



Issues Relating to Creditors and Claims

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Issues Relating to Creditors and Claims

- **Part 1: Treatment of Priority and “Unusual” Cross Border Claims.**
- **Part 2: Relative Voting Rights of Debt and Equity Holders and the Impact on Forum Selection.**
- **Part 3: Coordinating Creditor Access to Information and Representation.**



Part 1: The Treatment of Priority and Unusual Cross Border Claims

Nortel Networks – Factual Background

- **In January 2009, certain Nortel entities filed bankruptcy in Canada, the UK, and the U.S.**
- **Over the following year or so, Nortel sold substantially all of its businesses and intellectual property for approximately USD \$9 billion.**
- **How to divide the sales proceeds?**
 - **Multi-national debtors entered into Interim Funding and Settlement Agreement (“IFSA”).**

Nortel Networks – Terms of IFSA

- **IFSA provided mechanism to allow sale of Nortel businesses and assets to proceed without dispute among the multi-national debtors.**
- **Parties to IFSA agreed not to condition the execution of a sale agreement upon an allocation scheme for the sale proceeds.**
- **Sale proceeds were placed into an escrow account and each sale was accompanied by an escrow agreement.**
- **Nortel parties agreed to negotiate a protocol to resolve allocation disputes.**
- **Nortel parties agreed that disputes over the IFSA will be decided in a joint hearing of the U.S. and Canadian courts.**

Nortel Networks – Allocation Dispute

- **Nortel debtors could not agree upon a protocol to govern the allocation process.**
 - **U.S. and Canadian debtors want the Courts to determine the allocation of sale proceeds.**
 - **U.K. administrators believe the Nortel parties agreed the allocation of proceeds would be decided in a private, transnational arbitration proceeding.**
- **Nortel parties engaged in settlement discussions and three rounds of mediation, which did not result in an agreement.**
- **The allocation dispute is keeping the case “tied up in knots seemingly forever.” - U.S. Bankruptcy Judge Kevin Gross**
- **The U.S. and the Canadian courts decided not to compel arbitration. Accordingly, there will be a joint U.S. and Canadian trial on allocation issues beginning May 12, 2014.**

The Lehman/Nortel Pension Claims:

- The pension schemes in UK Lehman and Nortel cases were final salary schemes, both in substantial deficit.
- UK Pensions Regulator initiated proceedings under the Pensions Act 2004 to require certain other Lehman and Nortel affiliates to provide financial support for the schemes (“FSD Claims”).
- FSD Claims were the subject of litigation through the UK courts regarding priority.
- FSD Claims were not unlike claims for preferences or for a transfer at less than fair value - they were designed to right a wrong which we would all recognize.
- Supreme Court (UK) ruling was that FSD Claims were accorded status of unsecured debt.
 - UK lower courts had said they were an expense of administration because the liability was imposed after the commencement of the proceedings

Application of the Lehman/Nortel Example:

- For the purposes of discussion, assume that the FSD Claims were expenses of administration (pre-pref) - that brings the issue we are considering into sharp focus.
- The issue is that the FSD Claims are made against various companies in Europe, the U.S., and Canada. In Europe (because the COMI was in the UK) they would be afforded pre-pref status in the insolvencies and that impacts considerably on the dividends and voting rights.
- In both Europe and North America, the FSD Claims were against companies which had no direct responsibility for the UK pension scheme.

Issues with Cross Border Priority Claims:

- **Universalism vs. Territorialism**
 - **Should priority claims against a company in a foreign jurisdiction be admitted in an insolvency in that jurisdiction even though they do not originate in that jurisdiction?**
 - **Should this apply to all Priority Claims?**
 - **What about Tax Claims?**
 - **Is it right that a company should be able to avoid a claim, for which it is properly liable, by forum shopping?**
 - **Example: Company used employees in one jurisdiction and avoided an employee claim by filing in another jurisdiction.**
 - **What should one do where a creditor has a claim in several estates?**
 - **Example: A guarantee.**
 - **If they are allowable claims, should these claims be afforded the ranking of the jurisdiction they originated from?**
 - **Example: Universal Cross Priorities**
 - **If so, how would you implement this approach?**

Balancing Competing Interests:

- **Foreign Priority Creditors vs. Local Creditors.**
 - Those who have the claim which would otherwise be inadmissible or afforded a lower ranking than the jurisdiction it originated from (although they had the benefit of dealing with a cross border group).
 - Those who granted credit to the company which “picks up” the “unanticipated” foreign liability (although they had the benefit of dealing with a cross border group).
 - Will it make people nervous about granting credit? – probably not the small people, but may be the big people (put up cost of credit or reduce its availability?)
 - If such claims make restructurings difficult, should the interests of the group’s creditors generally override the particular rights of a creditor with leverage because they have a claim in more than one estate?

Cross Border Priority Resolution

- **If Cross Border Priorities are not resolved, what injustices occur or advantages are lost?**
 - The need for mandated, rather than discretionary, international cooperation in insolvencies.
 - Predictability
 - Fairness

Possible Solutions/Options for Working Group Consideration/Discussion:

- **Local country honors foreign priority unless contrary to public policy?**
 - **Marshall assets to one proceeding?**
 - **If the group trades as one entity - like Nortel and Lehman - do you ignore the niceties of separate legal entities?**
 - **EU Regulation?**



Part 2: Relative Voting Rights of Debt and Equity Holders and the Impact on Forum Selection

Voting rights of debt & equity differ from place to place

- **Shareholder approval**
- **Cramdown**
- **Secured creditor participation**
- **Insider subordination**
- **“Out of the money” creditor participation**

Shareholder Approval

Shareholder Approval - the issue

- **Before 2012, shareholder approval for a corporate plan of arrangement was required under German insolvency law**
- **Most other jurisdictions displace management with a court-appointed officer, obviating the need for shareholder approval**
- **Some jurisdictions are “mixed” in that the corporate debtor-in-possession functions through its managers, who are technically under the control of a Board of Directors**

Shareholder Approval - problems

- **A single entity subject to parallel proceedings could be subject to inconsistent rules for plan approval**
- **Multiple entities with cases pending in different jurisdictions could also be subject to inconsistent rules for plan approval**
- **Potential for shareholder approval being required for other significant acts, such as sale of the enterprise**
- **Potential for conflict or abuse when subsidiaries are involved**

Cramdown

Cramdown - background

- **Defined as the ability to approve a plan over the dissent of creditors or a class of creditors**
- **Deemed important to address the “holdout” problem**
- **Variations include**
 - **Cramdown on dissenting creditors** (via a liquidation test)
 - **Cramdown on a class of creditors or shareholders** (via a “waterfall” test)
 - **Cramdown on a class of secured creditors** (via a present value or a fairness test)

Cramdown – the problem

- **A law with stronger cramdown and lower barriers to cramdown gives leverage to the plan proponent (often the debtor)**
- **A law with weak cramdown and higher barriers to cramdown gives leverage to the opposing creditor**
- **A law with no cramdown requires 100% consent of all creditors, and gives complete power to the holdout creditor over the terms of restructuring**

Cramdown - implications

- **For groups of companies, a single jurisdiction with relatively strong cramdown powers is preferred**
- **Even multiple jurisdiction insolvency cases for a group of companies benefit from a single regime's cramdown law for purposes of cross-border restructuring**
- **However, in multiple jurisdiction cases, a jurisdiction with high cramdown thresholds may have to be excluded from an enterprise-wide restructuring**

Secured Creditor Participation

Secured creditor background

- **Secured creditors are those creditors with a power to obtain recovery from specific property to satisfy their claim**
- **Secured creditors may have the right (and perhaps the obligation) to seek recovery from the debtor directly**
- **Some secured creditors must take court action to recover from specific property**
- **Some are permitted to take direct action against specific property, without court involvement**

Secured creditors – the problem

- **Many insolvency regimes impose a “stay” on secured creditor enforcement actions – but a few regimes impose little or no stay**
- **Some regimes allow property subject to secured claims to be sold by the insolvency estate – but some impose limits on this power**
- **Some regimes allow the rights of secured creditors to be altered in varying degrees in a reorganization – but many do not**

Implications

- **In cross-border contexts, a hotchpot rule is an important limitation on “multiple recoveries,” but difficult to apply**
- **Cross-security creates special problems for enterprise cross-border insolvencies, as the participation rules may vary in different jurisdictions**
- **Special problems may arise for special local creditors that hold security interests (labor claims, pension claims, tax claims, environmental claims)**

Insider subordination

Insiders - background

- **Insiders are creditors with a significant ability to influence the direction of the enterprise**
- **Typical insiders include officers, directors, significant shareholders, owners, general partners, shadow directors, and other types of “control” persons or entities**
- **Persons or entities that engage in certain wrongful conduct whereby they exercise control may also be deemed or treated as insiders**

Insider subordination - issues

- **Many jurisdictions treat insider claims by subordinating their recovery rights below the rights of secured creditors**
- **Some jurisdictions require a showing of harm or wrongdoing before subordinating recovery rights**
- **Some jurisdictions automatically treat insider creditor claims as equity claims**
- **Some jurisdictions impose liability on insiders that eliminates any right of recovery**

Some implications

- **Jurisdictions with weaker enforcement against insiders might be deemed more favorable venues for voluntary insolvency proceedings by insiders making the decisions for the debtor**
- **Jurisdictions with stronger enforcement or subordination rules might be favored by unsecured creditors**
- **Secured creditors may have a closer alliance with insiders due to their lending relationship with the company**

“Out of the money” creditor participation (OMC’s)

OMC participation - background

- An “out of the money” creditor (or OMC) is one who no longer has an economic stake in the outcome of the proceeding because there is insufficient value under any circumstance to satisfy the claim
- Often applies to lien claimants when there is insufficient asset value to cover the lien claim (e.g., sufficient value only to pay 1st and partially 2nd, but not the 3rd).
- Also applied to equity claims in insolvent enterprises

OMC participation – the problem

- **Some regimes do not permit OMC's to vote on plans**
- **Some regimes do not permit OMC's to object to certain actions**
- **Some regimes do not permit OMC's with liens to participate as secured creditors**

OMC participation - implications

- **OMC shareholders may prefer to avoid jurisdictions where they have no vote or say**
- **A debtor or senior lender might prefer a jurisdiction that eliminates the rights of OMC lien creditors to participate**

**The foregoing factors can affect
the forum selected by “case
placers”**

Forum selection matters ...

Case placement is a reality. If players with an economic stake in the outcome can control the locus of an insolvency proceeding to maximize their potential for recovery – then they will do so.

Opportunistic case placement becomes a danger when it serves a relatively small constituency, at the expense of a much larger constituency of stakeholders

Addressing Forum Selection

A variety of mechanisms might be considered in addressing forum selection issues

-Harmonizing the elements that tend to affect forum selection most critically

-Setting international standards for forum selection irrespective of the nature of the insolvency regime

-Rewarding/punishing forum selection choices

Conclusion

“Forum shopping” in the insolvency context may be a good thing – in the sense of seeking out the optimal legal regime for restructuring

... or it may be a bad thing – in the sense of selecting a forum for its advantages to some stakeholders at the expense of others

Addressing the “drivers” to forum shopping is suggested as a worthy subject for consideration by UNCITRAL’s Working Group on Insolvency



Part 3: Coordinating Creditor Access to Information and Representation



Issue

Common goal among insolvency regimes is maximizing creditor recoveries.

A related goal is, or should be, providing creditors access to information to allow them to participate and protect their interests in a proceeding

We should consider the benefit approved creditor's committees might play in providing greater access to information for all creditors, presenting issues of similarly situated creditors and increasing efficiency

Balance of Interests

Debtor

- **Privacy of documents and information**
- **Selective resolution of claims of key creditors**
- **Sale or disposition of assets without interference**

Creditors

- **Transparency as to basis for bankruptcy, assets and value**
- **Truly collective resolution achieved**
- **Increase likelihood of maximizing value**

Existing Related Provisions

Legislative Guide: Recommendations 126-136

Generally addresses

- **Right to be heard**
- **Confidentiality**
- **Participation**
- **Voting**
- **Convening meetings of creditors**
- **Representation**
- **Committee membership, rights & functions**

Proposed additions

I. NOTICE:

a)Assets: Providing initial information on location, type of assets and asset value

b)Status: Reporting to creditors about the status of a case; a free flow of information

c)Sale & Distribution: Reporting on significant disposition of assets and payment of claims

Notice: a) Regarding Assets

Disclosure of nature, location, ownership and use of assets allows creditors to assess:

- **Likelihood of recovery**
- **Whether assets are essential to or severable from the proceeding**
- **Relevant applicable law jurisdictional law governing the assets**
- **How assets are owned within the enterprise group**
- **Whether intercompany claims exist**

Notice: b) Status of Case

Initial reporting to creditors as to the genesis of a case, general plans and methodology for a potential wind down, restructuring or sale of assets, and the existence of significant claims and disputes should be provided.

Periodic reports to creditors about hearing dates and deadlines should increase participation and transparency.

A balance can be achieved between access to information and privacy by carving out truly confidential information.

Notice: c) Sale & Distribution

How assets will be sold – auction, private sale

How distributions will be made

**Which creditors will receive distributions,
when and in what priority**

Will some creditors be preferred

**Will certain creditors receive advanced
distributions**

Will distributions be paid over time

**How long after commencement will assets be
sold and a distribution made**

Proposed additions

II. COOPERATION:

Between insolvency representatives and creditors or creditor representatives

In concurrent proceedings where creditor groups exist, between creditor groups

Cooperation With Creditors

Rights that exist for creditors in Country A, where an enterprise group has assets, may not exist in Country B where certain other assets may be located or from which distributions may be made. Understanding creditors' rights, allowing a creditor representative to represent the interest of creditors to a foreign court or administrator would increase the likelihood of a speedy and broad resolution of creditor claims and asset disposition.

Proposed Additions (cont'd)

III. ACCESS TO INSOLVENCY REGIMES:

Ease of creditor access to administrators or courts to assert claims or issues

Ensure consistency and simplicity in filing of creditor claims

Provide information to administrators or courts about common claims of similarly situated creditors

Access to Insolvency Regimes

Language: creditors doing business with an entity in one language, forced to communicate in an entirely different language

Electronic access to courts/administrators: balanced/limited to avoid burden on professional but would ↑access and ↓costs

Disclosure vs Advice: Disclosure to be informational only

Mediation/Resolution of disputes: An insolvency professional may consensually resolve disputes quickly and at lower cost

Creditors' Committee

The appointment of a committee of creditors representing the largest denomination of a cross-section of creditor claims, will provide greater access than most creditors have now without the cost to general creditors of participating. The Committee can take the laboring oar in communicating with creditors and simplifying access to the professional or court handling a proceeding and can streamline the claims process and improve the view of the public as to the proceedings.

Committee Appointment

- **Members selected by someone other than the insolvency professional, e.g. a court**
- **Members selected based on the size and type of their claims**
- **Interested creditors given an opportunity to request membership**
- **Representative of Committee chosen by members to speak on its behalf**
- **Representative's fees and expenses paid for by the bankruptcy/insolvency estate**

Key Elements of a Committee

- **Committee representative and members agree to confidentiality as to information received from insolvency professional**
- **Insolvency professional to provide Committee representative with information about operations and restructuring or liquidating plans**
- **Committee representative may challenge plans/operations and pursue other rights of creditors in the event of a disagreement with the professional over his/her actions**

Committee Challenges

- **Multiple committee representatives where creditors exist in multiple jurisdictions?**
- **Laws relating to creditors vary between jurisdictions; which country's creditors rights law apply?**
- **Avoiding conflicts between a committee appointed in the home country and in a related foreign proceeding**
- **Determining when providing access and information to general creditors is more beneficial than appointing a committee**

Benefits

Notice, access and cooperation leads to:

- **Greater buy-in by creditors for approval of a reorganization or liquidation plan**
- **Speedier resolution of disputes and distribution of assets**
- **Streamlined process with greater chance to maximize asset value**
- **Potential increase in cross-border deals with reduction of impediments to creditors in the event of a bankruptcy/insolvency**

Risks and Costs

With the addition of rights comes risk/cost:

- **Increase cost of notice and communication**
- **Potential slowdown of process**
- **Additional cost of creditor professionals for regimes willing to pay for a creditor representative**

These risks can be minimized or eliminated through the use of Creditors Committees and a creditor representative to represent the cross-section of creditors

Possible Location

Expansion of Recommendations in the Legislative Guide, Paragraphs 126-136

Inclusion in the Guide to Enactment & Interpretation addressing Article 27 of the Model Law involving cooperation

Future work on insolvency in enterprise groups



**Proposals for solution of some unanswered questions
Regarding Creditor Access and Information – Jasnica
Garašić**

1. RIGHT TO BE INFORMED ABOUT OPENING OF INSOLVENCY

PROCEEDINGS

Each creditor **has the right to participate in insolvency proceedings** commenced against his/her debtor.

(main and non-main insolvency proceedings)



It presupposes the right to be informed about opening of insolvency proceedings.

Difficulties in connection with foreign creditors
(geographical distance and information distance from local proceedings,
foreign language, costs)

The risk of non-recognising of foreign insolvency proceedings in the state,
whose creditors had no knowledge about its opening and had no possibility to
file their claim in the insolvency proceedings.

(public policy exception)

SOME EXISTING LEGAL PROVISIONS

Art. 13 (1) Model Law on Cross-Border Insolvency

Whenever under (*identify laws of the enacting State relating to insolvency*) notification is to be given to creditors in this State, such notification shall also be given to **the known creditors** that do not have address in this State.

The court may order that appropriate steps be taken with a view to notifying any creditor whose address is not yet known.

Art. 40 (1) European Regulation on Insolvency Proceedings

As soon as insolvency proceedings are opened in a Member State, the court of that State having jurisdiction or the liquidator appointed by it shall immediately inform **known creditors** who have their habitual residences, domiciles or registered offices in the other Member State.

UNKNOWN CREDITORS?

A modern international insolvency law should foresee:

*a domestic insolvency representative has the authorisation and duty to require the **public announcement** of a domestic decision to open insolvency proceedings in foreign states;

*a foreign insolvency representative has the authorisation to require the domestic **public announcement** of a foreign decision to open insolvency proceedings.

The debtor has assets and creditors in more than one country.

For example: [Art. 21 \(1\) sent. 1 of the European Regulation on Insolvency Proceedings](#):
The liquidator may request that notice of the judgment opening insolvency proceedings, and, where appropriate, the decision appointing him, be published in any other Member State in accordance with the publication procedures provided for in that State.

Possible location:

Interpretation of Article 27 lit. f) Model Law on Cross-Border Insolvency

UNKNOWN CREDITORS, THIRD PERSONS?

A modern international insolvency law should foresee:

- *a domestic insolvency representative has the authorisation and duty to require the **registration** of a domestic decision to open insolvency proceedings in public books and registers of foreign states;
- *a foreign insolvency representative has the authorisation to require the **registration** of a foreign decision to open insolvency proceedings in domestic public books and registers.

The debtor has assets and creditors in more than one country.

For example: [Art. 22 \(1\) European Regulation on Insolvency Proceedings](#):

The liquidator may request that the judgment opening the main insolvency proceedings be registered in the land register, the trade register and any other public register kept in the other Member States.

Possible location:

Interpretation of Article 27 lit. f) Model Law on Cross-Border Insolvency

2. THE ROLE OF CREDITOR COMMITTEES

- *when more insolvency proceedings have been opened against the same debtor
- *in case of enterprise group insolvency

A modern international insolvency law should foresee:

*direct communication between creditor committees in domestic and foreign insolvency proceedings

*cooperation to the maximum extent possible between a domestic creditor committee and a foreign creditor committee

These additional rules shall support the providing advice and assistance to the insolvency representatives, but also the control of the insolvency representatives.

Possible location:

Recommendation 133, new lit. f) Legislative Guide on Insolvency Law?

3. REPRESENTATION OF CREDITORS BY INSOLVENCY REPRESENTATIVE?

a) A modern international insolvency law should foresee:

- *insolvency representatives in domestic proceedings (both main and non-main) are authorised to **lodge claims in foreign insolvency proceedings** against the same debtor that have already been lodged in the proceedings for which they were appointed.
- *insolvency representatives in foreign proceedings (both main and non-main) are authorised **to lodge claims in domestic insolvency proceedings** against the same debtor that have already been lodged in the proceedings for which they were appointed.

For example: [Art. 32 \(2\) European Regulation on Insolvency Proceedings](#):

The liquidators in the main and any secondary proceedings shall lodge in other proceedings claims which have already been lodged in the proceedings for which they were appointed, provided that the interests of creditors in the latter proceedings are served thereby, subject to the right of creditors to oppose that or to withdraw the lodgment of their claims where the law applicable so provides.

These rules are important for creditors who are not familiar with the law and language of the state where other insolvency proceedings are being conducted, or when this state is located at a geographical distance.

Discussion: must the insolvency representative have the power of attorney in order to lodge the claim of a creditor in other insolvency proceedings?

Possible location:

Interpretation of Article 27 lit. f) Model Law on Cross-Border Insolvency

b) The right of insolvency representative to vote in foreign insolvency proceedings?

- *should the domestic insolvency representative be authorised to exercise **the right to vote in foreign insolvency proceedings** for claims lodged in domestic proceedings and simultaneously in foreign insolvency proceedings as well?
- *should the foreign insolvency representative be authorised to exercise **the right to vote in domestic insolvency proceedings** for claims lodged in foreign proceedings and simultaneously in domestic insolvency proceedings as well?

Has the exercising such a right in other insolvency proceedings an impact on the insolvency representative's impartiality in his/her domestic insolvency proceedings?

Creditors can have different interests in insolvency proceedings.

The meaning of [Art. 32 \(3\) European Regulation on Insolvency Proceedings](#):
The liquidator in the main or secondary proceedings shall be empowered **to participate** in other proceedings on the same basis as a creditor, in particular by attending creditors' meetings.

A possible solution:

The right of the insolvency representative to vote in other insolvency proceedings should be linked to the existence of the creditors' express authorisation that the insolvency representative exercise this right in a concrete case, with specific instructions regarding how to vote.

Possible location:

Interpretation of Article 27 lit. f) Model Law on Cross-Border Insolvency