International Secured Transactions and Insolvency

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I. New Developments in Chapter 15—Cross-Border Insolvency Proceedings in the United States

A. ELIGIBILITY TO BE A DEBTOR UNDER CHAPTER 15: *IN RE BERAU CAPITAL RESOURCES PTE LTD*, CASE NO. 15-11804 (BANKR. S.D.N.Y. OCT. 28, 2015)

During 2015, the ability of a foreign debtor to file for relief under Chapter 15 of the United States Bankruptcy Code[1] was further expanded. Chapter 15 was designed to provide foreign debtors with greater access to United States bankruptcy courts. However, a statutory anomaly has created a question on the eligibility of certain foreign debtors to qualify for Chapter 15 relief.

Problems arise when a foreign debtor is in need of certain protections afforded by Chapter 15, but has neither a place of business nor property within the United States. Section 109 of the Bankruptcy Code defines who may be a debtor under the various chapters of the Bankruptcy Code.[2] Chapter 15 does not contain any requirement for foreign debtors to have property or a presence in the United States as a predicate for relief, but the limitations of Section 109(b) on who may seek relief under Chapter 15 are expressly incorporated into Chapter 15 through Sections 103(a)[3] and 1501(c).[4] Section 109(a) provides that a person may be a debtor under the Bankruptcy Code if the person "resides or has a domicile, a place of business, or property in the United States."[5] While by definition, a foreign debtor would not have a residence or domicile in the United States, it could have a place of business or property.

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1. 11 U.S.C. §§ 1501 *et seq.*
2. 11 U.S.C. § 109.
3. 11 U.S.C. § 103(a).
4. 11 U.S.C. § 1501(c).
5. 11 U.S.C. § 109(a).

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In 2013, the United States Court of Appeals for the Second Circuit became the first circuit court to address this question. In *In re Barnet*, 737 F.3d 238 (2d Cir. 2013), the court determined, based on the express language of the statute, that the requirements to qualify as a debtor under Section 109 of the Bankruptcy Code expressly apply to foreign debtors under Chapter 15.[6]

In *Barnet*, plaintiffs, Australian liquidators, sought discovery from the United States parent of an affiliated hedge fund that was being sued by the liquidators in Australia.[7] The United States Bankruptcy Court for the Southern District of New York recognized the Australian proceeding as a foreign main proceeding (*Octaviar I*), and permitted the discovery to take place.[8] The hedge fund appealed directly to the Second Circuit, which reversed the lower court's decision.

While this result seemingly thwarted Congress's intent in enacting Chapter 15, Section 103(a) and Section 109(a) could not be reconciled with Chapter 15 without Congressional intervention. But, notwithstanding the Section 109(a) requirement that a Chapter 15 debtor demonstrate that it has a place of business or property in the United States, courts have been practical in their application of the statute.

It is a long-standing principle of bankruptcy law that a peppercorn is sufficient to meet the property test of section 109.[9] Thus, after the Second Circuit ruling in *Barnet*, the Australian liquidators filed a second Petition for Recognition asserting they had property in the United States. The property consisted of the foreign debtor's claims against the United States hedge fund and an undrawn retainer in the trust account of the foreign debtor's United States counsel. Upon a motion to dismiss, this second Chapter 15 proceeding in the Second Circuit, the court determined that both the foreign debtor's claims and the retainer constituted sufficient property in the U.S. to meet the requirements of Section 109.[10]

Shortly after the *Octaviar II* ruling, another New York bankruptcy court determined that a U.S. bank account set up by a claims agent on behalf of the Cayman liquidators constituted sufficient property in the United States to meet Section 109's eligibility requirements.[11]

Then on October 28, 2015, another New York bankruptcy court further expanded the scope and type of property needed to meet the Chapter 15 eligibility requirements by determining that a foreign debtor's contract rights in the United States, created under a bond indenture, were intangible property rights which satisfied the eligibility requirements of section 109.[12]

In this case, Berau Capital Resources (BCR) filed an insolvency proceeding in Singapore where it had its headquarters. BCR was an affiliate of BCE Class, a large global

6. *In re* Barnet, 737 F.3d 238, 247 (2d Cir. 2013).
7. *Id.* at 241.
8. *Id.*
9. *See, e.g.*, *In re* McTague, 198 B.R. 428 (Bankr. W.D.N.Y. 1996) ($194 in U.S. bank sufficient for Canadian resident to file Chapter 7 in the U.S.); *see also In re* Paper I Partners, L.P., 283 B.R. 661, 674 (Bankr. S.D.N.Y. 2002) (partnerships had property in the U.S. because their general partner had original documents for each debtor in its New York office); *In re* Yukos Oil Co., 321 B.R. 396 (Bankr. S.D. Tex. 2005) (attorney retainer constitutes property of the debtor in the U.S.).
10. *In re* Octaviar Administration Pty Ltd. (*Octaviar II*), 511 B.R. 361 (Bankr. S.D.N.Y. 2014).
11. *In re* Suntech Power Holdings, Co., Ltd., 520 B.R. 399, 411-14 (Bankr. S.D.N.Y. 2014).
12. *In re* Berau Capital Resources PTE LTD, 540 B.R. 80, 81-84 (Bankr. S.D.N.Y. 2015).

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coal mining conglomerate. BCR had been created as a special-purpose entity solely for the purpose of raising capital for the BCE Class. The capital was raised through the issuance of over $450 million in United States dollars denominated debt, which was now in default. Other affiliates of the BCE Class were in insolvency proceedings in Indonesia, and the conglomerate was in the process of negotiating a global financial restructuring. As part of that process, BCE Class was negotiating with its bondholders, but needed to insure that no bondholder filed litigation against it. To get the benefit of the injunctive relief available to Chapter 15 debtors, the BCR foreign representative filed a Chapter 15 proceeding in New York.[13]

Judge Glenn recognized the controversy created by the Second Circuit's *Barnet* opinion, but as a bankruptcy court located within the Second Circuit, was bound by the decision.[14] He discussed the cases that had determined eligibility based on property located in the United States in the form of a counsel retainer account, and indicated that BCR had set up such as account with its counsel.[15]

The court then expanded the interpretation of "property in the United States" and found eligibility based on the intangible property interest in the bonds. The court determined that BCR's $450 million in United States dollar denominated debt was not only governed by New York law, but contained a New York law forum selection clause. Additionally, the indenture trustee was a United States financial institution. Under the indenture, numerous acts had to be performed in New York by both BCR and the indenture trustee, and an authorized agent for service of process in New York had been designated. The court noted that it would be ironic if a foreign debtor's creditors could sue it in New York to enforce the debt under the indenture, but the foreign debtor could not seek bankruptcy protection to protect itself from such litigation.[16]

The court cited numerous cases finding that contracts create property rights for the parties to the contract, such rights are property of a debtor's estate and intangible rights are recognized as property rights under New York law. The court further determined, based on New York state case law, that while the *situs* of an intangible asset is a legal fiction, at times justice requires that a location be ascribed to such asset. That location could be "the domicile of the creditor; . . . the domicile or place of business of the debtor[; or,] the place . . . where the obligation was created or was meant to be discharged."[17] Because BRC was obligated to perform on the notes in New York and the notes were meant to be discharged in New York, BRC's property rights in the indenture were located in New York.[18] Therefore, the court concluded, BRC had a property interest in the U.S. and was eligible for Chapter 15 relief.

After the decision in *Berau*, Section 109 has become less of an obstacle to Chapter 15 eligibility. While the plain language of the Bankruptcy Code still requires a prospective Chapter 15 debtor to have a residence, domicile, place of business, or property in the United States in order to obtain relief under Chapter 15, United States courts relying on *Berau* have found ways to effectuate the broadest eligibility standards.

13. *See id.* at 82.
14. *See id.* at 81-82.
15. *See id.* at 82.
16. *Id.* at 82-83.
17. *Id.* at 83.
18. *In re Berau*, 540 B.R. at 84.

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B. Recognition of a Foreign Main Proceeding: *In re OAS S.A., et al.*, 533 B.R. 83 (Bankr. S.D.N.Y. 2015)

"Recognition of a foreign proceeding" is the critical step for a foreign debtor to get access to the courts of the United States. Recognition is governed by Section 1517 of the Bankruptcy Code that contains a loosely defined test that has resulted in much litigation and analysis.[19] On July 13, 2015, the United States Bankruptcy Court for the Southern District of New York issued an opinion recognizing the bankruptcy filings of three Brazilian companies as foreign main proceedings in a Chapter 15 case brought by the foreign representative.[20] The opinion contains a detailed analysis of the test for recognition, providing significant clarity on the issues of who may act as a "foreign representative" and what constitutes the "center of main interest" (COMI) of a foreign debtor.[21]

In *OAS*, three Brazilian debtors were part of an international Brazil-based conglomerate, the OAS Class, whose business focused on engineering and construction projects and related investments in such projects.[22] The OAS Class, through one of the Chapter 15 debtors, OAS Investments, had issued numerous tranches of U.S. dollar denominated public debt in the aggregate amount of $875 million, which was governed by New York law.[23] The OAS Class's financial problems began with its alleged participation in the Petrobras corruption scandal in Brazil.[24] In an effort to stabilize the OAS Class, a complex corporate transaction closed in December 2014 through which certain entities were merged.[25] This transaction arguably impaired the rights of the bondholders. Notwithstanding the December 2014 transaction, the OAS Class was unable to service its debt and defaulted in January 2015.[26] The bondholders sued in New York in February 2015.[27] In March 2015, several members of the OAS Class filed for bankruptcy protection in Brazil.[28] In April 2015, certain noteholders filed an insolvency proceeding for OAS Finance in the British Virgin Islands (the "BVI Proceeding") successfully obtaining the appointment of joint provisional liquidators (JPLs).[29]

The Brazilian court ordered the appointment of a statutory judicial administrator,[30] but the Brazilian debtors were still authorized to continue to operate their businesses pursuant to Brazilian insolvency law, which includes a quasi-debtor in possession concept.[31] The board of directors of the Brazilian debtors authorized the appointment of Renato Fermiano Tavares (Tavares) as the foreign representative for the purpose of negotiating and effectuating a global corporate restructuring.[32] The restructuring included seeking

19. *See* 11 U.S.C. § 1517(a), (b).
20. *In re* OAS S.A., et al., 533 B.R. 83 (Bankr. S.D.N.Y. 2015).
21. *See id.* at 99-101.
22. *See id.* at 86.
23. *See id.* at 87-88.
24. *See id.* at 88.
25. *See id.*
26. *See In re OAS*, 533 B.R. at 88.
27. *See id.* at 89.
28. *See id.*
29. *See id.* at 91.
30. *See id.* at 90.
31. *See id.* at 95-96.
32. *See In re OAS*, 533 B.R. at 90.

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Chapter 15 relief in the United States so as to enjoin the pending New York bondholder litigation.[33]

On April 15, 2015, Tavares filed Chapter 15 petitions for four members of the OAS Class, including OAS Finance and OAS Investments.[34] Tavares sought recognition of the Brazilian proceedings as foreign main proceedings.[35] Two bondholders objected on several grounds, two of which are discussed here. The bondholders alleged: (1) Tavares, the foreign representative appointed by the board of directors, did not satisfy the definition of "foreign representative" contained in 11 U.S.C. § 101(24);[36] and (2) one of the entities, OAS Investments, did not have its COMI in Brazil because it was an Austrian entity.

With regards to the qualifications of Tavares to act as the foreign representative, the noteholders argued that (1) a foreign representative was required to be authorized or appointed by a court, not by a board of directors; and (2) even if a board could appoint a foreign representative, the OAS Class board lacked authority to do so in this case because the debtors were not debtors in possession.[37]

The court determined it was not necessary for a foreign representative to be specifically appointed or authorized by a foreign court. Instead, the foreign representative must be "authorized in a foreign proceeding."[38] In so ruling, the court followed the Fifth Circuit ruling in the *Vitro* case,[39] and other Chapter 15 case law. The finding was also consistent with the UNCITRAL Model Law, upon which Chapter 15 is based, and its related Guide to Enactment.[40]

The court further determined it was not necessary for foreign debtors to have the exact rights of a debtor in possession under United States law in order for the board of directors to have authority to appoint the foreign representative. The Model Law is not based on United States definitional concepts. When a foreign debtor continues to operate its business and maintain some control over its assets, although under court supervision, it can appoint its own foreign representative.[41] What made the finding expansive in this case was that the Brazilian court had already appointed a judicial administrator. The court

33. *See id.*

34. *Id.* Tavares ultimately decided not to go forward with the Chapter 15 petition for OAS Finance, so the *OAS* Opinion only deals with three debtors.

35. Section 1517(b) provides:

> Such foreign proceeding shall be recognized—
> (1) as a foreign main proceeding if it is pending in the country where the debtor has the center of its main interests; or
> (2) as a foreign nonmain proceeding if the debtor has an establishment within the meaning of section 1502 in the foreign country where the proceeding is pending.

36. Section 101(24) provides: "The term 'foreign representative' means a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

37. *See In re OAS*, 533 B.R. at 91.

38. *See id.* at 92.

39. *In re* Vitro S.A.B. de CV, 701 F.3d 1031 (5th Cir. 2012).

40. *In re OAS*, 533 B.R. at 94-96. *See* UNCITRAL, UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT AND INTERPRETATION (2014), *available at* http://www.uncitral.org/pdf/english/texts/insolven/1997-Model-Law-Insol-2013-Guide-Enactment-e.pdf.

41. *See In re OAS*, 533 B.R. at 95-96.

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was not swayed by the noteholders' argument because the role of the judicial administrator was not to operate the companies or develop a restructuring plan. These roles were still left to the debtors. Therefore, the court determined the debtors' board of directors could appoint the foreign representative.[42]

The Court then addressed the issue of the COMI of OAS Investments. OAS Investments was a special purpose entity that had been incorporated in Austria solely for the purpose of issuing debt on behalf of and lending the proceeds to the other members of the OAS Class.[43]

Section 1502(4) provides that a "foreign main proceeding" is a foreign proceeding "pending in the country where the debtor has the center of its main interests."[44] The Bankruptcy Code does not define "center of . . . main interests," but section 1516 contains a rebuttable presumption that the location of a business debtor's registered office is its COMI.[45] Under this analysis, the COMI of OAS Investments was presumed to be Austria.[46] Similar to United States handling of bankruptcies involving corporate classes, under recent Brazilian law, the Brazilian court had determined that OAS Investments was eligible to file in Brazil along with its affiliated entities.

Thus, in order to recognize the Brazilian proceeding of OAS Investments as a foreign main proceeding, the United States court had to determine OAS Investment's COMI was in Brazil at the time it filed for Chapter 15.[47] It was critical that OAS Investments be eligible for Chapter 15 relief because it was the primary obligor on the notes subject to the New York litigation. Recognition as a foreign main proceeding would give OAS Investments the benefit of the automatic stay and other protections not afforded to proceedings designated as foreign non-main proceedings.

While the Bankruptcy Code does not set forth the types of evidence that will be required to rebut the presumption that a debtor's COMI is its place of registration, courts consider various factors, including the following:

> the location of the debtor's headquarters; the location of those who actually manage the debtor . . . ; the location of the debtor's primary assets; the location of the majority of the debtor's creditors or of the majority of the creditors who would be affected by the case; and/or the jurisdiction whose law would apply to most disputes.[48]

Additionally, the court can consider the "nerve center" test—the location where the debtor's activities are directed and controlled.[49] Using this analysis, the Bankruptcy Court determined that the nerve center of OAS Investments was Brazil. OAS Investments was a

42. *See id.* at pp. 96-97. The Court also judicially estopped the bondholders from arguing the Brazilian proceedings had divested management of control of the entities because they had argued the direct opposite in the BVI Proceeding in seeking the appointment of JPLs. *Id.* at 97.

43. *Id.* at 101.

44. 11 U.S.C. § 1502(4).

45. § 1516(c); *see In re OAS*, 533 B.R. at 100.

46. *See In re OAS*, 533 B.R. at 101.

47. The COMI of a Chapter 15 debtor is determined at the time the Chapter 15 petition is filed, unless it appears the filing date of the Chapter 15 case has been used to manipulate the COMI. *See id.* at 100 (citing *In re* Fairfield Sentry, Ltd., 714 F.3d 127, 133 (2d Cir. 2013).

48. *In re* SPhinX Ltd., 351 B.R. 103, 117 (Bankr. S.D.N.Y. 2006), *aff'd*, 371 B.R. 10 (S.D.N.Y. 2007).

49. *In re* Fairfield Sentry, Ltd., 714 F.3d at 138, n.10.

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creature of Austrian tax law. OAS Investments did not conduct business or have assets or a physical location in Austria. Its notes were issued pursuant to New York law, and its noteholders—its creditors—were all global entities. The strategy that led to the creation of OAS Investments and the issuance of the notes was developed in Brazil by the officers and directors of the OAS Class, all of whom were in Brazil. Furthermore, under the express terms of the indenture itself, it was clear that the expectations of the creditors of OAS Investments were that they would be paid through the OAS Class's Brazilian-based businesses. Additionally, the Court recognized that any global restructuring of the OAS Class would have to take place through the Brazilian proceedings. On this basis, the Court determined that the COMI of OAS Investments at the time of the filing of the Chapter 15 petition was Brazil.[50]

The *OAS* opinion is significant because it clarified the definitions of foreign representative and COMI, and effectuated the policy of promoting the practicalities of corporate class restructuring.

II. A Quiet Revolution: German Insolvency Law Reformed

A. Introduction

Over three years ago, in March 2012, German insolvency law was significantly changed by the enactment of a comprehensive set of amendments to Germany's 1999 Insolvency Code.[51] There were further reforms in 2014. The developments through 2015 show that the reformed German law may provide interesting options to international investors, especially when considering acquisitions in Germany. This section will give an overview on the instruments and mechanisms provided under the new German Insolvency Code and how they can be used to tailor existing or future investments in Germany.

B. Background and Recent Developments

Under traditional German insolvency law, the proceedings were dominated by an administrator appointed by the court who held far-reaching powers. While administrators were supposed to keep in mind the interests of all parties in a proceeding and equally serve all creditor classes, in fact, administrators could do as they saw fit. There was little supervision by the courts, and neither creditors nor management of the insolvent entity were able to exert much influence. This did not matter in the first decades after the Second World War when the German economy was growing rapidly and insolvency was of little relevance. However, the situation changed significantly with the oil crises of the 1970s when insolvencies became more frequent. At this time, criticism of the German insolvency regime began to mount. As foreign investments in Germany increased, creditors from abroad—many of them having a common law background—joined in the chorus and criticized the loss of control that accompanied German insolvency. Specifically, there was no secure way of determining which administrator

50. *In re OAS*, 533 B.R. at 101-03.

51. Insolvenzordnung [InsO] [Insolvency Code], *amended by* Das Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen [ESUG] [Act for the Further Facilitation of the Restructuring of Companies], Mar. 1, 2012.

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would be chosen by the insolvency court. In a number of major cases this even lead to forum shopping, with companies with English or United States creditors using making complex arrangements after moving at least parts of the debtor company to England.

As a response to that criticism, the reform law was enacted. Under this law, the most important decisions have been transferred away from the courts to either management or creditors. In addition, formerly underused sections of the law intended to introduce Chapter 11-type proceedings were strengthened. Overall, German law took a large step in the direction of the English and U.S. approach to bankruptcy. As a result, an insolvency of a German corporate entity can now be used to restructure its debt, legally alter its corporate structure and fundamentally change its ownership if supported by a majority of the stakeholders. With this, not only can investors improve the performance of investments in Germany that they have made in the past, it also means that insolvency has become a powerful tool in a merger and acquisition process with a view to target German entities.

Recent statistics and cases indicate a trend in that direction: While overall company insolvencies are low—down from a peak of about 39,000 in 2003 and 2004, to 24,000 in 2014 and probably 23,000 for 2015, if figures for the first half year can be extrapolated—the new instruments are obviously popular. Five out of the largest ten insolvencies and 22 out of the 50 largest insolvencies in 2014 used tools introduced or strengthened by the reform law. Anecdotal evidence from the judges at Germany's largest insolvency court in Berlin-Charlottenburg suggests that this trend has continued unabated in 2015.

C. Types of proceedings

A German insolvency of an entity of some significance[52] begins with the filing by either management or a creditor for the opening of insolvency proceedings. In a traditional proceeding, it then follows the appointment of a preliminary administrator by the court, the formal opening of main proceedings, the liquidation of assets, payments to creditors who are secured on some or all of these assets and—if liquid funds remain—the payment of a dividend to unsecured creditors. These traditional proceedings continue to exist and are the reality of German insolvency in the majority of all cases.

But since the reform law was enacted two other—related—options exist. These consist of two types of debtor-in-possession proceedings, under sections 270a and 270b of the Insolvency Code, respectively. In-possession proceedings were an earlier innovation in German law. They were modeled after United States Chapter 11 rules and written into German law during an earlier reform effort in 1999. Because this concept was alien to the German tradition, with their emphasis on the dominant role of the administrator, German judges mistrusted these reforms. Thus, few proceedings of this kind were successfully concluded. If debtors filed with the intention of staying in possession, courts nearly always found a reason to change to a traditional proceeding and transfer control of the case to an administrator.

To counteract that trend, the reform law strengthened in-possession proceedings in a number of ways. One solution has been to establish an experienced insolvency

52. There are more than 100,000 insolvency cases in Germany each year in which individuals seek debt relief. But this article focuses on enterprise insolvencies in which there are ongoing business operations.

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administrator, known to the insolvency court as a Chief Restructuring Officer (CRO) in the insolvent company. The court then appoints a so-called *Sachwalter*, a weaker version of an administrator, who is to supervise the management in the interest of the creditors but does not take over complete control. In practice, it is desirable—and permitted—to have some degree of coordination between the CRO and the *Sachwalter* beforehand.

The aim of the in-possession proceedings will always be to avoid liquidation in the traditional style. Instead, a plan will be presented to all relevant classes of stakeholders who consist of creditors as well as shareholders, with the latter having only a very weak vote. These stakeholders decide with a majority of classes whether debts will be forgiven or swapped for equity, whether shareholders will be replaced, whether shares will be transferred, or whether any other measure will be adopted. This vote is the decisive element in an "insolvency plan" (*Insolvenzplan*) under German law. These changes extended and strengthened the options that insolvency plans provide to such an extent that, when combined with the reformed in-possession proceedings, the law can be said to have been revolutionized and not reformed.

D. Insolvency plans

The rationale behind an insolvency plan is the assumption that the parties concerned presumably know best how their interests are served. Therefore, German law gives parties the option—also modeled after Chapter 11 of the United States Bankruptcy Code—to freely decide what should happen with an insolvent company entity and its assets. For this, four important questions must be addressed: (1) Who can propose the plan?; (2) What can be included in the plan?; (3) Who can vote on the plan?; and (4) What mechanisms are available to parties who wish to prevent the plan from taking effect or appeal it?

An insolvency plan can only be proposed by either the insolvent entity or the *Sachwalter*.[53] Creditors cannot propose a plan. Instead, they are limited to voting on the plans proposed by either insolvent entity or the *Sachwalter*. The law intentionally does not permit competing plans in the interest of simplified decision processes and speedier proceedings.

The contents of an insolvency plan can be anything that is permissible under German private or corporate law, so long as none of the participants in the proceeding are worse off under the plan than they would be in a liquidation of the assets. This is where creditors may regret that they cannot propose a plan themselves: even if they believe that a different plan would benefit them more, their arguments will not be heard. The comparison is always only between the results of a liquidation and the actual plan proposed.

The plan must contain a descriptive part in which the current state of the entity and especially its assets and liabilities are described. In addition, the measures proposed under the plan must be described, and the effects of the plan on the classes formed under the plan have to be outlined.

53. A plan can also be presented in traditional proceedings to give creditors the chance to deviate from a liquidation if they so wish. Then, either the company or the administrator can present a plan.

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In a second part of the plan, the formative part, the specific changes in the legal position of the participants are provided in detail. Thus, for one typical class—the unsecured creditors—the plan might contain the following provision: "Within six months after the plan becomes effective the unsecured creditors receive a payment of 10 percent of their claims while their remaining claims are forgiven." Once the plan becomes effective, such a provision alters the material relationship between all members of the class concerned and the insolvent entity as set out in the provision.

In this context it is vital to identify the classes that will vote on the proposed plan. It is expected that there will be a class of unsecured creditors, even if it is small, as in real estate special purpose vehicle (SPV) bankruptcies (such as the tax authorities or the property manager). If there are secured creditors, they form another class. Should they expect a shortfall from the value of their collateral as compared to their claims, then they can also vote as part of the class of unsecured creditors with the amount of that shortfall. Further classes can be formed and may include employees, small creditors, or shareholders. Shareholders must be in a separate class if their shares are affected by the plan. Generally, there is neither a limit on how many classes can be formed, nor on who must be in a specific class, as long as all members of one class can be shown to share a similar economic interest.

Accordingly, there must be valid reasons underlying the formation of the classes, and these reasons must be discussed in the descriptive part of the plan. The author of the plan has a wide range of options on how to form the classes as long as plausible reasons can be given plan.

If a majority of classes votes for the plan—with each class requiring a simple majority of individuals and of claims—dissenting classes will be outvoted, as long as they are not worse off under the plan than they would be under a liquidation and no class of equal rank[54] is better off than they. Thus, even if the opposing classes contain more individuals and higher claims than the classes that voted for the plan, the plan can still become effective. And while the Code contains a clause that is modelled after the absolute priority rule of United States Bankruptcy Code § 1129(b)(2)(B)(ii), in practice it is applied in such a way as to have no meaningful effect.

Obviously opposing classes who see themselves outvoted by a majority of other classes will file an appeal to attempt to improve their position. But, in the interest of a fast conclusion of proceedings, the Insolvency Code severely limits this possibility by imposing both various formal requirements as well as an option to have a plan declared valid despite an appeal.

Taken together, the above features and provisions make an insolvency plan an extremely effective way to change both the shareholder and/or the creditor structure of any corporate entity.

54. The tacit assumption of the German Insolvency Code is that the standard claim is for a sum owed to a creditor under contract, tort or on some other basis. The Code then ranks interest, costs, fines and shareholder loans behind standard claims.

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E. Plans in an M&A Setting

As noted earlier, the German Insolvency Code provided that, as a general rule, an insolvency plan can only be presented to the insolvency court by a *Sachwalter*, or an insolvency administrator, or the insolvent company itself. This seems to leave no room for an active investor to present a plan. But nothing under the German Insolvency Code prevents any investor from approaching the insolvent company, its management, or its *Sachwalter* with a proposal for an insolvency plan that is beneficial to at least a majority of the parties and, accordingly, has a good chance of being accepted by a majority of interested classes. A potential investor, approached in a merger and acquisition process outside insolvency, might realize that the potential target is not worth buying as is because of its current shape, but might have value if restructured. Then, the crucial question is whether any of the parties involved—existing advisors, management, or shareholders—can be made to understand that drastic measures will be necessary if a liquidation and the corresponding losses are to be avoided.

A German insolvency proceeding offers a number of other advantages such as up to three months of payroll financing through the unemployment insurance system, mitigation of restrictive labor law rules, and termination rights for long-term contracts such as leases. These advantages are little known outside specialist circles because traditionally insolvency has not been seen as a workable restructuring tool due to the problems, which led to the reform law. For this reason, it has been a subject that management professionals have tended to avoid. In addition, even in the legal and accounting professions practical knowledge of the reformed law and its application are regrettably rare. If these advantages can be communicated and a business plan is made on that basis, it often becomes apparent that there is residual value to be obtained through such a proceeding. Specific cases in which this has been applied successfully include literary publishers, television stations, IT-service businesses, real estate SPVs, and manufacturing businesses.

F. Conclusion

Since the reform in 2012 of German insolvency law, the insolvency plan has become a flexible instrument to restructure businesses in Germany. It is now used in roughly half of large enterprise insolvencies. But its potential has not been fully used so far as an acquisition tool, particularly for international investors. If considered in an early stage of an investment process, an investor can secure its position as a potential buyer and use an insolvency plan to restructure the target business in a way that makes it sustainable for the future.

III. New Developments in Secured Transactions Law

This update[55] is intended as a starting point for research into the secured transactions laws and registry laws of those countries discussed.

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55. Other recent works on this subject include Arnold S. Rosenberg, *Reform of Secured Transactions Laws: Global and Regional Trends and Recent Developments*, 46 U.C.C.L.J. 109 (2015); *idem.*, *Classification of Foreign Filing Systems*, in Practice Under Article 9 of the Uniform Commercial Code (S. Sepinuck ed., 2d

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A. Latin America and the Caribbean—Costa Costa Rica, El Salvador, Jamaica, and Panama

Costa Rica established a new legal framework for secured transactions on movable assets by enacting a statute based largely on the Organization of American States Model Interamerican Law on Secured Transactions (OAS Model Law) in 2014,[56] and in May 2015, Costa Rica went online with a new computerized central registry. Costa Rica thus joins Mexico, Colombia, Honduras, and Jamaica as the leading examples of countries in Latin America and the Caribbean that have meaningfully reformed their secured transactions laws, in ways that should satisfy the standards of UCC § 9-307(c) in most cases.[57]

Under the Costa Rican law, both present and future assets may be used as collateral. Functional equivalents of collateral such as sales of goods with retention of title and assignment of accounts receivable are covered and must be registered. Security interests may be enforced non-judicially both through public auction and private sale. The new web-based registry permits online registrations as well as amendments and terminations, and is searchable online.

El Salvador also went online with computerized registration of secured transactions on movable assets as part of its Centro Nacional de Registros (CNR)[58] pursuant to its version of the OAS Model Law. El Salvador's law,[59] like Costa Rica's, allows non-judicial enforcement through public auction and private sale. It also expands the range of movable assets that can be used as collateral and permits general descriptions of collateral. But, in El Salvador, questions have been raised regarding conflicts between the new law and existing provisions of the Commercial Code regarding the commercial pledge and the pledge given in the production credits.[60]

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ed. 2012); *idem.*, *Foreign Filing Systems: a Seven-Country Study*, 66 Consumer Fin. L.Q. Rep. 303 (2012); *idem.*, *Where to File Against Non-U.S. Debtors: Applying UCC §9-307(c) [Rev] to Foreign Filing, Recording and Registration Systems*, 39 U.C.C.L.J. 109 (2006); *International Secured Transactions and Insolvency*, 49 ABA/SILYIR 219 (2015); *International Commercial Transactions, Franchising and Distribution*, 47 ABA/SILYIR 201, 209 (2013). *See also* Dale Beck Furnish & D. Michael Mandig, *Transnational Financing – Uniform Commercial Code § 9-307(c) and Its Implications for Global Trade:* Dayka & Hackett LLC *v.* Del Monte, 44 U.C.C.L.J. 243 (2012).

56. Ley No. 9246, May 20, 2014, Ley de Garantías Mobiliarias [Secured Transactions Law], La Gaceta, Diario Oficial [L.G.], May 20, 2014 (Costa Rica).

57. Regarding Mexico's 2010 reform of its secured transactions laws and subsequent modernization of its centralized secured transactions registry, see Furnish & Mandig, *supra* note 55.

58. *Sistema de Registro de Garantías Mobiliarias*, Centro Nacional de Registros, https://www.e.cnr.gob.sv/sisrgm/ (last visited Apr. 12, 2016) (El Sal.).

59. Decreto No. 488, Sept. 19, 2013, Ley de Garantias Mobiliarias [Secured Transactions Law], Diario Oficial [D.O.], Oct. 14, 2013 (El Sal.).

60. *See Legal Uncertainty over Registry of Secured Transactions*, CentralAmericaData (Oct. 20, 2014), http://www.centralamericadata.com/en/article/home/Legal_Uncertainty_over_Registry_of_Secured_Transactions.

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Jamaica's registry went online in 2015, pursuant to its 2013 secured transactions law reform.[61] Panama's registry did as well, pursuant to its 2013 law on secured transactions.[62]

B. Asia and Africa—Hong Kong SAR, Liberia, Uzbekistan, and Indonesia

Hong Kong SAR's secured transactions legal framework continues to suffer from the enforceability in insolvency proceedings of unregistered retention of title agreements, so-called *Romalpa* agreements,[63] which are functional equivalents of security interests.[64] But these only affect sales of goods. Hong Kong's registry reportedly is now reliable and an accessible source of information[65] and, as of 2015, Hong Kong went online for registrations and searches of charges and mortgages on most kinds of personal property.[66] Under a collateral-specific approach,[67] Hong Kong now satisfies UCC § 9-307(c) standards with respect to all or most types of collateral other than goods.

Liberia, pursuant to a 2010 and 2013 modernization of its secured transactions laws, established a unified, notice-based secured transactions registry.[68]

Major new reforms and a new registry have also been reported in Uzbekistan.[69] Indonesia made its registry more user-friendly by reorganizing it according to debtor's name in Jakarta and Surabaya.[70]

61. Law No. 38-2013, Security Interests in Personal Property Act (2013) (Jam.).

62. Ley No. 129, Dec. 31. 2013, Que promueve el acceso al crédito y moderniza el sistema de garantías mobiliarias a través de la hipoteca sobre bien mueble y dicta otras disposciciones, Gaceta Oficial Digital, Jan. 8, 2014 (Pan.)

63. Aluminium Industrie Vaasen BV v. Romalpa Aluminium Ltd [1976] 2 All ER 552, [1976] 1 WLR 676.

64. Under UCC § 9-202, retention of title agreements are considered security agreements, and a seller retaining title under a *Romalpa* agreement in the United States would have to file a UCC-1 financing statement to perfect its security interest or be unperfected.

65. Private communication of Arnold S. Rosenberg with Richard M. Tollan, a Hong Kong solicitor and Solicitor Advocate of the High Court of the Hong Kong Special Administrative Region and a Partner with the law firm of Mayer Brown JSM at its Hong Kong office, on November 22, 2015.

66. Companies Ordinance, (2013) Cap. 622, §§ 334, 335 (H.K.). Registrations of charges are done electronically using Form NM1 through the e-Registry. The process is described in Part E of the e-Registry's FAQ, available at https://www.eregistry.gov.hk/icris-ext/apps/por01a/menu?filename=faq_esubmission_eng.pdf. Searches are done using the e-Registry's Cyber Search Centre, available at https://www.icris.cr.gov.hk/csci/.

67. *See* Arnold S. Rosenberg, *Where to File Against Non-U.S. Debtors*, *supra* note 55, at 134; Furnish & Mandig, *supra* note 55.

68. In 2015, Liberia finally implemented its Collateral Registry pursuant to its 2010 Secured Transactions Law, codified as Chapter 5 of the Liberian Commercial Code – Secured Transactions, and its April 2013 Regulations for Secured Transactions/Collateral Registry, available at http://www.cbl.org.lr/doc/others/collateral.pdf.

69. *Getting Credit: Doing Business Reforms*, World Bank Grp., http://www.doingbusiness.org/data/exploretopics/getting-credit/reforms (last visited Apr. 12, 2016).

70. *Id.*

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C. Europe—Albania, Czech Republic, and Hungary

Albania, which was one of the first former Communist countries to modernize its secured transactions laws, took a step backward by excluding intangible assets from non-possessory pledges.[71]

Meanwhile, the Czech Republic took a step forward by amending its legal regime for secured transactions. Under the 2014 amendment, pledges of receivables may be registered, and non-judicial enforcement of interests in collateral is permitted if agreed to by the parties.[72]

Hungary improved its secured transactions legal regime in its new Civil Code, effective in March 2014, by extending security interests to products and proceeds of collateral, permitting non-judicial enforcement of security interests in collateral in a greater variety of circumstances, and by establishing a modern notice-based registry.[73]

71. So reports the World Bank. Press Release, World Bank Group, Doing Business 2015: Albania Makes Significant Improvements in Three Areas of Business Regulatory Reform (Oct. 29, 2014), *available at* http://www.worldbank.org/en/news/press-release/2014/10/29/albania-makes-significant-improvements-in-three-areas-of-business-regulatory-reform, last accessed. But according to other reports, only financial collateral is excluded. Gjika & Associates, *A Recently Adopted Law on Financial Collateral in Albania*, CEE Legal Matters (Feb. 26, 2015), http://www.ceelegalmatters.com/index.php/legal-analysis-capital-markets/159-capital-markets/2064-a-recently-adopted-law-on-financial-collateral-in-albania. Whether these amendments are the same is unclear.

72. World Bank, Doing Business in 2015: Going Beyond Efficiency 39 (2014).

73. *Hungary*, Secured Transaction L. Reform Project, http://securedtransactionslawreformproject.org/reform-in-other-jurisdictions/hungary/ (last visited Apr. 12, 2016); *Getting Credit: Doing Business Reforms*, *supra* note 69.

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