Bondholder Rights Against Foreign Debtors: "Involuntary Chapter 15 Bankruptcy Cases"

2007-10-30

A recent bankruptcy decision in the Southern District of New York, which dismissed an involuntary Chapter 11 petition filed by bondholders of a foreign debtor, highlights the significance of the new Chapter 15 of the Bankruptcy Code, even in cases where Chapter 15 is not directly implicated.[i]

The Argentine Concurso Preventivo Proceeding

In 2002, during the Argentine currency crisis and recession, Compañía de Alimentos Fargo, S.A. (Fargo), Argentina's largest commercial producer and packager of bread products, defaulted on interest payments to its bondholders and filed a petition for a *concurso preventivo* under Argentine insolvency law. At least two aspects of the *concurso* proceeding troubled the bondholders. First, as a result of the *concurso* proceeding, unsecured creditors of Fargo, like the bondholders, were enjoined from taking any action against Fargo or its assets. But, secured creditors of Fargo remained free under Argentine law to commence and continue foreclosure proceedings against Fargo and its assets. This freedom is in stark contrast to US bankruptcy law, where the "automatic stay" under Section 362 applies to both unsecured and secured creditors. Second, in the course of the *concurso*, an Argentine appellate court ruled that the bondholders' claim against Fargo would be in the full amount of principal and unpaid pre-petition interest for distribution purposes, but would be only in the amount of unpaid pre-petition interest for voting purposes. This ruling effectively diluted the voting power of the bondholders and lessened their ability to direct the outcome of the *concurso* proceeding. Again, this ruling is in stark contrast to US law, under which bondholders have a claim for voting purposes in the full amount of principal and unpaid pre-petition interest.

The US Involuntary Chapter 11 Petition

In 2006, while litigation in Argentina was still pending and before any resolution of the *concurso* proceeding, Fargo's bondholders filed an involuntary Chapter 11 petition against Fargo in the United States Bankruptcy Court for the Southern District of New York. The bondholders' filing was allegedly in violation of the stay in place in the *concurso* proceeding, yet the filing of the involuntary petition also triggered the automatic stay under Section 362 of the Bankruptcy Code, which purported to enjoin Fargo's secured creditors against enforcement of their rights in Argentina. Fargo filed a motion to dismiss on a number of grounds, including permissive abstention under Section 305(a)

(1) of the Bankruptcy Code.

On October 15, 2007, Judge Bernstein entered an order granting Fargo's motion to dismiss. While the court recognized that Argentine insolvency law is not identical to US insolvency law in significant respects, it found that, overall, the Argentine *concurso* proceeding and related Argentine litigation is procedurally and substantively fair and will determine and adjust the parties' rights in a fair and equitable manner. The court was not swayed by the fact that Argentina does not impose an automatic stay on secured creditor remedies, nor by the fact that Argentina does not permit equitable subordination of claims, nor by the fact that the Argentine court's decision regarding the bondholders' voting rights would potentially disenfranchise the bondholders relative to their US voting rights. Moreover, Judge Bernstein questioned the purpose of the bondholders' Chapter 11 petition and whether they intended the filing to "hijack" the *concurso* or increase their leverage in negotiations related to the *concurso* by staying secured creditor remedies. Finally, Judge Bernstein considered whether a Chapter 11 case would be futile even if he allowed one to continue, given that Fargo's operations were exclusively within Argentina and its only real connection to the United States was the fact that the bondholder debt was issued under US law.

Evaluating the Involuntary Chapter 11 Petition in Light of Chapter 15

Judge Bernstein's decision is not surprising, given the difficulty bondholders have faced in sustaining involuntary Chapter 11 cases against foreign debtors in other circumstances, some of which contained fact patterns more supportive of the bondholders. (*See*, e.g., *In re Satélites Mexicanos, S.A. de C.V.* (Satmex), Chapter 11 Case No. 05-13862 (RDD),[ii] but contrast *In re Globo Comunicacoes e Participacoes S.A.* (Globopar), 317 B.R. 235 (S.D.N.Y. 2004).) Yet his decision highlights one possible perspective of US bankruptcy courts on bondholders' involuntary Chapter 11 filings against foreign debtors following the enactment of Chapter 15 of the US Bankruptcy Code--the importation of Chapter 15 principles to determine whether "the interests of creditors and the debtors would be better served" by dismissal of an involuntary Chapter 11 petition under 11 U.S.C. § 305(a)(1).

Chapter 15 contains detailed rules for the coordination of foreign and US bankruptcy proceedings, and the statute generally encourages deference to foreign proceedings pending where a foreign debtor has its center of main interests.[iii] A Chapter 15 case can only be commenced by a "foreign representative" of a foreign debtor seeking "recognition" of the foreign proceeding by a US bankruptcy court--bondholders cannot commence an "involuntary" Chapter 15 case. Because no foreign representative sought recognition of the Argentine *concurso* proceeding under Chapter 15, Chapter 15 did not directly apply and was not mentioned by Judge Bernstein in his decision.[iv]

Nevertheless, the existence of Chapter 15 likely influenced Judge Bernstein's decision to dismiss the bondholders' involuntary Chapter 11 case. Judge Bernstein's decision is consistent with the principles of Chapter 15, in its deference to bankruptcy proceedings in foreign debtors' "home" jurisdictions and in limiting the effect of parallel US proceedings to the foreign debtors' US assets, if there are any.

Indeed, when reading Judge Bernstein's opinion, it is difficult to imagine that the result would have

been much different if Fargo's bondholders had been able to file a Chapter 15 petition against Fargo. The US bankruptcy court would likely have recognized the Argentine *concurso* as a "foreign main proceeding,"[v] and it would have deferred to the *concurso* for all matters except, perhaps, those matters related specifically to assets of Fargo in the United States.[vi] Since Fargo's US assets appear to have been minimal, a hypothetical ongoing Chapter 15 case for Fargo may have had little more substantive effect than what actually happened--the dismissal of the Fargo bondholders' involuntary Chapter 11 petition and no continuing US proceeding.[vii] But, the bondholders may have still preferred some proceeding in which a US court might address the perceived inequities of the Argentine *concurso*--even a proceeding under Chapter 15--to no US proceeding at all.

The Bottom Line

Chapter 15 and its underlying principles are generally consistent with, and may influence, the way bankruptcy courts in the United States evaluate involuntary Chapter 11 petitions filed by bondholders against foreign debtors with limited US contacts, even when no Chapter 15 case is pending. Sustaining a cross-border involuntary Chapter 11 case has been difficult in the past, and the enactment of Chapter 15 is not likely to make sustaining such a case any easier moving forward.

[i] *In re Compañía de Alimentos Fargo, S.A.*, Memorandum Decision Granting Motion to Dismiss the Involuntary Petition, Involuntary Chapter 11 Case No. 06-12128 (SMB) (Bankr. S.D.N.Y. October 15, 2007).

[ii] WilmerHale represented the secured bondholders in the Satmex involuntary Chapter 11 filing, which was aggressively opposed by the debtor and resulted, as a settlement, in the filing of a Section 304 ancillary proceeding.

[iii] 11 U.S.C. § 1502(5) defines "foreign main proceeding" as a foreign proceeding pending where the foreign debtor has its center of main interests.

[iv] If Chapter 15 had applied, abstention under Section 305(a)(2) or (b) of the US Bankruptcy Code-which, unlike Section 305(a)(1), expressly reference Chapter 15 and its purposes-may have been considered in addition to or instead of abstention under Section 305(a)(1).

[v] Based on the facts recited by Judge Bernstein, it is difficult to imagine a court concluding that Fargo's center of main interests was in a jurisdiction other than Argentina, and there is a statutory presumption of that conclusion as well. *See* 11 U.S.C. § 1516(c).

[vi] For example, the automatic stay contained in 11 U.S.C. § 362 becomes effective upon the Chapter 15 recognition of a foreign proceeding; that stay is limited to the debtor and property of the debtor that is within the territorial jurisdiction of the United States. *See* 11 U.S.C. § 1520(a)(1).

[vii] Chapter 15 might also have been used to restrict the effects of the Chapter 11 case, had the Chapter 11 case survived. However, that strategy would have worked best if Fargo's foreign representative had sought recognition of the Argentine concurso under Chapter 15 before the involuntary Chapter 11 petition was filed. *See* 11 U.S.C. § 1528.

Authors

George W. Shuster Jr.

PARTNER

george.shuster@wilmerhale.com

+1 212 937 7232