercompany claims
    - Second insolvency agreement on information-sharing (the "information agreement") provides a mechanism for information sharing

SULLIVAN & STERLING LLP

European Foreclosures

- Taking Security
  - In the U.S. and in England, security normally is taken by appropriating an asset to secure a debt
    - *I.e.*, no transfer or removal of the asset from the security-giver is required
  - This is not always the case in continental Europe

SULLIVAN & STERLING LLP

European Foreclosures

- Present and Future Assets
  - In the U.S. and in England, it is possible to obtain security over existing and future assets
  - This is often not the case in continental Europe
  - Where assets constantly are changing, there often is a requirement to file updated details on a regular basis

SULLIVAN & STERLING LLP

European Foreclosures

- Enforcement of Security – Pre-Insolvency
  - In both the U.S. and England, the self-help principle applies in relation to enforcement of security and a security-holder can take steps itself to enforce its security
    - *I.e.* through a receiver
  - In continental Europe, enforcement of a security normally is managed through the court and assets are realized by public auction or a court-administered sale process

SULLIVAN & STERLING LLP

Shipping Industry

- Bankruptcies involve unique legal and practical issues:
  - Transitory nature of ships
  - Foreign domicile of most shipping companies
  - Awkward intersection of bankruptcy and admiralty law
    - U.S. bankruptcy has automatic stay and the opportunity for a "fresh start," and ensure equitable treatment of creditors
    - Admiralty law is creditor-oriented, generally permitting aggressive individual creditor remedies such as the seizure of assets

SULLIVAN & STERLING LLP

Shipping Industry

- Bankruptcy court will give consideration to applicable admiralty law in determining the validity and priority of any claims (including lien claims) with respect to the debtor's vessels, including the distribution of the sale proceeds to lien creditors, and rarely would yield jurisdiction to an admiralty court to determine such issues
- Shipping creditors that file claims in a bankruptcy case are deemed to consent to the equitable jurisdiction of the bankruptcy court, such that the bankruptcy court will assume jurisdiction to adjudicate (or even extinguish) those claims
- For the reorganized debtor or purchasers of the debtor's assets relying on a bankruptcy court's order, the risk remains that foreign courts may not recognize that certain maritime liens have been extinguished by a U.S. bankruptcy court sale of a vessel (as opposed to a U.S. admiralty court). Admiralty court sales, unlike bankruptcy court sales, are universally recognized as cleansing a ship of liens

Shipping Industry

- Maritime liens are secret liens that arise by operation of law
- Maritime liens, which may arise, among other ways, in connection with the provision of necessaries to a vessel (crew wages, repairs, towage, maintenance, etc.), need not be recorded
  - Such secret liens are often prioritized in the opposite manner of typical U.S. commercial liens — a "last in time, first in right" basis
- The lack of transparency of maritime liens creates a host of problems in a bankruptcy proceeding
- Caution must be taken by lenders negotiating post-petition financing with a maritime debtor, as unknown maritime liens may survive the bankruptcy and enjoy priority to the security interests granted to such lenders as part of the bankruptcy proceeding

SULLIVAN & STERLING LLP

Shipping Industry

- Vessel charters generally have been treated as executory contracts under the Bankruptcy Code
  - Consequently, a debtor charterer (or a debtor ship owner) under a charter may decide that the terms of a charter are unfavorable and reject the charter, resulting in a claim for damages arising from the breach of the charter in favor of the nondebtor counterparty
    - Generally, outside of the bankruptcy context, a breach of a charter by the ship owner will result in a maritime lien in favor of the charterer
- It is necessary that a shipping debtor globally coordinate its insolvency proceedings to enhance the likelihood of a successful reorganization
- The Bankruptcy Code seeks to facilitate coordinated foreign filings through Chapter 15, which enables the bankruptcy court to recognize and aid foreign insolvency proceedings

SULLIVAN & STERLING LLP

Energy Issues

- The need for increased revenue to service debt can create a negative feedback loop with companies selling more oil to generate more revenue increasing supply and putting further pressure on prices
- Lien priority issues (collateral gaps, M&M lienholders)
- Executory contracts (JOAs, leases, other)
- O&G interests
  - Mineral interests
  - Working interests
  - Royalty interests
  - ORRIs
  - Net profit interests
  - Production Payments

SULLIVAN & STERLING LLP

Energy Issues

- Unclear if OCS (Outer Continental Shelf) Lease is unexpired and executory
  - (ATP-NGP Litigation)
- OCS leases represent a growing portion of the oil and gas production in the United States, but unfortunately, how they should be characterized remains largely unaddressed

ABI Winter Leadership Conference
December 3-5, 2015

International/Secured Credit

Collateral Protection and Competing Priorities: Secured Credit in the International Arena

Rebecca A. Roof

AlixPartners LLP; New York

E. Patrick Shea

Gowlings; Toronto

Fredric Sosnick

Shearman & Sterling LLP; New York

Prof. Jay L. Westbrook

University of Texas School of Law; Austin

Table of Contents

Key Proposed or Pending Laws & Guides

- UNCITRAL Legislative Guide on Insolvency Law, Part Three: Treatment of enterprise groups in insolvency (2010)

- Draft Amended Guide on Secured Transactions

- United Nations Convention on the Assignment of Receivables in International Trade (New York, 2001) (4 signatures including US but only 1 ratification (not US) and not in force (takes 5)

International & Other Texts

- A number of international texts have been adopted or are pending concerning security interests:
- In Force for the United States:
  - Capetown (UNIDROIT) Entry into force: **01.03.2006** Contracting States: **68**
  - See also, http://www.unidroit.org/ aircraft, space, rail protocols

- UNCITRAL Legislative Guide on Secured Transactions (2007)
- UNCITRAL Legislative Guide on Secured Transactions: Supplement on Security Rights in Intellectual Property (2010)
- Model Law on Cross Border Insolvency
- Guide to Enactment and Interpretation (2013)

- Other pending texts at: http://www.uncitral.org/uncitral/en/uncitral_texts/security.html
- Additional References at: https://law.utexas.edu/faculty/jwestbrook/ABI Winter References.pdf

Objectives of a Secured Creditor

Three post-default objectives:

- Enforcement
  - Outside a proceeding
  - During a proceeding
  - As a Matter of Local Law
- Priority and Scope
- Leverage

Enforcement Outside and During Insolvency Proceeding

Outside a Proceeding

- Civil law: Often judicial, difficult, expensive
  - Debtor protective
- British & Commonwealth: Often easy, fast
- May provoke insolvency filing

During a Proceeding

- Many countries permit enforcement, but an increasing number have stays
- Model law on cross-border insolvency
  - 22 countries
    - Automatic stay for COMI proceeding
  - U.S. Bankruptcy Code 1520(a)(1)

Collateral Enforcement as a Matter of Local Law (1 of 3)

- Issues arising as a result of non-uniform secured transactions laws:
  - The uncertainty and transaction costs imposed on lenders in determining and attempting to comply with differing and conflicting laws;
  - The inability of some national regimes to deal with international transactions;
  - The need to modernize and facilitate international commerce;
  - The need to reduce transaction costs and risks created by non-uniform laws; and
  - Providing a neutral choice of law
- In an international context, it is not enough to have theoretical rights under the law
- The critical question is whether one can enforce those rights, recognizing that the legal system granting the rights may not be the same as the one in which enforcement occurs
  - The method of determining which jurisdiction's law is to be treated as controlling may vary from one jurisdiction to another
    - Moreover, the law of one jurisdiction may be treated as governing some aspects of the transaction and that of another jurisdiction as the controlling law for other aspects of it

Collateral Enforcement as a Matter of Local Law (2 of 3)

- The law of the foreign jurisdiction dictates the types of enforcement actions available to the lender
  - In some jurisdictions, for example, the self-help remedies (e.g. direct collection from account debtors) to which U.S. lenders are accustomed are not available
- A myriad of local laws of the foreign jurisdiction may affect the ability of the lender to realize on its collateral
- Insolvency proceedings and practices vary from jurisdiction to jurisdiction and may be very different from U.S. bankruptcy proceedings
- The lender needs to understand the availability of remedies and insolvency procedures of the foreign jurisdiction in determining whether and how to lend in that jurisdiction
- The lender needs to know whether there is legislation in the foreign jurisdiction similar to the UCC that generally renders ineffective any term in an agreement between an account debtor and the borrower that prohibits or restricts the assignment of, or creation of a security interest in, an account receivable
- The lack of such legislation can mean that a secured party seeking to enforce against an account debtor might be faced with the defense that the borrower breached its contract by assigning to the lender the right to payment from the account debtor
- In these jurisdictions, the lender may need to require its borrower to obtain consent of the account debtor to the security interest

Collateral Enforcement as a Matter of Local Law (3 of 3)

- In addition to seeking the advice of local lawyers and obtaining an opinion of local lawyers that a lien is enforceable, practical questions about enforcement should be explored
- The actual costs of enforcement should be understood
  - May include legal costs, taxes, and other costs that may make the liens economically unenforceable
- As a practical matter, enforcement remedies may be almost nonexistent in some countries
  - Enforcement may be limited to public auction
  - Possession of the collateral as a remedy may not be permitted
- Enforcement Risk Areas
  - Each foreign jurisdiction will have its particular enforcement risks that the secured lender will need to understand and address in its loan documentation and structuring
    - *I.e.* priming claims, title retention clauses (e.g. a conditional sale agreement or financing lease), and anti-assignment provisions
  - The lender will want to establish borrowing base reserves or consider obtaining insurance or consider alternative structures to address priming claims

Priority and Scope

- Choice of Law
- The dominant choice of law rule around the world is that the law of the situs governs security interests or "charges"
- E.g., EU Regulation arts. 7(2)(i), 8
- UCC 1-301, 9-301-07:
  - The UCC rule is unusual in using the debtor's "location" (most often state of incorporation) as the usual place of filing, with *situs* and other rules for the law governing different types of collateral (UCC 301, 307)
- UCC 1-301 is the foundational rule and severely limits agreed choice of law for security interests, cross referencing 1-301-07 for governing rules
- Note that choice of law for validity and scope may be different than for perfection and enforcement. (e.g. UCC 9-301 c. 2.)

- The scope of collateral legally available is often narrow. Marie Eva Kieninger surveys European secured credit systems, including scope:
  - SECURITY RIGHTS IN MOVABLE PROPERTY IN EUROPEAN PRIVATE LAW (2004)

Leverage

- Labor priorities fairly often prime security interests, especially in Latin America. Janis Sarra reports labor priorities for 62 different countries:
  - EMPLOYEE AND PENSION CLAIMS DURING COMPANY INSOLVENCY: A COMPARATIVE STUDY OF 62 JURISDICTIONS (2008)
- SEE also the Kieninger book *supra* for labor and liens
- As in the United States, a late grant of a security interest may be a preference
- Liquidation only in many countries
- But reorganization is growing
  - Must have secured stay or fail
  - Older laws often pro-debtor (L.A.)
- Potential substitute for security
  - By isolating assets in a particular entity (SPV) and restricting its capacity to transfer assets (e.g. by a captive board), one can achieve a sort of priority
- The difficulty of enforcing unsecured promises not to convey and the risk such promises do not defeat the validity of conveyances
- Problematic enforcement of fraudulent conveyance and similar avoiding powers

Sovereignty and Domestic Policies of the Individual States in Secured Transactions

- In the area of secured transactions more than in other areas of commercial law, issues of sovereignty remain central
- Many of the rules governing the enforcement of security rights reflect deep policy interests external to the credit relationship itself
  - For instance, when non-consensual statutory creditors receive a preferential position over secured creditors, it is because that preference is deemed necessary to achieve a particular social goal (such as obtaining the payment of accrued wages to employees)
- While some of these policies may be common to many jurisdictions (permitting, for example, the creation of a lien against property for the benefit of workers who contributed materials or labor toward its improvement), others may not be (permitting, for example, the creation of a lien against certain property for the benefit of innkeepers)
- The effect of debtor insolvency on security interests creates an additional layer of policy issues; under bankruptcy regimes as under secured credit regimes, the rules governing priority in the distribution of debtor assets reflect local social goals
- The deep-seated and often divergent State policies and interests implicated in this field will continue to draw issues of sovereign power into the harmonization debate
- Harmonization might flounder simply due to general differences in approach to property rights
  - These include some differences that affect security law directly, such as the question whether to accord proceeds the status of property, but also broader differences concerning the relationship between possession and property interests

Intercreditor Issues (1 of 3)

- The U.S. Bankruptcy Code provides many restructuring tools
  - Automatic stay on steps to enforce claims
  - Valuation principles
  - Ability to sell bankrupt business free and clear of remaining claims
  - DIP financing
- In the absence of consistent equivalent statutory provisions across Europe, the European intercreditor agreement provides for many of these principles contractually (many of which also appear in U.S. intercreditor agreements)
  - Meant to address the continuing concern that insolvency processes in Europe have the potential to destroy the value of a company
    - European debtors and creditors retain a far greater sensitivity to the negotiating leverage that various creditor classes have to force an insolvency filing, thus potentially threatening the whole restructuring and the likely recovery of all creditors
- To address the absence of a chapter 11 framework, typical European intercreditor agreements explicitly provide, by contract, for a number of features that local European commercial and insolvency laws do not consistently provide:
  - Standstill
    - With respect to liens on assets
    - With respect to making claims on the underlying direct debt obligations and guarantees
  - Scope of creditors
    - More extensive range of creditors included as parties to the agreement

Intercreditor Issues (2 of 3)

- Additional provisions typically included by contract in Europe
  - Release of junior debt claims
    - Automatic upon the occurrence of “distressed dispositions”
      - Typically accompanied by forced transfer provisions in which, as an alternative to outright release of the claims, the security trustee can acquire the creditors’ claims (to avoid the tax consequences that otherwise might result from outright forgiveness)
  - Limitations on amendment
    - Restrictions on modifications of the tranches of debt that are subject to the intercreditor arrangements
  - Debt purchase option
    - At par upon, and in some cases prior to, enforcement

Intercreditor Issues (3 of 3)

- Significant European Differences
  - Collateral package issues
    - Complex and variable collateral packages across Europe reflect several issues that mean collateral packages in some jurisdictions often can be incomplete
      - In some jurisdictions, such as the UK and Ireland, comprehensive collateral is easily available
      - In others, collateral may be limited either due to cost or practicability
  - Fear of bankruptcy
    - The continuing concern, despite some changes in bankruptcy laws, that being subject to a formal bankruptcy proceeding is likely to destroy value
  - Personal liability
    - Board members may be personally liable if the company continues to incur debts while insolvent
  - Typical bankruptcy protections inconsistent
    - Standstill and release provisions may now be more available by operation of law in certain jurisdiction since the time European intercreditor agreements first began developing, but not sufficiently consistent to avoid the need to adopt explicit contractual protections in intercreditor agreements

Unexpected Differences Between European and U.S. Practice (1 of 3)

- Single point of enforcement
  - The enforcement sale of the business by first lien creditors often is the principal tool to establish leverage against both the equity owners and junior creditors, whose claims would be released pursuant to the automatic release provisions contained in European-style intercreditor agreements
  - For this reason, a “single point of enforcement” often is critical from a structuring perspective
    - I.e. the ability to sell the business by enforcing a stock pledge over a single entity high enough up in the group structure to capture the value of the business as a going concern
  - Enforcement of an equity pledge in many European jurisdictions is a means of realizing value, often not subject to bankruptcy or statutory rules (*i.e.* automatic stay)
  - Moreover, exercising such enforcement rights may be necessary in order to trigger the debt claim and security release provisions contained in European-style intercreditor agreements

Unexpected Differences Between European and U.S. Practice (2 of 3)

- Addressing the issue of holdouts
  - The emphasis on out-of-court consensual processes requiring amendment and waivers under the governing documents results in senior creditor groups availing themselves of local law processes outside bankruptcy to bolster their positions in restructuring scenarios, in particular to stand up to holdouts
    - For example, a UK scheme of arrangement can be used to override provisions that require unanimous lender vote under English law credit agreements, through a debtor-led procedure requiring the approval of at least 75% in amount and a majority in number of the relevant class of creditors

Unexpected Differences Between European and U.S. Practice (3 of 3)

European Foreclosures

- Taking Security
  - In the U.S. and in England, security normally is taken by appropriating an asset to secure a debt
    - *I.e.*, no transfer or removal of the asset from the security-giver is required
  - This is not always the case in continental Europe
- Present and Future Assets
  - In the U.S. and in England, it is possible to obtain security over existing and future assets
  - This is often not the case in continental Europe
  - Where assets constantly are changing, there often is a requirement to file updated details on a regular basis
- Enforcement of Security – Pre-Insolvency
  - In both the U.S. and England, the self-help principle applies in relation to enforcement of security and a security-holder can take steps itself to enforce its security
    - *I.e.* through a receiver
  - In continental Europe, enforcement of a security normally is managed through the court and assets are realized by public auction or a court-administered sale process

Cross-Border Insolvency Agreements (1 of 2)

- Cross-border insolvency agreements are most commonly referred to in some States as “protocols”, although a number of other titles have been used, including “insolvency administration contract”, “cooperation and compromise agreement” and “memorandum of understanding”
- Agreements may be oral or written, intended to facilitate the coordination of cross-border insolvency proceedings and cooperation between courts, between courts and insolvency representatives and between insolvency representatives, sometimes also involving other parties in interest

Cross-Border Insolvency Agreements (2 of 2)

- A comparison of a number of insolvency agreements entered into in recent years reveals that there are some more generic or “standard” agreements which resemble each other and contain the same provisions, addressing:
  - background, purpose and goals;
  - comity and independence of the courts;
  - cooperation, including provisions on the procedure of communication, such as joint hearings;
  - retention and compensation of insolvency representatives;
  - notice;
  - recognition of stays of proceedings;
  - rights to appear and be heard;
  - effectiveness; and
  - modification and procedure for resolving disputes under the insolvency agreements and preservation of rights

Cross-Border Insolvency Agreements - Examples

- **AbitiBowater (2009)**
  - Multinational enterprise that operated through its various subsidiaries and affiliates in the United States, Canada and other countries
  - Filed in US and Canada
  - United States and Canadian proceedings were separate proceedings, an insolvency agreement was developed to implement administrative procedures to coordinate certain activities; to protect the rights of parties; to ensure the maintenance of the courts' respective independent jurisdictions; and to give due effect to any applicable doctrines, including comity
    - Included provisions common to a "standard" insolvency agreement
    - Provided for respective court copies of all or any orders, decisions, opinions or similar papers issued by the other court in the reorganization proceedings be shared
    - States explicitly that the agreement should not abrogate the requirements of a particular provision of law
    - Incorporates the Court-to-Court-Guidelines

Cross-Border Insolvency Agreements - Examples

- **Calpine (2007)**
  - Multinational enterprise that operated through various subsidiaries and affiliates in the United States, Canada and other countries
  - Filed in US and Canada, with the respective debtors being separate and distinct but memorandums of understanding being concluded on specific issues
  - In recognition of the close relationship between the companies, for example they were each the largest creditors of the other, an insolvency agreement was developed, inter alia, to coordinate and harmonize the proceedings
  - Was initially rejected by Canada court as premature but subsequently approved
  - Main goals were to avoid duplication of activities, to honor the sovereignty of the courts involved and to facilitate the fair, open and efficient administration of the insolvency proceedings
- **Re Nortel (Canada) -** as a prime example, positive and negative
  - Creditors with guarantees had privileged access to two entities in group and did substantially better than others
  - Courts' treatment of IP assets as owned by the group as a whole reduced their recoveries substantially

Cross-Border Insolvency Agreements - Examples

- **SemCanada Crude Company (2009)**
  - Separate insolvency proceedings for different enterprise group members in Canada and the United States
  - Became apparent that the businesses were closely integrated with the United States
  - Insolvency agreement was developed to implement basic administrative procedures and cross-border guidelines to coordinate certain activities in the proceedings, including the coordination of steps required to finalize, seek required approvals and implement the United States plan of reorganization in conjunction with the Canadian plans, including with respect to identifying creditors, calling and holding the required meetings of creditors
- **Madoff (2009)**
  - Insolvency proceedings commenced in England and the United States
  - Insolvency representatives concluded two insolvency agreements and sought approval by the United States court in June 2009; the basis of both agreements was the close relationship between the two companies and the fraud committed
    - First agreement (the “cross-border agreement”) included right to appear, costs, comity, amendment, effectiveness, and communication, preservation of assets and intercompany claims
    - Second insolvency agreement on information-sharing (the “information agreement”) provides a mechanism for information sharing

Shipping Industry (1 of 2)

Bankruptcies involve unique legal and practical issues:

- Transitory nature of ships
- Foreign domicile of most shipping companies
- Awkward intersection of bankruptcy and admiralty law
  - U.S. bankruptcy has automatic stay and the opportunity for a "fresh start," and ensure equitable treatment of creditors
  - Admiralty law is creditor-oriented, generally permitting aggressive individual creditor remedies such as the seizure of assets
- Bankruptcy court will give consideration to applicable admiralty law in determining the validity and priority of any claims (including lien claims) with respect to the debtor's vessels, including the distribution of the sale proceeds to lien creditors, and rarely would yield jurisdiction to an admiralty court to determine such issues
- Shipping creditors that file claims in a bankruptcy case are deemed to consent to the equitable jurisdiction of the bankruptcy court, such that the bankruptcy court will assume jurisdiction to adjudicate (or even extinguish) those claims
- For the reorganized debtor or purchasers of the debtor's assets relying on a bankruptcy court's order, the risk remains that foreign courts may not recognize that certain maritime liens have been extinguished by a U.S. bankruptcy court sale of a vessel (as opposed to a U.S. admiralty court). Admiralty court sales, unlike bankruptcy court sales, are universally recognized as cleansing a ship of liens

Shipping Industry (2 of 2)

Bankruptcies involve unique legal and practical issues:

- Maritime liens are secret liens that arise by operation of law
- Maritime liens, which may arise, among other ways, in connection with the provision of necessaries to a vessel (crew wages, repairs, towage, maintenance, etc.), need not be recorded
  - Such secret liens are often prioritized in the opposite manner of typical U.S. commercial liens — a "last in time, first in right" basis
- The lack of transparency of maritime liens creates a host of problems in a bankruptcy proceeding
- Caution must be taken by lenders negotiating post-petition financing with a maritime debtor, as unknown maritime liens may survive the bankruptcy and enjoy priority to the security interests granted to such lenders as part of the bankruptcy proceeding
  - Vessel charters generally have been treated as executory contracts under the Bankruptcy Code
    - Consequently, a debtor charterer (or a debtor ship owner) under a charter may decide that the terms of a charter are unfavorable and reject the charter, resulting in a claim for damages arising from the breach of the charter in favor of the nondebtor counterparty
      - Generally, outside of the bankruptcy context, a breach of a charter by the ship owner will result in a maritime lien in favor of the charterer
  - It is necessary that a shipping debtor globally coordinate its insolvency proceedings to enhance the likelihood of a successful reorganization
  - The Bankruptcy Code seeks to facilitate coordinated foreign filings through Chapter 15, which enables the bankruptcy court to recognize and aid foreign insolvency proceedings

Energy Issues (1 of 2)

- The need for increased revenue to service debt can create a negative feedback loop with companies selling more oil to generate more revenue increasing supply and putting further pressure on prices
- Lien priority issues (collateral gaps, M&M lienholders)
- Executory contracts (JOAs, leases, other)
- O&G interests
  - Mineral interests
  - Working interests
  - Royalty interests
  - ORRIs
  - Net profit interests
  - Production Payments
  - Joint Interest Billings (JIBs)

Energy Issues (2 of 2)

- Unclear if OCS (Outer Continental Shelf) Lease is unexpired and executory
  - (ATP-NGP Litigation)
- OCS leases represent a growing portion of the oil and gas production in the United States, but unfortunately, how they should be characterized remains largely unaddressed