ROUNDTABLE

Bankruptcy litigation

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ROUNDTABLE

BANKRUPTCY LITIGATION

The bankruptcy litigation arena has been consistently active over the past 12 months – a fertile environment for debtors, creditors and stakeholders to pursue meaningful resolutions to high-stakes litigation cases. At the same time, a number of key trends and developments have emerged in the bankruptcy litigation space, including the increasing prevalence of post-confirmation litigation trusts and mass tort cases. And, with the global economy likely to be stretched for some time to come, bankruptcy litigation is likely to be an ongoing option for creditors seeking to maximise recoveries.

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Pomerantz: Could you provide an overview of the most significant trends in the bankruptcy litigation arena over the past 12 months or so?

Miller: The most significant trend in Canada has been the increase in the use of pre-packs and out of court sales processes, with restructuring proceedings being used to simply implement a transaction and facilitate the payment of proceeds. This can be attributed to sophisticated parties requiring certainty as to the outcome of any proceeding, and the high cost of companies remaining in a court proceeding for a prolonged period of time. The economic climate has also meant that a number of these pre-filing processes are to facilitate a credit bid, where the enterprise value is significantly below what the first lien debt is owed. Another clear trend is the degree to which every issue is litigated rather than negotiated. Negotiated, consensual resolutions used to be the hallmark of Canadian restructuring proceedings. That has been replaced by a pattern whereby every issue warrants extensive out of court examinations of fact witnesses, retaining of expert witnesses and full trials. There have also been some high profile cases over the past year, including the Target Canada and US Steel Canada proceedings, where creditors have attacked or threatened to attack the legitimacy of debt claims asserted by the parent corporation against the debtor subsidiary.

Durrer II: In our experience, the second half of 2015 and the first half of 2016 was the subject of increased bankruptcy litigation as a tactic to extract value or shift value from one constituency to another. As is often the case, however, this approach can sometimes backfire. For example, in The Sports Authority Chapter 11 case pending in the United States Bankruptcy Court for the District of Delaware, litigation among the debtor's term loan lenders and consignment vendors quickly led to the conversion of the case from a reorganisation to a total liquidation. We also continue to see litigation against a debtor's directors and officers threatened or filed as a tool to apply pressure to a debtor and related parties.

Pfeiffer: Increasingly we have been seeing a trend toward successful mediation and mediators with experience in bankruptcy in particular, working with the parties toward a consensus in moving forward with the plan without too much litigation. Testifying experts and other consultants have also been involved with the mediation and advising their clients on the reasonableness of the proposed terms.

Chatz: There are a number of significant trends in the realm of bankruptcy litigation. However, I think the most important issue that has arisen has occurred with the US Supreme Court's Decision in *Baker Botts LLP v. Asarco LLC,* 135 S. Ct. 2158 (2015) where law firms cannot seek reimbursement for their attorney's fees when their fees are attached by third-parties. The *Asarco* decision has created a new ability of adverse and aggressive parties to place counsel dependent upon estate funds for payment of their fees at risk. The ability to use fees as leverage is disconcerting and the Supreme Court's decision reflects a lack of understanding of fairness to professionals in the bankruptcy arena.

Montgomery: Litigation around restructurings is becoming more common, at the same time as courts are applying ever-closer scrutiny. Regulatory changes allowing IPs to sell claims and the emergence of specialist litigation funding have led to an increase in litigation around formal insolvency proceedings.

Martin: The last year has been a continuation of what we had been seeing in the bankruptcy litigation arena over the past several years.

In our experience, the second half of 2015 and the first half of 2016 was the subject of increased bankruptcy litigation as a tactic to extract value or shift value from one constituency to another.

VAN C. DURRER II

As asset values continue to be depressed, unsecured creditors often view litigation as their only avenue towards meaningful recoveries. Creditor bodies are threatening litigation as a way to hold up confirmation of bankruptcy plans in order to negotiate a greater recovery than they otherwise would have received. Additionally, post-confirmation litigation trusts are becoming increasingly common. It is now rare for a plan of reorganisation for a major bankruptcy to be confirmed without the inclusion of a litigation trust as a mechanism to allow the continuation of actions to recover for the creditors. Also, mass tort cases seem to be more prevalent, as well as cases alleging criminal misconduct, such as allegations of securities fraud, Foreign Corrupt Practices Act violations, tax fraud and other similar matters.

Davis: Intercreditor disputes are on the rise as returns for second or subordinated lienholders remain depressed. Allegations of overreaching within the capital stack has led to more litigation, on the one hand, and evolving contractual language, on the other, to clarify the scope of the subordinated arrangement. Similar intercreditor disputes are occurring among unsecured noteholders, with the indenture trustee in such disputes caught in the middle. Part and parcel with this growth in intercreditor litigation has been a trend toward bankruptcy-related litigation occurring in non-bankruptcy courts, including state court. The low returns for unsecured creditors in Chapter 11 cases has led to an increase in veil piercing and other creative attempts to disregard the corporate form and get at the beneficiaries. Similarly, professionals are the target *de jour* for disgruntled creditors.

Nolan: English law offers an array of insolvency and restructuring processes which debtors can utilise, or any combination of them, such as administrations, pre-packs, CVAs and schemes of arrangement. Each comes with their own procedures, case law and specific considerations. We have recently seen a series of important cases concerning the use by overseas companies of schemes of arrangement through the English courts for debt restructuring purposes which have either been challenged or received heightened scrutiny by the court, for example, *VGG, Stemcor, Codere* and *India Kiat*. Pre-packs have also recently undergone increased scrutiny, especially where such sales are to a connected party such as in a 'phoenix' transaction, and a voluntary assessment system – the 'pre-pack pool' – has been set up with the aim of increasing transparency and credibility of such transactions.

Pomerantz: In what ways does the bankruptcy litigation process differ from other types of litigation? To what extent do issues of cost and speed impact on the process?

Chatz: The bankruptcy litigation process has always been more efficient than general litigation outside of the federal courts. Bankruptcy courts have the resources to facilitate expedited litigation and the courts also, with the input of the parties, generally are desirous of assuring that bankruptcy litigation is resolved so that distributions to creditors can occur in an expeditious manner. The cost of litigation is always at the forefront in the bankruptcy process as in any other litigation process. However, while little can be done to mitigate the costs given the impacts of electronic discovery and the mounds of information going back and forth at even the initial stages of litigation, bankruptcy court litigation can ease the burden and processes.

Montgomery: Speed is the biggest differentiator. If a creditor or other stakeholder is seeking to block a restructuring, often it will matter less whether they are ultimately successful, if they can introduce enough delay that the company has to follow a different route. To minimise disruption, preparation, taking all threats seriously and a quick response are all essential.

Davis: There are elements of rough justice and expedience in contested matters and confirmation or sale related litigation that is unique to bankruptcy. There has always been a sense that some bankruptcy judges are more interested in brokering a recovery for the estate rather than in strictly enforcing the law. As the shockwaves caused by the *Stern* decision subside, with bankruptcy judges increasingly acting in the role of magistrate judges for non-core litigation related to bankruptcy cases, the pressure on adversary proceedings to be managed consistent with district court practice is growing. The dichotomy between litigating contested matters and adversary proceedings is becoming starker. Meanwhile, the high cost of litigating in the bankruptcy courts remains the greatest challenge to the system.

Durrer II: A unique aspect of bankruptcy litigation is that in so-called 'bet the company' situations, the litigation must be concluded quickly and efficiently in order that the reorganisation may proceed to a conclusion. For instance, the Caesars Entertainment Operating Company bankruptcy has been mired in litigation for almost 18 months, and reorganisation plan discussions have been impeded by the remaining uncertainty of the litigation. Recently, the implementation of the reorganisation plan of Relativity Media was threatened while the debtor there pursued an emergency three-day trial against Netflix, Inc. in order to compel it to cooperate with the plan. Bankruptcy judges and practitioners are adept at litigating such vital issues in an efficient manner, simply because they must do so in time to save the company.

In Canada, bankruptcy litigation differs from other types of litigation in that you have a court officer playing an active role in the proceeding.

D.J. MILLER

Nolan: Insolvency litigation frequently involves multiple parties rather than just a claimant/applicant and respondent. Debtors, different classes of secured and unsecured creditors and equity holders may take a different position on the same issue. There may also be disputes specific to valuation or implementation of a restructuring. In the UK, the proceedings will also usually have an insolvency practitioner playing a central role in the proceeding such as an administrator or a liquidator on behalf of the debtor. In addition, such litigation could significantly delay implementation of restructuring. This can have a critical effect if the company has urgent liquidity or operational issues, which need to be addressed in order for the company to continue as a going concern.

Martin: Bankruptcy courts are courts of equity and there is a tendency for the rules of evidence to be applied a little more loosely. The tendency for a judge to directly question a witness and a judge's admonition that he will give weight appropriately signal a more active involvement by the bench. From a cost and speed standpoint, bankruptcy litigations can move forward much more quickly. Prior experience with my colleagues on the document review side indicate that they, who are more actively involved in non-bankruptcy litigation, are surprised by the speed with which some of our bankruptcy litigation moves forward.

Pfeiffer: Bankruptcy litigation involving large Chapter 11 bankruptcies generally proceeds more rapidly than other types of litigation as there is a need to get the debtor out of bankruptcy quickly and efficiently. This typically is a faster and sometimes less expensive form of the same litigation that takes place outside of the bankruptcy process. For example, litigation over the proposed settlement of avoidance actions as part of the restructuring plan is significantly shorter than full scale litigation when a trustee pursues avoidance action claims long after the debtor emerges. Residential mortgage trusts is a unique area of bankruptcy litigation in which the mortgage trust trustee is similar to a debtor in that they are both neutral parties that can have multiple constituents who take different sides on an issue, which means they both have to deal with triangulation.

Miller: In Canada, bankruptcy litigation differs from other types of litigation in that you have a court officer playing an active role in the proceeding. Most often that role is as court appointed monitor – in restructuring proceedings under the Companies' Creditors Arrangement Act – or as receiver, interim receiver or trustee in bankruptcy, in proceedings under the Bankruptcy and Insolvency Act. As an officer appointed by the court, there is considerable weight given to their views and this can greatly impact the conduct of litigation and the process whereby issues will be determined, the evidence before the court and the weight that is given to the evidence. Cost and speed of resolution can also impact the process, as the court overseeing the bankruptcy and its court officer are interested in ensuring a speedy resolution and, to the extent possible, minimising costs to the estate.

Pomerantz: Have you seen any common issues arising in bank- ▸▸

ruptcy processes in today's market? In what ways do these issues complicate bankruptcy litigation?

Davis: There seems to be an increase in litigation over the parameters of what constitutes an executory contract. In certain industries and market segments, like technology and energy, recovery value for unsecured creditors is driven by the debtor's ability to shed or maintain certain key contracts. The May 2016 ruling of Judge Chapman in the *Sabine Oil & Gas* bankruptcy is a great example. Sabine is a classic E&P company that needed to reject the gathering agreement with its midstream pipeline operator. The midstream company argued that the key gathering agreement provision was a covenant running with the land which is a property right not subject to rejection in bankruptcy. Judge Chapman disagreed and permitted Sabine to reject the burdensome gathering agreement.

Nolan: Overseas debtors have increasingly looked to English schemes of arrangement or administrations to take advantage of the flexibility of the English regime, finding jurisdiction by moving their COMI, the governing law of their debt documents, or otherwise. In particular in the area of schemes, the last 12 months have seen the courts define limits to their jurisdiction, as debtors have become increasingly creative in trying to establish a connection to England. Even where such proposals are unopposed, the process is far from a 'rubber-stamping' exercise and restructuring lawyers will need to provide ever more robust evidence in supporting schemes going forward.

Martin: Valuation disputes are increasingly common, especially with respect to the current cycle of oil and gas companies. Lenders are fighting for adequate protection of their collateral, as well as any diminution in value of the collateral during the pendency of the bankruptcy. Disputes in this area also centre on whether any diminution in collateral value entitles the lender to a claim for adequate protection of its collateral. An alternative position put forward by the unsecured creditors is that any diminution claim should be limited just to the diminution caused by the bankruptcy proceedings and not from the fluctuations in the underlying market. This issue is particularly relevant in the current gyrating oil and gas market. The current market uncertainty of oil and gas property values almost guarantees that there will be valuation disputes which also impact the determination of which security in the capital structure is the fulcrum security. Another common issue that is complicating bankruptcy litigation is the granting of third-party releases to directors and officers, both former and current. While the debtors receive a discharge upon confirmation, this benefit is not extended to non-debtor parties.

Pfeiffer: These disputes often come down to one issue: money. The common denominator in adjudicating disputes over money is frequently valuation. Examples in which valuation plays a central role include asset valuation for purposes of assessing whether a loan is over-collateralised, liability valuation for purposes of assessing allowed claims or the appropriate interest rate for debtor-in-possession or exit financing, and enterprise valuation in the context of splitting up the pie in a reorganisation or assessing solvency for purposes of assessing fraudulent transfer claims.

Miller: The frequency with which pre-packs and pre-filing sales processes are undertaken is not slowing down, and continues to constitute the majority of CCAA filings, by number, over the past year. The determination of creditor claims is intended to be addressed in a fairly summary manner under Canada's insolvency statutes. However, it has become more common recently for large claims to be litigated through full trials within bankruptcy proceedings, often involving expert witnesses and numerous fact witnesses, which complicates and lengthens the claims litigation process and increases the costs of the proceeding. Disputes with regulatory authorities in a bankruptcy proceeding often lead to litigation, because the issue is important in setting a precedent or reflecting a public position of the regulatory body. One very recent case to watch is the Alberta Queen's Bench decision in *Redwater Energy* regarding the ability of a court officer to abandon non-performing properties with environmental liabilities on a selective basis, or if the court appointed officer must take possession of all property. The implications for sales, including the ability to require the provincial regulator to transfer licences for the retained assets to a purchaser, is very important given the activity in the oil and gas sector right now. The case represents yet another example of the tension between provincial regulations and the federal bankruptcy and insolvency regime in Canada, and will likely end up before the Supreme Court of Canada.

Overseas debtors have increasingly looked to English schemes of arrangement or administrations to take advantage of the flexibility of the English regime.

ELAINE NOLAN

Durrer II: While bankruptcy litigation as a leverage tactic has been on the rise, we predict a shift in the near future. Specifically, we anticipate that more constituencies will be contesting issues of valuation. Candidly, we believe that litigation for leverage sake will decrease due to the general uptick in distressed situations. In other words, practitioners will simply be too busy to engage in litigation for litigation's sake, and we anticipate more negotiated consensual resolutions in the coming months.

Chatz: The improving state of the economy has really changed the debtor/creditor relationship and the multitude of ways in which equity affects the bankruptcy processes. We are beginning to see, not only the return of plans of reorganisation as compared to Chapter 11 liquidations, some returns to unsecured creditors and even equity holders in certain instances. The value of property is increasing and that greatly affects the parties' relevant positions in bankruptcy. You're seeing more aggressive debtors knowing that they're in a stronger position that they were several years ago. At the time same time, secured lenders are equally repositioning themselves given the returns the bankruptcy process will provide.

Montgomery: Schemes of arrangement remain the restructur- ▸▸

ing tool of choice for all companies with English law debt. In the last 12 months, the courts have tightened up the focus on expert evidence of alternatives and analysis of the technical jurisdictional issues. Schemes remain a very attractive implementation tool, but ever more careful preparation is required, especially as challenges, including apparently spurious challenges to cause delay, are on the increase.

Pomerantz: How have recent court rulings impacted on the bankruptcy litigation space? How are the issues involved in such cases likely to affect how parties conduct themselves going forward?

Pfeiffer: The rulings regarding safe harbours for avoidance actions, such as 546(e), will affect which transfers can be the target of avoidance actions going forward. The elimination of certain avoidance actions that would otherwise be available will result in relatively lower recoveries for junior creditors. This lower recovery will likely cause junior creditors to be more aggressive when contesting what they believe is a biased low enterprise value in reorganisation disputes because they will have fewer avoidance claims, and their resulting value, to bring going forward.

Davis: There are a couple of relatively recent decisions that are causing a buzz in the bankruptcy litigation community. The US Supreme Court in May 2016 expanded the scope of what constitutes actual fraud for purposes of opposing a discharge in bankruptcy. In *Husky International Electronics, Inc. v. Ritz*, the Supreme Court held that the phrase "actual fraud" includes more than just fraud in the inducement or intentional misrepresentations. A fraudulent transfer scheme, where a debtor transfers assets with the intent of "concealment or hindrance", is sufficient to constitute the requisite fraud for an objection to a debtor's discharge. Objections to discharge must be brought by adversary proceeding and generally involve protracted litigation.

Nolan: The High Court's decisions in the Lehman Brothers Europe *Waterfall II* application – heard in three parts and the first two parts granted leave for appeal in the Court of Appeal – were possibly the most significant rulings in the UK insolvency space in the past 12 months. The case relates to the application of an estimated £6-7bn surplus left over following the payment of all debts of Lehman Brothers International Europe. Over 30 novel points of law were raised as well as questions of construction. One question, which asked whether payments made by the administrators should be notionally treated as having been applied to interest first before being applied to principal, is worth more than £1bn depending on the outcome.

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JOSEPH P. DAVIS III

Chatz: The Supreme Court's ruling in *Asarco* has had an impact upon how parties handle themselves with respect to utilisation of leverage with respect to professionals compensated by the bankruptcy estate, are placed at risk in the context of litigation. The ability to object to fees and have parties who are subject to fee petitions, having no ability to recoup their fees for the defence of leverage based fee objections, is troubling. In addition, the Court's decision *In re Husky International Electronics, Inc. v. Ritz* decided on 16 May 2016, has created a new ability to potentially pursue insiders of the debtor for acts undertaken when that principal served as a director of the company that fails and transfers funds to other entities, leaving that principal potentially subject to non-dischargeable debt.

Durrer II: We continue to analyse the aftermath or a series of opinions issued from the Southern District of New York involving bond indentures qualified under the Trust Indenture Act (TIA). Historically, courts have interpreted the TIA to require unanimous consent by bondholders in order to effect any change to the payment terms of the governing indenture, contrasted with mere majority consent to effect changes to non-payment terms. However, in recent cases, the district courts ruled that proposed out-of-court restructurings that allegedly involved changes to non-payment terms of governing bond indentures violated the TIA, on the theory that these changes affected the practical ability of a bondholder to recover payment on its bonds.

Montgomery: Apcoa Parking and VGG are recent examples of scheme cases where the court has expressed views on the scope of its jurisdiction over foreign debtors and the evidence needed to satisfy it that the scheme is appropriate. They have shown that careful preparation and anticipation of challenges is key to minimising delay and navigating to a successful outcome for debtors and creditors as a whole.

Miller: Canada's main restructuring statute was extremely brief until very recently, and remains 'bare bones' compared to the US Bankruptcy Code for example, so the practice in Canada had evolved primarily based on decisions issued by the court on a case by case basis. This created tremendous flexibility for parties to negotiate solutions that fit the facts and circumstances of a particular case, without requiring the court to issue legal determinations that would be binding on future cases. However, a trend started several years ago and is continuing, whereby parties are taking polarised positions on virtually all issues in a proceeding, and requiring the court to make legal determinations that have far-reaching implications not only for the case before it, but for all future restructuring proceedings. Examples of this trend include determinations on specific government claims, pension priorities and the ability to seek post-filing interest on unsecured debt, to name a few. Whereas parties were previously prepared to negotiate and reach a reasonable outcome based on the uncertainty that existed and the facts of a particular case, that negotiating tension no longer exists for many critical issues.

Pomerantz: How would you characterise the evolving dynamic between various creditor committees and creditor classes in a modern bankruptcy process? To what extent do you see mul-

tiple parties collaborating to reach a viable solution?

Nolan: The role and influence of different creditor classes ultimately comes down to valuation issues or any hold up rights that any tranche of debt may have. An added complication is that capital structures in Europe have become more complex, with bonds often existing alongside term loans or revolver debt. Therefore, understanding how the finance documents work including voting thresholds, enforcement instructions, releases of junior claims and so on, is key. In putting forward a restructuring proposal, for example a Scheme, the debtor or lead creditors will generally want to avoid splitting the classes to make implementation more achievable. The recent scheme judgment in *Stemcor* was noteworthy in this regard, highlighting that creditors that would receive governance rights as a result of a debt-to-equity swap may be considered to be in a different class to otherwise equivalent creditors.

Miller: Creditor committees do not exist as a statutory construct under the CCAA, unlike proceedings under the US Bankruptcy Code, for example. Creditor committees are only created and recognised in Canada by court order, and that is usually restricted to cases where there are large numbers of vulnerable stakeholders such as employees or pensioners. The committee exists for administrative convenience, in order to obtain input from otherwise disparate individuals, to provide a forum for informally binding a class subject to the ability to opt out of representation, and to ensure that key information relating to the proceeding is disseminated to the individuals. A creditor committee in Canada has no mandate or ability to take aggressive positions in respect of the claims of other creditors or take actions with a view to recovering for its members benefits to which it is not otherwise entitled as a matter of priority or otherwise.

Martin: Creditors in bankruptcies change their alliance depending on the issue at hand. This dynamic has always been part of the process. A creditor may be aligned with a party on one issue and adverse to the same party on another. Debtor management shifts its alliances based on perceived values of the company's assets. As perceived values change, the fulcrum security changes and debtor's management often attempts to ally itself with the fulcrum security.

Montgomery: Increasing challenges to restructurings mean that there continues to be an appetite to reach a global deal, including out-of-the-money creditors where possible. That is only possible if the company and senior creditors are sufficiently prepared to see down challenges as an alternative, but recognising that there is a cost to having to do that, both in time and money. Where creditors' leverage builds incrementally, where debtors come up against traditional maintenance covenants for example, the role of the coordinating committee in negotiating a restructuring over time remains vital. In a high-yield restructuring, committees are still the centre of gravity, but individual holders can dilute that.

Durrer II: As the number of distressed situations increases, we expect to see the committee dynamic increase as well. Specifically, we would anticipate multiple committees, both officially appointed with the sanction of the court, and unofficial or so-called *ad hoc* committees. Complex multi-layered debt structures are now the norm. From the optimist's point of view, the development of multiple committees will foster focused interaction and negotiation. From the pessimist's point of view, it will promote more aggression and litigation. We will see which point of view prevails.

Davis: Collaboration among creditors is like parliamentary politics – alliances last as long as the necessity remains. Once the expectations of collaboration go unfulfilled, litigation is the result. It's the nature of the beast.

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TIMOTHY J. MARTIN

Pfeiffer: While we have seen increased collaboration among parties to reach solutions, there has been a rise in contentiousness between creditor classes in several large scale bankruptcy litigations. The focus on valuation of the business enterprise or underlying assets and ensuring that creditors receive fair and equitable treatment has been a cause of contention.

Chatz: I compliment the United States Trustee's Office for appointing multiple committees in cases where divergent interests exist which cannot be served by an unsecured creditor's committee. These types of committees include, committees of pension holders, employee based committees, as well as asbestos claimants based committees, among others. Nothing is ever simple. There are usually limited funds available to assure payments to the parties and the stakes are very high with respect to all creditor interests.

Pomerantz: International issues are increasingly common in bankruptcy related litigation, for example with respect to fraudulent transfer litigation. Could you highlight some of the key cross-border challenges and how parties can navigate them?

Martin: The US Bankruptcy Code is meant to apply to property "wherever located and by whomever held" but Section 548 avoidance actions to recover fraudulent transfers present some unusual challenges. Some courts – notably, some in the Southern District of New York – hold that these avoidance powers may not apply outside the United States. Once an action is brought, the complaint must be served in accordance with both US and foreign requirements. Furthermore, collection of any successful action may be challenging. In sum, if material extraterritorial avoidance actions are anticipated, one should choose the bankruptcy court venue that permits such actions, seek counsel with competent representation in the defendant's country, and carefully consider the collectability of any action before it is brought.

Miller: Until recently, most Canadian proceedings under the CCAA involved some cross-border aspects with the United States, since it's our largest trading partner and due to its geographic proximity ▸▸

with Canada. That has generated a large body of precedents for the use of cross-border protocols, which have been extremely effective in navigating cross-border challenges. However, the most recent downturn affecting the oil and gas and mining industries in Canada has given rise to a proliferation of new issues. The publicly-traded debtor parent company may be Canadian and subject to a main proceeding under the CCAA, but a large portion of its assets are located in South and Central America or in other less-developed countries. This creates a number of challenges, from language issues to more fundamental problems of recognition and enforcement of stays of proceedings. In one current proceeding, the foreign country has adopted the UNCITRAL Model Law framework but has never utilised it in connection with a Canadian insolvency proceeding.

Chatz: The 2005 revisions to Chapter 15 may be the greatest success from the often scourged BAPCPA amendments. Practitioners from across the globe have really embraced the benefits brought by recognition of foreign proceedings in the United States, including the fraudulent transfer context. Parties are more than comfortable these days to file a Chapter 15 to protect assets in foreign countries from continuing litigation when there has been a related insolvency proceeding filed in their home country.

Nolan: A key element to European cross-border litigation is supporting evidence. Parties are increasingly usually looking to experts to provide evidence by way of written or live statements to support, or reject, the recognition of insolvency processes in foreign jurisdictions.

Davis: Cross-border insolvency litigation is growing and will continue to grow. There are significant evidentiary challenges when litigating over conduct that took place overseas. No country has the broad discovery rights that exist in the US and expectations for international discovery have to be tempered. No one should fear raising issues of foreign law in the bankruptcy courts, however. Bankruptcy courts in the US, especially in Delaware, are comfortable analysing foreign law. The use of foreign law experts is vital to helping bankruptcy judges parse through unfamiliar laws and recovery schemes.

Montgomery: Where cases involve foreign debtors, we increasingly see litigation in its home jurisdiction being threatened or brought, in an attempt to block or delay the English restructuring. This can be avoided with careful planning and an ability to respond quickly. Otherwise, within the EU, the status of schemes in other jurisdictions is the subject of ongoing debate. Outside the EU, even in insolvent cases, the extent of cross-border recognition and assistance between courts continues to fluctuate and cannot always be relied upon.

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CRAIG MONTGOMERY

Pomerantz: In your opinion, are mediators and arbitrators now playing a more active and meaningful role in the bankruptcy process?

Durrer II: We continue to see judges and practitioners promoting the use of mediators in the bankruptcy and insolvency contexts, and we expect that to continue. As a consequence, we have also seen an expansion of the ranks of mediators beyond current and former judges to practitioners concentrating in this area as well. While parties may disagree about the merits of each other's respective positions, the objective views of a mediator often serve to temper the parties' opposing views, help identify common ground and facilitate communication among the parties.

Pfeiffer: Both mediators and arbitrators are playing a more significant role in the bankruptcy process, which may be a result of parties taking the mediation process more seriously or the mediation process becoming more sophisticated.

Martin: In order to keep the process moving, judges now routinely require mediation on issues before the process moves on to full-blown litigation. The use of a mediator is often a very effective mechanism for bringing very recalcitrant parties to more reasonable stances. In WP Steel, the use of a mediator provided the mechanism for parties as diverse as the debtor's principal, the secured lender, representatives of the employee's union and the general unsecured creditors committee to craft a settlement in a situation that could have dragged on interminably without a good solution for any of the parties.

Chatz: Mediators and arbitrators are now playing a more active role in cases. I am not in fact sure that those roles are meaningful. The ability of bankruptcy courts to expedite litigation minimises the needs, in my opinion, for mediators or arbitrators generally. The cost with respect to arbitration or mediation is an overlay that may in fact not be necessary given the court's ability generally to facilitate trials efficiently. For many lawyers who may be fearful of litigation, mediation is easier. I prefer litigation because I do not perceive that the process of mediation is always in the best interest of a client who may be better served by attempting to settle on the courthouse stairs.

Davis: There is no question that the use of mediators in contentious bankruptcies is on the rise. Equally important is the improved quality of available bankruptcy mediators. The arbitration of critical disputes during Chapter 11 proceedings is still uncommon but viable if the dispute is non-core. The bankruptcy court for the Eastern District of Tennessee in *McGhehee* earlier this year ruled that bankruptcy courts do not have the discretion to decline enforcement of an arbitration agreement relating to a non-core proceeding. However, the courts have been reluctant in a series of recent decisions to cede adjudication of core proceedings to private arbitrators.

Montgomery: In formal proceedings, particularly where there is a claim against directors and officers, where enforcement will usually be an issue, there will always be scope for mediation and settlement.

Miller: Parties in Canadian bankruptcy proceedings seem increasingly intent on moving issues from the negotiation context to a litigation forum. While mediators, much more so than arbitrators, are involved in cases, it is rarely for assistance with the 'key issues', but rather for peripheral issues.

Nolan: Mediators and arbitrators playing a more active in certain selected instances, but in the UK we are significantly behind the US in the adoption of alternative resolution mechanisms.

Pomerantz: With many parties emerging unsatisfied from a bankruptcy dispute, what are the most significant factors that need to be observed to reach as positive an outcome as possible for all those involved?

Chatz: I am not sure that the predicate of parties being unsatisfied from a bankruptcy dispute is the proper matter in which to discuss this question. Litigation is very expensive. Effective returns from a bankruptcy estate are often speculative. Advising a client as to the expense of litigation, the time consumption of dispute resolution, and the collectability questions, are the key predicates to assuring client satisfaction. In any litigation context, if a client is not aware of the costs and the post-judgment collectability issues, of course there is going to be disappointment. The providing of budgets prior to the commencement of a litigation matter for a client is critical to fairly allowing the client to manage their expectations.

Montgomery: Preparation and early engagement with all stakeholders, including shareholders, where applicable, are key factors. In complex situations, litigation is likely, so ensuring that the law firm's transactional team includes an integrated litigation specialist who is fully embedded and briefed and giving input from an early stage, helps to prevent litigious scenarios and to enable a quick response when they arise. Apparently spurious challenges need to be taken seriously, as the threshold to introduce delay can be quite low.

Nolan: At the forefront of all parties' minds must be how to preserve or enhance the value of the business, in turn increasing the size of the pie for stakeholders. That's easier said than done. But generally this means reaching agreement on a financial compromise plan as quickly as possible so that management can focus on operational improvements. Prolonged financial restructurings can often lead to suboptimal outcomes, especially when the cost of publicity, delays and advisers are factored in.

Davis: The most important factor is assessing how little your client will accept or, conversely, how much will it pay, before unleashing expensive litigation. Once you understand your client's pain threshold, the risk and cost of litigating becomes manageable. More often than not, early settlement benefits clients, even if they don't realise it at the time.

Martin: The effectiveness of a mediator is judged by the mediator's ability to bring the parties to a place where they can all be satisfied that they are all equally dissatisfied with the outcome. However, willingness to compromise is necessary for a successful mediation and too frequently such willingness does not exist.

Pfeiffer: Each situation is different, and the strategy for each party is dictated by the circumstances and relationships between parties.

Miller: One of the most significant factors that needs to be observed is that time doesn't make insolvency less painful for any stakeholder. It is a difficult process under any circumstance, made more difficult by lengthy delays where no tangible progress appears to be made and professional fees are eroding creditor recoveries. If the actions of specific parties are causing unnecessary delays which threaten the ability to achieve a successful outcome within a reasonable timeframe, parties need to take whatever means are available to neutralise those actions as quickly as possible.

In any litigation context, if a client is not aware of the costs and the post-judgment collectability issues, of course there is going to be disappointment.

BARRY A. CHATZ

Pomerantz: What bankruptcy litigation issues do you feel will continue to remain in the spotlight? Conversely, are any issues likely to decline in significance?

Davis: A couple of developments worth watching are litigation in the areas of involuntary filings and the use of unitranche agreements among lenders. The decision of the 11th Circuit last year in *In re Maury Rosenberg* increased the risks for creditors considering the pursuit of an involuntary bankruptcy petition when it held that a debtor who successfully defeats an involuntary petition is entitled to not only fees and costs, but also consequential damages from petitioning creditors. Unitranche AALs, like the one used in *Radio Shack*, differ from intercreditor agreements in that the debtor is not a party to an AAL. It remains to be seen if the bankruptcy courts will enforce them or if that litigation will be fought in non-bankruptcy courts.

Durrer II: Practitioners will continue to pay attention to developments in Trust Indenture Act litigation, particularly where companies attempt to develop out-of-court restructuring solutions. We would predict an uptick in litigation exploring the limits of so-called 'safe harbours' that insulate certain commodities transactions as well as transactions among financial institutions from many of the impacts of Chapter 11. These safe harbours have global implications as well. Finally, we would anticipate increased focus on valuation issues as more companies with complex debt structures fall into distress.

Pfeiffer: Most bankruptcy litigation revolves around valuation, so that issue is least likely to decline in significance. Disputes over business enterprise valuation take centre stage in litigation over a reorganisation plan or avoidance actions. Asset valuation is the primary issue in disputes over collateral. Debt valuation is directly or indirectly the primary issue in disputes over DIP or cram-down ▸▸

loans. There are also interesting issues related to whether a security should be treated as debt or equity.

Martin: Clearly, with the advent of second, third and fourth lien creditors, the whole area of adequacy of perfecting security interests and Chapter 5 avoidance actions is and will continue to be front and centre. When there are no apparently unencumbered assets at the beginning of a case, creditors with no prospect of recovery seek, or threaten, whatever litigation may result in a recovery for them.

Nolan: We expect to continue to see overseas debtors being creative to find jurisdiction with the English courts. In *Codere*, it was found that incorporating an English subsidiary that assumed the debtor group's liabilities could be sufficient for the court to establish jurisdiction for a scheme of arrangement. The court considered that 'forum shopping' in this manner may be justified if there is a compelling case that a scheme will be more favourable than alternative restructuring regimes in foreign jurisdictions. It is noteworthy that this case was very much creditor-driven and unopposed, while the courts have been far more reticent where creditors challenge the scheme, such as in *India Kiat*.

Montgomery: The position in relation to cross-border recognition of insolvency judgments is becoming more settled after a period of uncertainty, especially where offshore jurisdictions are involved. I expect that the boundaries of scheme jurisdiction, recognition and fairness will continue to be tested.

Chatz: An issue that I'm particularly surprised about, and pleased for its re-emergence, is the Seventh Circuit Court of Appeals' revival of § 105 of the Bankruptcy Code. Over the past several years, and maybe even decades, appellate courts and the Supreme Court in *Law v. Siegel* have stripped any power and efficacy to the language of section 105 of the Bankruptcy Code. In *Caesars Entertainment Operating Co. v. BOKF, N.A.*, the Seventh Circuit recognised the Supreme Court's limitations but also reenergised the "extensive equitable powers that bankruptcy courts need in order to perform their statutory duties".

Pomerantz: Do you expect to see an uptick in the number of bankruptcy-related actions being taken against directors and officers (D&Os)? What are the key challenges in this area?

There will likely be an uptick in actions related to D&Os who approved pre-petition transfers that resulted in the debtor receiving less than reasonably equivalent value when the debtor was insolvent.

ALLEN PFEIFFER

Pfeiffer: There will likely be an uptick in actions related to D&Os who approved pre-petition transfers that resulted in the debtor receiving less than reasonably equivalent value when the debtor was insolvent. Some of the parties that cannot successfully pursue fraudulent transfer litigation claims due to safe harbours such as 546(e) will likely go after the next deepest pocket: the D&Os that approved the otherwise fraudulent transfers and their associated insurance policies.

Montgomery: An uptick is likely for three reasons. First, the creditor base of many distressed debtors is becoming increasingly willing to see litigation as a tool, including against officers. Second, insolvency practitioners now have wider rights to sell claims to third-parties with an appetite to pursue them. Finally, the availability of litigation funding continues to grow, with a number of specialists emerging, who focus on the insolvency sector.

Martin: As the economy continues to languish, creditors will continue to look for ways to maximise recoveries, including pursuing all available insurance proceeds. Aware of this trend, distressed companies are improving their governance by appointing independent directors. Directors and officers are also negotiating third-party releases as part of plans of confirmation, cutting off creditors' ability to pursue recoveries from D&O policies.

Durrer II: Directors and officers always remain at risk of litigation in distressed situations. We do expect the threat of litigation against directors and offices to decrease in the coming 12 months simply due to the level of increased activity in the distressed arena simply because practitioners will be compelled to focus on more substantive issues. That said, directors and officers are well-served to engage with quality advisers early and to take advantage of independent directors, committees, or advisers early in order to insulate themselves from exposure in such situations. The timely formation of independent or special committees is a powerful technique to cloak all directors with the protections of the business judgment rule.

Chatz: Director and officer litigation is often a fertile delta for recovery for parties in cases. However, challenges exist immediately for debtors given that their actions may be subject to defences including *in pari delicto* and others. The existence of director and officer coverage reflects that such is property of the estate but the proceeds are generally available for the directors and not for the debtor and general claimants initially. The goal of a creditors committee or other third-parties is to attempt to garner value from a director and officer policy early on before it is drained with defence costs. Getting insurance carriers to in fact agree to early settlements, however, is often a conundrum. I believe this is an area for future focus for the courts to assure that the directors and officers when sued within a case facilitate some type of early conference with the court with the insurance carrier's counsel to assure that maximum returns come from the policy rather than being depleted during the early phases of litigation.

Miller: I expect we will see an uptick in this area in the near future. With the increase in out of court sale processes, and restructuring proceedings frequently being used to simply implement a sale transaction and approve payment of sale proceeds, directors and officers may be leaving themselves exposed. In Canada, directors and officers receive a release as part of a plan of arrangement, but plans are not being utilised in many recent proceedings. Increasingly, sale transactions and distribution orders are occurring without a plan. Court orders approving the sale and distribution do not contain ▸▸

such releases as a matter of course, and the court will not generally grant them if affected creditors oppose their inclusion. Accordingly, while proceeding without a plan and releases for directors may be considered more cost-effective and efficient from a timing perspective, I think we will see the pendulum swing back in favour of obtaining releases pursuant to a plan.

Nolan: In the UK, even where it is found that directors continued to trade when insolvency was considered inevitable, the decision in the recent case of *Re Ralls Builders Ltd* stresses that liability will not be imposed unless the continued trading actually worsens the position of the creditors. The case further affirmed the importance of the receipt of professional advice as soon as a company gets into difficulties. The receipt of advice, and adherence to it, will be significant when the court comes to consider when, and whether, the elements of wrongful trading are made out.

Davis: Claims against directors and officers have been a staple of insolvency litigation for a long time. D&O litigation will remain active going forward as the returns to unsecured creditors continue to be low in most Chapter 11 cases. Secured creditors are beginning to use D&O claims to leverage settlements in asset-based loans with lower than expected liquidation values, especially in retail cases. There are a lot of opportunities for lenders to bring claims against officers who sign false borrowing base certificates. While the business judgment rule provides broad protection for officers and directors in the ordinary course, it doesn't shield against the use of materially inaccurate BBCs.

Pomerantz: How do you expect the bankruptcy litigation arena to unfold throughout 2016 and beyond? What overriding trends and developments will continue to dominate this space?

Miller: Class actions arising out, or existing in conjunction with bankruptcy proceedings, will continue to gain momentum. We are seeing cracks in the commercial real estate and construction markets in Ontario and continuing situations involving fraud. A trend that is relatively new but gaining interest in Canada is litigation financing, which is giving rise to increased opportunities in cases that might not otherwise be pursued. Given the experience in other countries where this has existed for some time, I expect we will see more of it in the coming year. For the past several years, some stakeholders had taken quite aggressive positions on a number of key issues that frequently arise in the restructuring of insolvent companies, which has led to legal determinations as to rights and remedies that many of those parties are now stuck with in the context of other proceedings. The market has shifted quite dramatically in Canada over the past 12 months due to the downturn in the oil and gas and mining sectors, and parties are finding that they have limited options for recovery. The pendulum has shifted, and various stakeholders who previously considered themselves to be in positions of great leverage are struggling to adjust.

Martin: Valuation fights will continue to be common. Without a marked improvement in the economy, there will be an increase in the number of disputes centred around collateral value. Valuations of collateral, enterprise value and allocation of value will continue to be an issue in bankruptcy litigation, especially Chapter 5 recovery disputes.

Nolan: We expect jurisdictional issues regarding schemes of non-English debtors to be continued to be scrutinised by the English courts. Likewise, pre-pack sales to connected parties will continue to remain in the spotlight, with the operation of the 'pre-pack pool' to be monitored. In terms of live cases, the appeal of the Lehman Brothers Europe Waterfall I application will be heard in the Supreme Court in October, while the Waterfall II Parts A and B appeals will be heard in the Court of Appeal in the following spring. The High Court judgment in respect of Part C is expected to be released later this year.

Montgomery: The trends we have seen over the last 12 months will be amplified in the coming wave of high yield debt restructurings. Such debt is more tradable than traditional bank debt and bondholders are more likely to include certain types of distressed debt traders, who may see litigation as a tool to increase their return and may be less concerned about an ongoing relationship with the debtor. In the event of Brexit, we will also see a period of uncertainty around recognition and enforcement, which could prove fertile ground for cross-border litigation.

Davis: As long as the restructuring process leaves subordinated lenders and unsecured creditors with large recovery shortfalls, which certainly is the case now and should be for some time, litigation will be active. Internal investigations are a hot area that will continue to grow in 2016. Creditor disaffection results in creative litigation, and that creativity is being manifested in claims against not only directors and officers, but also professionals, participating lenders, plan sponsors and equity holders. Subordinated lenders are fighting back against senior lenders that they perceive to be benefitting at their expense. Those trends aren't going away anytime soon.

Chatz: With the improvement of the US economy, the debtors' role within the context of a case and the stake of insiders relating thereto, may re-emerge within the process. Since the economic crisis of 2008, many bankruptcy cases have been commenced for strategic purposes and the equity players have no true role as the other creditor bodies are materially under secured. Value is a component that is returning within many sectors of the economy, CMBS loans are coming due and may not be readily refinanceable leading to bankruptcies to restructure indebtedness which will also benefit insiders and equity holders. Other areas of strength are within the economy and issues may occur that will force otherwise solvent companies into Chapter 11 including large judgments or other issues. As such, an improved economy leads to a new dynamic of equity having a role within the bankruptcy process for the benefit of all creditors.

Pfeiffer: Clearly, energy-related firms and Puerto Rico will continue to be at the forefront of bankruptcy litigation through 2016. The low price of oil and gas will continue to affect the E&P space, as well as related industries such as shipping, chemicals and metals and mining. Puerto Rico will pose some interesting questions over the coming months. Will lenders be treated the same as similarly situated creditors or will favoured creditors, such as pensioners, get special treatment? What are the implications for other sovereigns, Illinois for example, that do not have access to bankruptcy and may ultimately be unable to pay all of its bills?

Durrer II: We predict that bankruptcy litigation as a leverage tactic will diminish in the coming months due primarily to increased distressed activity. While this may seem counterintuitive, we think that practitioners will be compelled to focus on the substance of disputes and restructurings and the delay and distraction that result from litigation as a leverage tactic will be reduced as a consequence. ■