Westinghouse Chapter 11 Bankruptcy: National Security Also an Issue

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For over a century, the name "Westinghouse Electric" has been synonymous with the electricity industry here and abroad, often spoken in the same breath as titans such as Edison and Tesla. Within the industry itself, Westinghouse is legendary as one of the pioneers of nuclear power generation, foremost as the builder of the world's first commercial atomic reactor some 60 years ago.

Sadly, times have changed. Victimized by cost overruns at four nuclear plants presently under construction in Georgia and South Carolina, the company, now a division of Toshiba of Japan, was forced to file for Chapter 11 in the Bankruptcy Court for the Southern District of New York.[1] As such, Westinghouse will now seek to "reorganize."

But this Chapter 11 case is already proving to be like no other.[2] Certainly, the Westinghouse bankruptcy will share commonalities with other significant reorganization cases of the recent past, and comply with the provisions of the modern Bankruptcy Code as the case wends its way through the courts. Yet it will surely be unique, for this debtor's main capability, the construction and servicing of nuclear reactors, implicates matters of national security and international politics, normally issues not extant in more prosaic Chapter 11s.

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While the Westinghouse bankruptcy raises innumerable and complex legal points, it would be premature to address them all today. For now, we will restrict ourselves to illuminating those topics we deem most pertinent to those interested in this case, and with a view toward nonbankruptcy matters that are sure to impact heavily upon the ultimate resolution of this Chapter 11. We will commence with a brief overview of the fundamental goals of bankruptcy reorganization.

THE "THREE RS"—REORGANIZE, RESTRUCTURE, AND REHABILITATE

Chapter 11 of the Bankruptcy Code is best understood by referring to the three controlling precepts for distressed companies seeking the protection afforded by the bankruptcy process. Those guiding principles are "reorganize, restructure, and rehabilitate." The first "R," "reorganize," bestows its name upon this section of the insolvency law.

Typically, "reorganize" in this context means the troubled entity is compelled to

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undergo a significant overhaul of its businesses, in the main by jettisoning unproductive or underperforming operations, focusing on core competencies, and otherwise striving to return to profitability.[3] This streamlining is not achieved without some turmoil, to say the least. Reorganization almost always involves "downsizing," a polite euphemism for terminating employees. Here, hard choices will have to be made as to what will be the contours of a new, reorganized Westinghouse.

Next is "restructuring." Like any debtor, Westinghouse will need to undergo a sharp review of its debt structure, analyzing its bank loans, notes, and lines of credit. A distressed entity will often seek to reduce interest rates to a more manageable level, extend the duration of its loan repayments (for instance, convert the term of a loan from 10 years to 20), and, of course, seek the outright forgiveness of debt.

Suffice to say, lenders never easily acquiesce to such changes to the original bargain. Creditors have an expectation, and a legal right in the first instance, to be repaid in accordance with the terms originally agreed to. Yet sometimes reality supersedes the law, and lenders, while never filled with joy at such prospects, yield to the inevitable. It remains to be seen what elasticity the major financial creditors of Westinghouse have left, if any.

Chapter 11's last guiding "R" is "rehabilitate," fundamentally best understood as the company going from losing money to making money. This is easy to say, but hard to do. In the garden variety case, the debtor usually is deemed to be rehabilitated after it has successfully exercised its prerogatives in reorganizing its business, and in restructuring its debt.

In the instant case, all the above is problematic at best. Westinghouse operates in a domain where nuclear power is no longer a popular choice, with the sector's market share and future prospects having shrunk accordingly. Westinghouse must confront this predicament as the company fights to apply the three essential maxims of Chapter 11.[4]

Having described the fundamental precepts of reorganization that Westinghouse must execute upon if it is to emerge from Chapter 11, we may now turn to more specific issues that Westinghouse (and any debtor, for that matter) must confront in a modern reorganization case.

AUTOMATIC STAY

Section 362 of the Bankruptcy Code imposes a prohibitive "automatic stay" the moment an entity enters the bankruptcy process.[5] Effective immediately upon filing, without the need for a court hearing, the automatic stay brings to a grinding halt any and all litigation seeking to collect an obligation from the reorganizing debtor. Indeed, the statute is one of the most powerful and efficacious strictures found in the current insolvency law.

As to the stay's purposes, there are several. First, the automatic stay prevents the dismemberment of the debtor's assets while the Chapter 11 case is pending. After all, if creditors could continue to attack piecemeal, there would be nothing left to reorganize. Second, Section 362 coordinates the bankruptcy process, effectively "inviting" every creditor to present its claim to the bankruptcy court, to be scrutinized for legitimacy and accuracy. This process enables a sorting out, if you will, such that the debtor now knows to whom it is indebted, and for how much, with an attendant ability to contest any claims it alleges are specious.

Third and last, the automatic stay provides the debtor with breathing room, a respite from the crush of unpaid creditors who are held in place for the duration of the case. Indeed, one of the most salutary benefits of Section 362 is that it freezes all prebankruptcy claims, which do not accrue interest while the Chapter 11 continues. This temporary relief from paying down old debt can be enormously beneficial to a debtor's cash flow during the reorganization process.

With regard to Westinghouse's bankruptcy filing, it already enjoys the full benefits of Section 362, just like any other debtor. Foremost, now relieved of debt service, Westinghouse will have a fighting chance to reorder its affairs as it seeks to return to profitability.

Yet notwithstanding the immediate salve applied by Section 362, work has only begun for Westinghouse. Key items among its next steps in its efforts to reorganize are the following.

POSTBANKRUPTCY FINANCING

As indicated earlier, the automatic stay effectively unshackles the Chapter 11 entity

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from servicing its prebankruptcy debt. While that undoubtedly frees up cash for purposes of continuing to operate the debtor's business during the reorganization phase, even that newfound resource may not be enough to fund ongoing operations. If so, it is then incumbent upon the debtor to seek "post-petition financing."

The natural question is, who would loan money to an already-bankrupt company? The answer to that dilemma is provided by Section 364 of the Bankruptcy Code. The statute authorizes the debtor, subject to court approval, of course, to establish new credit facilities. The first of two options is to have this fresh credit extended on an unsecured basis, yet classified as an "administrative expense" for purposes of repayment.[6] The second pathway is to have the new credit facility categorized as a "superpriority" for purposes of repayment.[7]

To be clear, the bankruptcy process divides indebtedness into distinct categories. Section 507 demands that so-called priority claims be paid first and foremost in any bankruptcy proceeding.[8] This quality is in contradistinction to unsecured claims that fall dead last within the bankruptcy scheme of repayment, to the dismay of those unlucky creditors.

First to be paid in a Chapter 11 case among these more fortunate priority creditors are administrative expenses—in short, the costs of operating and reorganizing the debtor. Of course, this charge would include prioritizing the repayment of credit extended postbankruptcy. Yet "superpriority" financing trumps all others, even priority creditors, as it is truly first in line to be repaid, if the entity is to emerge from Chapter 11.

These post-petition lenders enjoy a preemptory status, essentially in derogation of the claims of prebankruptcy creditors. But the reality is: what else is to be done? How else does one convince new money to be loaned to a debtor seeking the funds it needs to reorganize? Such is the way of Chapter 11.

Applying these truisms to the instant case, it has been reported that Westinghouse has secured some $800 million in postpetition financing.[9] One hopes such monies will enable the company to successfully reorganize. But existing creditors of Westinghouse, take note: at the end of the day, these lenders will be paid in full long before you see any repayment.

EXECUTORY CONTRACTS

As mere attorneys, we are not equipped to address the operational details of how Westinghouse might approach the reorganization of its business. However, we can impart knowledge of how some such changes can be accomplished within the context of a reorganization case.

When a troubled company files for Chapter 11, it embarks upon an entirely new plane of existence, with a new set of imperatives. One directive among many is that the debtor must reexamine all of its pending contractual obligations. This duty is no mere academic exercise; it is the precursor to the debtor exercising the power granted it by Section 365 of the Bankruptcy Code.

Section 365 permits a debtor to "assume" or "reject" its "executory" contracts.[10] First, a definition: an "executory" contract is any contract where some performance is still due and owing from one or both sides of the accord. The statute empowers the debtor, giving it the ability to retain contracts the debtor deems worth continuing, with the concomitant power to eradicate any past bargain that has now become too burdensome to fulfill.

To be clear, Section 365 treats the rejection of any executory contract as the equivalent of a breach of that accord, giving rise to a claim for money damages, calculated as if the debtor had breached the contract as of the date it filed for bankruptcy.[11] Such damage claims are classified as unsecured, relegating them to the back of the line in the Bankruptcy Code's scheme of repayment, where they will be paid the same percentage as other unsecured claims. Plainly stated, anything close to a full recovery is inconceivable for counterparties whose accords have been selected for elimination. Obviously, this wreaks havoc with contractual opposites who can only await a fraction of the compensation they would otherwise normally receive.

In contradistinction, Section 365 simultaneously contemplates the "assumption" of executory contracts. The debtor is permitted to assume those contracts that, in its sound business judgment, are worth continuing. Yet the debtor must recognize that a contract is assumed *cum onere*—that is, with its burdens, as well as its benefits. The statute most certainly does not allow the debtor to rewrite a contract to its whim.

Furthermore, the reorganizing entity can only assume with court approval, and a necessary step to secure that approval is the debtor both curing any past defaults under the contract and providing adequate assurance to the counterparty of its future performance of the accord.[12] This step affords the other side of the contract an opportunity to oppose assumption where defaults remain and/or there is doubt the debtor can meet the obligations it seeks to reinstate.

Precise to the instant situation, it is quite obvious that Westinghouse holds a plethora of executory contracts. Without mincing words, Westinghouse will be allowed to "cherry pick" among those arrangements, keeping those it likes and discarding the rest. Counterparties to such accords will be held in limbo until the debtor makes decisions as to what arrangements it will honor, and those it intends to abandon.

Above all else, this debtor's exercise of its Section 365 power to reject or assume contracts will take on epic proportions with regard to its pending commitments to construct new nuclear plants, given those projects are allegedly the source of the cost overruns that drove parent Toshiba to place Westinghouse into bankruptcy in the first place.[13] Given the ramifications either way, surely there will be a titanic struggle over the future of those very significant accords.

LABOR CONTRACTS

The Chapter 11 process holds separate and apart from routine contracts that species of accords known as collective bargaining agreements (i.e., union contracts). It is a given that Westinghouse employs workers skilled in a variety of trades, many of whom are members of powerful unions, which, over the years, have vigorously bargained for their members' current compensation and benefits. What can both sides expect on this front?

The future of Westinghouse's union contracts will be dictated by the strictures of Section 1113 of the Bankruptcy Code. This statute was appended to the then-new Bankruptcy Code decades ago at the behest of organized labor, which was greatly concerned that reorganizing debtors now had a weapon by which they could break existing collective bargaining agreements with impunity.[14] It is for that reason Section 1113 imposes a much more rigorous procedure for the disposition of labor union contracts than ordinary Section 365 contract rejection.[15]

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Foremost in this process, Section 1113 demands that the debtor first enter into good-faith negotiations with representatives of its organized labor force in order to consensually modify any labor pact that the debtor now finds too burdensome.[16] If a new bargain cannot be arrived at, then and only then will the bankruptcy court entertain the debtor's motion to discard its old labor accords, and replace them with altered agreements.[17] To be sure, the reorganizing entity bears the burden of proving it has no option but to take such draconian steps.

Guided by the foregoing precepts, we can only forecast here that Westinghouse will have much to do in its Chapter 11 case in order to assure amity with its workers. Certainly, it will be under greater scrutiny, and bear the heavier burden, to justify any modification of its pending labor contracts. It remains to be seen what will result.

A WESTINGHOUSE SALE?

We have saved the best for last. This is a topic that, by far, poses the most challenges and uncertainties, not only for Westinghouse, but also for all those that would be impacted by the success or failure of this Chapter 11 case. Yet it is for those very reasons that we once again stress that we are only at the beginning of the instant reorganization. As such, we can only preview the essence of these

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issues. In order to do so accurately, let us first review certain basic principles applicable to all Chapter 11 cases.

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Section 363 of the Bankruptcy Code provides that a debtor may use, sell, or lease any asset or part of its business, as it deems best to assist in its efforts to reorganize.[18] Put another way, this proviso imparts the necessary statutory authorization for the debtor to truly reorganize, by reshaping its business via asset sales and the like. As a quick example, regard the multitude of airline bankruptcies in recent years, where troubled carriers routinely sold off aircraft, gates, and landing rights, in order to raise cash and place a renewed focus upon core competencies.

Indeed, a sensitive issue in the realm of bankruptcy in recent years has been the utilization of Section 363 to consummate a sale of the entire debtor to a new owner, foregoing the nominal prerequisites of a formal Chapter 11 plan. Such was the outcome in the Chrysler Chapter 11, whereby the automaker was purchased *in toto* by Fiat, via a Section 363 asset sale. While creditors aggrieved by the process insisted that the chosen methodology was an affront to the normal workings of a reorganization case, ultimately the path chosen garnered judicial approval.[19]

We note that the inherent conflict between these widely different modes of successfully exiting Chapter 11 is that Section 363 is only appropriate when selling *parts* of a debtor in order to effectuate a reorganization, but a transaction couched as a "363 sale" is improper if, in reality, it calls for the sale of the entire company. The latter procedure has been roundly criticized, and rightly so, as a shadowy substitute for the nominal rigors and protections of forcing a debtor to propose a Chapter 11 plan, have it voted upon by creditors, and then finally approved by the bankruptcy court.[20]

Having exposited these possibilities, and critically forewarned that at least one of them could very well be deemed violative of proper procedures for Chapter 11 cases, the point remains here that Westinghouse has a range of options before it. Without question, it can undertake any number of so-called Section 363 sales, and thereby shed assets, facilities, and even operational divisions, for these dual purposes: raise cash with which to both fund ongoing operations and accumulate cash for the ultimate repayment of creditors and achieve focus on only the most viable of the entity's businesses, bringing the debtor closer to a successful emergence from Chapter 11.

Given this "Chrysler option," it is conceivable that Westinghouse can follow the path blazed by the troubled automaker eight years ago, and sell itself, lock, stock, and barrel, in a Section 363 sale to a buyer willing to assume the debtor's liabilities and commitments, as well as its assets. To be sure, the utilization of the traditional and more appropriate Chapter 11 plan could achieve the same end, and without the legal controversy. Both these roads inevitably invoke certain weighty concerns that, while technically legal in origin, range far afield into the realms of international relations and homeland security.

We speak here specifically of the possibility that Westinghouse might wish to sell key assets or even auction the entire company to a foreign entity, possibly even one under the open or subtly disguised control of a foreign government. And given certain forces that are already allegedly interested, the US government is deeply concerned.

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GEOPOLITICS AND NATIONAL SECURITY ISSUES

At the time of this writing, news reports indicate a great deal of consternation over the Westinghouse bankruptcy by the Trump administration.[21] The reason for the White House's concern is easy to comprehend.

Westinghouse is the repository of vital technology and sensitive nuclear secrets, and while such capabilities are ostensibly devoted to building atomic facilities for peaceful purposes, theoretically that knowledge could be perverted to more dangerous ends. It is not an exaggeration to state that there are serious national defense, energy, and geopolitical concerns here.

The latest reports indicate that the federal government is concerned, *very* concerned, that a buyer from or controlled by the People's Republic of China might seek to purchase all or part of Westinghouse.[22] The implications of such a development go far beyond the limited space left to us here, to say nothing of the intricacies, legal and otherwise, such a scenario presents.

That is why we will leave for another article, if such becomes necessary, a detailed discussion of a mysterious organization, the Committee for Foreign Investment in the United States (CFIUS). In brief, this secretive aggregation of top cabinet members, national security and defense officials, and technical experts is directed to confidentially vet any and all attempts by foreign governments or their operatives to purchase US businesses or assets, and advise the US president of their findings and concerns.[23]

The president then has a multitude of options. The president has the statutory authority to permit the transaction to proceed or insist it be modified or even prohibit it entirely, the last especially on the grounds that such a change in control would be detrimental to national security or contrary to America's best interests.[24]

That is all we have to say regarding CFIUS at this early date. If the progress of the Westinghouse Chapter 11 demands it, we will return to the matter in a subsequent article. For now, we close with the following summation.

CLOSING OBSERVATIONS

The current Chapter 11 case of Westinghouse will be most revealing of the functioning of the reorganization section of the Bankruptcy Code. Paramount to all other considerations, this debtor will be called upon to fulfill the three Rs of Chapter 11—reorganize, restructure, and rehabilitate.

Paramount here, Westinghouse will soon be compelled to make momentous decisions regarding the rejection or assumption of its outstanding contracts, especially those construction deals whose demise or survival will have a lasting impact upon the nuclear power industry in this country and abroad. This debtor must seek accommodation with its unionized workforce, and the success or failure of those efforts will impact the progress of its reorganization efforts.

Finally, and most intriguing of all, is the potential for intervention by CFIUS. It is most likely that confidential government body will eventually come to the fore. The advice it then gives to the president regarding any possible sale of the debtor's assets or of Westinghouse itself will be highly determinative as to the final outcome of this unique and intriguing Chapter 11.

NOTES

1. Gold, R., & Negishi, M. (2017, March 29). Toshiba's Westinghouse Electric files for bankruptcy protection. *Wall Street Journal.* Retrieved from https://www.wsj.com/articles/toshibas-westinghouse-electric-files-for-bankruptcy-protection-1490771532.
2. *In re Westinghouse Electric Company, LLC, et al.*, No. 17-BK-10751 (Bankr. S.D.N.Y.) (Ch. 11) (Wiles, B.J.), filed March 29, 2017.
3. 11 U.S.C. § 1107 and § 1108, respectively, provide that a debtor may maintain possession of its assets, and continue to operate its business. The grant of authority gives rise to the appellation "debtor in possession" for entities that have filed for reorganization pursuant to Chapter 11.
4. See Note 1.
5. 11 U.S.C. § 362(a).
6. 11 U.S.C. § 364(b).
7. 11 U.S.C. § 364(c)(1).
8. 11 U.S.C. § 507(a).
9. See Note 1.
10. 11 U.S.C. § 365(a).
11. 11 U.S.C. § 365(g)(1) (rejection deemed a breach of contract as of the bankruptcy filing date).
12. 11 U.S.C. § 365(b)(1)(C) (must provide adequate assurance of the future performance of the contract to be assumed).
13. See Note 1.
14. See *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984). In fact, this landmark case was not only the direct cause of the passage of Section 1113, but it also provided the catalyst for a host of amendments to the Bankruptcy Code in 1984 that severely circumscribed the power of the newly appointed bankruptcy judges.
15. 11 U.S.C. § 1113(a).
16. 11 U.S.C. § 1113(b).
17. 11 U.S.C. § 1113(c).
18. 11 U.S.C. § 363(b).
19. *Indiana State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC*), 576 F.3d 108 (2d Cir. 2009), cert. granted, judgment vacated, and remanded to dismiss appeal as moot, 558 U.S. 1087 (2009).
20. See 11 U.S.C. § 1123 (necessary contents of a reorganization plan), 11 U.S.C. § 1126 (creditor voting upon a plan), and 11 U.S.C. § 1129 (requirements for court approval of a plan of reorganization).
21. See Jacobs, J., Mohsin, S., & Dlouhy, J. (2017, April 5). Trump team takes steps to keep Chinese from Westinghouse. *Bloomberg.com*. Retrieved from www.bloomberg.com/politics/articles/2017-04-04/trump.
22. Ibid.
23. See 50 U.S.C. App. § 2158, et seq., where CFIUS was codified into its present form.
24. 50 U.S.C. App. § 2170(d).

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