Transatlantic court-ing behaviour: the US v. the UK

Ian Wallace and **Adhuv Prinja** examine the role of the courts in US Chapter 11 bankruptcy proceedings and how it compares to an English administration.

The UK and the US have historically been perceived as leading jurisdictions in the development of restructuring and insolvency law – to the extent that dozens of local insolvency regimes around the world have been modelled on some combination of their processes. Both regimes are highly sophisticated, and feature well-developed legislation supported by decades of case law that offers both debtors and creditors alike a degree of certainty and predictability that is not always available in other jurisdictions. But while clear parallels can be drawn between the US and English restructuring processes, they are by no means identical, and certain key distinctions can be drawn when it comes to the involvement and role of the court in particular.

Which tools to compare?

Chapter 11 of the US Bankruptcy Code is one of the most well-known international restructuring tools, providing the means through which a debtor can effect a financial restructuring and serving as the principal restructuring tool in the US legal system. This court-supervised reorganisation regime allows a company to rehabilitate its business as a going concern, to maximise value and ensure the equality of treatment of creditors with similar rights. The Chapter 11 process is highly effective and powerful, particularly to an insolvent debtor, in light of its worldwide automatic stay and the ability to 'cram down' dissenting creditors, or potentially a class thereof.

> **Despite both Chapter 11 and administration having a shared goal… there is a fundamental policy divergence as to who is in the best position to achieve this.**

In the English restructuring toolkit, administration under the Insolvency Act 1986 is perhaps the most obvious comparator to Chapter 11 as an analogous rescue proceeding, such comparisons being the primary focus of this article.

A distinguishing feature of the English legal system, however, is the plurality of options available to effect a financial restructuring, covering the entire range of potential court involvement.

The administration process sees the greatest level of court supervision (albeit with significantly less involvement than the US court in Chapter 11), and the administrator, as an officer of the court, performs a quasi-judicial function. At the far end of the spectrum, the company voluntary arrangement (CVA) process under the Insolvency Act 1986 generally adopts the most 'light-touch' approach. An English scheme of arrangement, a court-sanctioned process under the Companies Act 2006 with simply a directions hearing and sanction hearing conducted before a judge, represents something of a middle-ground.

The court in Chapter 11 proceedings

A notable feature of Chapter 11 is the high degree of court involvement and the number of court hearings in a typical case.

Chapter 11 proceedings are most commonly initiated by the debtor filing a voluntary petition at court, which it must make in good faith. While there are certain thresholds to be met to access Chapter 11 (eg having sufficient connection to the court's jurisdiction) there is importantly no specific insolvency requirement. The debtor is also required to file a disclosure statement with the court setting out its assets and liabilities.

> Both regimes are highly sophisticated, and feature well-developed legislation supported by decades of case law that offers both debtors and creditors alike a degree of certainty and predictability.

The court will then remain heavily involved through the entirety of the Chapter 11 case. The voluntary petition is generally accompanied by a range of 'first-day' motions seeking orders from the court in relation to the debtor's business and circumstances – for example orders may be sought relating to the manner in which cash will be used and controlled during the case or authorising asset disposals. Each motion needs to be approved by the court, and are typically filed throughout the lifespan of a case. Where a motion is contested, further court hearings will be required to handle objections and reach a resolution. The post-petition Chapter 11 process is therefore heavily court and lawyer-driven.

The court will ultimately need to confirm the creditor-approved 'plan of reorganisation' and, following implementation of the plan, a further court filing is required to formally close the proceedings.

Each Chapter 11 case is assigned a dedicated bankruptcy judge, who carries the case throughout its duration (cases can be pre-packaged and completed in a matter of weeks, but sometimes can run for months or even years). The most sophisticated Chapter 11 judges are seasoned insolvency experts with years of practising experience, and will take a very hands-on role in directing the course of the restructuring and managing the competing interests of creditors and other stakeholders.

The court in administration proceedings

By way of contrast, while the English court plays an important role in administration proceedings, the majority of the process is conducted out of court by the administrators.

The English court is able to exercise its discretion as to whether to grant an administration application, which can be brought by the company, its directors or by a secured creditor holding a 'qualified floating charge'. In contrast to a Chapter 11 filing, both in-court and out-of-court appointment routes are available to, and used by, applicants.

After the court has granted the administration application, the process will largely be driven by the administrators and their team, together with their independent legal advisors. While court involvement persists, it is to a significantly lesser degree than in Chapter 11 proceedings. The administrators' proposals need to be filed at court and hearings are required to approve any extension of the administration beyond its 12-month duration and to approve certain interim distributions. Unlike Chapter 11 proceedings, however, an English administration process will not typically feature regular hearings for motions in respect of debtor conduct, and it is unusual for creditors to directly petition the court in the same way that they regularly would in Chapter 11.

The degree of court involvement is perhaps the single most obvious difference in terms of course of conduct between a UK and a US insolvency case. In the UK, it is the administrators who run the process with their team, exercising their discretion to adjudicate claims and monetise assets or achieve a sale of the business. In the US, all key issues are brought before the judge by way of hearing, often on a daily basis, and it is the bankruptcy court, more than anyone else, that has the final decision on all material issues. To take one recent example, at the time of writing, approximately 3,000 filings have been made on the Toys 'R' Us Inc Chapter 11 docket compared to only two filings made in respect of the Toys 'R' Us Ltd's English administration proceedings.

Who controls the process?

Another key area of divergence between Chapter 11 and administration is the question of who controls the debtor and the process.

Chapter 11 proceedings are regarded as a 'debtor-in-possession' process – meaning that existing management will typically remain in place – and no insolvency practitioner is appointed.[1] This means that management – either the existing or a new team – will maintain day-to-day control of the debtor, although major business decisions outside the ordinary course, such as disposals of material assets or incurring additional secured debt, will need to be court-approved.

The administration process follows a somewhat different path, and control of the company will pass to the administrators. The directors of the company are under a duty to assist administrators in their functions, but day-to-day control is surrendered. As the administrators are officers of the court, performing a quasi-judicial function, intense court oversight and regular hearings are therefore not required.

Despite both Chapter 11 and administration having a shared goal of being rescue proceedings and providing potential rehabilitation for the ailing company, there is a fundamental policy divergence as to who is in the best position to achieve this.

One might conjecture that this difference of approach is based as much as anything on deep-rooted cultural and historic principles: the "American dream" where every businessman has the opportunity to rebuild his fortune in the face of adversity and failure is forgiven, versus centuries of English history where risk is required to be aligned with responsibility and everyone held culpable for their actions (and debts).

> Comparisons will continue to be drawn between the US and English legal systems as the two most popular and developed forums for complex financial restructurings.

In truth this is an over-simplification and the UK and US approaches have at least as much in common as they have apart, but nevertheless this departure in overall approach has a far-reaching impact, particularly on matters such as corporate governance and board decision making. In the US, directors are arguably incentivised to file for Chapter 11 to secure protection for the debtor through the automatic stay, and to provide themselves with the exclusive platform to propose a plan of reorganisation to the company's creditors. In England, directors are faced with difficult decisions owing to the risk of incurring personal liability for wrongful trading and, in certain circumstances, may be incentivised to file for administration and cede control to an insolvency practitioner.

Closely associated with this is the differing role of the chief restructuring officer, which in English restructurings is often engaged early in the process to support the directors and have a minimal ongoing role (if any) post-filing for administration. In the US, directors are arguably less likely to relinquish control to a »

	UK administration	US Chapter 11
Who can file?	Either the debtor or a creditor with a floating charge (or the court)	Primarily just the debtor (although involuntary processes can be launched by creditors in certain circumstances)
Who controls the business?	The court-appointed administrators	Existing management (other than in rare cases where a trustee is appointed)
How much court-involvement is there?	The court usually hears the initial application and then only occasional hearings thereafter where the administrators want to receive instructions on key issues	Very high level of court involvement, with dozens of hearings over the course of a case and hundreds of legal pleadings filed
How expensive is the process?	Varies depending on complexity of the case. Typically administrations are less expensive than Chapter 11 but complex/high profile cases can still be very costly	Typically perceived as comparatively expensive, particularly for long-running cases

chief restructuring officer or other financial adviser, although in practice creditors will often condition their ongoing support for the debtor on such appointments. The chief restructuring officer or financial adviser can play a central role in the formation of the reorganisation plan both pre- and post-filing.

Regional variance

A by-product of greater court involvement in the Chapter 11 process is the risk of regional variance and there are perceived differences between filing venues in the US. Certain bankruptcy courts are seen as more creditor-friendly, while others are seen as more debtor-friendly. This is arguably a natural result of the more prominent role of the judge in Chapter 11

> Bankruptcy is viewed differently in the US. Many major corporations have been through one or more bankruptcies and there is less of a negative perception.

and the numerous filings made relating to the ongoing management of the debtor. Indeed, there are a growing number of voices in congress calling to limit the ability to 'forum shop' for Chapter 11 filings, which is currently relatively straightforward given the low requirement thresholds to entry in a particular state. It is also important to note that while Chapter 11 cases are subject to federal laws – the Bankruptcy Code and the Bankruptcy Rules – certain aspects of a case may be governed by state-specific laws.

In this regard, arguably the English Courts are more consistent than their US counterparts owing to the unitary legal system in England and Wales and the powers of the administrator being clearly defined in the Insolvency Act, versus the US judge-driven process that is more susceptible to variance.

Cultural differences

Comparisons will continue to be drawn between the US and English legal systems as the two most popular and developed forums for complex financial restructurings. This cannot be done in a vacuum, however, and the role of the courts within each system's rescue processes is perhaps rooted in the different sociological and cultural attitudes towards insolvency and debt recovery.

In England, and arguably wider Europe, there has historically been a greater stigma associated with bankruptcy, which is largely seen as the 'end of the road' for a company. Risk and responsibility are closely tied for management, and where management has 'failed' and an entity files for administration, a court-appointed insolvency practitioner is seen as the person best equipped to try to rescue the business.

Bankruptcy is viewed differently in the US. Many major corporations have been through one or more bankruptcies – leading to the terms 'Chapter 22' and 'Chapter 33' as companies repeat the Chapter 11 process – and there is less of a negative perception as regards such processes, which are considered to be an opportunity to reorganise and rehabilitate the debtor. US business culture, more so than British/European, seems to emphasise the importance of risk-taking to achieve success, and Chapter 11 is set up to provide management with a second chance to rescue the business, albeit under the supervision of a judge.

Which process is preferable?

Whether Chapter 11, with the more prominent role of the judge, the intensive role of the courts and the displacement of management, has a comparative advantage over English administration will depend on the point of view of the relevant participant.

For the debtor, the high degree of court (and consequently lawyer) involvement in Chapter 11 can mean high costs being incurred during the life-cycle of a case, and subsequently it is seen by many as the preserve of larger debtors only. Contrastingly, English restructuring processes are available to, and utilised by, companies of all sizes.

From a creditor's perspective, while Chapter 11 provides a very sophisticated tool with ultimately a relatively consistent and predictable outcome, cases can become protracted, adviser-heavy and highly litigious. The requirement for motions heard by the court in respect of debtor conduct, which are open to challenge, can mean a drawn-out and costly process, materially impacting creditor recoveries.

> In England, and arguably wider Europe, there has historically been a greater stigma associated with bankruptcy, which is largely seen as the 'end of the road' for a company.

That said, the undeniable power and flexibility of the Chapter 11 process to implement a long-term solution for a business gives it significant appeal both to debtors and creditors, and the advantages and disadvantages of either process will ultimately depend on the specific nature of the company and the circumstances of the restructuring. □

[1] The US Bankruptcy Code provides for the appointment of a trustee, if required, however this is rarely used in practice and is typically only seen where, for example, there are concerns regarding fraud.

IAN WALLACE is a partner at White & Case LLP.

ADHUV PRINJA is an associate at White & Case LLP.