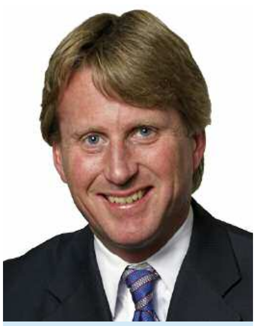
The case of Arcapita and the role of U.S. courts in international restructurings

Brad Geer, Anne Davey, and Zachary Cohen report on a case involving a foreign entity using Chapter 11, and some interesting global litigation



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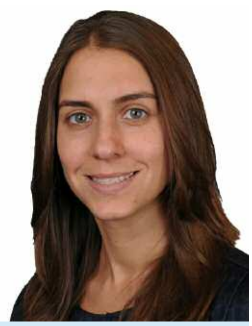

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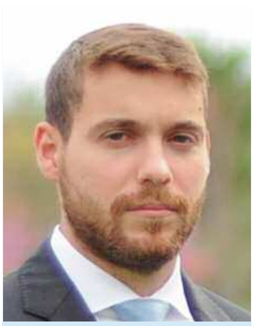

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United States Bankruptcy Courts, particularly in New York and Delaware, are some of the most preferred courts for multinational corporate bankruptcy filings.

This trend has been on display throughout the most recent credit cycle, as companies with global operations and assets (think shipping) have frequently selected the U.S. as their destination of choice for reorganisations and recapitalisations. There are a number of advantages foreign companies enjoy when choosing the U.S. for dealing with distress, as well as pitfalls and limitations that companies and their advisors should be mindful of.

The Chapter 11 cases of Arcapita Bank B.S.C.(c) ("Arcapita" or the "Company") and its subsidiaries present a compelling case study for the benefits and potential pitfalls of relying on U.S. Bankruptcy Courts. Arcapita was a leading global manager of Shari'ah-compliant alternative investments and operated as an investment bank. It was not a domestic bank licensed in the United States, and it did not have any branches in the United States. However, Arcapita did have an office in Atlanta. The Company was headquartered in Bahrain and regulated under an Islamic wholesale banking license issued by the Central Bank of Bahrain (CBB). Arcapita's subsidiaries were holding companies that held minority ownership interests in a global portfolio of operating companies, and AIHL, a wholly owned subsidiary of Arcapita, was incorporated as a Cayman Islands exempt company in 1998 for the purpose of holding Arcapita's ownership interests in its investments.

Like virtually all private equity institutions and investment banks, Arcapita was adversely impacted by the global economic downturn, and it was especially hard hit by the debt crisis in the Eurozone. This hampered the Company's ability to obtain liquidity through capital markets and resulted in a reduction in asset values (and concomitant difficulties in monetising certain of the Company's illiquid and complex assets owned by the Company's affiliated portfolio companies). As a result, Arcapita did not have adequate liquidity to repay its $1.1 billion unsecured murabaha, Shari'ah-compliant syndicated facility, due March 28, 2012 (the "Syndicated Facility"). Prior to filing for Chapter 11 protection, Arcapita's management team actively engaged in discussions with lenders in the Syndicated Facility regarding potential out-of-court restructuring scenarios. Arcapita, however, was unable to achieve the 100% lender consent required under a Shari'ah-compliant facility in order to fulfil the terms of an out-of-court restructuring.

Additionally, one or more hedge funds that were minority participants in the Syndicated Facility – and which, according to Arcapita, "purchased their interests at deep discounts and were seeking to leverage their opposition to a restructuring to obtain a buyout at par, while other lenders may well receive a less favourable treatment—threatened action that would have, if successful, undermined the Company's going concern value to the detriment of other creditors and stakeholders."[1] The threats, according to Arcapita's management, included "involuntary and value-destructive straight liquidation proceedings in the Cayman Islands," and forced Arcapita to consider reorganisation options under the laws of various other jurisdictions. Arcapita ultimately believed that Chapter 11 was the most effective vehicle for implementing a comprehensive restructuring plan that would maximise recoveries for all creditors and stakeholders. On March 19, 2012, Arcapita filed its voluntary petition for Chapter 11 bankruptcy protection in the Southern District of New York.

Given the diversity of creditors in the Syndicated Facility and their competing interests, Chapter 11 proved to be an effective instrument for Arcapita to implement its restructuring. Creditors in the Syndicated Facility were composed primarily of non-U.S. lenders who favoured a "kick the can down the road"

approach that would include modifications to the Syndicated Facility, including maturity extensions and no reduction in principle. On the other hand, the minority holders described above were looking for an immediate payoff at par. Additionally, other U.S. creditors were well versed in U.S. bankruptcies and were willing to make sacrifices in the form of principal haircuts in order to maximise their ultimate recoveries. The Chapter 11 process forced the entire creditor group into a single voting class, which allowed for the restructuring to go effective despite hold-outs and competing priorities, by obtaining the requisite class majority (at least two-thirds in amount and more than one-half in number of those voting).

While Chapter 11 benefited the Arcapita estate by binding most creditor hold-outs, it was not completely successful in binding all non-U.S. interested parties. Arcapita is still litigating with several Middle Eastern banks on retrieving certain cash deposits, displaying the limitations that U.S. Courts sometimes have in influencing international entities. Pre-petition, Arcapita deposited approximately $35 million of cash into several healthy Middle Eastern banks that were also pre-petition unsecured creditors in Arcapita. Arcapita has direct claims to withdraw the $35 million in order to distribute the funds in accordance with its plan of reorganisation. However, the Middle Eastern banks have asserted that they have set off rights against their unsecured claims and therefore will not release the cash. The litigation has been ongoing for over four years.

As displayed in the case of Arcapita, there are a number of advantages foreign companies enjoy when choosing the U.S. for dealing with financial distress. Chapter 11 of the U.S. Bankruptcy Code is one of the best-developed insolvency regimes in the world, allowing for a level of predictability for stakeholders. One of the most appealing features of Chapter 11 is its ability to solve the "hold out" problem. In the absence of 100% lender consent, it is often difficult to accomplish a balance sheet restructuring on an out-of-court basis. This condition holds true in the U.S. and internationally. However, Chapter 11 allows for the confirmation of a reorganisation plan with less than unanimous stakeholder support through section 1129 and other provisions of the U.S. Bankruptcy Code. If a debtor can obtain the requisite class majorities (at least two-thirds in amount and more than one-half in number of those voting) and/or meets the other tests for confirmation under Chapter 11, all dissenters and abstainers will be bound by the plan.[2]

Enforceability is another appealing feature of Chapter 11. In the case of the U.S. and other major financial centers, the issue of enforcing a court's rulings on creditors not based in that court's jurisdiction is largely mitigated. This is because most institutional creditors have some sort of presence in the U.S. or another major financial center. That is to say, odds are high that most creditors will have a presence in the U.S., so debtors can realistically expect that a U.S. Bankruptcy Court's decisions will be enforced. However, as was the

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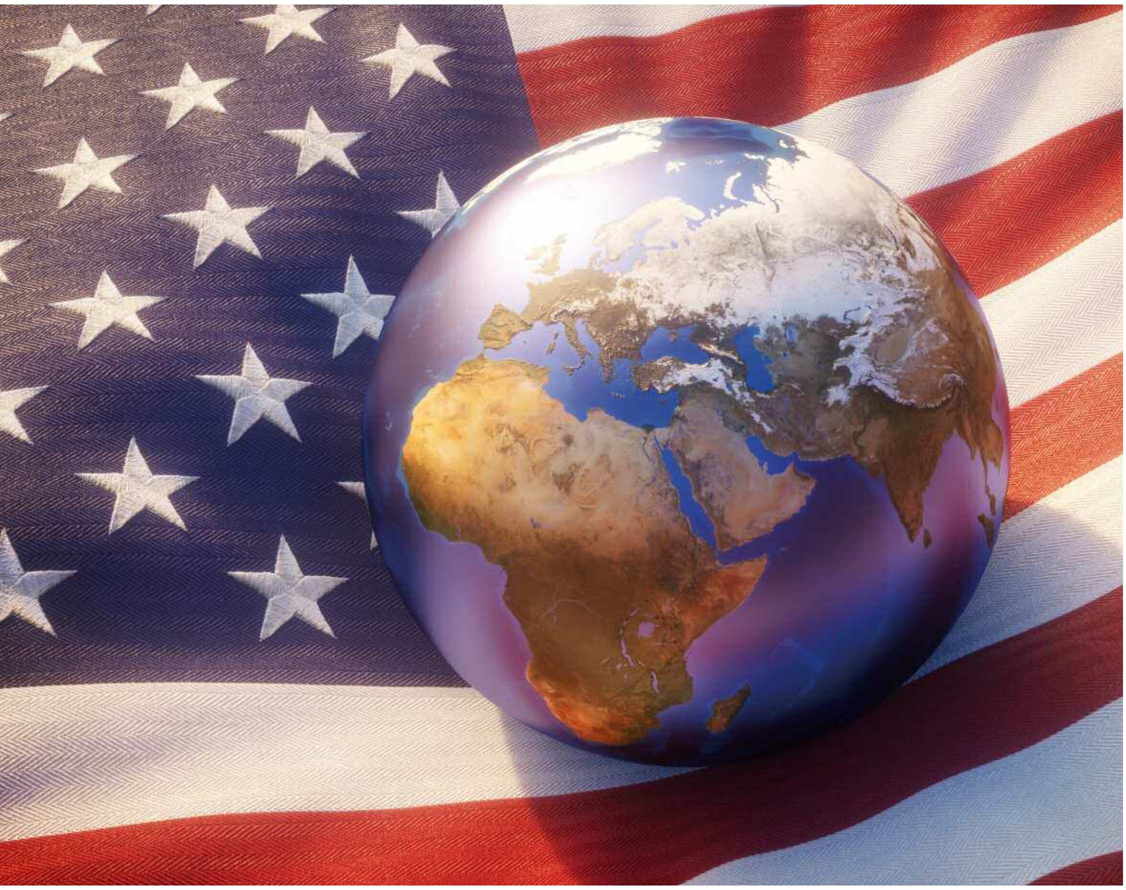

> THE U.S. HAS LONG BEEN ONE OF THE MOST POPULAR VENUES FOR MULTINATIONAL CORPORATE BANKRUPTCY FILINGS

case in Arcapita, the benefit of enforceability is not always guaranteed.

Another of the most obvious advantages of Chapter 11 is the automatic stay provided for in Section 362 of the U.S. Bankruptcy Code. This is an automatic injunction that comes into immediate effect upon the filing of a Chapter 11 petition. It bars any party from taking steps to pursue or enforce claims against the debtor or the property of the estate outside of the bankruptcy proceedings. It has worldwide effect, and the consequences for violating it can be severe.[3]

Filing in the U.S. also creates a bankruptcy estate made up of the debtor's entire property, "wherever located." This allows corporations to administer all of their assets around the world without commencing procedures in each jurisdiction where they do business or own assets.[4] Finally, a foreign entity only needs minimal ties to the U.S. to qualify for relief under U.S. bankruptcy laws. Section 109 of the U.S. Bankruptcy Code, entitled "Who may be a debtor," provides that "only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor."[5] The U.S. Bankruptcy Code does not specify a specific minimum amount or threshold of property that is required to be in the United States in order for an entity to be a debtor in a U.S. bankruptcy case. In fact, the most common way to satisfy the property requirement is to have a bank account in the U.S. or pay a U.S. law firm a retainer on behalf of the debtor and its affiliates. A bank account with only $100 suffices, and the account can even be open shortly before a bankruptcy filing.[6] Thus, it is relatively easy to qualify as a debtor in U.S. Bankruptcy Courts.

The U.S. has long been one of the most popular venues for multinational corporate bankruptcy filings. This should not be a surprise to most restructuring professionals, given the many benefits that foreign companies enjoy when choosing the U.S. Courts (including the ability to bind hold-outs, enforceability, the automatic stay, and the ease with which a foreign company can qualify as a debtor in the U.S.). We would expect this trend to continue as the U.S. Bankruptcy Code continues to be one of the best-developed insolvency regimes in the world, and the case of Arcapita provides a useful case study of the benefits and pitfalls multinational corporations can face when relying on U.S. Bankruptcy Courts. ■

Footnotes:

1 Declaration of Henry A. Thompson in Support of the Debtors' Chapter 11 Petitions and First Day Motions and in Accordance with Local Rule 1007-2, In re: Arcapita Bank B.S.C(C), et al., Case No. 12-11076

2 Crossing Borders: International Reorganizations, By James H.M. Sprayregen and David A. Agay, February 10, 2010

3 DOES CHAPTER 11 WORK FOR FOREIGN SHIPPING COMPANIES?, Maritime Reporter and Engineering News, April 2013

4 Absolute Priority, Coming to America; Corporate Bankruptcy Tourism, November 11, 2014

5 New York Law Journal, Using the Bankruptcy Code For International Restructuring, June 13, 2016

6 Section 109(a) – Filing a Chapter 11 Case for a Foreign Business, Maurice Horwitz, June 8, 2015

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