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Rise In Section 363 Sales Not Confined To Ch. 11

Law360, New York (November 11, 2009) -- Despite recent pronouncements that the worldwide recession has ended, an enduring overall financial malaise and credit crunch have caused a marked paradigm shift in U.S. bankruptcy cases.

Companies struggling to find affordable financing in Chapter 11 (in the form of debtor-in-possession financing, refinancing or exit financing), or seeking to minimize the administrative costs associated with full-fledged Chapter 11 cases, are increasingly opting for section 363 sales or prepackaged bankruptcies in an effort to fast-track the process.

The pervasiveness of sales of all or substantially all of a company's assets under section 363(b) of the Bankruptcy Code (as opposed to sales or reorganizations under a Chapter 11 plan) even led the Second Circuit Court of Appeals to observe in its recent ruling upholding the sale of Chrysler's assets to a consortium led by Italian automaker Fiat that "[i]n the current economic crisis of 2008-09, § 363(b) sales have become even more useful and customary ... [and] [t]he 'side door' of § 363(b) may well 'replace the main route of Chapter 11 reorganization plans.'"

Expedited section 363 sales in other Chapter 11 cases involving General Motors and the Chicago Cubs suggest that this prediction may be right on the mark.

Even foreign debtors with U.S. assets are rapidly becoming aware of the benefits of the section 363 sale process as a means of effecting an expeditious liquidation or transfer of assets.

Oct. 17, 2009, marked the four-year anniversary of the effective date of Chapter 15 of the Bankruptcy Code, which was enacted as part of the comprehensive bankruptcy reforms implemented pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

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Governing cross-border bankruptcy and insolvency cases, Chapter 15 is patterned after the Model Law on Cross-Border Insolvency (the “Model Law”), a framework of legal principles formulated by the United Nations Commission on International Trade Law in 1997 to deal with the rapidly expanding volume of international insolvency cases. The Model Law has now been adopted in one form or another by 17 nations or territories.

Although it has been largely overlooked in the evolving Chapter 15 jurisprudence to date, the powers conferred upon the representative of a foreign debtor in a chapter 15 case include the ability to sell the debtor’s U.S. assets under section 363(b) of the Bankruptcy Code.

Only a handful of courts have addressed section 363 sales in chapter 15 in the short time since it was enacted. One of them was a New Jersey bankruptcy court presiding over a chapter 15 case filed on behalf of a company subject to insolvency proceedings in the British Virgin Islands.

In In re Grand Prix Associates Inc., the court granted the foreign representative’s motion to sell limited partnership interests held by the debtor under section 363(b) free and clear of competing interests and approved a master settlement agreement among the debtor and various creditors under Rule 9019 of the Federal Rules of Bankruptcy Procedure.

Procedures and Relief Under Chapter 15

Under chapter 15, a duly accredited representative of a foreign debtor may file a petition in a U.S. bankruptcy court seeking “recognition” of a “foreign proceeding.”

“Foreign proceeding” is defined as:

"A collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation."

Because more than one bankruptcy or insolvency proceeding may be pending against the same foreign debtor in different countries, Chapter 15 contemplates recognition in the U.S. of both a “main” proceeding — a case pending in whatever country contains the debtor’s “center of main interests” — and “nonmain” proceedings, which may have been commenced in countries where the debtor merely has an “establishment.”

Upon recognition of a foreign “main” proceeding, certain provisions of the Bankruptcy Code automatically come into force, while others may be deployed in the bankruptcy court’s discretion by way of “additional assistance” to the foreign bankruptcy case.

Among these are the automatic stay (or an equivalent injunction) preventing creditor collection efforts with respect to the debtor or its assets located in the U.S. (section 362,

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subject to certain enumerated exceptions) and the right of any entity asserting an interest in the debtor's U.S. assets to "adequate protection" of that interest (section 361).

The provisions also include the power to avoid unauthorized post-recognition asset transfers (section 549); rules regarding the post-recognition effect of security interests in a foreign debtor's U.S. assets (section 552); and procedures governing the use, sale or lease of a foreign debtor's U.S. property (section 363).

In particular, section 1520(a)(2) of the Bankruptcy Code provides that "sections 363, 549, and 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that the sections would apply to property of an estate."

Also, section 1521(b) states that "[u]pon recognition of a foreign proceeding, whether main or nonmain, the court may ... entrust the distribution of all or part of the debtor's assets located in the United States to a foreign representative or another person ... authorized by the court, provided that the court is satisfied that the interests of the creditors in the United States are sufficiently protected."

If the foreign proceeding is recognized as a "nonmain" proceeding, the bankruptcy court may, but is not required to, grant a broad range of provisional and other relief designed to preserve the foreign debtor's assets or otherwise provide assistance to a main proceeding pending elsewhere.

Once a foreign main proceeding is recognized by the bankruptcy court, the foreign representative is authorized to operate the debtor's business in much the same way as a Chapter 11 debtor in possession.

He can also commence a full-fledged bankruptcy case under any other chapter of the Bankruptcy Code, so long as the foreign debtor is eligible to file for bankruptcy in the U.S. and the debtor has U.S. assets.

In fact, if the foreign representative seeks relief on the debtor's behalf under section 544, 547 or 548 (e.g., for the purpose of avoiding preferential or fraudulent transfers), he is required to file a case on the foreign debtor's behalf under another chapter of the Bankruptcy Code.

The ability to sell a debtor's assets under section 363 of the Bankruptcy Code is an important tool that permits trustees, Chapter 11 debtors in possession and foreign representatives to effect an orderly and expeditious sale or liquidation of individual assets or even a debtor's entire business.

The section 363 sale process can be undertaken by means of a public auction with detailed bidding procedures or through a private sale, depending upon whichever

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vehicle in the discretion of the bankruptcy court is most likely to result in the highest and best offer for the assets in question.

To expedite the sales process, section 363(f) of the Bankruptcy Code authorizes sales free and clear of competing interests in the property under certain specified conditions.

Section 363(m) promotes the finality of the bankruptcy sales process by providing that an order authorizing a sale to a good faith purchaser cannot be undone even if the order is reversed on appeal unless the party challenging the sale obtains a stay pending appeal.

A New Jersey bankruptcy court recently considered how the section 363 sales process should operate in a chapter 15 case in Grand Prix Associates.

Grand Prix Associates

Grand Prix Associates Inc. and its affiliates ("Grand Prix") were incorporated under the laws of the British Virgin Islands ("BVI") for the purpose of investing in private equity limited partnerships.

The investments were partially funded by Blackthorne Property Inc. ("Blackthorne"), to which Grand Prix granted a lien on substantially all of its assets as security for the financing.

A consortium of limited partnership lenders (the "LP Lenders") also provided financing to Grand Prix for the purpose of satisfying capital calls with respect to acquired partnership interests.

As security for the obligation, Grand Prix pledged its shares and granted the LP Lenders security interests in accounts and securities located in New Jersey.

Substantially unfunded capital calls caused Grand Prix to commence insolvency proceedings on March 13, 2009 in the BVI (the "BVI Proceeding").

The BVI court appointed Plaza Management Overseas SA ("Plaza") as Grand Prix's foreign representative and directed Plaza to file a chapter 15 case on Grand Prix's behalf in the U.S. for the purpose of preventing creditors from seizing Grand Prix's pledged U.S. assets.

Plaza filed a petition for recognition under Chapter 15 of the BVI Proceeding as a foreign main proceeding on March 18, 2009, in New Jersey. Together with the Chapter 15 petition, Plaza filed a motion seeking provisional relief in the form of an injunction preventing any actions in the U.S. to collect against Grand Prix's assets.

On March 24, 2009, the LP Lenders and certain other parties filed suit in New York State Supreme Court against the principals of Grand Prix, Blackthorne and certain other

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parties alleging, among other things, that the defendants had engaged in fraud and tortuous contractual interference in connection with the loan transactions. The bankruptcy court granted the injunctive relief on April 2, 2009.

Following extensive negotiations among Grand Prix, Blackthorne, the LP Lenders and various limited partnerships in which Grand Prix held investments, Plaza filed an amended chapter 15 petition on May 8, 2009, together with a master settlement agreement resolving the disputes among the parties.

The bankruptcy court entered an order recognizing the BVI Proceeding as a foreign main proceeding on May 18, 2009, directing, however, that the recognition order would be vacated nunc pro tunc to the date immediately preceding execution of the settlement agreement if that agreement was not ultimately approved by the court.

The master settlement agreement and an accompanying transaction agreement resolved the disputes among the parties (including the New York litigation) and provided for, among other things, the sale and/or assignment of various limited partnership interests held by Grand Prix to the LP Lenders and certain other parties, and the exchange of mutual releases.

Plaza filed a motion seeking approval of the sale under sections 363(b)(1), 363(f) and 1520(a)(2). Plaza also filed a motion seeking an order approving the master settlement agreement under Rule 9019 of the Federal Rules of Bankruptcy Procedure.

The Bankruptcy Court's Ruling

The bankruptcy court approved both motions.

Initially, the court noted, in keeping with Chapter 15's underlying purpose in harmonizing foreign and U.S. bankruptcy or insolvency proceedings, sections 1525 and 1527 of the Bankruptcy Code expressly require communication and cooperation among U.S. courts, foreign courts and foreign representatives with respect to the supervision and administration of a foreign debtor's assets, including approval of agreements related to the coordination of proceedings.

According to the court, the master settlement agreement promotes the goals of these provisions because it "proposes a resolution that will conclude the instant Chapter 15 proceeding, the BVI Proceeding, and the claims and issues between the parties."

Under Rule 9019, the court explained, the proponent of a settlement bears the burden of proving that a settlement is in the best interests of the estate and the debtor.

In determining whether to approve a proposed settlement, the bankruptcy court must consider: (1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexities of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (iv) the paramount interests of creditors.

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The court concluded that Plaza had satisfied its burden of demonstrating that the master settlement agreement and the sale transaction were negotiated in good faith, were reasonable given the circumstances and should be approved under Rule 9019.

Among other things, the evidence demonstrated that the litigation was extremely costly, complex, time consuming and of uncertain outcome, and that other litigation would ensue in the absence of a settlement.

All of these factors, the court reasoned, supported the conclusion that the settlement was in the best interests of creditors.

Turning to Plaza's motion to sell Grand Prix's limited partnership interests free and clear, the court explained that, because the sale transaction was outside the ordinary course of Grand Prix's business, Plaza must demonstrate that "there is a sound business justification for the transaction."

In addition, the court noted, Plaza bears the burden of proving that the sale satisfies the requirements of section 363(f), and that the purchaser is acquiring the assets in good faith under section 363(m).

Thus, the standard applied by the court in assessing the propriety of a non-ordinary course asset sale in Chapter 15 was no different than the standard governing section 363(b) sales in Chapter 7 or 11 cases.

The bankruptcy court concluded that Plaza had satisfied these burdens, based upon its findings that the settlement and sale had a sound business purpose because they would resolve "expensive and lengthy" litigation and the proposed sales price was fair because it would satisfy all obligations to creditors, capital calls and related costs.

Finally, the court ruled that Plaza met its burden of proving that the purchaser "acted in good faith and without collusion" with respect to the sale transaction, based upon evidence showing, among other things, that the negotiations were undertaken at arm's length.

Outlook

Chapter 15 filings remain relatively uncommon even four years after the U.S. enacted its version of the Model Law in 2005. Calendar years 2006, 2007 and 2008 saw 74, 42 and 76 Chapter 15 filings, respectively.

As of Oct. 9, 2009, 104 chapter 15 cases had been filed in the U.S. in this calendar year.

Even so, representatives of foreign debtors are increasingly relying on Chapter 15 as a reliable means of protecting a foreign debtor's U.S. assets pending a determination as to whether such assets (or their proceeds) should be repatriated abroad to be

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administered in the venue of the debtor’s foreign main proceeding, which serves as a centralized forum to resolve all claims against the debtor or its assets.

Grand Prix Associates and the handful of similar rulings to date (for example, a Virginia bankruptcy court’s April 2008 decision in In re Loy) suggest that sales under section 363 are likely to be an important part of the chapter 15 process.

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The opinions expressed are those of the authors and do not necessarily reflect the views of Portfolio Media, publisher of Law360.

In re Chrysler LLC, 576 F.3d 108 (2d Cir. 2009).

In re Grand Prix Associates Inc., 2009 WL 1850966 (Bankr. D.N.J. June 26, 2009).

In re Loy, 2008 WL 906503 (Bankr. E.D. Va. April 3, 2008).

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