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Can Chapter 15 Be an Ally to Bondholders in Foreign Insolvency Cases?

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Increasingly, U.S. bondholders and other creditors of foreign debtors have turned to U.S. courts in chapter 15 cases in an attempt to improve their position against a foreign debtor or other stakeholders. However, chapter 15 filings themselves are not within the direct control of U.S. bondholders, and chapter 15 contains limitations that may restrict its usefulness to U.S. bondholders that are seeking to protect or enhance their rights. In some cases, a chapter 15 case that looks like an open door for bondholders to challenge foreign insolvency proceedings turns out to be a picture window through which they can only watch the results of a foreign insolvency unfold. How can U.S. bondholders best employ the potential leverage that chapter 15 may afford them in cross-border insolvency disputes?

Chapter 15 as a Door for U.S. Bondholders

U.S. bondholders often confront impediments in seeking to protect their rights in foreign insolvency proceedings of foreign issuers. These impediments take many forms, including differing sets of procedural rules, a less-rigorous standard of review, increased deference to the debtor, lack of transparency,[1] nationalism or a combination of these factors. Despite these hurdles, U.S. bondholders in two notable cases, *Ad Hoc Group of Vitro Noteholders v. Vitro S.A.B. de C.V.*[2] and *In re Elpida Memory Inc.*,[3] were successful — although to differing degrees — in convincing U.S. courts to revisit foreign courts' rulings in insolvency proceedings abroad.

1 *See* Tally M. Wiener and Ido J. Alexander, "Transparency in Chapter 15 Cases," *ABI Journal*, Vol. XXXIII, No. 6, p. 34 (June 2014).
2 701 F.3d 1031 (5th Cir. 2012).
3 Case No. 12-10947 (CSS), 2012 WL 6090194 (Nov. 20, 2012).

In *Vitro*, U.S. bondholders successfully challenged a foreign representative's efforts to enforce a nondebtor discharge injunction in the U.S. that would have prevented the bondholders from pursuing the U.S. assets of subsidiary guarantors. Vitro's reorganization plan, which was approved by a Mexican court under the *Ley de Concurso Mercantiles*, provided that three series of U.S.-issued unsecured notes would be extinguished, and that the obligations owed by the guarantors of those notes would be discharged. The guarantors — Vitro subsidiaries — were not debtors in the Mexican bankruptcy proceeding. In addition, Vitro's reorganization plan was confirmed only through counting the supporting votes of those nondebtor subsidiary guarantors, which held more than 50 percent of the voting claims in the form of intercompany debt.

Vitro's foreign representative, which had commenced a chapter 15 case in the U.S. to protect the U.S. assets of the guarantors from U.S. creditor remedies, sought to give full force and effect in the U.S. to the Mexican court's order approving Vitro's *concurso* plan. The foreign administrator also requested that the chapter 15 court issue a permanent injunction prohibiting actions in the U.S. against Vitro and its nondebtor subsidiaries. The bondholders challenged this request.

The U.S. Court of Appeals for the Fifth Circuit upheld the bondholders' challenge. Its decision centered on comity: whether a U.S. court should enter a discharge injunction to protect foreign nondebtors from the enforcement of U.S.-issued debts owed to U.S. investors based on the judgment of a foreign court. Based largely on the conclusion that such relief would not be permissible under U.S. law on the circumstances of the case, the Fifth Circuit

refused to recognize the Mexican court's approval of the plan and denied the injunction. The chapter 15 strategy backfired, and rather than serving as a mechanism to quash U.S. bondholder remedies, the chapter 15 case gave the U.S. bondholders a mechanism to upend the results of the Mexican insolvency that they had been unable to stop south of the border.[4]

As another example, in *Elpida*, U.S. bondholders obtained U.S. bankruptcy court review (under U.S. standards) of a sale of U.S. assets that had previously been approved by the Japanese court presiding over Elpida's main insolvency proceeding. Elpida commenced a Japanese insolvency proceeding and, later, a chapter 15 case in the U.S. In the Japanese proceeding, Elpida obtained approval for transactions involving the disposition of certain of its assets, including assets located in the U.S. Months after the consummation of the asset dispositions, and in response to concerns expressed by Elpida's bondholders, Elpida sought retroactive approval of the transactions in the chapter 15 case.

Elpida argued that the approval should be based only on an evaluation of comity: whether the Japanese approval process afforded the parties basic due-process rights such that it should be respected in the U.S. The bondholders argued that because the transactions involved U.S. assets, they should be independently reviewed by the bankruptcy court under the standards of § 363(b) of the Bankruptcy Code, notwithstanding the Japanese court's prior approval. The bankruptcy court agreed with the bondholders and re-evaluated the sale "*de novo*" under § 363(b) standards. While this victory was ultimately pyrrhic — the U.S. court approved the sale under U.S. standards — the bondholders made it more difficult for the debtor to effect its restructuring on the basis of Japanese process and standards alone.

In addition to seeking to apply U.S. standards to restructuring transactions involving U.S. assets, Elpida's bondholders also sought and obtained more vision into the Japanese proceeding. The bondholders were primarily concerned that due to the opaqueness of the Japanese insolvency case, there had not been adequate disclosure of the terms of proposed transactions involving U.S. assets and the effect of those transactions on Elpida's creditors. To remedy these concerns, the bondholders asked the U.S. bankruptcy court to impose conditions on Elpida's ability to continue enjoying the automatic stay. The parties ultimately agreed on an order that required Elpida to report regularly to the bondholders regarding its U.S. assets and prevented Elpida from transferring or disposing of U.S. property outside the ordinary course of business without first giving notice to the bondholders or getting court approval.

The Debtor Holds the Key to Chapter 15

Notwithstanding that bondholders were able to use chapter 15 as a door to obtain protections in *Vitro* and *Elpida*, the key to the chapter 15 door remains in the debtor's exclusive control. First, a chapter 15 case can only be commenced by a "foreign representative" of a foreign debtor seeking recognition of a foreign proceeding in a U.S. court.[5] U.S. bondholders cannot commence a case directly.

Second, while not all foreign debtors are eligible for chapter 15 relief, eligibility might be within the debtor's control. The U.S. Court of Appeals for the Second Circuit's recent decision in *Barnet* clarifies that a foreign debtor must satisfy the requirements of § 109 of the Bankruptcy Code in order to qualify as a debtor eligible to commence a chapter 15 case[6] (*i.e.*, the debtor must have a place of business or assets in the U.S.). This is not a prohibitively high threshold to clear. Indeed, on remand from the Second Circuit, the bankruptcy court held that the debtor satisfied § 109's requirements because it had property in the U.S. in the form of U.S.-law causes of action against U.S. defendants in a U.S. court, as well as a retainer deposited with counsel to the foreign representative.[7]

> **U.S. bondholders are often at a disadvantage in seeking to enforce their rights against a foreign debtor in a foreign insolvency proceeding. While the relief available to bondholders in chapter 15 might mitigate that disadvantage in certain circumstances, bondholders are constrained by the debtor-centric nature and limited purpose of chapter 15.**

Third, once a chapter 15 case has been commenced, a particular transaction must sufficiently implicate U.S. assets or interests to be reviewable by a U.S. court.[8] Lastly, chapter 15 is generally structured to grant relief only at the request of the foreign representative of the debtor, and in some cases, U.S. bondholders may only be able to obtain protections related to, or in reaction to, whatever relief that the foreign representative decides to request in a U.S. court.

Since the chapter 15 process is led by the debtor, and the ability of U.S. creditors to pursue their agenda within chapter 15 might be limited, U.S. creditors may prefer to challenge a chapter 15 filing at the outset and place their hopes in litigation against the debtor in nonbankruptcy courts in the U.S. However, that strategy faces obstacles, too.

In *In re Cozumel Caribe S.A. de C.V.*,[9] a noteholder sought to terminate the recognition of the chapter 15 case based on alleged debtor misconduct. In declining to revoke recognition and effectively dismiss the chapter 15 case, the court indicated that "comity ... is not an all-or-nothing exercise," and that revocation was an excessive remedy. While the court left open the possibility that dismissal could be an appropriate remedy for extreme misconduct, its clear message was that revocation of recognition will rarely be

4 The disapproval of the releases in *Vitro* was largely a function of the manner in which they were obtained in the Mexican proceeding, and should not be viewed as a categorical prohibition on enforcement of such releases in U.S. courts in chapter 15. *See In re Sino-Forest Corp.*, 501 B.R. 655 (Bankr. S.D.N.Y. 2013).

5 *See* 11 U.S.C. § 1517.

6 *In re Barnet*, 737 F.3d 238 (2d Cir. 2013).

7 *In re Octaviar Admin. Pty. Ltd.*, Case No. 14-10438 (SCC) (Bankr. S.D.N.Y. June 19, 2014).

8 *In re Fairfield Sentry Ltd.*, 484 B.R. 615 (Bankr. S.D.N.Y. 2013) (holding that transaction unreviewable under U.S. standards whereby foreign court had primary interest and no unique U.S. interests); *but see Octaviar*, Case No. 14-10438 (SCC), slip. op. at 13.

9 508 B.R. 330 (Bankr. S.D.N.Y. 2014).

ordered. The noteholder in *Cozumel Caribe* retained its ability to challenge specific relief requested by the foreign representative in the chapter 15 case — the approach that was successful for creditors in *Vitro* and *Elpida* — but its more aggressive revocation strategy did not work.

However, a foreign representative does not have unbridled discretion when it comes to the manner in which the foreign proceeding will be recognized by the U.S. courts. In *Morning Mist Holdings Ltd. v. Krys (In re Fairfield Sentry Ltd.)*,[10] the U.S. Court of Appeals for the Second Circuit held that a debtor's center of main interests (COMI) must be determined at the time that the chapter 15 petition is filed and cannot be manipulated by the debtor in bad faith. A COMI can be an important factor in chapter 15 and influence whether a foreign insolvency proceeding is a "foreign main proceeding" in which certain debtor protections arise automatically. In proscribing the debtor's ability to manipulate the COMI, this decision may limit the debtor's use of chapter 15 (and its attendant debtor protections such as the automatic stay) in order to hold creditors at bay.

What the Key to Chapter 15 May Cost a Debtor: "Automatic" Creditor Protection

Despite the debtor-centric nature of chapter 15, U.S. creditors may argue that a foreign representative's filing of a chapter 15 case triggers greater "automatic" creditor protections than the foreign representative may have intended in pursuing a chapter 15 strategy. In *Jaffe v. Samsung Elecs. Co. Ltd.*,[11] a foreign representative sought to use German law to terminate the debtor's out-licenses of U.S. patents in a German insolvency proceeding, and filed a chapter 15 case to extend the effects of the German proceeding to the U.S. The bankruptcy court held, and the U.S. Court of Appeals for the Fourth Circuit affirmed, that the foreign representative could not avail itself of chapter 15 and at the same time use German law to terminate license rights involving U.S. patents. Rather, once within the chapter 15 context, the foreign representative's treatment of U.S. patent licenses must be subject to the licensee protections of § 365(n) of the U.S. Bankruptcy Code.

Thinking about *Jaffe* broadly, it might stand for the proposition that certain U.S. creditor protections are a price to be paid by a foreign representative in exchange for using the "key" that chapter 15 might provide to access U.S. bankruptcy courts. If so, the Fourth Circuit's ruling leaves open the possibility that certain creditor protections can be imposed as a general condition to a foreign representative's use of chapter 15, which may enhance U.S. creditor rights beyond more specific challenges of the type in *Vitro* and *Elpida*.

"Involuntary" Chapter 15 Cases

Even when no chapter 15 case has been commenced, bondholders may still have options under chapter 15. Depending on the impediments they face and the goals they wish to achieve, they may be able to exert leverage over the process by seeking to compel, or at least encourage, a chapter 15 filing.

In one recent case, a minority group of bondholders commenced an involuntary chapter 7 case against Suntech Power Holdings Co. Ltd., a Cayman Islands holding company for a Chinese operating company in the solar energy sector. The bondholders had obtained judgments on their bond debt against Suntech in New York state court, and they sought to use the U.S. bankruptcy process as a means to address what they perceived as having been closed out of restructuring negotiations between the company and its creditors.[12] Suntech opposed the petition on numerous grounds, including that the bondholders had commenced the case in bad faith. Ultimately, Suntech commenced an insolvency proceeding in the Cayman Islands, and the bondholders and Suntech entered into a restructuring-support agreement pursuant to which Suntech sought recognition of the Cayman Islands proceeding through a chapter 15 filing in the U.S. This was a circuitous route to chapter 15, but it seems possible that no chapter 15 case would have been filed had the bondholders not taken aggressive action in a U.S. non-bankruptcy court at the outset.

While the bondholders' approach in *Suntech* appears to have influenced the debtor's decision to commence a chapter 15 case, such an approach is not without risk. For example, in *In re Compañía de Alimentos Fargo SA*,[13] the bondholders filed an involuntary petition in the U.S. while the debtor had a foreign insolvency proceeding pending in Argentina. In that case, the court granted a motion by the debtor to dismiss the chapter 11 filing, finding that the Argentine proceeding was procedurally and substantively fair, and that dismissal would be in the best interests of comity. In reaching its decision, the court also questioned the bondholders' motivations and whether they intended to "hijack" the Argentine proceeding or gain leverage in any negotiations. The availability of chapter 15 as a debtor-driven mechanism likely influenced the court's refusal to permit a creditor-driven insolvency to proceed.

Conclusion

U.S. bondholders are often at a disadvantage in seeking to enforce their rights against a foreign debtor in a foreign insolvency proceeding. While the relief available to bondholders in chapter 15 might mitigate that disadvantage in certain circumstances, bondholders are constrained by the debtor-centric nature and limited purpose of chapter 15. Nevertheless, in some situations, bondholders might be able to exert leverage to encourage a chapter 15 filing. In all events, U.S. creditors of foreign debtors should pay close attention to the dynamics of chapter 15, and evaluate whether they can slip through the chapter 15 door without it being slammed in their faces. abi

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10 714 F.3d 127 (2d Cir. 2013).

11 737 F.3d 14 (4th Cir. 2013).

12 *See In re Suntech Power Holdings Co. Ltd.*, Case Nos. 13-13350, 14-10383 (Bankr. S.D.N.Y.).

13 376 B.R. 427 (Bankr. S.D.N.Y. 2007).