AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

The International Scene

By George W. Shuster, Jr. and Benjamin W. Loveland

Cross-Border, Cross-Debtor, Multi-Debtor Issues in Proceedings

George W. Shuster, Jr.
WilmerHale; Boston and New York

Benjamin W. Loveland
WilmerHale; Boston and New York

George Shuster is a partner and Benjamin Loveland is counsel with WilmerHale in its Boston and New York offices.

Cross-border cases can present complex problems between the debtor and its creditors, but these cases also highlight complexities in the relationships among international debtors from the same corporate family. Each related debtor might be subject to an insolvency proceeding for itself in the country where it is organized, and may also be entangled in the insolvency proceedings of its corporate affiliates in the countries where those affiliates are organized. These permutations can present an array of challenges for each debtor.

The cross-border insolvency of telecommunications giant Nortel Networks has proven to be an archetype for interdebtor, cross-border issues. When numerous foreign affiliates are in liquidation or other insolvency proceedings in multiple jurisdictions — with different liquidators, administrators, or other representatives, different courts, and different judges — the time, expense and complexity of the proceedings may increase exponentially. The *Nortel* cases were commenced in January 2009, and litigation among the Nortel debtors is continuing in 2016.

Nortel's sprawling insolvency proceedings involved three primary sets of debtors in three primary jurisdictions (and other secondary debtors in still other jurisdictions). Nortel Networks Inc., one of the company's primary operating subsidiaries (and a U.S. entity), filed a chapter 11 case in the U.S. Bankruptcy Court for the District of Delaware, where it remained a debtor in possession. Nortel's corporate parent and certain of its other operating subsidiaries sought relief in Canada under the Companies' Creditors Arrangement Act, where a monitor was appointed. Nortel's European affiliates were placed into administration in the U.K. under the control of joint administrators. The joint administrators for the European debtors filed a chapter 15 proceeding in Delaware, which recognized the U.K. administration as a "foreign main proceeding."[1]

The Nortel debtors, each with its own constituents and each represented by a different fiduciary, sparred with each other over many issues. Critically, they disputed, for years, the proper method for allocating among the debtors more than $7.3 billion in proceeds generated by sales of businesses lines and assets owned by the debtors.

In many respects, the *Nortel* cases reflect the hallmarks of international cooperation. For example, the U.S. and Canadian courts developed a cross-border protocol that facilitated communication between them, conducted a 21-day trial simulcast between both courts, and ultimately reached a joint resolution on a method for allocating the sale proceeds under both U.S. and Canadian law. In other respects, the *Nortel* cases serve as a reminder of the thorny issues that can and do arise in complex cross-border cases. This article discusses some of those issues — both issues that arose in the *Nortel* cases, as well as other issues that have arisen or that could arise in cross-border, multiple-debtor scenarios.

Automatic Stay Issues

In standard U.S. bankruptcy cases, the automatic stay prevents creditors from taking actions against the debtor. Similar injunctive principles also exist in other countries' insolvency laws. In international multi-debtor insolvencies, these principles take on additional significance as they intersect, and they can affect relationships among corporate debtor affiliates.

For example, in the *Nortel* cases, a relatively simple debtor/creditor issue transformed into a dis-

1 A "foreign main proceeding" is a proceeding pending in a country where the debtor's center of main interests is located. 11 U.S.C. § 1517. Recognition as a "foreign main proceeding" results in certain provisions of the Bankruptcy Code, including the automatic stay, applying automatically to the debtor's chapter 15 case. 11 U.S.C. § 1520.

pute among Nortel entities in the U.S. and Europe. Following the courts' ruling on the proper allocation method for proceeds of the sale of Nortel's business lines, a licensor of software to the U.S. debtors sued the U.S. and Canadian debtors in the Delaware bankruptcy court. The licensor asserted claims for violations of its intellectual property rights that related to Nortel's asset sales.[2] The licensor sought relief from stay in the Canadian court so that it could prosecute its claims against the Canadian debtors in the U.S., but the Canadian court denied that relief, ruling that the licensor had not demonstrated a sufficient basis to displace the Canadian court's jurisdiction to keep all claims against the Canadian debtors within a single proceeding.[3]

In response to the claims by the licensor against them, the U.S. chapter 11 debtors asserted claims for contribution in the Delaware bankruptcy court against the European debtors. The U.S. debtors alleged that the European debtors should bear a share of any liability to the licensor claimant.

The European debtors argued that when the U.S. court recognized the European debtors' U.K. insolvency proceeding as a "foreign main proceeding" pursuant to § 1517(b)(1) of the Bankruptcy Code, the automatic stay came into place pursuant to §§ 362 and 1520(a)(1). Accordingly, they argued that the stay prevented not only U.S. suits *by creditors* against the European debtors, but also U.S. suits *by the U.S. debtors* against the European debtors. The U.S. court agreed that the stay applied in the chapter 15 case. However, the U.S. court concluded that the U.S. debtors' claims against the European debtors related solely to the *post-petition* business line sales, and therefore, the stay (which, by its terms, applies only to *pre-petition* claims) did not bar the U.S. debtors' claims. Nevertheless, the U.S. court was clear that the automatic stay would apply to any party — including an affiliated debtor — seeking to pursue *pre-petition* claims against the European debtors in the U.S. court, with the result that any such claims would have to be filed in the English Court where the European debtors' main insolvency proceeding was pending.

The European debtors also sought to invoke a U.K.-law statutory moratorium, analogous to the U.S. automatic stay, that they claimed was applicable to *both* pre- and post-petition claims. The European debtors claimed that the U.K. moratorium should be respected in the U.S. on the basis of comity pursuant to § 1509, which provides that once a foreign debtor has been recognized under chapter 15, "a court in the United States shall grant comity or cooperation to the foreign [debtor's] representative."[4] The U.S. court declined to enjoin the U.S. debtors from proceeding on the basis of the U.K. moratorium, but did not elaborate on its reasons for doing so.[5] That decision is currently on appeal.[6]

The various courts' decisions concerning whether to stay actions by debtors, against debtors, under varying legal regimes raise questions about the extent to which claims against a debtor should be concentrated in its "home" court (*i.e.*, the court where the debtor's main insolvency proceeding is pending). There is no easy answer to many of these questions, and many of them, like those in *Nortel*, depend heavily on the particular structure and facts of the insolvency proceedings.

Personal Jurisdiction Issues

Following the U.S. court's denial of the European debtors' stay motion, the European debtors moved to dismiss the complaint.[7] They argued, among other things, that because the U.S. court lacked personal jurisdiction over them, any suit against them would have to be heard by the English court. In determining the motion to dismiss, the U.S. court undertook a traditional personal-jurisdiction analysis under U.S. law to evaluate whether it had "specific" personal jurisdiction over the European debtors.

The analysis focused on the relationship between the European debtors, the forum and the litigation. The U.S. court noted that the European debtors had been present throughout the U.S. debtors' chapter 11 cases, and that they were the beneficiaries of the business line sales that gave rise to the adversary proceeding. The court listed a number of factors that led it to conclude that the European debtors were intimately involved in the chapter 11 cases, the business-line sales and the allocation dispute, and that the adversary proceeding was sufficiently related to those matters to render the European debtors subject to personal jurisdiction.

In reaching its decision, the U.S. court did not discuss the European debtors' pending U.S. chapter 15 case and did not analyze whether that case was related to the adversary proceeding in the context of a personal-jurisdiction analysis. The U.S. court's decision leaves open the possibility that a chapter 15 debtor may not be subject to personal jurisdiction in a U.S. court for every matter pertaining to its bankruptcy case or its affiliates' cases. However, the decision also highlights the risk that by participating in a set of cross-border insolvency proceedings, each corporate family member might be consenting to jurisdiction in the courts of its affiliates' bankruptcy cases.

Substantive-Consolidation Issues

When ordered, substantive consolidation (similar to corporate veil-piercing) may result in the pooling of the assets and liabilities of multiple entities. The law concerning substantive consolidation of U.S. debtors with their affiliates remains unsettled in many respects, including, in particular, whether a U.S. court may use the doctrine to bring a U.S. affiliate of a U.S. debtor into a bankruptcy case involuntarily, without the affiliate having been subject to a bankruptcy petition. While the boundaries of substantive consolidation in the U.S. are sometimes faint, in the cross-border context they are even less clear.

On the one hand, bankruptcy courts in chapter 15 cases have upheld orders of consolidation from foreign courts in a debtor's main insolvency proceeding. For example, in *In re Rede Energia SA*,[8] the U.S. Bankruptcy Court for the Southern District of New York noted that substantive consolidation is not in and of itself "manifestly contrary"

2 *In re Nortel Networks UK Ltd.*, 538 B.R. 699 (Bankr. D. Del. 2015).
3 *Id.* at 702.
4 11 U.S.C. § 1509(b)(3).
5 538 B.R. at 704.
6 *Joint Administrator and Foreign Representatives for Nortel Networks U.K. Ltd. v. SNMP Research Int'l Inc.*, No. 15-879-LPS (D. Del.).
7 *SNMP Research Int'l v. Nortel Networks Inc. (In re Nortel Networks Inc.)*, Adv. Pro. No. 11-53454 (KG), 2016 WL 386198 (Bankr. D. Del. Feb. 1, 2016).
8 515 B.R. 69 (Bankr. S.D.N.Y. 2014).

to U.S. public policy for purposes of chapter 15 such that a U.S. court should necessarily decline to respect a foreign court's order granting consolidation on the basis of chapter 15's public-policy exception.[9] The court stated that "[alt]hough the Ad Hoc Group argues that the Brazilian Bankruptcy Court did not address factors [that] may 'ordinarily' be considered by a United States Court confronted with the issue of substantive consolidation, it is not appropriate for this Court to superimpose requirements of U.S. law on a case in Brazil or to second-guess the findings of the foreign court."[10]

Based on these cases, even where foreign law standards for consolidation are not identical to those in the U.S., courts seem inclined to respect the foreign court's consolidation of debtors and their affiliates, as long as such consolidation was not ordered in a manner that would violate chapter 15's public-policy exception. However, if consolidation under foreign law were "manifestly contrary" to U.S. public policy, or otherwise fundamentally inconsistent with the standards for consolidation under U.S. law, it stands to reason that a U.S. court might not uphold it.[11]

On the other hand, questions remain about the extent to which a U.S. court in a chapter 11 or 15 case would be willing to substantively consolidate the debtor's estate with the estates of one or more of its affiliates. For example, if the standards for substantive consolidation under U.S. law are satisfied, would a court be willing to consolidate a chapter 11 or 15 debtor with a non-U.S. debtor that is subject to a foreign insolvency proceeding but not subject to the chapter 11 or 15 case (or even a non-U.S. debtor that is not the subject of any insolvency proceeding)?

These questions raise issues of comity and the extraterritorial reach of the U.S. Bankruptcy Code and, in particular, the extraterritorial reach of substantive consolidation, which is an equitable remedy that is (at least in certain respects) sometimes viewed as on the fringes of the U.S. Bankruptcy Code. As previously described, a U.S. court's ability to grant any relief among a debtor and its affiliates might be subject to the threshold question of whether the U.S. court has personal jurisdiction over those entities.

Asset-Sale Issues

The sale of assets by a chapter 15 debtor and its foreign affiliates also raises issues regarding the proper standard to be applied by a U.S. court reviewing such transactions. At least one decision — *In re Elpida Memory Inc.*[12] — suggests that where U.S. assets are involved, a U.S. court might apply the business-judgment standard under § 363 of the Bankruptcy Code, even where the sale was previously approved by a foreign court presiding over the debtor's foreign main insolvency proceeding. At the other end of the spectrum, *In re Fairfield* demonstrates that where no U.S. assets are involved, a U.S. court may not review such a previously approved asset sale.[13]

These decisions indicate that sales of U.S. assets will likely require review by a U.S. court applying U.S. law. They also demonstrate that identifying U.S. vs. non-U.S. assets, particularly intangible assets, can be difficult and can give rise to litigation.[14] There is no clear answer to the question of what standard should apply when a chapter 15 debtor and its foreign affiliates propose to enter into a transaction that would result in the sale of both U.S. and non-U.S. assets, particularly if the foreign affiliates are not the subject of a foreign insolvency proceeding that would permit a foreign court to review the sale.

Conclusion

Cross-border insolvency proceedings might be a highly useful tool in the reorganization or liquidation of a corporate family with entities organized in multiple countries. However, the complexities of those proceedings can be daunting. In these situations — and in the cross-border insolvency context in particular — "debtor-vs.-debtor" disputes may raise webs of issues that are difficult, time-consuming and costly to untangle. abi

Reprinted with permission from the ABI Journal, Vol. XXXV, No. 5, May 2016.

9 Section 1506 of the Bankruptcy Code provides that "[n]othing in [chapter 15] prevents the court from refusing to take an action governed by [chapter 15] if the action would be manifestly contrary to the public policy of the United States." 11 U.S.C. § 1506.

10 *Rede Energia*, 515 B.R. at 100; *see also In re OAS S.A.*, 533 B.R. 83, 105 (Bankr. S.D.N.Y. 2015) ("Although Brazilian law may impose different requirements for substantive consolidation, the different standards, standing alone, do not signify that Brazilian Bankruptcy Law is manifestly contrary to our own public policy.").

11 *Cf., Ad Hoc Group of Vitro Noteholders v. Vitro SAB de CV*, 701 F.3d 1031 (5th Cir. 2012) (declining on comity grounds to uphold grant of nondebtor discharge injunction under Mexican reorganization plan because such relief would not have been available to debtors in U.S.).

12 No. 12-10947 (CSS), 2012 WL 6090194 (Bankr. D. Del. Nov. 20, 2012).

13 *See In re Fairfield Sentry Ltd.*, 484 B.R. 615 (Bankr. S.D.N.Y. 2013). While the U.S. Court of Appeals for the Second Circuit disagreed with the Southern District of New York bankruptcy court that the assets at issue in *Fairfield* were not "within the territorial jurisdiction of the United States," and therefore instructed the Southern District of New York bankruptcy court to review the sale by applying the standards in § 363, the Second Circuit did not disagree with the bankruptcy court's more general ruling that where no U.S. assets are involved, no U.S. review is required. *Krys v. Farnum Place LLC (In re Fairfield Sentry Ltd.)*, 768 F.3d 239 (2d Cir. 2014).

14 *See In re Berau Capital Res. Pte Ltd.*, 540 B.R. 80 (Bankr. S.D.N.Y. 2015) (considering proper situs of intangible contract rights in contest of debtor's eligibility for relief under chapter 15).