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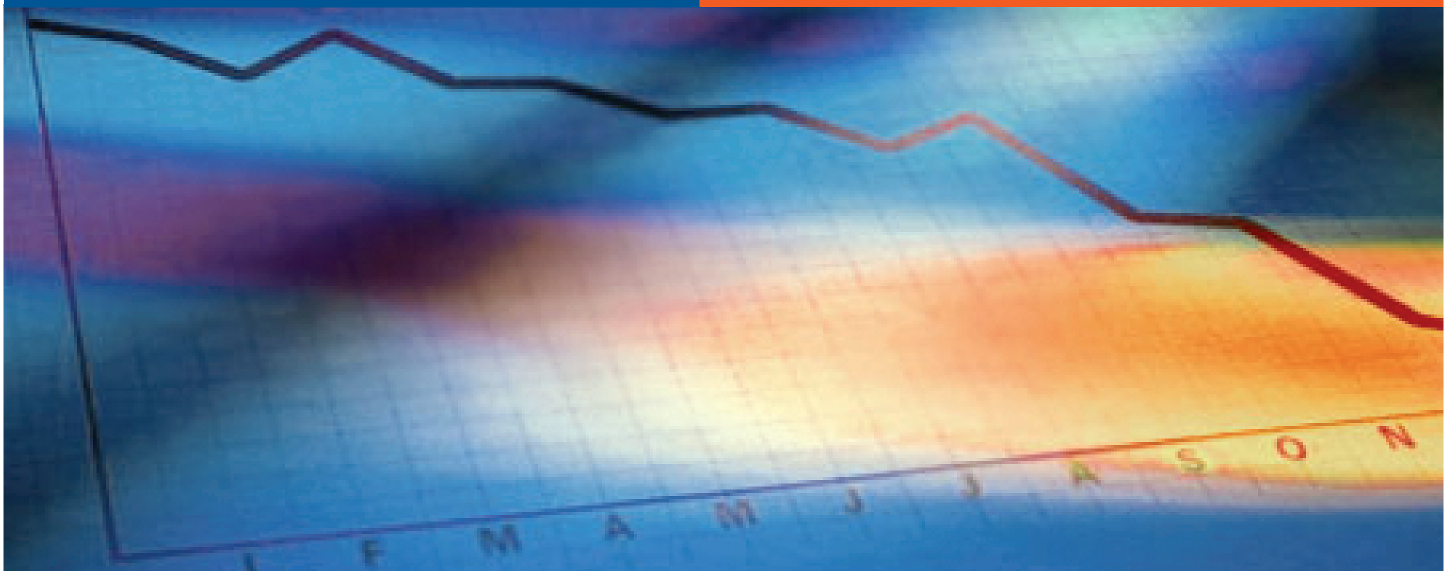

U.S. Bankruptcy Basics

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U.S. BANKRUPTCY BASICS

- 6 types of bankruptcy cases: (1) chapter 11 reorganization (also used for liquidation in certain circumstances), (2) chapter 7 liquidation, (3) chapter 9 municipality debt adjustments, (4) chapter 12 family farmer or fisherman debt adjustments, (5) chapter 13 debt adjustments for individual wage earners, and (6) chapter 15 ancillary proceedings and cross-border cases.

- Specialized federal bankruptcy courts in each of 94 federal districts have jurisdiction over bankruptcy cases.

- Chapter 11 proceedings are most often used by commercial enterprises -- debtor generally remains in control of its assets and corporate governance, subject to certain restrictions and bankruptcy court oversight, and must pay post-petition obligations on a current basis as they come due.

- Chapter 7 proceedings are strictly used to liquidate a debtor's assets under the direction of a court-appointed, independent trustee, and bankruptcy court oversight.

- The filing of a petition by (i.e., "voluntary") or against (i.e., "involuntary") a debtor commences a bankruptcy case -- in an involuntary case, the debtor has an opportunity to answer and dispute the alleged bankruptcy or consent to bankruptcy.

- Upon the filing of a bankruptcy case, an estate is created consisting of all assets in which the debtor has a legal or equitable interest as of the filing date.

- The filing of a bankruptcy case subjects the debtor to broad financial disclosure -- required to file schedules of assets and liabilities, statement of financial affairs and monthly operating reports in chapter 11 cases.

- Upon the filing of a petition, an automatic statutory stay is imposed against any persons or entities continuing or commencing most actions, proceedings or other formal or informal attempts to recover pre-petition claims against the debtor or its assets -- exceptions for certain repo, commodity, forward and securities contracts.

- Bankruptcy Code provides chapter 11 debtors with powers to facilitate reorganization, including to: (a) assume or dispose of certain contracts and leases; (b) commence actions to avoid pre-petition and post-petition transfers; (c) obtain post-petition financing with "super-priority"; (d) liquidate and dispute claims, and (e) negotiate and confirm a plan for reorganization.

- Chapter 11 plans and disclosure statements are subject to notice and a hearing -- plans require the vote of all impaired classes of creditors: for a class of creditors to approve a plan, at least 2/3 in amount and 1/2 in number must vote in favor of the plan

- If not all classes vote in favor, bankruptcy court may still approve plan if "cram down" rules are satisfied.

CONSIDERATIONS FOR FOREIGN CREDITORS IN U.S. BANKRUPTCY CASES

- Creditors are entitled to file "appearances" and proofs of claim against a debtor.

- Proof of claim must be filed by the deadline set by the bankruptcy court overseeing the bankruptcy and be supported by proof of the amounts owed to such creditor.

- Foreign creditors should consider whether they are already subject to jurisdiction in the U.S. -- through U.S. offices or operations, contractual submission to jurisdiction within the U.S., or "sufficient contacts" -- before filing appearances and/or proofs of claim.

- Filing of an appearance, even where "limited", may subject a foreign creditor to jurisdiction in the U.S.

- Filing of a proof of claim against a debtor by a foreign creditor will be a submission to jurisdiction – among other things, the foreign creditor may then be sued in applicable preference actions (i.e., for avoidance of certain payments/transfers made within 90 days before the bankruptcy) or fraudulent conveyance actions (i.e., for avoidance of certain transfers made within a year or more before the bankruptcy that are actually intended to defraud creditors or for insufficient consideration) in the bankruptcy case.

- If a foreign creditor is not already subject to jurisdiction -- determine whether claims against the debtor have been listed in correct amount and not as disputed, unliquidated or contingent in the debtor's schedules of assets and liabilities (required to be filed in accordance with the Bankruptcy Code).

- If foreign creditor is not already subject to jurisdiction and claims are correctly listed in the debtor's schedules -- should not file a proof of claim against the debtor to avoid exposure to potential preference and fraudulent conveyance actions, among other pitfalls of jurisdiction.

- Foreign creditor must monitor the debtor's case in event that debtor exercises its right to amend its schedules -- impacting foreign creditor's listed claim -- or if plan adversely or improperly provides for foreign creditor's claim.

- If foreign creditor is not already subject to jurisdiction and claims are <u>not</u> listed in the debtor's schedules at all, are incorrectly listed, or are listed as contingent, disputed or unliquidated -- foreign creditor should carefully consider the benefits of filing a proof of claim, including prospective percentage distribution on those claims (if ascertainable) against potential exposure to preferential, fraudulent conveyance or other actions, including potential amounts of such actions.

- The automatic statutory stay of most actions against the debtor or its assets is, on its face, a worldwide injunction and may have extraterritorial effect – for example, if an order issued by a U.S. Court is enforceable in the foreign jurisdiction or the foreign party is subject to U.S. jurisdiction.

UNDERSTANDING U.S. PREFERENCE ACTIONS

- A debtor-in-possession or a trustee may bring an action to avoid certain transfers or payments which were made by a debtor to an unaffiliated creditor within 90 days prior to filing of the debtor's bankruptcy petition -- these avoidable transfers are known as "preferential transfers."
- A debtor-in-possession or trustee may bring a preference action against an "insider" to avoid payments made within 1 year prior to the filing of the bankruptcy petition.
- Creditors sued for avoidance of preferential transfers will not necessarily have done anything wrong, and are often entitled to have received such preferential transfers by contract or otherwise.
- A "preferential transfer" is an equitable remedy against a creditor who has theoretically received preferential treatment in comparison to other similarly-situated creditors who may not have received payments due in the same period.
- Preferential transfers are those transfers which:
    - have been made to or for the benefit of a person/entity to whom the debtor owes a debt;
    - for or on account of any debt owed by the debtor before such transfer was made -- "antecedent debt";
    - while the debtor was insolvent;
    - within 90 days prior to filing of the debtor's bankruptcy petition (or 1 year prior to the bankruptcy petition if made to an "insider" of the debtor); and
    - enables such creditor to receive more than it would receive in: (a) a liquidation; (b) if the transfer was not made; and (c) the bankruptcy case itself.
- Creditor from whom the transfer is sought to be avoided does not have to be the same creditor to whom the "antecedent debt" was owed -- may be the initial transferee, the person to whom the transfer was then further transferred, or the person for whose benefit the transfer was made (i.e., a guarantor or surety).
- There are defenses to a preference action, including, among others:
    - "simultaneous exchange" -- transfer was intended by debtor and creditor to be a simultaneous exchange where debtor received new value in goods or services from the creditor and exchange was, in fact, substantially simultaneous;
    - "ordinary course" -- transfer was for payment of a debt incurred by debtor in the ordinary course of its business and was: (a) made according to the ordinary course of dealing between debtor and creditor; or (b) was made according to ordinary business terms.
    - "new value" -- after such transfer, creditor from whom transfer is sought actually gave new value to debtor in the form of after received goods or services.
- To protect against a preference -- require security for the debts or make sure potential debtor-counterparty pays on a regular and uniform basis in terms of timing and manner and, if possible, according to contract terms – NOTE that security interests granted within the 90 days prior to bankruptcy may also be considered preferential.

UNDERSTANDING U.S. FRAUDULENT CONVEYANCE ACTIONS

- Debtor-in-possession or trustee may bring an action to avoid certain transfers or payments made by debtor within 2 years prior to the filing of the bankruptcy petition -- these avoidable transfers are known as "fraudulent transfers."

- Each state has its own fraudulent transfer/fraudulent conveyance statutes, which may carry longer "reach-back" period(s) (sometimes as long as 6 years, such as in New York) and may otherwise differ from, but may also be alleged by a debtor/trustee simultaneously with, the Bankruptcy Code version of the action.

- Recipient of a fraudulent transfer (and/or the debtor who made the transfer) may not have necessarily known or intended a "fraud" be committed in the transfer giving rise to the action.

- A "fraudulent transfer" under the Bankruptcy Code is the transfer of an interest of the debtor in property, or any obligation incurred by the debtor, made or incurred within 2 years prior to the debtor's bankruptcy petition, and may be:

    - "actual fraud" -- made with intent to hinder, delay or defraud its creditors; or

    - "constructive fraud" -- received less than reasonably equivalent value in exchange for such transfer/obligation, and (a) was/was about to be engaged in a business/transaction for which its remaining property would be unreasonably small, (b) intended to incur/knew it would incur debts it would be unable to pay, or (c) made to or for the benefit of an insider under an employment contract not in the ordinary course.

- Entity from whom transfer is sought to be avoided may be initial transferee, person to whom transfer was then further transferred, or person for whose benefit the transfer was made (i.e., a guarantor or surety).

- Defenses to a fraudulent transfer action exist under applicable case law and certain circumstances outlined in the Bankruptcy Code, including by negating the factors outlined above.

- To protect against a "constructive fraud" action, ensure fair market value is paid for goods or services to be provided by a potential debtor-counterparty, or that no more than fair market value is paid for any goods or services to be provided to a potential debtor-counterparty, and that terms of transaction are arm’s length, especially for related party transfers.

SECTION 363 ASSET SALES UNDER THE U.S. BANKRUPTCY CODE

- A sale of any property of the debtor outside of the ordinary course of business, or of substantially all a debtor's assets, including certain executory contracts, must be approved by the Bankruptcy Court in accordance with Bankruptcy Code and Rules.
- Sales may be accomplished by "private sale" or "public auction."
- Debtors and Bankruptcy Court favor public auctions -- auctions protect purchaser and sale from claims that the transaction was not arm's length and/or debtor failed to maximize value of the asset(s) for the benefit of its creditors.
- Public auction usually begins with a "stalking horse bidder" who has agreed to buy asset(s) pursuant to a purchase and sale agreement, subject to bankruptcy court approval.
- After entering into the purchase and sale agreement with the stalking horse bidder, debtor will usually make a motion describing the basis and terms of sale, procedures for accepting "higher and better" offers, and a proposed time and place for the auction.
- Such motion will also provide:
    - deadline for submission of "competing bids";
    - that a "qualified" competing bid will be on the same or substantially similar terms as purchase and sale agreement of stalking horse bidder;
    - for full or partial expense reimbursement ("breakup fees") to the stalking horse bidder if they are not the winning bidder after auction;
    - minimum amounts for an initial "overbid" and further incremental bid amounts at auction.
- "Qualified" competing bids and the "best" (or winning) bid will usually be based on price, terms and purchaser's ability to complete the transaction.
- Advantageous to be stalking horse bidder (as opposed to a challenging/competing bidder) -- controls terms of transaction and terms of auction.
- Purchase and sale agreements in a bankruptcy differs from non-bankruptcy counterparts:
    - conditioned on Bankruptcy Court approval;
    - purchase of assets on "as is, where is" basis;
    - representations and warranties of debtor-seller limited in type and survivability -- debtor is not economically viable, will ultimately be discharged from debts/obligations in a bankruptcy, and properly drafted order approving sale will provide for the same or better protections to purchaser;
    - indemnification by seller-debtor is rare.
- Sale order should provide for sale of the asset(s) free and clear of any liens, claims, encumbrances or other interests in the asset(s), and that purchaser is a "good faith" purchaser -- generally protect(s) a purchaser from, and is enforceable against, any claims by a third party (or the debtor) on the asset(s).
- Each sale of assets in bankruptcy context is unique -- fundamental principal is that sale be conducted in a manner is reasonably calculated to maximize value for the company's creditors.

VENDOR'S RECLAMATION CLAIMS IN U.S. BANKRUPTCY CASES

- A person/entity selling goods to a debtor, in the ordinary course of business, which were received by the debtor within the 45 days prior to the filing of its bankruptcy case has a right to reclaim such goods under the Bankruptcy Code.

- Debtor must have been insolvent when it received the goods.

- To exercise this right, seller must make a written demand on the debtor not later than 20 days after filing of debtor's bankruptcy petition.

- Seller must be able to establish that goods to be reclaimed are or were in the debtor's possession when Seller requested reclamation and are identifiable (i.e., have not been integrated into a "finished product").

- Seller must also establish that goods were sold in ordinary course of business as between seller and debtor.

- Right to reclamation of seller is subject, however, to any security interests held by another entity in the goods once they came within possession of debtor.

- Right to reclamation is limited to goods themselves, and not proceeds of goods.

- Although written demand preserves the reclamation right of a seller, seller should ultimately assert its rights to reclamation by filing a complaint in bankruptcy court to commence an "adversary proceeding."

- If a seller fails to provide written notice of exercise of its reclamation rights within time period prescribed, seller may still assert a right to administrative expense, but only for those goods received by debtor within 20 days prior to filing of the bankruptcy petition.

- Claim for administrative expense, like assertion of right to reclamation, is subject to objection of debtor and approval by Bankruptcy Court.

SERVING ON A CREDITORS' COMMITTEE IN A U.S. BANKRUPTCY CASE

- A committee of creditors holding unsecured claims against debtor may be appointed by the U.S. Trustee's office in every chapter 11 reorganization case, provided there are creditors willing to serve and unless bankruptcy court orders otherwise on request of a party-in-interest.
- Creditors' committee will ordinarily consist of creditors holding largest claims against debtor.
- Creditors' committee may be smaller or larger, and include persons not necessarily holding the seven largest claims.
- U.S. Trustee has some latitude in choosing which creditors will serve on a creditors' committee.
- Holders of disputed claims may also serve on the creditors' committee.
- Creditors' committee should be representative of different categories of claims against debtor -- committee represents all creditors holding unsecured claims against debtor.
- Creditors' committee has fiduciary duties to:
    - provide *access* to information to all creditors holding claims of the type represented on committee,
    - solicit and receive comments from holders of claims of the kind represented by committee,
    - provide periodic reports on its disclosures to the general body of creditors, and
    - act in the best interests of all similar creditors.
- Creditors' committee is also authorized to perform certain functions not typically afforded to individual creditors, including:
    - consult directly with debtor-in-possession/trustee concerning administration of the case,
    - investigate operations, business, management, conduct, assets, liabilities and financial condition of debtor,
    - participate in formulation of a plan and solicit acceptances of a plan, and
    - perform any other actions which are in the best interests of creditor body as a whole.
- Members of a creditors' committee thus have access to a higher level of information and involvement in administration of a debtor's bankruptcy case and in treatment of their claims/interests as representative of all creditors.
- Creditors' committee is entitled to engage professionals such as attorneys and accountants to represent them as a committee -- approved out of pocket expenses of committee members and fees and expenses of approved professionals of committee will be paid out of bankruptcy estate, <u>not</u> by individual committee members.