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NORTON ROSE FULBRIGHT

International Restructuring Newswire

A quarterly newsletter from the bankruptcy, financial restructuring and insolvency team at Norton Rose Fulbright

Summer 2018

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International Restructuring Newswire

International Restructuring Newswire is published by Norton Rose Fulbright and is not a substitute for fact-specific legal counsel.

International Restructuring Newswire
Published by Norton Rose Fulbright – Summer 2018 – Issue 3

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To our clients and friends:

We are pleased to announce that we have expanded our Restructuring Newswire to include articles from all the jurisdictions worldwide. This expanded quarterly publication has been re-titled the *International Restructuring Newswire*, and will include articles from our global team of insolvency and restructuring lawyers.

Since our combination with Chadbourne & Parke and Henry Davis York in 2017, the firm has grown to 60 offices and over 4,000 qualified lawyers in 33 countries, operating across Europe, the US, Canada, Latin America, Asia, Australia, Africa, the Middle East and Central Asia. We have one of the world's largest global financial restructuring and insolvency practices. Our restructuring and insolvency team is cross-functional, as it comprises acknowledged professionals in restructuring, insolvency, and insolvency litigation, and is also able to call on the expertise of our global teams in the fields of banking and finance; corporate, M&A and securities; employment and labor; real estate; and tax.

Our global team delivers world-wide enhanced financial restructuring and insolvency services to our clients. Our clients include lenders, private equity and distressed debt funds, hedge funds, bondholders, corporate debtors, office-holders, creditors, management and other relevant stakeholders.

We advise on all aspects of both contentious and non-contentious financial restructuring and insolvency matters, with particular emphasis on complex, cross-border cases. Our areas of experience include complex loan restructurings; committee representations; pre-packaged, pre-negotiated and traditional plans; bankruptcy and insolvency litigation; municipal bankruptcy and insolvency; debtor-in-possession and exit financings; cross border recognition proceedings; sale and acquisition of distressed assets; sale and purchase of distressed debt and portfolio sales; and lender liability disputes.

If you would like to know more about our global restructuring practice, please contact me.

Howard Seife
Global Head Financial
Restructuring and Insolvency

In the news

April

Orlando, FL, April 13, 2018
Marian Baldwin Fuerst spoke at the ABA Business Law Section Spring Meeting on a panel on International Bond Defaults: *Navigating the Thicket of Recalcitrant Sovereigns, Aggressive Bondholders, and Conflicting Laws.*

New York, NY, April 20, 2018
Scott Atkins spoke at the INSOL International Annual Regional Conference (in his capacity of Chair of INSOL's Taskforce 2021) about the ongoing implementation of INSOL's 2021 Strategic Plan.

May

New York, NY, May 1, 2018
Howard Seife led a panel at INSOL International's Annual Regional Conference. The panel discussed *The Future Under the Trump Administration: Winners and Losers in the U.S. Economy.*

Amsterdam, the Netherlands, May 6-8, 2018
Lee Pascoe spoke on a panel at the Annual IBA Global Insolvency and Restructuring Conference. The panel discussed the regulation of cryptocurrencies, the lessons learned from the insolvency of the Mt Gox cryptocurrency exchange in Japan and the legal issues that may arise when a business utilising or trading cryptocurrency experiences an insolvency event.

London, UK, May 22, 2018
Mark Craggs, David Rosenzweig and Charlotte Winter, along with Jim Tucker of KPMG, spoke at Norton Rose Fulbright's annual Aviation Summit, which took place in London on May 22, 2018, concerning recent airline insolvencies across Europe and the differences from Chapter 11 airline cases. The event is heavily attended each year by airlines, financiers, industry experts and others interested in the aviation industry.

New York, NY, May 24, 2018
Sam Kohn spoke on a panel at ABI's 20th Annual New York City Bankruptcy Conference. The panel examined recent developments in Puerto Rico and other municipal restructurings. The panel included the Hon. Julie A. Manning, Chief US Bankruptcy Judge, District of Connecticut.

In the news

June

Sydney, Australia, June 7, 2018

Scott Atkins (in his capacity of Deputy President of the Australian Restructuring Insolvency and Turnaround Association) spoke at the Association's Sydney conference on recent developments in restructuring and insolvency.

July

Jersey, Channel Islands, July 3, 2018

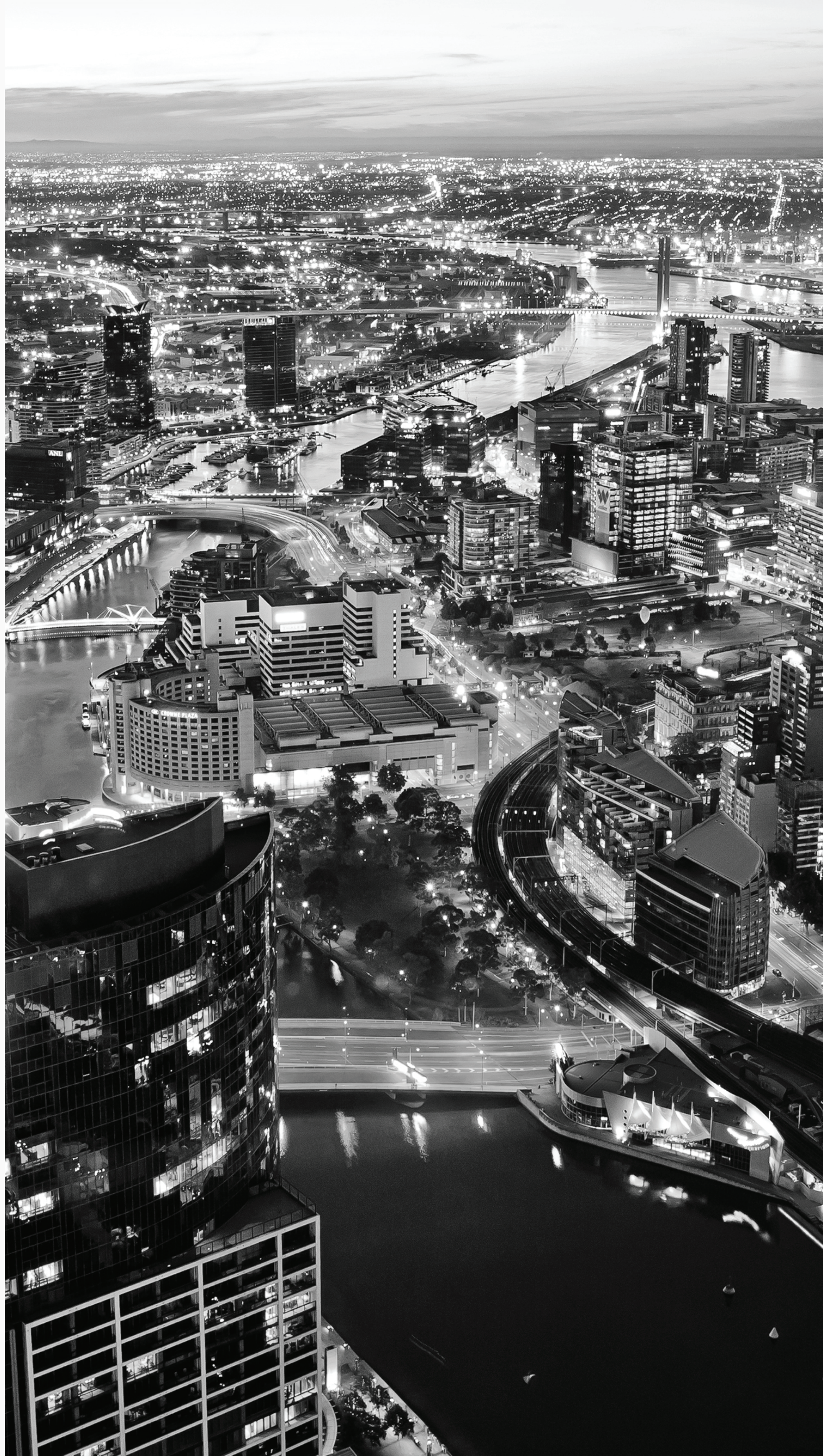
John Verrill participated on a panel at INSOL International's Channel Islands One Day Seminar. The Panel discussion topic is *"Evolution or revolution - Is insolvency in a state of transition?"* Other panel contributors include Hon. Elizabeth S. Stong, US Bankruptcy Court, Eastern District of New York, Jamie Toynton of Grant Thornton, Jersey, and Nigel Saunders of Ogier, Jersey.

International Corporate Rescue

Scott Atkins, Jonathon Turner, Gabriel Perrottet and Oliver Perrottet published an article in *International Corporate Rescue:* "Australia's Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and its Impact on Corporate Rescue."

Cross Border Insolvency Investigations

Noel McCoy and Candy Lau recently co-authored an article in *International Corporate Rescue* (Issue 3 of Volume 15), entitled "Tracing Assets in Asia Pacific: A Comparative Analysis of the Availability of Norwich Pharmacal Orders in Australia, Hong Kong and Singapore." The article explores obtaining third party discovery in cross border insolvency fraud investigations.



Australian law reform: the new 'safe harbour' for directors and stay on enforcement of 'ipso facto' clauses

Jeffery Black, Nicole Schaillee and Karli Cibich

Australian insolvency laws recently underwent the most comprehensive review and reform since the early 1990s. Despite some calls for an overhaul of the Australian insolvency regime to replace it with a Chapter 11 style equivalent, we settled for a swathe of reforms aimed at, on the one hand, improving efficiencies in the formal insolvency processes and, on the other hand, promoting a culture of entrepreneurship. This article will focus on the latter of these reforms – the introduction of the safe harbour and ipso facto reforms.

The reforms are aimed at fostering a culture of restructuring in amidst an insolvency regime that imposes tough penalties on directors that continue to trade a company while it is insolvent. Such is the concern around penalties that it is often the case that directors will act early to appoint an insolvency practitioner to the company at the expense of exploring viable restructuring options.

The legislature hopes that a move away from a focus on "stigmatising and penalising failure" will follow introduction of the new 'safe harbour' provisions and the stay on the exercise of the so called 'ipso facto' rights in certain circumstances.

While the law reforms apply to Australian companies and directors, they present significant benefits for foreign stakeholders who may, in a distressed scenario, be able to support the company through the period of financial distress, or effect a refinancing or achieve a pay out at a higher return than otherwise would have been available in liquidation. Arguably, to date, the scope for such better commercial outcomes has been significantly restricted.

A side note: the term "safe harbour" as used in Australia is not to be confused with the meaning of that term in the US. That is, the safe harbor provisions under Section 546(e) of the US Bankruptcy Code protect defendants from anti avoidance suits. In Australia, the term 'safe harbour' is a quasi-defence for directors against the statutory duty to prevent a company trading while insolvent.

The new 'safe harbour' for directors

What is Insolvent Trading?

The *Corporations Act 2001* (Cth) (**Corporations Act**) imposes a duty on directors to prevent a company from incurring a debt (or debts) when the director has reasonable grounds to suspect the company is, or may become, insolvent. Under Australian law, a company is considered to be insolvent when it is unable to pay its debts as and when they fall due and payable.

Although there are some defences available to a director, liability for insolvent trading under Australian insolvency laws can expose a director to a range of penalties including civil or criminal penalty orders or orders for compensation to creditors who suffered loss. It is not uncommon for management liability policies (e.g., Director and Officer Policies) to exclude claims relating to insolvent trading from the scope of the indemnity. Consequently, insolvent trading claims can expose directors to bankruptcy and loss of personal assets if they do not have the financial capacity to satisfy any monetary judgment entered against them.

Introduction of safe harbour provisions

Successful insolvent trading claims are rare. However, it was recognised by the Federal Government that:

> The threat of Australia's insolvent trading laws, combined with uncertainty over the precise moment a company becomes insolvent, have long been criticised as driving directors to seek voluntary administration even in circumstances where the company may be viable in the longer term.

It was also recognised that Australia's insolvency laws:

1. can discourage directors to be innovative or take reasonable risks to restructure or trade the company out of its financial difficulties due to concerns about personal liability;

2. penalise failure, particularly in circumstances when a director may have otherwise been acting honestly and in good faith;

3. have the potential to unnecessarily affect the enterprise value of a business when a voluntary administrator is appointed prematurely, particularly in circumstances where there may be the ability to turnaround or restructure the business so it can continue; and

4. can result in companies being placed into liquidation unnecessarily due to the loss of confidence of stakeholders in the business following the appointment of an administrator.

Commercial contracts typically include ipso facto clauses that give a party a right to immediately terminate the contract upon the occurrence of an 'event of default' or an 'insolvency event'.

The safe harbour reforms introduced into the Corporations Act came into effect on 19 September 2017. The amendments are designed to:

1. drive cultural change in the boardroom by encouraging directors to keep control of their company (instead of appointing an insolvency practitioner);

2. encourage directors to engage with stakeholders early when possible insolvency is suspected; and

3. encourage directors to focus on reasonable rescue and turnaround efforts, rather than taking a traditionally conservative approach and placing the company into voluntary administration.

Safe harbour and the concept of a 'better outcome'?

In effect, the amendments give directors a safe harbour from the civil insolvent trading provisions contained in section 588G of the Corporations Act whilst attempting to restructure or turnaround the business.

The safe harbour provisions apply if (and subject to certain conditions being met) after the director starts to suspect the company is or may become insolvent, the director starts to develop *"one or more courses of action that are reasonably likely to lead to a better outcome for the company."* The period of safe harbour continues from the time at which the director starts to develop the course of action and ends at the earliest of any of the following times:

1. the director fails to take steps to implement the proposed course of action within a reasonable period of development (What is a "reasonable period" for development will depend upon the particular circumstances. However, conscientious attention to developing the plan in an expedient manner is expected.);

2. when the director ceases to take any such course of action;

3. when the course of action ceases to be reasonably likely to lead to a better outcome for the company (Directors should closely monitor the course of action to ensure that the course of action developed is not carried out beyond the point at which it can said to still be reasonably likely to lead to a better outcome.); or

4. an administrator or liquidator is appointed to the company.

A "better outcome" is defined in the legislation to mean *"an outcome that is better for the company than the immediate appointment of an administrator or liquidator of the company"*. This test necessarily requires both a comparison of the return to creditors in an immediate insolvency versus a later insolvency and an assessment of the impact on other stakeholders, such as employees and shareholders.

Significantly, the plan developed and implemented by the director does not need to succeed in order for safe harbour protection to apply. It is possible that the course of action will result in a worse outcome for the company than if an administrator or liquidator was appointed immediately upon insolvency having been suspected. However, the safe harbour protection will still apply to the debts incurred by a director during that period so long as the course of action was still likely to lead to a better outcome at the time the decision was taken.

Consequently, a director seeking to rely on the safe harbour provisions should document the proposed course of action including identification of the assumptions behind the plan, provision of an explanation for why the plan is likely to result in a better outcome and specification of a clear set of steps required to implement the proposed course of action, together with a timetable of milestones capable of assessment.

The legislation specifies five factors (although, without limitation) that a Court may consider in determining whether a course of action is “reasonably likely to lead to a better outcome”, when safe harbour is asserted in proceedings. That is, whether the director is:

1. properly informing himself or herself of the company’s financial position; or
2. taking appropriate steps to prevent misconduct by officers or employees of the company that could adversely affect the company’s ability to pay all its debts; or
3. taking appropriate steps to ensure that the company is keeping appropriate financial records consistent with the size and nature of the company; or
4. obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice (An “appropriately qualified entity” is not defined in the legislation. However, an accountant, lawyer or other specialist with skills in turnarounds or restructures is likely to satisfy this test.); or
5. developing or implementing a plan for restructuring the company to improve its financial position.

The factors are not mandatory and not all factors need necessarily apply in order for a director to have the protection of safe harbour. However, best practice requires attention to each matter raised when seeking to rely on the safe harbour provisions.

Conditions to safe harbour
There are certain conditions to the operation of the safe harbour provisions, which are designed to ensure that safe harbour protects those directors who act “honestly and diligently”:

1. the debt must be incurred directly or indirectly in connection with the proposed course of action. The debt can include ordinary trade debts incurred in the usual course of business or debts taken on for the specific purpose of effecting the plan (including debts incurred in connection with a restructure or loss-making trade), but will not include debts outside this purpose or incurred for an improper purpose;
2. the company must continue to pay all employee entitlements (including superannuation) as and when they fall due; and
3. the company must continue to comply with all tax reporting obligations.

Further, the protection provided by the safe harbour provisions does not extend beyond protecting a director from civil liability for insolvent trading. During the safe harbour period, directors must continue to comply with their other legal obligations, for example director duties to act in good faith and the best interests of the company.

In addition, the safe harbour protections do not prevent the appointment of an insolvency practitioner (including an administrator, liquidator or receiver) by a third party during the safe harbour period.

Finally, a company listed on the Australian Securities Exchange (**ASX**) must comply with any continuous disclosure obligations. The ASX has issued guidance, which clarifies that the fact an entity’s directors are relying on the safe harbour provisions is not, in and of itself, a matter the ASX would require an entity to disclose.

Stay on enforcement of ipso facto clauses

Typical ipso facto clauses in commercial contracts
Ipso facto – or *by the fact itself* – is a term used to describe clauses in commercial contracts that provide a party with certain rights (including

termination) upon the occurrence of a specific event. The right may be exercised regardless of the counterparty's continued performance of its obligations under the contract.

Commercial contracts typically include ipso facto clauses that give a party a right to immediately terminate the contract upon the occurrence of an 'event of default' or an 'insolvency event'. For example, such rights may allow one party to terminate or modify the contract solely due to the financial position of the company or due to the commencement of a formal insolvency process.

A typical termination clause in a contract may take the following form:

> *Without limiting any other right A may have under this agreement or otherwise at law, A may terminate this agreement by notice in writing to B if an Insolvency Event occurs in respect of B.*

An Insolvency Event is often defined to include circumstances where a company is subject to a scheme of arrangement with creditors, has a receiver or receiver and manager appointed to all or part of its property, or enters into voluntary administration.

Ipso facto clauses are not limited to termination rights. They may include clauses that, upon the occurrence of an event, give a party the right to charge higher interest, automatically change the priority waterfall or allow a party to assign or novate the contract.

Motivation for change - why stay a party's ability to exercise its rights?

The legislature takes the view that the ipso facto clauses reduce the scope for a successful restructure or prevent the sale of business as a going concern. The stay is intended to assist viable but financially distressed companies to continue to operate while they restructure.

The stay also promotes the first objective of the voluntary administration regime - for the business, property and affairs of the insolvent company to be administered in a way that "maximises the chance of the company, or as much as possible of its business, continuing in existence."

The scope of the "ipso facto" stay

The so called 'ipso facto' provisions commence on 1 July 2018 and apply to contracts entered into on or after 1 July 2018.

The new ipso facto provisions were introduced under the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* (Cth) by way of an amendment to the Corporations Act, being the statute that governs insolvency processes in Australia, amongst other things.

The provisions impose a stay on enforcing rights merely because of the financial condition of the company or because the company is in voluntary administration, receivership or subject to a deed of company arrangement. Necessarily, the stay does not apply if a resolution or Court order has been made to wind up the company.

The provisions also impose a stay on self-executing clauses, being those clauses in contracts that start to apply automatically upon the occurrence of a certain event and without any party making a decision that the provision should start to apply.

Importantly, the stay does not prevent a counterparty from terminating a contract for reasons unrelated to the financial condition or insolvency of the company (e.g., for non-performance of an obligation). However, where a party has not exercised its termination right prior to the insolvency of a company, it may be difficult to establish that the reason for enforcing that right is for anything other than the financial condition or insolvency of the company.

The stay is not a blanket stay. A number of rights, self-executing clauses and contracts are excluded from the operation of the stay, reflecting that there is a variety of situations where the stay on ipso facto clauses is unnecessary or undesirable. More on the exclusions later.

In addition to certain exclusions applying, counterparties may obtain the consent of the receiver or voluntary administrator to exercise its ipso facto rights or an order from the Court that the stay does not apply, provided the Court is satisfied that it is appropriate in the interests of justice to do so.

Furthermore, although contracts will remain on foot, a counterparty is not required to continue to advance new money or credit to an insolvent company. So, if you are an investor who has provided finance to the company, you will not be required to make any further advances, although the financing agreement will remain on foot.

The exclusions – when is a party not bound by the stay

At the time of writing, the legislature had released draft regulations prescribing the relevant exclusions for the purposes of the ipso facto reforms. Following consultation with industry groups and professionals, we expect the draft regulations will change, albeit the general tenor of the exclusions is expected to remain.

The exclusions are aimed at certain arrangements where the inability of a party to exercise ipso facto rights or the stay on the operation of self-executing clauses may disrupt markets or undermine complex financial products, or would lead to a perverse outcome.

Examples of rights and self-executing provisions that are proposed to be excluded from the operation of the stay, such that parties may continue to rely on such clauses notwithstanding the financial condition or insolvency of a company, include:

- the right to charge higher interest rates and enforce indemnities for costs in financing arrangements;
- the right to terminate forbearance or standstill arrangements (Such arrangements are considered integral tools that assist restructurings. The failure to exclude such rights may act as a disincentive for parties to take that initial step, thereby making it difficult for a financially distressed company to create a stable platform from which it can explore restructuring options.);
- the automatic operation of 'flip clauses' that work to change the priority waterfall;
- the exercise of set-off and netting rights and rights of assignment and novation;
- the operation of self-executing provisions that relate to circulating security interests (i.e., floating charge assets);
- the exercise of step-in rights that are typically contained in construction contracts or long term service contracts (Such step-in rights provide for another person to 'step in' and perform the contract in the event of the insolvency of the of one party.); and
- the right to appoint a receiver in circumstances where the party has a security interest in the property of the company and a controller has already been appointed to the property of the company (This exclusion is aimed at ensuring that rash decisions are not made to appoint receivers if there are several parties with such rights).

The draft exposure regulations also carve out of the stay certain types of contracts, including contracts that relate to financial products (including derivative, underwriting and subscription contracts, rights issues, margin lending facilities and bonds), arrangements to sell all or substantially all of the company's business, netting arrangements, subordination, flawed asset and factoring arrangements and arrangements relating to clearing and settlement facilities, to name a few.

Interestingly, the draft regulations also exclude from the stay arrangements to which a special purpose vehicle (**SPV**) is a party. Although the legislature intends this to capture securitisation arrangements, it has attracted criticism as being too broad. The concern is that it will see a practice develop of using SPVs so as to circumvent the stay (and we query whether the anti-avoidance provisions would be sufficient to guard against such structures).

We expect the final form of the regulations to be released in a short time, and before 1 July 2018.

What this means for counterparties

The continued performance of contracts while a company undertakes a restructuring (albeit through a formal insolvency procedure) is hoped to have the effect of enabling the company to continue into the future and thereby limit the flow on effects to its counterparties.

As we stated above, the stay only applies to contracts entered into on or after 1 July 2018. While the reforms include anti-avoidance restrictions to prevent parties from contracting out of the operation of the stay, parties may consider varying contracts rather than entering new contracts, although a substantial variation may, under Australian law, be deemed to be a new contract.

Conclusion

It is hoped that the law reforms have the intended effect – to develop a culture of restructuring in Australia so that investors – foreign and domestic – have an opportunity to obtain a better outcome in the event that a company is in financial distress.

There is a school of thought that there ought to be a complete overhaul of Australia's insolvency regime to further promote the culture of restructuring. A missed opportunity or not, the reforms provide a necessary step in the right direction.

Please contact the authors for more information, including citations.

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FirstEnergy Solutions: Ohio bankruptcy court finds that it, not FERC, has jurisdiction on rejection of power contracts

Jamie Copeland

Bankruptcy can be an unfamiliar place. It gives a debtor many tools capable of drastically changing its relationship with creditors, contract counterparties, and other interested parties. Bankruptcy can alter not only debtor-creditor relationships, but also the debtor's relationship with its regulators. Regulators and bankruptcy courts with potentially competing or conflicting jurisdiction and authority create confusion and unique challenges and opportunities for debtors. These problems can be particularly acute in certain sectors of the energy industry.

The Federal Energy Regulatory Commission ("**FERC**") is the federal agency vested with exclusive authority to regulate rates for interstate power transmission and wholesale electric energy. Under the Federal Power Act, power companies are required file certain privately-negotiated power purchase agreements ("**PPAs**") and contracts with FERC for its review and approval of the contract's rates and conditions. FERC's plenary and exclusive jurisdiction over wholesale power rates, terms, and conditions of service is embodied in the "filed rate doctrine," which provides that "so long as the filed rate is not changed in the manner provided by the [Federal Power Act] it is to be treated as though it were a statute, binding upon the seller and purchaser alike." Under the filed rate doctrine, a party "can claim no rate as a legal right that is other than the filed rate . . . and not even a court can authorize commerce in the commodity on other terms." Under the Bankruptcy Code, however, these FERC-approved PPAs are potentially subject to rejection by the debtor.

Bankruptcy Code section 365 generally allows a debtor to assume (and under certain circumstances, assign) or reject executory contracts and unexpired leases. Debtors commonly use rejection under section 365 to shed burdensome contracts and leases or otherwise leverage the threat of rejection to renegotiate terms. Section 365 is particularly important for power companies whose revenues are frequently a function of locked-in, FERC-approved rates under PPAs and other energy contracts. PPA counterparties, however, have argued that rejecting a filed rate contract under section 365 violates the Federal Power Act, the filed rate doctrine, and otherwise interferes with FERC's exclusive jurisdiction. Various courts have considered these issues, and have reached conflicting conclusions.

In *NRG Energy, Inc.*, the US District Court for the Southern District of New York ruled that FERC's jurisdiction and authority over approved PPAs is unaffected when a counterparty files for Chapter 11. Thus, FERC could prevent the termination of a PPA and order the debtor to continue to pay the existing rates notwithstanding the imposition of the automatic stay or the debtor's powers under section 365. In *In re Mirant Corp.*, both the US Bankruptcy Court for the Northern District of Texas and the US Court of Appeals for the Fifth Circuit rejected *NRG Energy's* analysis, finding no conflict between FERC's jurisdiction over power rates under the Federal Power Act and the bankruptcy court's jurisdiction over the debtor's estate (including the right to reject under section 365) under the Bankruptcy Code. Thus, the bankruptcy court could enjoin FERC from taking actions in derogation of the bankruptcy court's jurisdiction, including prohibiting FERC from compelling the debtor to perform under a rejected PPA.

The US Bankruptcy Court for the Northern District of Ohio recently confronted these issues in *In re FirstEnergy Solutions Corp.* Although these issues remain unsettled, in *FirstEnergy,* the Court examined *Mirant Corp.*, *NRG Energy*, and *Calpine* in detail and determined that there is no jurisdictional conflict between the Bankruptcy Code and the Federal Power Act, and further, that FERC could be subject to the Bankruptcy Code's automatic stay.

Conflicting decisions: NRG Energy, Mirant Corp., and Calpine

NRG Power Marketing, Inc. ("**NRG**"), a subsidiary of NRG Energy, Inc., was obligated under a PPA with Connecticut Light & Power Company ("**CLP**") to provide energy at a fixed price. CLP defaulted under the PPA when it failed to make certain payments, but NRG continued to perform. In May 2003, shortly before filing for Chapter 11 relief, NRG notified CLP that it intended to terminate the PPA. Later that day NRG filed for bankruptcy in the Southern District of New York and simultaneously moved to reject the PPA pursuant to section 365. The next day, Connecticut's Attorney General and the Connecticut Department of Public Utility Control petitioned FERC for an order staying the termination to prevent harm to CLP's customers. FERC then entered an order staying the termination and further requiring NRG to continue to perform under the PPA. Two weeks later, the bankruptcy court approved NRG's motion to reject the "money-losing" PPA, but declined to interfere with the FERC proceeding or its stay order. NRG then sought declaratory judgment and injunctive relief from the district court to set aside FERC's stay order and proceed with the PPA's termination. The district court dismissed NRG's complaint.

According to the district court, whether NRG could stop performing under the PPA fell squarely within FERC's regulatory purview. The district court also found that it lacked jurisdiction to review FERC's stay order as the Federal Power Act provides that only US courts of appeals can review FERC orders. As NRG's PPA drama unfolded, Mirant Corporation ("**Mirant**") was taking notes, and when it filed for Chapter 11 protection just days after the NRG decision, it chose to pursue a different rejection strategy.

In 2000, Potomac Electric and Power Company ("**PEPCO**") sold its power plants and assigned its PPAs to Mirant. PEPCO and Mirant entered into what the parties called a "back-to-back agreement," whereby Mirant agreed to buy power from PEPCO at the same price PEPCO was obligated to pay for it under certain PPAs. The agreement resulted in Mirant paying well above market rates and incurring substantial losses. After Mirant filed for bankruptcy, it sought to reject the back-to-back agreement without notice to PEPCO, and it also sought injunctive relief against PEPCO and FERC to protect the bankruptcy court's jurisdiction over Mirant's PPAs and the back-to-back agreement. PEPCO and FERC then sought relief in the district court. The district court disagreed with the bankruptcy court and found that FERC had "exclusive authority to determine the reasonableness of wholesale rates for electricity sold in interstate commerce," and that the Bankruptcy Code does not except parties from compliance with the Federal Power Act. Mirant appealed, and the Fifth Circuit reversed.

The Fifth Circuit agreed with the bankruptcy court's holding: there is no conflict between FERC's regulatory authority and the bankruptcy court's jurisdiction under section 365. The court found that rejection under section 365 constitutes a breach of contract, but the Federal Power Act does not grant FERC authority over the remedies available for breach of a FERC-approved contract. The court further observed that FERC-approved contracts were not specifically excluded under section 365 even though the Bankruptcy Code does expressly require regulators to approve the rejection of certain other obligations.

Mirant Corp. and *NRG Energy* are plainly inconsistent. In the years since, neither the courts nor Congress resolved the conflict. In fact, shortly after the *Mirant Corp.* decision, District Court Judge Richard C. Casey (who also issued the *NRG Energy* decision) issued an opinion in *In re Calpine Corp.* that expressly disagreed with the Fifth Circuit and ruled that "rejection based on dissatisfaction with the rates . . . constitute[es] [an impermissible] collateral attack on the filed rate itself." After analyzing the structure of section 365 and related Bankruptcy Code provisions, Judge

Although courts acknowledge that "many cases will be close," proceedings that relate primarily to public safety or policy are generally excepted from the stay.

Casey found that "[b]ecause there is nothing in the Bankruptcy Code that limits FERC's jurisdiction, [the debtor] cannot achieve in Bankruptcy Court what neither it, nor any other party . . . nor any other federally regulated energy company in the country could do without seeking FERC approval: cease performance under the rates, terms, and conditions of filed rate wholesale energy contracts in the hopes of getting a better deal."

FirstEnergy Solutions: The bankruptcy court, not FERC, can reject power contracts

FirstEnergy Solutions Corp. ("**FES**") is a power generation company based in Ohio that, among other things, sells energy to regional transmission organizations. FES was party to nine "bundled" long-term PPAs that obligated FES to purchase power, capacity, renewable energy credits, and related services. FES and 13 other power companies are also parties to an intercompany power agreement (the "**ICPA**") companies pursuant to which they are obligated to purchase power from the Ohio Valley Energy Corporation ("**OVEC**").

In early 2018, FES's strained balance sheet and declining financial condition were no secret. In anticipation of an FES bankruptcy filing, OVEC initiated a FERC proceeding on March 26 and sought the entry of an order finding that any breach of the ICPA would violate the filed rate doctrine and FERC had exclusive jurisdiction to consider that question. On March 31, FES filed its petition for Chapter 11 relief. Shortly thereafter FES filed an adversary proceeding against FERC seeking declaratory judgment and injunctive relief preventing FERC from taking any action that would interfere with the bankruptcy court's jurisdiction to consider FES's motions to reject its bundled PPAs and the ICPA.[1] The court entered a temporary restraining order against FERC pending its decision to grant a preliminary injunction. On May 11, it granted FES's request for a preliminary injunction against FERC.

In previous cases, courts focused their analysis on the use of Bankruptcy Code section 105—which grants bankruptcy courts broad authority to enter "any order . . . that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code—to protect the bankruptcy court's jurisdiction. The court's analysis, however, began with the applicability of the automatic stay under section 362. Section 362 generally operates to stay the commencement or continuation of an array of judicial and administrative proceedings as well as any act to exercise control over estate property. Section 362(b)(4) also provides that the automatic stay does <u>not</u> apply to "the commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such governmental unit's or organization's police and regulatory power." Therefore, the court first considered whether the "police and regulatory power" exception to the automatic stay applied to the FERC proceeding or a similar proceeding where a counterparty to a FERC-regulated power contract seeks to enforce the contract after its rejection under section 365. To determine whether FERC would be exercising its "police and regulatory power," the court employed two tests: the pecuniary purpose test and the public policy test.

Under the pecuniary purpose test, courts focus on whether a governmental proceeding relates primarily to the protection of the government's pecuniary interest in a debtor's property, and not to matters of public safety. Under the public policy test, courts distinguish between proceedings that adjudicate private rights and those that affect public policy. "[W]hen the action incidentally serves public interests but more substantially adjudicates private rights, courts should regard the suit as outside the police power exception, particularly when a successful suit would result in a pecuniary advantage to certain private parties vis-a-vis other creditors of the estate, contrary to the Bankruptcy Code's priorities." Although courts acknowledge that "many cases will be close," proceedings that relate primarily to public safety or policy are generally excepted from the stay. Therefore, under these tests, only actions instituted to effectuate FERC's public-policy goals (as opposed to those instituted to protect a pecuniary interest in the debtor's property or to adjudicate private rights) will be excepted from the stay.

In *FirstEnergy*, the court concluded that the FERC proceeding passed the pecuniary interest test but failed the public policy test. The court observed that a regulatory proceeding need not be wholly unrelated to the public policy of the legislation administered by the agency to fail the public policy test and fall subject to the automatic

1 OVEC sought to have the ICPA rejection motion decided by the district court rather than the bankruptcy court. The district court quickly denied OVEC's request and noted, in *dicta*, that FERC and the bankruptcy court had concurrent jurisdiction and that both would need to approve the debtor's rejection. After holding a conference with the parties, the district court reaffirmed its decision not to decide the rejection motion, but deleted from its previous decision the *dicta* regarding the bankruptcy court and FERC's concurrent jurisdiction.

stay. Here, however, the court found that "the obvious and dominant purpose of the FERC [p]roceeding" was for the debtor's counterparties to leap frog similarly situated creditors. If OVEC or other PPA counterparties succeed in obtaining the relief requested in the FERC proceeding, the primary impact would be a pecuniary advantage to those counterparties relative to other unsecured creditors. Further, the court noted that any FERC order compelling performance under "the ICPA or any PPA would, in substance, be designed to obtain or control the property of the estate and therefore, be void *ab initio*." Next, the court considered whether—even if the automatic stay did not apply—it still had the power to enjoin FERC under Bankruptcy Code section 105 to preserve its jurisdiction over the debtors' estates and the rejection motions. Like the court in *Mirant Corp.*, the court ruled that it could enjoin FERC "to avoid the cost and delay of unnecessary proceedings that would ultimately be held void."

Bankruptcy courts generally apply the "usual rules" in deciding whether to issue an injunction under section 105: whether (i) there is a strong or substantial likelihood of success on the merits, (ii) there would be irreparable injury absent the injunction, (iii) there would be substantial harm to others if the injunction was issued, and (iv) the public interest would be served. The court found that FES would likely prevail in its adversary proceeding to preserve the court's jurisdiction. FERC argued that it had concurrent jurisdiction with the bankruptcy court and that the bankruptcy court could approve the rejection of a filed rate power contract, but FERC could then conduct a regulatory review and require the debtor to perform anyway. The court rejected that argument as "at best, a costly procedural delay of the final determination of the treatment rejection claims will receive in the bankruptcy case" and "[a]t worst, . . . an inappropriate violation of the Bankruptcy Code's priority scheme." The court's decision relied heavily on the bankruptcy and circuit court decisions in *Mirant Corp.*, including their analyses of section 365 and other Bankruptcy Code provisions that limit "general rejection authority" and "prohibit[ ] rejection of certain obligations imposed by regulatory authorities." Simply put, no such limitation or prohibition protects energy contracts, whether filed with FERC or otherwise.

The court further held that "rejection, including the attendant cessation of performance, does not intrude on FERC's jurisdiction over filed rates" because, among other things, "that rate is given full effect when determining the breach of contract damages resulting from the rejection." "The economic disappointment a power contract counterparty experiences in a debtor-party's bankruptcy case cannot be avoided by invoking the Federal Power Act and the filed rate doctrine any more than can the disappointment of any other general unsecured creditor be avoided by invoking the law of contract or tort." FERC and OVEC argued that FERC's approval of a privately negotiated power contract is, in effect, a regulation "as it relates to the wholesale power in that area." If true, such contracts would likely fall outside section 365's scope (as "regulations" cannot be rejected) and would arguably give rise to "an ordinary course regulatory compliance obligation" that FES would have to satisfy. After noting the argument's "seductive appeal," the court disposed of it as largely unsupported by (if not contrary to) FERC-related caselaw. Accordingly, the court could not agree with *Calpine* and found that the bankruptcy court had jurisdiction to reject filed rate contracts. The court then found that the remaining factors plainly weighed in favor of granting the injunction.

Conclusion

FERC, OVEC, and other intervening parties have appealed the court's decision, and on June 8, it approved OVEC's request to certify its appeal directly to the US Court of Appeals for the Sixth Circuit. The *FirstEnergy* court's decision nevertheless adds support for view that bankruptcy courts can use injunctive relief to protect their jurisdiction against a parallel FERC proceeding and also provides new guidance regarding whether such relief is necessary at all given the broad protection of the Bankruptcy Code's automatic stay. If the Sixth Circuit affirms, the *FirstEnergy* decision would bolster caselaw holding that the Federal Power Act and the filed rate doctrine cannot stop a bankruptcy court from approving a debtor's rejection of a FERC-approved PPA.

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Lessons learned from airline insolvencies

Marc Craggs

Airline insolvencies differ from insolvencies of companies in other business sectors in a number of key respects: (a) the financing arrangements for the manufacture and purchase of aircraft, and the associated ownership and leasing arrangements, can be extremely complex and often vary considerably from case-to-case; (b) the airline industry is heavily regulated and the regulations to which airlines are subject can impose limitations on the manner in which they operate and the ease with which enforcement action can be taken; and (c) the valuable assets involved in operating an airline's business (and the subjects of a key part of a financier's security package) are, by nature, moveable and their movement in the ordinary course – and the ability to move them with ease between different jurisdictions at short notice – can introduce complicated questions of conflict of laws and cross-border insolvency in distressed situations. The recent administration of Monarch Airlines brought these and other issues into sharp relief, and is considered in the final part of this article.

There is no special insolvency procedure in England and Wales applicable to airline insolvencies. However, the implementation of the Cape Town Convention (and its related Aircraft Protocol (the "**Protocol**")) by the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (the "**2015 Regulations**") has curtailed restrictions which ordinarily apply to the exercise of third parties' rights on the commencement of insolvency proceedings (for example, the moratorium applicable in administration).

Insolvency proceedings

The commencement of insolvency proceedings with respect to an airline can mean different things from the perspective of the parties involved, depending on the type of proceedings and how they have been instituted. It is possible in certain circumstances (and depending on the jurisdictions involved) to use certain proceedings in a strategic and pre-planned manner so as to preserve the value of the airline's business. However, in circumstances in which insolvency proceedings are instigated unexpectedly or in a haphazard fashion – whether by the directors of the airline or other stakeholders – a financier or lessor can be left with a limited amount of control, the outcome can be considerably less certain and the overall effect can be one of value destruction.

An insolvency office-holder appointed to an airline which has entered into insolvency proceedings will inevitably face a huge task of assimilating and processing a large amount of information very quickly at the outset of a case and dealing with a number of counterparties and stakeholders. The burden on the insolvency office-holder will be considerable, although in circumstances in which the insolvency office-holder's firm has had a number of weeks or months of prior involvement with the airline, they will be better-placed to take decisions quickly once appointed. Considerations as to passenger and public safety can affect markedly the roles and responsibilities of those involved in an airline insolvency.

Post- as well as pre-insolvency, a lessor or financier should have regard to the practicalities on the ground when considering whether or not to take enforcement action (for example, gaining access to the aircraft and any storage facilities); however, much may depend on the type of proceeding to which the operator has, or will, become subject.

The commencement of insolvency proceedings may trigger cross-default provisions in an airline's contracts with other parties (which may, for example, result in the termination of leases and sub-leases). The extent to which counterparties will be entitled to rely on such termination provisions will depend on the jurisdictions involved and whether there are applicable prohibitions on ipso facto clauses (i.e. termination provisions which are triggered by the commencement of insolvency proceedings) under the relevant insolvency laws.

The effect of the 2015 Regulations is to adapt the UK's insolvency regime in certain key respects relating to enforcement of security over airframes and aircraft engines, in the case of leases and security agreements entered into after the enactment of the 2015 Regulations. It is necessary for the debtor to have consented in writing to the exercise of the creditor's remedies under the 2015 Regulations in the event of a default, but it suffices for these purposes for the debtor – as is now common practice – to do so in the relevant mortgage deed or security agreement at the outset of the financing. Under the 2015 Regulations, upon the occurrence of a relevant insolvency-related event (for example, the commencement of administration), the insolvency practitioner is required to:

(a) give possession of an aircraft object in respect of which a relevant "international interest" has been registered under the Cape Town Convention to the creditor at the earlier of the expiry of 60 days or the date on which the creditor is otherwise entitled to possession; or

(b) cure all defaults (other than the default constituted by the commencement of insolvency proceedings) and agree to perform all continuing obligations under the relevant agreement.

Once the 60-day waiting period has expired (if applicable), the administration moratorium preventing the enforcement of security and repossession of leased assets ceases to apply and the court's power to order the disposal of secured or leased property is disapplied. From that point, it is not necessary for the creditor to obtain a court order for possession and, once possession has been obtained, the creditor has the right to deregister and export the aircraft (with the assistance of the CAA).

It is prudent for a financier or lessor to act swiftly when faced with an airline that has gone into administration. In particular, a lessor should seek confirmation from the administrator that they will pay for his usage of aircraft as an expense of the administration. In this connection, it may be advisable to exercise contractual rights of termination under the lease in order that it is clear that any continued usage of the aircraft is done on terms that make it clear that the lessor will receive payment for ongoing usage.

In the event of an airline entering into insolvency proceedings, it may be necessary for the responsible insolvency office-holder or a lessor or financier to take action to recover property in a large number of jurisdictions, depending on the size and geographical reach of the airline's business. In all cases, it will be necessary to seek local advice, since complex questions of cross-border insolvency law and conflicts of laws are likely to arise, particularly with regard to the entitlements and priorities of secured creditors. It may be necessary for the insolvency office-holder to seek local advice at an early stage in order to form a view as to the extent to which their appointment in England and Wales is likely to be recognised in other jurisdictions and if it will be necessary formally to seek recognition in other jurisdictions as a precondition to being able to gain access to, maintain and preserve the relevant aircraft.

The advent of the Cape Town Convention means that – quite apart from operating licence issues which are likely to arise following an insolvency filing – a continued period of trading for an airline in insolvency proceedings in the UK is unlikely. This position can be contrasted with the position in certain other jurisdictions, which are more conducive to continued trading of an airline which is subject to insolvency proceedings. For instance, there are numerous examples of US Chapter 11 proceedings in respect of US and foreign airlines (including the Colombian airline, Avianca) in which the relevant carriers have continued to operate throughout, which has largely been attributable to the willingness of lessors and other creditors to support the restructurings undertaken. Recent similar examples in Europe include Alitalia in Italy and Air Berlin in Germany, which was able to continue operating flights for a number of months following its entry into insolvency proceedings with the financial support of the German government.

One of the features of the UK Government's Airline Insolvency Review which commenced in April 2018 will be to examine options to enable a temporary period of continued operation of an airline following the appointment of administrators, perhaps with governmental financial support. It will be interesting to see how the proposals develop in the course of the review period and the recommendations which are ultimately made.

Security deposits and maintenance reserves

It is common, on the entry by a lessee into insolvency proceedings, for disputes to emerge in relation to entitlements to security deposits and maintenance reserves. The nature and status of such amounts varies from case to case and it will be necessary carefully to consider the terms of the lease and any related agreements in order to ascertain the question of entitlement to those amounts in subsequently-commenced insolvency proceedings.

The purpose of a security deposit is to serve as "security" for the payment by the lessee of rent and other payments under the lease and the performance by the lessee of the other obligations under the lease. Despite being characterised as security, such amounts rarely constitute a security interest properly so-called. As such, in an ordinary case, the application of security deposits will not be precluded by the administration moratorium since there will normally be no question of the enforcement of security.

As with security deposits, leases will typically provide that maintenance reserves payments will become the property of the lessor immediately on payment and the lessor will be at liberty to commingle the amounts paid with its own cash resources. Similarly, the administration moratorium does not normally restrict the application of maintenance reserves.

Liens and powers of detention

In certain circumstances, particular creditors of an airline are able to obtain proprietary or detention rights over an aircraft ranking higher than those of the lessor, owner or mortgagee of that aircraft. Where the Cape Town Convention applies, certain overriding non-consensual rights and interests similarly have priority over registered interests without having been themselves the subject of registration. These are specified in the 2015 Regulations to be possessory liens in respect of work done on the aircraft and any right to detain the aircraft arising under an Act of Parliament (e.g. in respect of unpaid air navigation charges or airport charges).

Where a lien or a priority right arises, the financier will be required to discharge the debt owing before it can obtain access to the aircraft. In the case of the exercise of a fleet lien of the type described above, this is capable of giving rise to extreme hardship to financiers and can erode the value of their security significantly.

Monarch Airlines

Prior to its entry into administration on 2 October 2017, Monarch Airlines was an airline operating scheduled flights from five UK airports to destinations in the Mediterranean and the Canary Islands. Along with many airlines worldwide, it had encountered difficult market conditions and, in 2014, it underwent an extensive restructuring process. Although the group returned to profitability in 2015, continued challenging conditions in the European

Considerations as to passenger and public safety can affect markedly the roles and responsibilities of those involved in an airline insolvency.

aviation market led to further deterioration in the group's financial position in the course of 2016. Monarch underwent a business review in 2017 and, in the autumn of that year, KPMG was engaged to run a sales process for the group's airline operating and travel businesses and to formulate a contingency plan to help preserve value and minimise passenger disruption in the event that it was not possible to find any sale or investment solution that would restore the group to profitability. The sale process was ultimately unsuccessful. With the group's Air Travel Organiser's Licence ("ATOL") due to expire on 30 September 2017 and all other options having been exhausted – and in light of the continuing difficult market conditions – the directors of Monarch resolved to place the company into administration. The administration order was made with effect from 4am on 2 October 2017 and KPMG partners were appointed as joint administrators.

Following as well as prior to their appointment, the administrators assisted the CAA in the repatriation of Monarch customers who were stranded overseas. The (prospective) administrators and the CAA had concluded that it would not be possible to use Monarch's existing fleet for this purpose and had therefore worked to assemble a fleet of especially-leased aircraft and shadow aircrews for the purpose in and around key destinations.

The administrators rolled out an extensive communications programme in the very early stages of the administration, in conjunction with the CAA, using legacy Monarch systems and their own website, in order to provide customers with the necessary information and options available to them in the circumstances.

The administrators commenced the return to lessors of leased aircraft and related equipment shortly following their appointment. By the end of the first week of the administration, all the leases had been terminated and the lessors were taking steps to gain access to the aircraft and move them to different airports. The process of gaining access to the aircraft was not entirely straightforward, however, and the lessors first needed to reach agreement with certain airports and other authorities (the CAA on behalf of NATS and Eurocontrol), which had asserted liens in respect of unpaid charges, before being able to take possession of the aircraft. Nevertheless, within six weeks of the administrators' appointment, all aircraft had been returned to the lessors and moved to alternative locations.

In parallel with the exercise of returning aircraft to the lessors, the administrators sought a judicial review of the decision of the coordinator for the allocation of slots at certain airports – Airport Coordination Limited ("ACL") – to refuse to allocate Monarch the slots to which it had been entitled following its entry into administration. On appeal, the Court of Appeal held that an undertaking did not inevitably cease to be an "air carrier" when it became unable to operate air transport services (reversing the Divisional Court on the point); even an airline that had no reasonable prospect of resuming air transport services qualified as an air transport undertaking, even though it might be a failed undertaking. The Court of Appeal was of the view that matters relating to an airline's financial circumstances and its ability to continue trading were not within the remit of ACL and instead should be dealt with in the course of the licensing process. Accordingly, the Court of Appeal made a declaration that Monarch was entitled to be allocated the slots in question and made an order requiring ACL immediately to allocate those slots to Monarch.

A number of important practice points can be drawn from the early stages of the administration of Monarch, including:

(a) The timing of any insolvency appointment is key. In particular, considerations of passenger and pilot safety – as well as obtaining certainty as to the location of aircraft – are paramount. The pre-dawn filing of Monarch allowed an optimum outcome on all such fronts.

(b) Close engagement and cooperation with the CAA is critical to achieving an outcome that is the best achievable in difficult circumstances. In particular, the administrators' interaction with the CAA in the passenger repatriation exercise ensured that all passengers (and not only those with ATOL protection) were able to be repatriated safely in the early stages of the administration, with a minimum cost to the administration estate. In the Monarch case, the CAA's pragmatic and responsive approach, in pursuit of its consumer protection objective, allowed the delivery of optimal

outcomes. It is to be hoped that the CAA and its equivalent regulatory bodies in other jurisdictions will take a similar approach in future insolvencies, although each case will of course vary depending on its own facts and circumstances.

(c) A comprehensive, multi-platform communications programme following an insolvency filing will assist in the efficient management of customer expectations and reduce the adverse consequences of the insolvency filing from a public perception perspective, including on social media.

(d) Administrators should cooperate as far as possible with lessors in returning leased aircraft in circumstances in which their continued use is not required for the purposes of the achievement of the purpose of the administration.

(e) Slots allocated to an airline which enters into, or is already subject to, insolvency proceedings are potentially valuable assets which are capable of being exchanged for consideration, thereby increasing realisations for the benefit of the administration estate and returns to creditors generally.

This article is an abridged form of a practice note on airline insolvency which was first published on LexisPSL Restructuring and Insolvency.

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Bankruptcy court enforces non-consensual third party releases in Chapter 15 case

Shantel Watters-Rogers

Third party releases are provisions that release non-debtors, such as officers, directors, shareholders, or non-debtor affiliates, from claims and causes of action held by creditors or other non-debtor parties. Third party releases are often analyzed in chapter 11 cases, but are also dealt with in chapter 15 cases. The courts of appeal for the Fifth, Ninth, Tenth and the District of Columbia Circuits have held that third party releases in a chapter 11 reorganization case can only be issued with the consent of the affected creditors, while the courts of appeal for the Second, Third, Fourth, Sixth, Seventh and Eleventh Circuits have held that third party releases are permissible in chapter 11 cases without the consent of creditors in limited circumstances, which vary by circuit.

A recent holding by the United States Bankruptcy Court for the Southern District of New York (the "**Bankruptcy Court**") confirmed that third party releases embodied in a UK scheme of arrangement can be enforced in United States chapter 15 cases. In *In re Avanti Communications*, the Bankruptcy Court found third party releases in a UK scheme of arrangement enforceable under sections 1521 and 1507 of the United States Bankruptcy Code. The opinion emphasized the overwhelming approval by creditors for the debtor's restructuring proposal. The court found that enforcing the third party releases in this case would non-consensually bind only a small number of creditors who abstained from voting.

Chapter 15 of the Bankruptcy Code provides a mechanism for a foreign debtor or a foreign representative to seek recognition of a foreign insolvency, liquidation, or bankruptcy proceeding and the enforcement of a foreign court's orders issued in such proceedings in the United States. *Avanti* focuses on whether a UK court order authorizing third party releases in a scheme of arrangement should be enforced under chapter 15, which reflects principles of comity, a doctrine by which the laws and rulings of one country are recognized by the courts of the United States. The bankruptcy court held the third party releases ordered by the UK court should be recognized and enforced in the United States.

Background on Avanti Communications Group PLC

Avanti Communications Group PLC (the "**Debtor**" or "**Avanti**"), a company incorporated in England and Wales, is headquartered in London and operates satellites in and around Europe, Western Asia, and Africa. The satellites are used in markets such as broadband and government.

Avanti financed its satellite construction and operation with a loan facility and issued senior secured notes to creditors maturing in 2021 (the "**2021 Notes**") and 2023 (the "**2023 Notes,**" collectively, the "Notes"). In 2017, Avanti encountered delays with two satellites, which resulted in financial hardship for Avanti. Due to the financial strain, Avanti began to discuss a scheme of arrangement for its capital structure. Avanti ultimately decided on a scheme of arrangement that would amend the 2021 Notes and equitize the 2023 Notes (the "**Scheme**")

The scheme of arrangement

The Scheme provided that the 2023 Notes would be exchanged for 92.5% of Avanti's share capital. The share capital was to be distributed *pro rata*, according to the principal amount of 2023 Notes each creditor held. The Scheme also provided that the creditors were to approve the third party releases, including releases in favor of Avanti's direct and indirect subsidiaries that guaranteed the 2023 Notes. The releases barred creditors from pursuing any claims or liability in connection with the 2023 Notes against Avanti or its non-debtor affiliate-guarantors (the "**Third Party Releases**"). Avanti also solicited consent from the noteholders (the "**Consent Solicitations**"), to amend, among other things, the maturity date and interest rate of the 2021 Notes, and the jurisdiction provision of the 2023 indenture. The Consent Solicitations were approved by holders of 98.09% of the aggregate principal amount of the 2021 Notes, and holders of 87.73% of the aggregate principal amount of the 2023 Notes (the "**2023 Noteholders**").

In connection with the restructuring, Avanti commenced a proceeding in the UK (the "**UK Proceeding**") to seek approval of the Scheme from the High Court of Justice of England and Wales (the "**UK Court**"). Upon Avanti's request, the UK Court issued an order convening a meeting of the creditors of the Scheme, namely, the 2023 Noteholders (the "**Scheme Creditors**"), and authorizing the appointment of a foreign representative to represent Avanti in a chapter 15 case in the United States. Thereafter, Avanti solicited votes from the Scheme Creditors. At the meeting of creditors, Scheme Creditors holding 98.3% by value of the outstanding 2023 Notes voted in favor of the Scheme. None of the Scheme Creditors voted against the Scheme. Avanti therefore requested an order from the UK Court sanctioning the Scheme. Finding that all the requirements for sanction were met, the UK Court sanctioned the Scheme.

The Bankruptcy Court held the third party releases ordered by the UK court should be recognized and enforced in the United States

The Chapter 15 case

In order to ensure that the Scheme would be enforced in the United States, Avanti filed a petition for recognition under chapter 15. In the Second Circuit, where New York is located, a debtor must satisfy the requirements of Section 109(a) of the Bankruptcy Code to be eligible for chapter 15 relief. Under Section 109(a), a debtor must have either a domicile, residence, a place of business, or property in the United States. The Bankruptcy Court found that Avanti satisfied the property requirement, as the foreign representative's counsel held funds from Avanti as a retainer, and the 2023 indenture was governed by New York law and provided that New York was the forum for any disputes. The Bankruptcy Court further found that the UK Proceeding and the chapter 15 petition satisfied the requirements for recognition, and that Avanti's representative satisfied the "foreign representative" requirement. Consequently, the Bankruptcy Court granted recognition to the UK Proceeding. The bankruptcy court acknowledged that schemes of arrangement under UK law have been routinely recognized as foreign proceedings in chapter 15 cases. Finding that the requirements of sections 1507(b) and 1521(a) were satisfied and furthered the goals of a chapter 15, the Bankruptcy Court entered an order enforcing the Scheme.

The Avanti court's decision

Section 1521(a) of the Bankruptcy Code grants a bankruptcy court the power to grant "any appropriate relief" in a chapter 15 case "where necessary to effectuate the purpose of [chapter 15] and to protect the assets of the debtor or the interest of the creditors." Additionally, section 1507(b) of the Bankruptcy Code permits a bankruptcy court to grant "additional assistance" under chapter 15 if, among other things, the just treatment of creditors is ensured. Section 1507(b) centers around the principle of comity, by which foreign proceedings and judgments are recognized and respected by United States courts. In *Avanti*, the bankruptcy court held that the Third Party Releases should be recognized and enforced under chapter 15 because the UK Proceeding afforded creditors a full and fair opportunity to vote on the Scheme in a manner similar to that required by US due process standards. While some United States courts have previously ruled similarly to *Avanti* in chapter 15 cases, third party releases are not always recognized in chapter 15 cases.

In *In re Vitro*, a Fifth Circuit case, the court declined to grant a third party release in a chapter 15 case. The *Avanti* court distinguished *Vitro* by focusing on the lack of consent by non-insider creditors for the third party releases in *Vitro*. In *Vitro*, creditors holding 74.67% of the principal amount of the voting claims approved the reorganization

plan. However, over 50% of the votes were from creditor subsidiaries of Vitro considered by the court to be insiders. Under 11 U.S.C. § 1129(a)(10), insider votes are not counted towards the vote needed to approve a chapter 11 reorganization plan. The misalignment of the insider votes in Vitro's Mexican proceeding with the fundamental policies of the United States legal system designed to protect against insider manipulation of the vote resulted in the *Vitro* court refusing to grant the third party release.

In *Avanti*, the Scheme was overwhelmingly approved by non-insider creditors who held the 2023 Notes. Unlike *Vitro*, (non-insider) holders of 98.3% in value of the outstanding 2023 Notes voted to approve the Scheme, and the vote bound only a small number (1.7%) of non-consenting creditors.

In the United Kingdom, not less 75% in value of each class of creditors must approve a scheme of arrangement. In *Avanti*, there was a single class of creditors and the Scheme Creditors holding 98.3% in value of the 2023 Notes voted to approve the Scheme. The vote met the UK requirement and did not present the insider issues found in *Vitro*, as the vote did not disenfranchise creditors who would be negatively impacted by the Scheme, other than the 1.7% who abstained from voting on the Scheme and the Third Party Releases.

Conclusion

The *Avanti* court decided to enforce the Third Party Releases. The decision appears to have hinged on the near unanimous support by the creditors. No objections were filed against the Scheme in the United States court, likely demonstrating implicit acceptance by the creditors for the Third Party Releases. Overall, the *Avanti* opinion recognizes the importance of the affected creditors' support of the scheme of arrangement. Indeed, this appears to be a critical factor for the ruling. Although third party releases are met with the least resistance when the creditors unanimously approve the releases, *Avanti* shows that support from a large majority of impacted creditors may be sufficient.

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