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UNITED STATES

Pedro A Jimenez is a partner in the restructuring practice of Paul Hastings and is based in the firm's New York office. Mr Jimenez has been recognised as a leader in the firm's cross-border bankruptcy and restructuring work and has actively participated in a number of high-profile bankruptcy and restructuring matters, including Cal Dive, Chrysler Corporation, Dana Corporation, General Maritime, Grupo Isolux, LyondellBasell, Omega Navigation, OSX, Overseas Shipholding Group, Spansion Corporation, and Takata Corporation.

Mr Jimenez has extensive cross-border experience in advising clients on global restructurings, Chapter 11 and Chapter 15 cases. His out-of-court and in-court company representations span multiple industries including automotive, energy, manufacturing, mining, shipping and technology.

Mr Jimenez has lectured and authored numerous articles on cross-border insolvency matters and is a member of the American Bar Association, the American Bankruptcy Institute and INSOL International.

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> *"The bankruptcy cases of Puerto Rico and several of its governmental instrumentalities have dominated a lot of the bankruptcy press in 2018."*

GTDT: In the last year, have you seen any developments or trends in the nature and volume of insolvency filings?

Pedro A Jimenez: In 2017, we saw an increase in pre-packaged or pre-negotiated public company Chapter 11 restructurings with nearly one in four of the year's total bankruptcies cases where the debtor had already negotiated at least some of the terms of its reorganisation or restructuring with a sponsor or a large majority of its creditors. The past year saw continued popularity in pre-packaged bankruptcy cases in the United States. This was largely due to more certainty existing around the outcome in a 'pre-pack', with less interruption to a company's day-to-day operation. Pre-packaged bankruptcies also streamline the costs associated with operating in bankruptcy, as a debtor entity can complete a Chapter 11 pre-packaged bankruptcy in a small fraction of the time that it would normally take to complete a more traditional Chapter 11 case. Because of the greater certainty and shorter time to complete, pre-packaged bankruptcies can also significantly reduce the costs and expense associated with completing a more traditional bankruptcy case.

Another growing trend are retail bankruptcies, especially those of traditional brick and mortar retailers. Brick and mortar retailers continue to struggle to compete against online retailers – a trend that has been going on for a number of years. Mattress Firm, Sears, and Toys "R" Us are three prime examples of large, traditional brick and mortar retailers that filed for bankruptcy in the past year because of the tremendous impact on their businesses from online retailers. For many, there has been a perfect storm of decreased foot traffic to malls and shopping centres and an increase in the number of expensive debt obligations coming due. However, with greater pressure to remain in Chapter 11 for as little time as possible, many of these companies file with a very short runway in which to accomplish a restructuring. Debtors, creditors, investors and the bankruptcy courts have compressed bankruptcy cases that historically took years to complete into bankruptcy cases that last as short as a few months. The recent events in the Sears bankruptcy case are a perfect example of this trend – Sears filed for bankruptcy in October 2018 and will have a little more than three months to close on a restructuring transaction or have to liquidate its stores.

GTDT: Describe the one or two most notable insolvency filings in your jurisdiction in the past year.

PAJ: The bankruptcy cases of Puerto Rico and several of its governmental instrumentalities have dominated a lot of the bankruptcy press in 2018. Puerto Rico, a territory of the United States, has endeavoured for more than two years in efforts to restructure more than US$70 billion of bond debt across several of its instrumentalities, all while attempting to recover from one of the strongest hurricanes ever to hit the island.

Retail-related bankruptcies received much attention in 2018, but I've been keeping an eye on a few media companies – with more than US$20 billion in debt– that have filed for bankruptcy protection in the past year. Most of these have been pre-packaged filings, and some of that had to do with valuations for the companies being significantly lower than they were when the debt was issued.

GTDT: Have there been any recent legislative reforms? Is there a perceived need for reform?

PAJ: In January 2018, Senators John Cornyn and Elizabeth Warren introduced the Bankruptcy Venue Reform Act of 2018, a bill aimed at prohibiting a corporate debtor from using its state of incorporation as a venue for its bankruptcy case and limiting the ability of affiliate companies to all use the same bankruptcy venue. Specifically, under the proposed legislation, a corporate debtor would be limited to using its principal place of business or location of its principal assets as the venue for a bankruptcy filing. With regards to affiliates all maintaining their bankruptcies in the same venue, the proposed legislation would prohibit an affiliate from filing for bankruptcy

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in the same venue unless that affiliate 'owns, controls, is the general partner, or holds 50 per cent or more of the outstanding voting securities' of the debtor that qualifies to maintain a bankruptcy case in that venue. While not specified in the legislation, the proposed legislation would dramatically reduce the number of bankruptcy cases that could be maintained in the United States Bankruptcy Court for the District of Delaware, a bankruptcy court that has long been the preferred venue for many large corporate bankruptcy cases that relied upon the debtor's state of incorporation as the basis for venue to lie in Delaware. The proposed legislation remains pending.

GTDT: In the international insolvency field, have there been any legislative or case law developments in terms of coordination of cross-border cases? What jurisdictions are you most likely to have contact with?

PAJ: Whether and to what extent a foreign debtor needs to have assets or property in the United States continues to be a hot topic for US bankruptcy courts; specifically, bankruptcy courts located in the Second Circuit Court of Appeals, which circuit includes the Southern District of New York. In 2013, the Second Circuit Court of Appeals issued a decision in the case of *Drawbridge Special Opportunities Fund*, in which the Second Circuit ruled that in order for a foreign debtor to be eligible to commence a cross-border bankruptcy case under Chapter 15 of the United States Bankruptcy Code, the debtor needed to have property or a place of business in the territorial jurisdiction of the United States. Since the *Drawbridge* decision, several bankruptcy judges in the Southern District of New York have held that any property satisfies the ruling in *Drawbridge*, the most recent decision in the case of *Avanti Communications*, decided earlier this year. In *Avanti Communications*, published in 2018, the Bankruptcy Court for the Southern District of New York held that a foreign debtor's retainer with its US law firm in New York, as well as its New York law-governed bonds, constituted property in the United States sufficient to confer eligibility to commence and maintain a cross-border bankruptcy case under Chapter 15.

Nearly every large US bankruptcy case of 2018 had a significant cross-border insolvency component. A great example is with *Takata Corporation*, an automobile airbag and other automobile safety systems manufacturer that commenced insolvency proceedings in Japan and the United States. Takata, which had manufactured automobile airbags that had been deemed unsafe and subject to recall in numerous countries, maintained operations in Asia, Europe, North and South America. As part of the sale of Takata's non-airbag businesses and restructuring of the airbag business, Takata Corporation, its


Pedro A Jimenez

buyer and the numerous automobile original equipment manufacturers (the OEMs) that were Takata's largest customers and creditors had to navigate a series of cross-border insolvency issues in Brazil, China, Germany, Mexico, among others, in order to provide certainty to the transaction and Takata's ability to continue producing new airbags so that the OEMs could continue to replace defective airbags that were the subject of recalls.

Like many of the automobile manufacturers that purchased airbag products from Takata, Nissan had a multi-billion dollar warranty claim against Takata for the airbags Takata sold to Nissan and which were the subject of recalls in various countries. At the same time, in order to comply with its commitment to its customers to remove and replace defective airbags from Nissan vehicles that had been recalled, Nissan worked very closely with Takata to ensure that Takata could continue to manufacture airbag inflators for Nissan. These two objectives led Nissan to back a sale of Takata's non-airbag businesses to a third party where sale proceeds could be used to fund a recovery to individuals who had been injured by Takata airbags and also provide a recovery to Nissan (and the other auto manufacturers) for the cost that Nissan had incurred (and would continue to incur) in replacing defective airbags from Nissan vehicles. Takata's airbag business, meanwhile, was restructured in order to permit Takata to continue producing new inflators for

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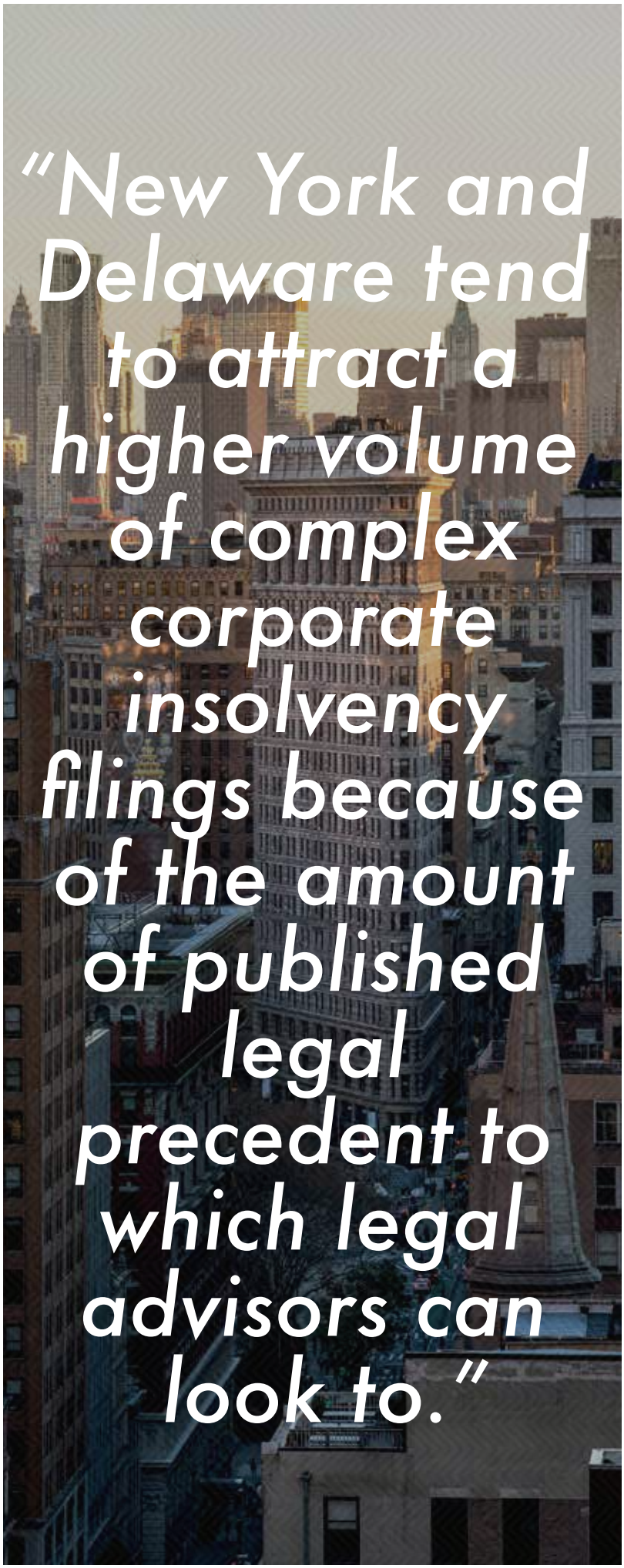

a limited period of time, while also assisting the auto manufacturers in the warehousing and disposal of airbag inflators that had been removed from vehicles.

In terms of other cross-border trends, Mexico is a jurisdiction facing economic headwinds, and those are compounded by uncertainty around the López Obrador administration's fiscal positions. In particular, possible energy reform has left much of the sector – and its debt – in a precarious position, and many creditors are wary about the long-term prospects. Pemex's US$106 billion debt is the highest of any state-owned oil company in Latin America, and unless the company can reverse declining annual production, international investors will have to make tough decisions. More broadly, while many Mexican companies shored up capital in the run-up to the 2018 election, much of that debt is dollar-denominated, and subject to fluctuations in foreign exchange rates, which have been volatile over the last year.

GTDT: In your country, is there a particular court or jurisdiction that sees a higher concentration of insolvency filings? What is the attraction of that forum?

PAJ: New York and Delaware tend to attract a higher volume of complex corporate insolvency filings because of the amount of published legal precedent to which legal advisors can look to in advising clients on particular issues that are likely to come up in the context of the restructuring. However, other venues are beginning to see their fair share of complex cases, including the Southern District of Texas, which has overseen a large number of the energy related bankruptcies of the last two years. Finally, New York continues to lead the way in the number of cross-border insolvencies. That trend dates back to pre-2005 time period primarily due to the sophistication of the judges in New York with regards to cross-border issues – for instance, former Judge Burton Lifland, was a US bankruptcy judge in New York who participated in the UNCITRAL delegation who drafted the cross-border insolvency protocols.

GTDT: Is it fair to describe your jurisdiction as either 'debtor-friendly' or 'creditor-friendly' in terms of how insolvency filings proceed?

PAJ: A bedrock principle on which US bankruptcy and insolvency law is based is that a reorganisation of a business is preferable to liquidation because a reorganised business preserves jobs, preserves continuity of business with customers and suppliers and promotes a higher level of recovery to the company's creditors, including its lenders and investors. Thus, bankruptcy law in the United States is based less on debtor-friendliness versus creditor-friendliness and more on what tools are needed to help a business survive to achieve these objectives.

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THE INSIDE TRACK

What two things should a client consider when choosing counsel for a complex insolvency filing in this jurisdiction?

Companies that operate in multiple jurisdictions or have international creditors need to make sure they have counsel who understands the debtor protection laws in each of those jurisdictions. With nearly every complex filing today having a significant cross-border component to it, a company considering a filing in the United States should carefully evaluate the cross-border expertise and footprint of the advisors it is interviewing. Similarly, the company should also evaluate what experience the proposed advisor has in dealing with contentious restructurings – especially restructurings where one or more recalcitrant creditors may already be in the capital structure (or looking to purchase into the capital structure).

What are the most important factors for a client to consider and address to successfully implement a complex insolvency filing in your jurisdiction?

First, Chapter 11 contains many valuable features that can assist a multinational business restructure. For instance, if the business is attempting to restructure US dollar-denominated debt which requires unanimous or near-unanimous consent to restructure outside of a bankruptcy filing, the multinational business might file a Chapter 11 case in the United States to restructure that debt since the consent requirements for a Chapter 11 plan are much lower. Second, the venue of the bankruptcy filing will also be critical – while US bankruptcy law is a federal law, the bankruptcy courts sit in different circuits and each circuit may have interpreted different provisions of the US Bankruptcy Code differently.

What was the most noteworthy filing that you have worked on recently?

I helped Nissan to navigate the numerous issues associated with the worldwide restructuring of airbag maker Takata Corp, which included bankruptcy filings in Japan and the United States. The most challenging aspect of the representation was how to help Nissan in its dual role as both creditor and customer of Takata.

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A few examples of the tools that are available to assist a debtor to achieve a successful reorganisation are:

- the ability of the debtor to obtain financing in bankruptcy on terms that provide an incentive for parties to lend to an entity in bankruptcy;
- an automatic stay (injunction) to prevent creditors from foreclosing against the debtor entity or its assets to afford it a 'breathing spell';
- as described in greater detail below, the ability to sell assets, including the going concern sale of the debtor's business;
- the ability to restructure (and keep) or reject burdensome contracts and leases;
- the ability to address unionised labour or retiree obligations; and
- the ability to restructure debts, including secured obligations, through a plan of reorganisation.

GTDT: What opportunities exist for businesses wanting to purchase assets out of an insolvency, and how efficient is the process? What are the best ways to take advantage of opportunities in this area?

PAJ: Part and parcel of the trend that many, if not most, of the bankruptcy cases we are seeing are the cases where the bankruptcy filing is used as a vehicle to effect the sale of all or substantially all of the assets of the company.

US bankruptcy law is well-designed to permit a debtor to sell assets outside or as part of a plan of reorganisation, and all in a way as to promote the debtor obtaining a higher value for the assets than what it may be able to achieve outside of a bankruptcy. US bankruptcy law contains four important features to help a debtor realize the highest value for its assets. First, the debtor can sell the assets through what US bankruptcy professionals call a '363 sale', named after the section of the US Bankruptcy Code that permits a debtor to sell assets outside of a plan of reorganisation or liquidation. Because a 363 sale is accomplished through a motion filed with the court (rather than through a plan of reorganisation), a 363 sale normally can be accomplished fairly quickly, a real selling point to any potential buyer who does not want to have to wait an extended period of time before it can close on the sale of assets. Second, US bankruptcy law permits a debtor to sell assets 'free and clear' meaning that a buyer who purchases assets in a bankruptcy case takes those assets free and clear of all liens, claims and encumbrances, with very minor exceptions like environmental claims. That is an extremely valuable feature for

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the selling debtor, who can market and sell those assets at the highest possible price since it can use the bankruptcy process to effectively cleanse most, if not all, of the claims and liens that may otherwise attach to the assets if the sale were to take place outside of a bankruptcy. Creditors who hold liens, claims or encumbrances against the assets that are being sold have those liens, claims and encumbrances transferred to the proceeds generated by the asset sale in the same priority and amount that existed against the assets, with the proceeds from the sale normally distributed at the time of the closing on the sale or as part of a later plan of reorganisation or plan of liquidation.

Third, because 363 sales can effectuate the sale of all or substantially all of a debtor's assets, the debtor can sell a going concern business, including all of the valuable contracts that are necessary for the successful operation of that business. Often, 363 sales look to sell valuable contracts that the debtor has with third parties, and with limited exceptions, those contracts can be transferred as part of the assets that are being sold, including over the objection of the contract counterparty. This is an extremely valuable tool for helping a debtor achieve the highest possible value as it permits the debtor to sell its business as a going concern.

Finally, 363 sales are accomplished through an order entered by a federal bankruptcy court: which order contains findings that the buyer is a 'good faith buyer' and that the buyer is paying reasonably equivalent value for the assets. Both of those findings are extremely valuable as it permits the buyer to close on the sale without the potential litigation overhang or challenge from creditors that the buyer paid too little for the assets.

As far as what buyers can do to seek to take advantage of these provisions, one very important note for a potential buyer is to look to engage with the debtor seller early, including potentially serving as the 'stalking horse' buyer for the assets, since a 'stalking horse' buyer normally has some say over how the marketing process is run and can also have its costs and expenses reimbursed (plus a potential break-up fee) paid if it turns out that another party ends up paying more to purchase the assets.

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ISBN: 978-1-83862-202-2

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